



**AUDIT COMMITTEE MEETING
OF THE BOARD OF DIRECTORS
INLAND EMPIRE UTILITIES AGENCY*
AGENCY HEADQUARTERS, CHINO, CA 91708**

**MONDAY, DECEMBER 11, 2017
9:00 A.M.**

CALL TO ORDER

PUBLIC COMMENT

Members of the public may address the Board on any item that is within the jurisdiction of the Board; however, no action may be taken on any item not appearing on the agenda unless the action is otherwise authorized by Subdivision (b) of Section 54954.2 of the Government Code. Those persons wishing to address the Board on any matter, whether or not it appears on the agenda, are requested to complete and submit to the Board Secretary a "Request to Speak" form, which is available on the table in the Board Room. Comments will be limited to five minutes per speaker. Thank you.

ADDITIONS TO THE AGENDA

In accordance with Section 54954.2 of the Government Code (Brown Act), additions to the agenda require two-thirds vote of the legislative body, or, if less than two-thirds of the members are present, a unanimous vote of those members present, that there is a need to take immediate action and that the need for action came to the attention of the local agency subsequent to the agenda being posted.

1. ACTION ITEMS

A. MINUTES

The Committee will be asked to approve the Audit Committee meeting minutes from September 20, 2017.

B. IEUA FISCAL YEAR (FY) 2016/17 AUDITED COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)

It is recommended that the Committee/Board:

1. Approve the Inland Empire Utilities Agency Comprehensive Annual Financial Report for fiscal year ended June 30, 2017; and
2. Direct staff to distribute the report as appropriate, to the various federal, state, and local agencies, financial institutions, bond rating agencies, and other interested parties.

C. **FISCAL YEAR (FY) 2016/17 SINGLE AUDIT REPORT FOR FEDERAL GRANT PROGRAMS**

It is recommended that the Committee/Board:

1. Approve the Single Audit Report for FY 2016/17; and
2. Direct staff to distribute the report, as appropriate, to the State Controller's Office, the Federal Audit Clearing House, and other interested parties.

D. **INTERNAL AUDIT DEPARTMENT CHARTER AND AUDIT COMMITTEE CHARTER**

It is recommended that the Committee/Board reconfirm the Audit Committee Charter and the Internal Audit Department Charter and direct staff to implement the charters.

2. **INFORMATION ITEMS**

A. **PAYROLL OPERATIONS AUDIT & COMPARABLE AGENCIES' SURVEY (WRITTEN/POWERPOINT)**

B. **SOUTHERN CALIFORNIA EDISON UTILITY PAYMENTS FOLLOW-UP AUDIT (WRITTEN)**

C. **INTERNAL AUDIT DEPARTMENT STANDARD OPERATING PROCEDURES (SOP) (WRITTEN)**

D. **INTERNAL AUDIT DEPARTMENT QUARTERLY STATUS REPORT (WRITTEN)**

E. **AUDIT COMMITTEE FINANCIAL ADVISOR CONTRACT EXTENSION (WRITTEN)**

3. **GENERAL MANAGER'S COMMENTS**

4. **AUDIT COMMITTEE ADVISOR COMMENTS**

5. **COMMITTEE MEMBER COMMENTS**

6. **COMMITTEE MEMBER REQUESTED FUTURE AGENDA ITEMS**

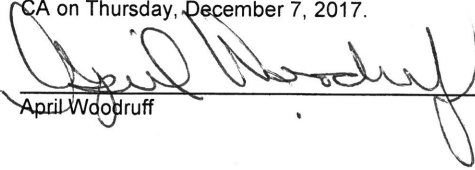
7. **ADJOURN**

In compliance with the Americans with Disabilities Act, if you need special assistance to participate in this meeting, please contact the Board Secretary (909-993-1736), 48 hours prior to the scheduled meeting so that the Agency can make reasonable arrangements.

Proofed by: JK

DECLARATION OF POSTING

I, April Woodruff, Board Secretary/Office Manager of the Inland Empire Utilities Agency, A Municipal Water District, hereby certify that a copy of this agenda has been posted by 5:30 p.m. in the foyer at the Agency's main office, 6075 Kimball Avenue, Building A, Chino, CA on Thursday, December 7, 2017.



April Woodruff

**ACTION
ITEM**

1A

MINUTES
SPECIAL AUDIT COMMITTEE MEETING
INLAND EMPIRE UTILITIES AGENCY*
AGENCY HEADQUARTERS, CHINO, CA
WEDNESDAY, SEPTEMBER 20, 2017
9:00 A.M.

COMMITTEE MEMBERS PRESENT

Kati Parker, Chair
Steven J. Elie

COMMITTEE MEMBERS ABSENT

None

STAFF PRESENT

P. Joseph Grindstaff, General Manager
Chris Berch, Executive Manager of Engineering/AGM
Randy Lee, Executive Manager of Operations/AGM
Christina Valencia, Executive Manager of Finance & Administration/AGM
Jason Gu, Grants Officer
Sally Lee, Executive Assistant
Sylvie Lee, Manager of Planning & Environmental Resources
Suresh Malkani, Principal Accountant
Sapna Nangia, Senior Internal Auditor
Teresa Velarde, Manager of Internal Audit

OTHERS PRESENT

Jean Cihigoyenette, JC Law Firm
Travis Hickey, Audit Committee Advisor

The meeting was called to order at 9:00 a.m. There were no public comments received or additions to the agenda.

ACTION ITEMS

The Committee:

- ◆ Approved the Audit Committee meeting minutes of June 12, 2017.

INFORMATION ITEMS

The following information items were presented, received, or filed by the Committee:

- ◆ Contracts and Procurement Follow Up Audit
- ◆ Payroll Operations Audit
- ◆ Internal Audit Department Status Report for September 2017

GENERAL MANAGER'S COMMENTS

The General Manager had no comments.

COMMITTEE MEMBER COMMENTS

There were no Committee Member comments.

COMMITTEE MEMBER REQUESTED FUTURE AGENDA ITEMS

There were no Committee Member requested future agenda items.

CLOSED SESSION

The Board went into Closed Session at 9:24 a.m., A. PURSUANT TO GOVERNMENT CODE SECTION 54956.9a(d)(4) – CONFERENCE WITH LEGAL COUNSEL – ANTICIPATED LITIGATION; INITIATION OF LITIGATION: One (1) Case

The meeting resumed at 9:45 a.m., and General Counsel Jean Cihigoyenetché stated that the below-mentioned matters were discussed in Closed Session, and the Board took the following actions:

Regarding Conference with Legal Counsel – Anticipated Litigation; Initiation of Litigation:

One Case

The Board took no reportable action.

With no further business, the meeting adjourned at 9:45 a.m.

Respectfully submitted,

Sally Lee
Executive Assistant

*A Municipal Water District

APPROVED: DECEMBER 11, 2017

**ACTION
ITEM**

1B



Date: December 20, 2017

To: The Honorable Board of Directors

From: Halla Razak, General Manager

Committee: Audit

12/11/17

Finance & Administration

12/13/17

Executive Contact: Christina Valencia, Executive Manager of Finance & Administration/AGM

Subject: IEUA Fiscal Year (FY) 2016/17 Audited Comprehensive Annual Financial Report (CAFR)

Executive Summary:

The Comprehensive Annual Financial Report (CAFR) for fiscal year ended June 30, 2017 was prepared in conformity with generally accepted accounting principles (GAAP) as set forth by the Governmental Accounting Standards Board (GASB) and audited by the Lance, Soll & Lunghard, LLP (LSL), the Agency independent audit firm. Based on their audit and testwork results, LSL found the financial statements presented fairly, in all material respects, the respective financial position of each major fund and the aggregate remaining fund information as of June 30, 2017, and the respective changes in financial position, and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). LSL issued an unmodified opinion.

The Agency's statement of net position of \$586 million as of June 30, 2017 reflects an increase of \$55 million from the prior fiscal year. The increase is primarily due to a higher number of new wastewater and water connection fees, higher operating revenues from the multi-year rate and fee adjustments adopted by the Board in 2015 to achieve cost of service for the Agency's major programs, and higher grant proceeds. Attached is the audited CAFR, in substantially final form, with a detailed explanation of significant revenues and expenses.

Staff's Recommendation:

It is recommended that the Board of Directors:

1. Approve the Inland Empire Utilities Agency Comprehensive Annual Financial Report for fiscal year ended June 30, 2017; and
2. Direct staff to distribute the report as appropriate, to the various federal, state, and local agencies, financial institutions, bond rating agencies, and other interested parties.

Budget Impact Budgeted (Y/N): N Amendment (Y/N): N Amount for Requested Approval:

Account/Project Name:

Not Applicable

Fiscal Impact (explain if not budgeted):

There is no impact on the Agency's FY 2017/18 Budget as a result of this item, since related audit service fees are budgeted in the Administrative Services Fund under Professional Services.

Prior Board Action:

On December 21, 2016, the Board of Directors approved the Agency's Comprehensive Annual Financial Report for FY 2015/16 reviewed by the Audit Committee & Finance and Administration Committee on December 14, 2016.

On March 16, 2016, the Board approved Contract No. 4600002079 with Lance, Soll & Lunghard LLP for financial auditing and single audit services, for three fiscal years, with the option to extend two additional fiscal years, beginning in FY 2015/16.

Environmental Determination:

Not Applicable

Business Goal:

The IEUA FY 2016/17 Comprehensive Annual Financial Report is consistent with the Agency's Business Goal of Fiscal Responsibility in providing transparent communication of the Fiscal Year activity and the net position of the different programs of the Agency.

Attachments:

Attachment 1 - Background

Exhibit A - FY 2016/17 Comprehensive Annual Financial Report in Substantive Completed Form - click to download (hard copy available upon request)

Exhibit B - PowerPoint

Exhibit C - Financial Audit Results

Background

Subject: IEUA Fiscal Year 2016/17 Audited Comprehensive Annual Financial Report

The Agency's Comprehensive Annual Financial Report (CAFR) for fiscal year ended June 30, 2017 was prepared in conformity with generally accepted accounting principles (GAAP) in the United States of America, as set forth by the Governmental Accounting Standards Board (GASB). Responsibility for both the accuracy of the presented data, and the completeness and fairness of the presentation, including all disclosures, rests with the management of the Agency. To the best of staff's knowledge, the data presented is accurate in all material respects, and reported in a manner designed to fairly present the financial position and results of operations for the various Agency funds and account groups. Disclosures are included within the CAFR to enable the reader to gain an understanding of the Agency's financial activities. Exhibit A is a copy of the Agency CAFR in substantially final form.

FY 2016/17 Financial Highlights

The Agency's statement of net position for fiscal year (FY) ended June 30, 2017, reflects \$586 million, an increase of \$55 million compared to the prior fiscal year. The gain is primarily due to higher operating revenues from the multi-year rate adjustments adopted by the Board of Directors through FY 2019/20 necessary to establish rates and charges that fully recover the cost of service, as well as the increase in the non-operating revenues from a higher number of new connections to the regional wastewater and the regional water systems.

Advance Refunding of 2008A Bonds

The Chino Basin Regional Financing Authority Revenue Bonds, Series 2008A (2008A bonds) were issued in January 2008 for a par amount of \$125 million, at a fixed annual interest rate of 5% and a final maturity date of November 1, 2038. The 2008A Bonds were callable for the first time in November 2017. To leverage historically low municipal interest rates and optimize use of available cash reserves, an advance refunding was executed in February 2017. The refunding resulted in total present value savings of around \$36 million over the life of the bonds and net of the \$50 million payment.

As a part of the audit testing, Lance, Soll and Lunghard, LLP (LSL) found a discrepancy in the recording of the \$5.5 million cash held by the Agency's custodial bank in an irrevocable escrow account established to support interest payments for the 2008A bonds due through November 1, 2017. Given the infrequent nature and complexity of these type of transactions, LSL advised management it is not uncommon to find such errors in the related entries. Management is committed to accurate financial reporting and has implemented review procedures as recommended by LSL, including expanded review of pertinent journal entries and guidance requested from external auditors, to ensure accurate recording and compliance with accounting standards.

Increase in the Wastewater and Water Connection Fees

Connection fees to the regional water and wastewater systems, were significantly higher than the prior fiscal year. Wastewater connections fees were \$30.5 million, with 5,189 new units compared to 4,176 units and \$24.9 million in the prior fiscal year. Water connection fees, which took effect on January 1, 2016, were \$5.4 million compared to just \$997,010 in FY 2015/16.

Imported Water Pass-Through Sales and Purchases

Imported water deliveries for FY 2016/17 were 47,848-acre feet (AF) compared to 31,714 AF reported in FY 2015/16, an increase of 16,134 AF. Following unprecedented water conservation and plentiful winter rain and snow, in May 2016 MWD lifted the Water Supply Allocation restrictions and penalty rates put in place in response to the unprecedented drought and response to the Governor's Executive Order calling for statewide mandatory water reductions to reduce water usage across the State by 25% from 2013 levels. Governor Brown ended the drought state of emergency in April 2017. Higher imported water deliveries was also partly due to the purchase of 6,000 AF of replenishment water for groundwater recharge. No replenishment water was purchased in the prior fiscal year. Overall imported water purchases are still 63% below purchases in FY 2013/14.

Continued Funding of Employee Retirement Liabilities

Funding of the other post-employment benefits (OPEB) and pension unfunded liabilities continued in FY 2016/17; \$2.0 million and \$4.5 million, respectively. Since the inception of the funding plan, cumulative contributions of \$11.0 million for OPEB and \$13.5 million for pension have been made through fiscal year ended June 30, 2017. As of June 30, 2017, the most recent actuarial valuation date, the OPEB plan is 71% funded with an unfunded actuarial accrued liability of \$4.9 million. The net pension liability measured as of June 30, 2016 using an annual actuarial valuation as of June 30, 2015 was 76.8% funded at \$39.2 million.

Construction Project Work in Progress (WIP)

The number of open projects under the category of Work in Progress (WIP) increased by 21% in FY 2016/17 compared to FY 2015/16. WIP was also higher mainly due to the ongoing construction of the Water Laboratory project slated for completion in fall of 2018, higher execution of capital replacement and rehabilitation (R&R) projects and the beginning of the design phase for the RP-5 Solids and Liquids Expansion and RP-1 Capacity Recovery projects.

External Auditors' Independent Audit

The Agency's independent audit firm, Lance, Soll & Lunghard, LLP (LSL) performed the annual financial audit. LSL issued an unmodified ("clean") opinion over the financial statements for the Fiscal Year ended June 30, 2017, indicating that the financial statements are presented fairly and in accordance with GAAP and free of material misstatements. LSL found no material deficiency in internal controls over financial reporting.

LSL also completed the Single Audit Report for all billing activity for FY 2016/17 to be processed by the Federal Clearing House by March 2018. Federal Expenditures of \$11.8 million were

comprised of Title XVI Water Reclamation and Reuse of \$11.1 million, and \$.7 million from the Water State Revolving Fund. No findings in the Single Audit were noted by LSL.

Fiscal Year 2016/17 is the second audit completed by LSL in accordance to the contract approved by the Board of Directors on March 16, 2016 for three fiscal years, with the option for an additional two fiscal years, beginning in FY 2015/16. The agreement covers the audit of the Inland Empire Utilities Agency (Agency) financial statements, review of the annual appropriations limit calculation, and audit of the Agency's federal awards in accordance with Office of Management and Budget (Single Audit).

Internal Audit Department Review

Internal Audit staff performed an additional quality control check/review of the draft financial statements with emphasis on; overall mathematical accuracy, validation of the MD&A, notes, and statistical sections, including continued disclosure compliance as required by bond covenants, to the financial statements or to other supporting information.

Internal Audit staff's review did not include tests of transactions, or tests of the reliability of the totals and amounts included in the various categories, accounts, funds, statements, etc. Staff relies on the work of the external auditors to test the reliability of the financial information reported. Staff's review is only one of an additional quality control to ensure a professional presentation, consistent with prior years.

Government Financial Officers Association (GFOA) CAFR Award

For the past eighteen years, the Agency has applied for and received the GFOA CAFR Award for excellence in financial reporting. The deadline to submit the FY 2015/16 CAFR is December 31, 2017.

The IEUA FY 2016/17 Comprehensive Annual Financial Report is consistent with the Agency's Business Goal of Fiscal Responsibility in providing transparent communication of the Fiscal Year activity and the net position of the different programs of the Agency.



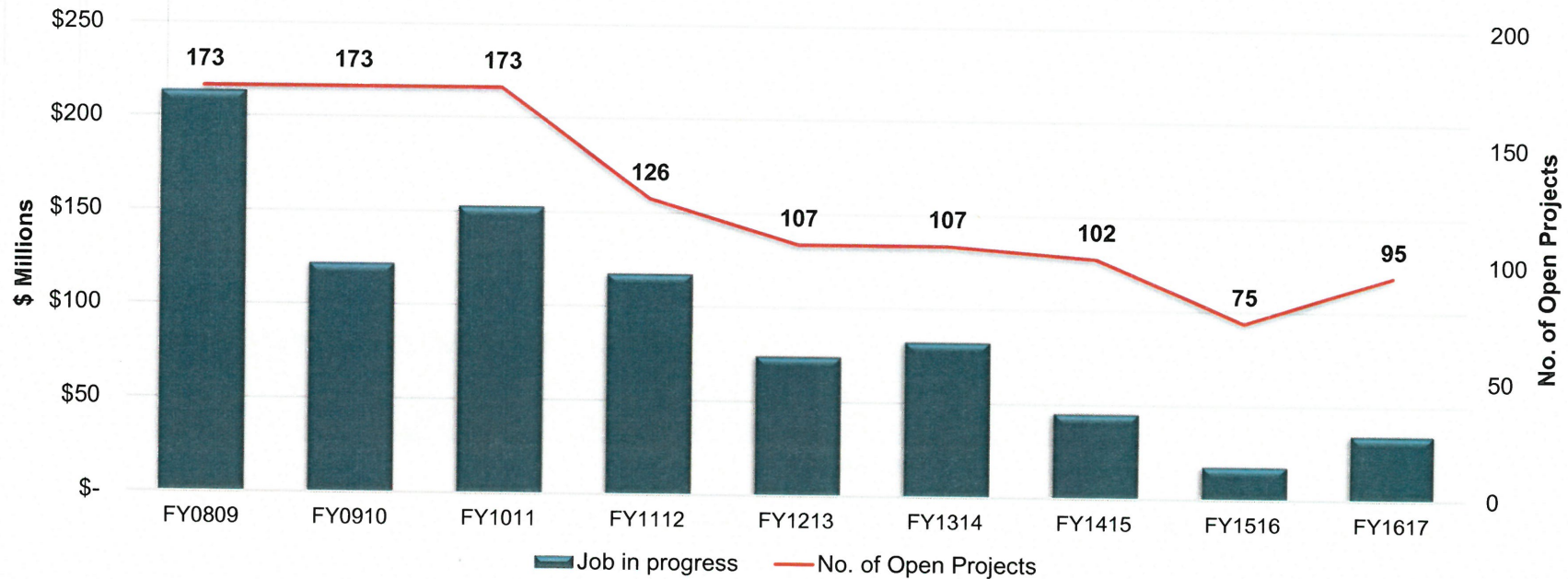
Comprehensive Annual Financial Report Fiscal Year Ended June 30, 2017

FY 2016/17 Highlights

- **2008A Bond Advance Refunding: \$36 million savings**
- **Water Connection fees: \$5.4 million.**
- **Wastewater Connection fees: \$30.5 million**
- **Imported water deliveries: 47,848 AF**
- **Continued funding of employee retirement liabilities: \$6.5 million in fiscal year, \$24.5 million from inception.**
- **External Auditors unmodified (“clean”) opinion**

FY 2016/17 Highlights

- 21% increase in number of open projects



Change in Operating and Non-Operating Activities

\$ in millions

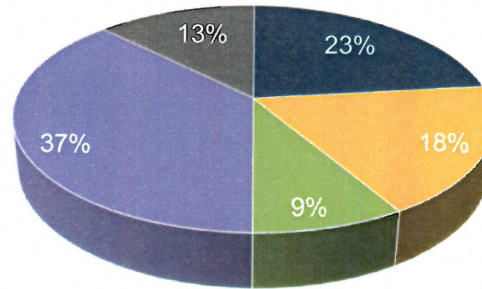
| Description | FY 2015/16 | FY 2016/17 | Change | |
|--|-------------------|-------------------|-----------------|---------------|
| | | | Amount | % |
| Operating Revenues | \$ 100.00 | \$ 120.00 | \$ 20.00 | 20.0 |
| Operating Expenses | \$ (131.00) | \$ (146.00) | \$ (15.00) | 11.5 |
| Net Operating Activities | \$ (31.00) | \$ (26.00) | \$ 5.00 | (16.1) |
| Non-Operating Revenues | \$ 93.00 | \$ 102.00 | \$ 9.00 | 9.7 |
| Non-Operating Expenses | \$ (25.00) | \$ (21.00) | \$ 4.00 | (16.0) |
| Net Non-Operating Activities | \$ 68.00 | \$ 81.00 | \$ 13.00 | 19.1 |
| Total Increase (Decrease) in Net Position | \$ 37.00 | \$ 55.00 | \$ 18.00 | 48.6 |
| Beginning Net Position | \$ 493.00 | \$ 531.00 | | |
| Ending Net Position | \$ 531.00 | \$ 586.00 | \$ 55.00 | 10.4 |

The \$ values are presented in millions and have been rounded

FY 2016/17 Ending Cash Position

- **\$3.7 million decrease from prior fiscal year**
 - Refinance of the 2008A bond
 - Higher connection fees

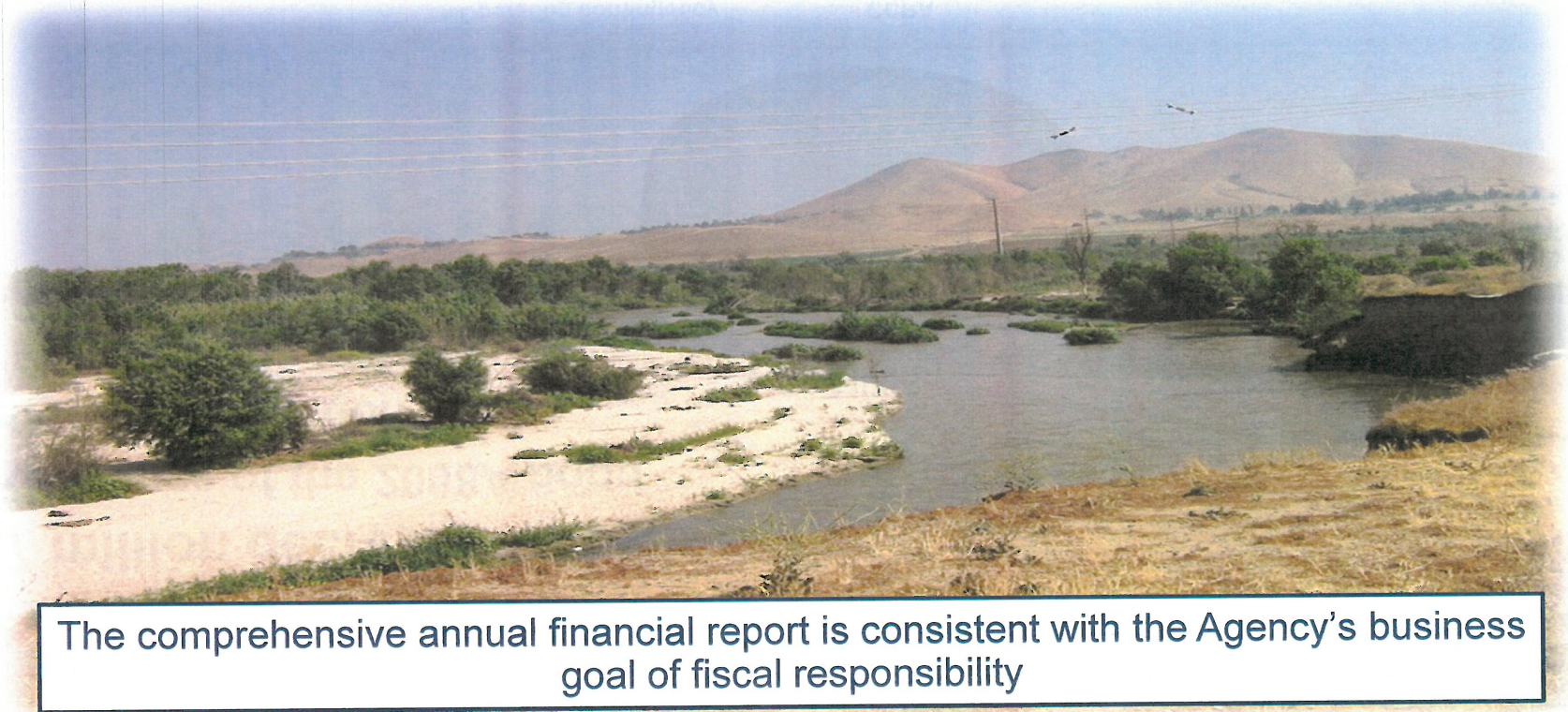
\$172 Million



- Operating contingency
- Insurance and retirement
- Debt service & redemption
- CCRA
- Capital expansion & replacement

CCRA: Capital Capacity Reimbursement Account held by Member Agencies

Questions



The comprehensive annual financial report is consistent with the Agency's business goal of fiscal responsibility



INLAND EMPIRE UTILITIES AGENCY FISCAL YEAR ENDED JUNE 30, 2017 FINANCIAL AUDIT RESULTS



Inland Empire Utilities Agency

A MUNICIPAL WATER DISTRICT

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on YOU



HIGHLIGHTS FROM LAST MEETING

- Met last with auditors June 12, 2017
- Discussed our planning and audit approach
- Met individually with some members
- Audit fieldwork planned to begin September 18, 2017
- One month earlier than prior year



FY 2017 Audit Communication Results

Financial Audit

- Opinion Letter
- Report on Internal Control and Other Matters
- Audit Communication Letter (SAS 114 – **conclusion**)

Single Audit

- Schedule of Expenditures of Federal Awards
- Report on Internal Control over Compliance



Opinion Letter

- Unmodified Opinion

- Based on our audit of significant transactions, our understanding of the Agency's policies and procedures, and our testwork results, we have issued an Opinion that the financials statements are free of material misstatements at June 30, 2017.



Report on Internal Control over Financial Reporting and on Compliance and Other Matters

- In planning and performing the audit, we consider the Agency's Internal Controls over Financial Reporting specific to giving an opinion of the Financial Statements, but this is not the purpose of the audit.
- No opinion is expressed on the internal controls
- During our course of audit procedures weaknesses may come to our attention and communicated to Management and to you in this letter.



Other Matters Noted

- Large adjustments made during the audit is required to be disclosed as part of the results of our audit.
- Not considered a material weakness or significant deficiency since this is considered a one time occurrence due to the infrequency in nature and complexity of the transaction.
- Large adjustment related to the Advance refunding of the 2008A Revenue Bond, required a decrease to cash with fiscal agent of \$5.5 million during our audit.



Audit Communication Letter (SAS 114 – conclusion)

- Significant Audit Findings
 - Accounting Practices
 - Significant and Appropriate Estimates: OPEB and Pension Liabilities
 - No Difficulties Encountered in Performing the Audit
 - Corrected and Uncorrected Misstatements
 - Bond defeasance corrected
 - No Disagreements with Management to disclose
 - Management Representation includes a letter to the auditors regarding their acceptance of responsibilities and disclosures of no known errors or fraudulent activities to communicate to auditors



Audit Communication Letter (SAS 114 – conclusion)

- Other items
 - As of result of moving up the audit dates, several journal entries were received during and after our audit fieldwork, which increases the audit risk. We recommended re-evaluating the dates and year-end process.
- **FUTURE YEAR – New Accounting Pronouncements**
 - OPEB Liability and Plan Funding Reporting – GASB 75
 - Possibly change from your OPEB Net Asset to an OPEB Net Liability
 - Changing the actuarial valuation on OPEB to mirror Pension and required to recognize the full liability.



Single Audit

- Federal Expenditures of \$11.8 million.
 - Title XVI Water Reclamation and Reuse \$11.1 million
 - Water State Revolving Fund .7 million
- No findings noted



Thank you

- Contact information:
 - Deborah.harper@lslcpas.com
 - 714-672-0022
- Any Questions



Audit Committee

**ACTION
ITEM**

1C



Date: December 20, 2017

To: The Honorable Board of Directors

From: Halla Razak, General Manager

Committee: Audit Committee

12/11/17

Finance & Administration

12/13/17

Executive Contact: Kathy Besser, Executive Manager of Ext. Aff. & Policy Dev./AGM

Subject: Fiscal Year (FY) 2016/17 Single Audit Report for Federal Grant Programs

Executive Summary:

The Single Audit Act and the new Office of Management and Budget (OMB) Uniform Guidance, require each non-Federal entity that expends \$750,000 or more of Federal grants to undergo an annual independent audit. The objectives of the Single Audit are to determine whether there are issues that could have a direct and material effect over compliance for each major federal grant award program, internal control over compliance requirements of federal grant award programs, and eligibility of federal grant award program expenditures. In FY 2016/17, IEUA incurred \$11,798,196 in total federal costs for 2 federal programs, USBR \$11,088,961 and EPA \$709,235. The Agency's independent external audit firm, Lance Soll & Lunghard LLP, performed the annual single audit for fiscal year ended June 30, 2017. The Single Audit Report for the FY 2016/17 expressed the following opinion over the Agency's expense of federal funds:

1. IEUA is in compliance with each major federal grant award program.
2. No significant deficiencies in internal control over major federal award programs.
3. No findings or questioned costs to major federal award programs.
4. IEUA qualifies as a "Low-Risk Auditee."

Staff's Recommendation:

1. Approve the Single Audit Report for FY 2016/17; and
2. Direct staff to distribute the report, as appropriate, to the State Controller's Office, the Federal Audit Clearing House, and other interested parties.

Budget Impact *Budgeted (Y/N): Y Amendment (Y/N): N Amount for Requested Approval:*

Account/Project Name:

Fiscal Impact (explain if not budgeted):

The audit fee for the Single Audit Report is within the Agency's FY 2017/18 budget in the Administrative Services (GG) fund (100000/111100/520110) under the professional fees and services category.

Full account coding (internal AP purposes only): - - - Project No.:

Prior Board Action:

On March 15, 2017, the Board reviewed the FY 2015/16 Single Audit Report presented to the Audit Committee on March 6, 2017.

On December 16, 2015, the Board reviewed the FY 2014/15 Single Audit Report presented to the Audit Committee on December 9, 2015.

Environmental Determination:

Not Applicable

Business Goal:

The IEUA FY 2016/17 Single Audit Report is consistent with the Agency's Business Goal of fiscal responsibility in providing transparent communication regarding federal grant award programs.

Attachments:

Attachment 1 - IEUA Single Audit Report ending June 30, 2017



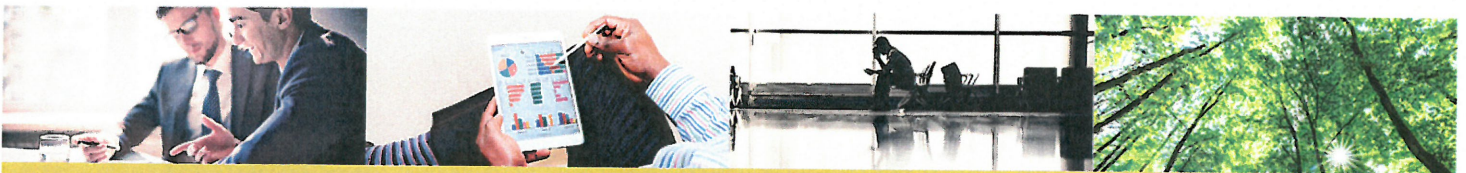
INLAND EMPIRE UTILITIES AGENCY

JUNE 30, 2017

SINGLE AUDIT REPORT

DRAFT

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INLAND EMPIRE UTILITIES AGENCY

SINGLE AUDIT REPORT

JUNE 30, 2017

DRAFT

INLAND EMPIRE UTILITIES AGENCY

SINGLE AUDIT REPORT

JUNE 30, 2017

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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*.....

Independent Auditors' Report on Compliance for Each Major Program and on Internal Control Over Compliance; and Report on the Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

Schedule of Expenditures of Federal Awards for the Year Ended June 30, 2017

Notes to the Schedule of Expenditures of Federal Awards for the Year Ended June 30, 2017

Schedule of Findings and Questioned Costs for the Year Ended June 30, 2017

Schedule of Prior Year Findings and Questioned Costs for the Year Ended June 30, 2016

DRAFT

INLAND EMPIRE UTILITIES AGENCY

SINGLE AUDIT REPORT

JUNE 30, 2017

DRAFT



CPAs AND ADVISORS

To the Board of Directors
Inland Empire Utilities Agency
Chino, California

Accounting for Advance Refunding of Bonds Payable

As part of our audit testing, we examined the cash held with fiscal agent accounts and observed that the amount recorded on the Agency's books was approximately \$5.5 million more than what could be substantiated by the supporting bank statements, as cash held in escrow was recorded in the general ledger accounts. We determined that the cause of this condition was a journal entry which was incorrectly recorded for the purpose of defeasing in the Revenue Bonds, Series 2008A. This resulted in cash and investments held with fiscal agents being overstated by the above amount.

Given the infrequent nature and complexity of these type of transactions, it is not uncommon to find errors. To ensure these type of entries, including non-recurring and one-time transactions, are accounted for in accordance with authoritative guidance, and properly presented in the financials, we recommend the Agency implement more extensive review procedures. We recommend that the Agency implement review procedures to ensure that uncommon transactions, such as advance refunding of long-term debt, are accounted for in accordance with authoritative guidance, and are properly recorded in the general ledger.

Management Response:

The transaction came about due to a bond defeasance, which is subject to complex accounting rules for recording the extinguishment of the old debt and recording of the new debt, including the treatment of any funds held in escrow before the old bonds are retired. The Agency is committed to accurate financial reporting and will ensure that future transactions of this nature are reviewed for compliance with accounting standards and will seek outside guidance from the auditors or other resources, where necessary, before finalizing the accounting entries.

Agency's Response to Findings

The Agency's response to the findings identified in our audit was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Agency's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Agency's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Lance, Soll & Lughard, LLP

Brea, California

2017



INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Inland Empire Utilities Agency
Chino, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of each major fund and the aggregate remaining fund information of the Inland Empire Utilities Agency (the Agency), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Agency's basic financial statements and have issued our report thereon dated [REDACTED], 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Agency's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control. Accordingly, we do not express an opinion on the effectiveness of the Agency's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Agency's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. We noted one item as other matters that are required to be reported under *Government Auditing Standards*.



CPAs AND ADVISORS

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE AND REPORT ON THE SCHEDULE OF
EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE

To the Board of Directors
Inland Empire Utilities Agency
Chino, California

Report on Compliance for Each Major Federal Program

We have audited the Inland Empire Utilities Agency (the Agency)'s compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Agency's major federal programs for the year ended June 30, 2017. The Agency's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Agency's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Agency's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Agency's compliance.

Opinion on Each Major Federal Program

In our opinion, the Inland Empire Utilities Agency complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2017.





To the Board of Directors
Inland Empire Utilities Agency
Chino, California

Report on Internal Control over Compliance

Management of the Agency is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Agency's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Agency's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on the Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of each major fund and the aggregate remaining fund information of the Agency, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Agency's basic financial statements. We issued our report thereon dated **October 31, 2017**, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for the purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements.



CPAs AND ADVISORS
To the Board of Directors
Inland Empire Utilities Agency
Chino, California

The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Lance, Solt & Loughard, LLP

Brea, California
October 31, 2017

DRAFT

INLAND EMPIRE UTILITIES AGENCY

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

| <u>Federal Grantor/Pass-Through Grantor/Program Title</u> | <u>Federal CFDA Number</u> | <u>Pass-Through Entity Identifying Number</u> | <u>Passed Through to Subrecipients</u> | <u>Total Federal Expenditures</u> |
|---|----------------------------|---|--|-----------------------------------|
| <u>U.S. Department of the Interior</u> | | | | |
| Direct programs: | | | | |
| Title XVI Water Reclamation and Reuse * | 15.504 | N/A | \$ 11,083,261 | \$ 11,083,261 |
| Reclamation States Emergency Drought Relief | 15.514 | N/A | - | 5,700 |
| Total U.S. Department of the Interior | | | 11,083,261 | 11,088,961 |
| <u>Environmental Protection Agency</u> | | | | |
| Passed through the State of California Water Resources Control Board: | | | | |
| Capitalization Grants for Clean Water State Revolving Funds * | 66.458 | C-06-7885-110 | - | 709,235 |
| Total Environmental Protection Agency | | | - | 709,235 |
| Total Expenditures of Federal Awards | | | \$ 11,083,261 | \$ 11,798,196 |

* Major Program

Note a: Refer to Note 1 to the schedule of expenditures of federal awards for a description of significant accounting policies used in preparing this schedule.

Note b: There were no federal awards expended in the form of noncash assistance and insurance in effect during the year.

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The accompanying notes are an integral part of this schedule.

INLAND EMPIRE UTILITIES AGENCY

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2017

Note 1: Summary of Significant Accounting Policies Applicable to the Schedule of Expenditures of Federal Awards

a. Scope of Presentation

The accompanying schedule presents only the expenditures incurred by the Inland Empire Utilities Agency (the Agency), that are reimbursable under federal programs of federal financial assistance. For the purposes of this schedule, federal awards include both federal financial assistance received directly from a federal agency, as well as federal funds received indirectly by the Agency from a non-federal agency or other organization. Only the portion of program expenditures reimbursable with such federal funds is reported in the accompanying schedule. Program expenditures in excess of the maximum federal reimbursement authorized or the portion of the program expenditures that were funded with state, local or other non-federal funds are excluded from the accompanying schedule.

b. Basis of Accounting

The expenditures included in the accompanying schedule were reported on the modified accrual basis of accounting. Under the modified accrual basis of accounting, expenditures are incurred when the Agency becomes obligated for payment as a result of the receipt of the related goods and services. Expenditures reported included any property or equipment acquisitions incurred under the federal program. The Agency has elected not to use the 10-percent *de minimis* indirect cost rate allowed under the Uniform Guidance.

Note 2: Reconciliation of State Water Resource Control Board and GAAP Expenditure Reporting

For the year ended June 30, 2017, the following adjustments were necessary to reconcile the federal awards provided to the Agency for the Capitalization Grants for Clean Water State Revolving Funds federal awards program per the State Water Resource Control Board's records to the federal expenditures reported by the Agency under accounting principles generally accepted in the United States of America (GAAP).

| | |
|---|-------------------|
| Federal awards per the State Water Resource Control Board: | |
| C-06-5318-110 | \$ 7,586,911 |
| C-06-7885-110 | 1,261,335 |
| | <hr/> |
| Subtotal | 8,848,246 |
| | <hr/> |
| Adjustment for expenditures reported in the prior fiscal period: | |
| C-06-5318-110 | (7,586,911) |
| C-06-7885-110 | (552,100) |
| | <hr/> |
| Subtotal | (8,139,011) |
| | <hr/> |
| Total Federal Expenditures of the Capitalization Grants for Clean Water State Revolving Funds Program (GAAP) | \$ 709,235 |
| | <hr/> <hr/> |

INLAND EMPIRE UTILITIES AGENCY

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2017**

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unmodified Opinion

Internal control over financial reporting:

- Significant deficiencies identified? ___yes X no
- Material weaknesses identified? ___yes X none reported

Noncompliance material to financial statements noted? ___yes X no

Federal Awards

Internal control over major programs:

- Significant deficiencies identified? ___yes X no
- Material weaknesses identified? ___yes X none reported

Type of auditors' report issued on compliance for major programs: Unmodified Opinion

Any audit findings disclosed that are required to be reported in accordance with Uniform Guidance? ___yes X no

Identification of major programs:

| <u>CFDA Number(s)</u> | <u>Name of Federal Program or Cluster</u> |
|-----------------------|--|
| 15.504 66.458 | Title XVI Water Reclamation and Reuse Capitalization Grants for Clean Water State Revolving Funds |

Dollar threshold used to distinguish between type A and type B program \$750,000

Auditee qualified as low-risk auditee? X yes ___no

INLAND EMPIRE UTILITIES AGENCY

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2017**

SECTION II - FINANCIAL STATEMENT FINDINGS

No matters were reported.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

No matters were reported.

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INLAND EMPIRE UTILITIES AGENCY

**SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2016**

SECTION I - FINANCIAL STATEMENT FINDINGS

No matters were reported.

SECTION II - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

No matters were reported.

DRAFT


Audit Committee

**ACTION
ITEM**

1D

Date: December 20, 2017

To: The Honorable Board of Directors

From:  for Halla Razak, General Manager

Committee: Audit

12/11/17

Manager Contact: Teresa Velarde, Manager of Internal Audit

Subject: Internal Audit Department Charter and Audit Committee Charter

Executive Summary:

The Board approved charters require that the Internal Audit Department (IA) perform periodic reviews of both the Audit Committee Charter and the IA Charter, and make recommendations for any necessary updates and revisions. Attached are the charters presented for your review, discussion, further direction and final approval. No changes are proposed at this time. The Audit Committee Charter documents the Audit Committee's purpose, composition, authority, and responsibilities. The IA Charter documents IAs mission, purpose, authority, and responsibilities. The purpose is to assist the Board and Audit Committee in fulfilling their oversight responsibilities for financial reporting, internal controls, and compliance with legal and regulatory requirements and to assist management by providing objective evaluations and recommendations to improve operations and achieve organizational goals.

Both charters follow the guidance set forth by the Institute of Internal Auditing (IIA) International Standards for the Professional Practice of Internal Auditing (Standards).

Staff's Recommendation:

Reconfirm the Audit Committee Charter and the Internal Audit Department Charter and direct staff to implement the charters.

Budget Impact Budgeted (Y/N): N Amendment (Y/N): N Amount for Requested Approval:

Account/Project Name:

N/A

Fiscal Impact (explain if not budgeted):

N/A

Prior Board Action:

On March 15, 2017, the Board of Directors reconfirmed the approved Audit Committee and the Internal Audit Charter.

Environmental Determination:

Not Applicable

Business Goal:

The Charters are consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by documenting the Audit Committee's and the IAs purpose, authority and responsibilities.

Attachments:

Attachment 1 - Audit Committee Charter
Attachment 2 - Internal Audit Department Charter



INLAND EMPIRE UTILITIES AGENCY
Audit Committee Charter
Reconfirmed on December 20, 2017

PURPOSE

The Audit Committee (Committee) is established under the authority of the Inland Empire Utilities Agency (IEUA or Agency) Board of Directors (Board) and reports directly to the Board. The primary purpose of the Committee is to assist the Board in fulfilling their oversight responsibilities for financial reporting, internal controls, and compliance with legal and regulatory requirements applicable to Agency operations.

While assisting the Board with these fiduciary duties, the Committee also provides an open avenue of communication between the Board, IEUA Management, the Internal Audit Department, and the external auditors. This advisory and oversight link provides the following benefits to the organization and stakeholders:

- Increased objectivity and credibility of financial reports.
- Increased management accountability.
- Support for measures to improve management performance and internal controls.
- Increased employee awareness of unethical, questionable, or illegal activities.
- Enhanced independence and effectiveness of the Internal Audit Department.
- Assurance that appropriate management action plans are implemented for audit findings and recommendations.

COMPOSITION, COMPENSATION & TERM OF SERVICE

The Committee shall consist of two members from the Board of Directors, each with equal voting rights, with one selected as the Committee Chairperson. The members will be appointed by the Board President.

The Audit Committee shall have access to at least one financial expert, an outside party with no voting rights, who will provide advisory and consulting duties and shall be compensated as agreed upon, in writing with the audit committee, the Board, Agency management and its designees.

All members of the Audit Committee shall possess or obtain a basic understanding of governmental financial reporting, accounting and auditing and shall have a requisite interest in financial reporting issues of the Agency. The financial expert shall be an individual with sufficient financial experience and interest to provide guidance and assistance to the Audit Committee. The financial expert should through both education and experience, and in a manner specifically relevant to the government sector, possess: 1) an understanding of generally accepted accounting principles and financial statements; 2) experience in preparing or auditing financial statements of comparable entities; 3) experience in applying such principles in connection with the accounting for estimates, accruals, and reserves; 4) experience with internal accounting controls; and 5) an understanding of Audit Committee functions.

INLAND EMPIRE UTILITIES AGENCY
Audit Committee Charter
Reconfirmed on December 20, 2017

The members of the Board serving on the Audit Committee shall be compensated in accordance with the guidelines established for the IEUA Board of Directors in Ordinance No. 105 adopted April 19, 2017, and as amended from time to time, entitled:

"Ordinance of the Inland Empire Utilities Agency, a Municipal Water District, San Bernardino County, California, establishing compensation/benefits and authorizing reimbursement of expenses for the Board of Directors and their appointed representatives to the Metropolitan Water District of Southern California Board of Directors and outside Committee Members."

The service term for each Committee member will be two years. Prior to term expiration, the Board President or their designee will conduct a review of Board Committee members' eligibility and the Board of Directors will conduct a review of the external/outside Committee member's eligibility. The Board President will then reconfirm the Committee members or select and confirm new members as needed. All activities and actions pertaining to selection or reconfirmation of Committee members will be documented by the Board, or their designee, and recorded in the next regularly scheduled IEUA Board of Directors' meeting minutes.

AUTHORITY

The Audit Committee has unrestricted access to all information and records, including IEUA personnel and documents. The Committee will have adequate resources to fulfill its oversight responsibilities, including the right to seek independent professional advice and counsel. The Committee is empowered to:

- Meet, as deemed appropriate and necessary, with IEUA Management and employees, the Manager of Internal Audit and audit staff, external auditors and legal counsel.
- Recommend to the Board the approval of the Internal Audit Department's Annual Audit Plan and any changes to the Plan or the Manager of Internal Audit duties.
- Authorize special audits and investigations into any matters within its scope of responsibility.
- Authorize an internal audit or review of any department or function under the control of the Board of Directors, or within the scope of influence of the IEUA.
- Recommend to the Board the appointment, compensation and scope of work of any public accounting firm employed by the IEUA.
- Recommend to the Board the approval of any auditing and consulting services.

INLAND EMPIRE UTILITIES AGENCY
Audit Committee Charter
Reconfirmed on December 20, 2017

- Review and recommend to the Board the external auditor's audit scope and approach, ensuring that the scope:
 1. Is in compliance with Generally Accepted Auditing Standards (issued by the American Institute of Certified Public Accountants).
 2. Is in compliance with Government Auditing Standards (issued by the Government Accountability Office).
 3. Will include a Single Audit that will be performed, if required, subject to the Office of Management and Budget (OMB) Circular A-133.
 4. Will include an opinion on each major fund presented in the Agency's financial statements.
- Review and recommend to the Board the approval of external auditors' reports, along with Management's written responses, when appropriate.
- Resolve any disagreements between Management, the Internal Audit Department, and the external auditors regarding financial or operational controls and reporting.
- Ensure corrective action is taken on internal accounting control weaknesses identified by the internal and external auditors.

RESPONSIBILITIES

The Audit Committee is chartered with performing oversight for the Board of Directors. In addition to reviewing this Charter annually and updating it as needed, the Committee has responsibilities in the areas of Financial Reporting, Internal Controls, the Internal Audit Department, the External Audit and external auditors, Compliance requirements, and Other Matters as provided in the following sections. The Committee has the overall responsibility to ensure the general requirements underlying these items are carried out. However, the Audit Committee has the flexibility and authority to determine and choose the best course of action and the best method for carrying out its responsibilities. The following items are best practice guidelines that may be employed:

Financial Reporting:

- Review annual financial statements and consider whether they are complete, consistent with information known to Committee members, and reflect appropriate accounting principles.
- Advise the Board and management of any situations that would cause the Committee to believe the audited financial statements may contain material misstatements or omissions.
- Inquire of the General Manager and Executive Manager of Finance & Administration/ AGM regarding the fiscal health of the Agency as well as the financial status of the Agency in relation to its adopted budget.
- Inquire of management, the Manager of Internal Audit, and the external auditors about whether significant financial, managerial, and operational information is accurate, reliable, complete, and timely.
- Inquire of Agency management, the Manager of Internal Audit, and the external auditors about significant risks or exposures facing the Agency; assess the steps management has

INLAND EMPIRE UTILITIES AGENCY
Audit Committee Charter
Reconfirmed on December 20, 2017

taken or proposes to take to minimize such risks to the Agency; and periodically review compliance with such steps.

Internal Controls:

- Discuss with Agency management, the Manager of Internal Audit, and the external auditors the reliability and effectiveness of the Agency's internal control environment to mitigate risk, including information technology security and control.
- Discuss with Agency management, the effectiveness of the Agency's process for identifying and assessing significant risks and exposures, and the steps Agency management has taken to communicate, monitor and mitigate these risks.
- Understand the scope of the internal and external auditors' reviews of internal controls, and obtain and review reports of significant findings, recommendations, and Agency management's action plans to mitigate risks.
- Review all significant accounting policy changes submitted by Agency management with the Internal Audit Department, and/or the external auditors, and provide recommendations to the Board and Agency management.
- Periodically review Agency policies and procedures governing Board of Director and employee conduct, including conflict of interest, misconduct, fraud and other sensitive issues or non-compliance and recommend changes to the Board and Agency management as appropriate.
- Discuss with Agency management, the Manager of Internal Audit, and the external auditors whether adequate policies have been established and the Agency complies with policies, standards and applicable laws and regulations.
- Discuss with Agency management, the Manager of Internal Audit, and the external auditors whether significant legislative or regulatory issues impacting Agency operations are identified, recognized, communicated and appropriately addressed.
- Review with Agency management, the Manager of Internal Audit, and the external auditors the audit scope and plan of the Internal Audit Department and the external auditors. Address the coordination of audit efforts to assure the completeness of coverage, reduction of redundant efforts, and the effective use of audit resources.
- Review with Agency management and the Manager of Internal Audit:
 - Significant findings, recommendations, and management's responses thereto.
 - Any difficulties the Internal Audit Department encountered in the course of their audits, including any restrictions on the scope of their work or access to required information.
 - Any changes required in the scope of their internal audits.
 - The Internal Audit Department budget and staffing.
 - The Internal Audit Department Charter.
 - The Internal Audit Department's compliance with applicable standards (for example, Governmental Auditing Standards, or the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing).

INLAND EMPIRE UTILITIES AGENCY
Audit Committee Charter
Reconfirmed on December 20, 2017

- Periodically review the Agency's Code of Conduct/Ethics Policy to ensure that it is adequate and up to date.
- Review with the Manager of Internal Audit and the Agency's general counsel the results of their reviews of compliance monitoring with the Code of Conduct/Ethics Policy.
- Review the procedures for the receipt, retention, and treatment of complaints received by the Agency regarding accounting, internal accounting controls, auditing matters, or suspected fraud that may be submitted by any party internal or external to the organization. Review any complaints that might have been received, the current status, and resolution if one has been reached.
- Review procedures for the confidential, anonymous submission by Agency employees of concerns regarding questionable accounting or auditing matters, or suspected fraud. Review any submissions that have been received, the current status, and the resolution if one has been reached.
- Inquire of Agency management, the Manager of Internal Audit, and the external auditors about significant risks or exposures facing the Agency. Assess the steps management has taken or proposes to take to communicate, manage, and minimize such risks to the Agency; and periodically review compliance with such steps.
- Review with the Manager of Internal Audit, and the external auditors:
 - The adequacy of the Agency's internal controls including computerized information system controls and security.
 - Any significant findings and recommendations of the Manager of Internal Audit, and the external auditors together with management's responses thereto.

Internal Audit Department:

- Request that the Agency's Manager of Internal Audit prepare the Audit Committee's meeting agendas designed to ensure that all of the responsibilities of the Audit Committee as described herein are addressed at least once a year.
- Ensure there are no unjustified restrictions or limitations placed on the Internal Audit Department.
- Review with the Board, General Manager, and the Manager of Internal Audit the Internal Audit Department Charter, Annual Audit Plan, staffing, budget, and organizational reporting structure to ensure they meet the Committee's goals, objectives, and responsibilities to the Board and Agency management.
- Review and recommend to the Board the approval of the Internal Audit Department's Annual Audit Plan and any significant changes that may occur during the year.
- Review, as needed, all internal audit reports, findings, and recommendations.
- Review and recommend to the Board the appointment, replacement, dismissal, or change in duties of the Manager of Internal Audit.
- Review the effectiveness of the Internal Audit Department's function, including compliance with The Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing (Standards)*.

INLAND EMPIRE UTILITIES AGENCY
Audit Committee Charter
Reconfirmed on December 20, 2017

- Conduct the Manager of Internal Audit performance appraisals and recommend Manager of Internal Audit merit increases and incentive compensation to the Board.
- Hold management accountable for the appropriate resolution of Internal Audit Department's recommendations and ensure that disposition has been determined for Audit Department recommendations from the prior year. If management has determined that Internal Audit Department recommendations need not be implemented because of adequate compensating controls, based upon a cost/benefit analysis or because the risks are at an acceptable level in accordance with the Agency's goals and objectives, evaluate the reasonableness of such determinations and advise the Board of Directors accordingly.

External Audit:

- Review the external accounting firm's proposals and fee structure, and provide recommendations and external audit plan approval to the Board.
- Review the external auditors' proposed audit scope and approach to ensure emphasis is placed on areas the Committee, Board, Management and external auditors believe special attention is warranted and that efforts are coordinated with the Internal Audit Department.
- Evaluate the external auditor's independence, and if needed, recommend the Board take the appropriate action to satisfy the Agency with the external auditor's independence.
- Review the effectiveness of the external auditor's work and provide the Board with the final approval to continue or discharge the current firm.
- Communicate to the external auditors areas of internal control with a heightened risk of fraud or error, any known or suspected employee fraud, management fraud, pressures or incentives for management to distort reported financial results, or any known or suspected accounting errors or misstatements.
- Communicate to the external auditors any areas of concern applicable to the external auditors' scope of responsibility (fraud, errors, or misstatements involving amounts significant to the financial statements taken as a whole).
- Review all significant written communications between the external auditors and management, such as any management letter comments or schedule of unadjusted differences (i.e. management letter, schedule of audit, or significant unusual or non-routine items, etc.)
- Hold management accountable for the appropriate resolution of external auditor recommendations, ensure that disposition has been determined for auditor recommendations from the prior year, and where management has determined that auditor recommendations need not be implemented because of adequate compensating controls or based upon a cost/benefit analysis, evaluate the reasonableness of such determinations and advise the Board of Directors accordingly.
- Review with the external auditor that performs the financial statement audit:
 - All critical accounting policies and practices used by the Agency.
 - All alternative treatments of financial information within generally accepted accounting principles that have been discussed with the Agency's management, the ramifications of each alternative, and the treatment preferred by the Agency.

INLAND EMPIRE UTILITIES AGENCY
Audit Committee Charter
Reconfirmed on December 20, 2017

- Review with management and the external auditors:
 - The Agency's annual financial statements, related notes, and management's discussion and analysis.
 - The external auditors' audit of the financial statements and their report thereon.
 - The external auditors' judgments about the quality, not just the acceptability, of the Agency's accounting principles as applied in its financial reporting.
 - The external auditors' single audit of the federal awards administered by the Agency and their reports thereon.
 - Any significant changes required in the external auditors' audit plan.
 - Any serious difficulties or disputes with management encountered during the audit.
 - Matters required by Statement on Auditing Standards (SAS) No. 114, The Auditor's Communication With Those Charged With Governance; U.S. Government Accountability Office's (GAO) Government Auditing Standards; and the U.S. Office of Management and Budget's Circular A-133 related to the conduct of the audits.

- Evaluate whether or not the performance of any extra work or special projects requested of the Agency's external audit firm violates the independence standards of the GAO.

- Recommend that the Board of Directors approve the Agency's annual financial report, if the Committee believes that they are fairly presented, to the extent such a determination can be made on the basis of reading the financial statements and discussions with Agency management and the external auditors.

Compliance:

- Review with management and the external auditors the Agency's internal controls for identifying laws and regulations affecting operations, risks for non-compliance including litigation and fines, and implementing controls to prevent recurrence.
- Review the reports, findings and recommendations of any audits or examinations performed by external agencies.
- Review with Agency counsel any legal, tax, or regulatory matters that may have a material impact on the Agency's operations and its financial statements.

Other Matters:

- The Audit Committee shall engage consultants, specialists, or other audit firms as necessary to assist the committee in the discharging of its responsibilities.
- The Audit Committee shall direct the Manager of Internal Audit to review the Agency's Audit Committee Charter annually in order to advise the Audit Committee as to needed or recommended changes.

INLAND EMPIRE UTILITIES AGENCY
Audit Committee Charter
Reconfirmed on December 20, 2017

- The Audit Committee shall report to the Board of Directors issues discussed in the Audit Committee meeting that, in the judgment of the committee, warrant communication to the Board to help the Board fulfill its oversight responsibility.

ETHICAL CONDUCT

Audit Committee members are prohibited from participating in any event or matter that would create, or appear to create, a conflict of interest. These activities may include having a significant financial interest or operational influence in vendors, contractors, customers or competitors of IEUA. Any activity creating an actual or apparent conflict should be immediately reported to the Audit Committee Chair and the Board of Directors for resolution.

MEETINGS

The Audit Committee shall meet no less than quarterly.

The Manager of Internal Audit will schedule and coordinate all quarterly Committee meetings, and will call additional meetings if requested to do so by any Committee member, the Board, the General Manager or the external auditors. The Manager of Internal Audit will provide all Committee members with written notification and an agenda at least 72 hours before the scheduled quarterly meetings or as soon as reasonably possible for any special meetings, all in accordance with the requirements of the Brown Act.

The General Manager and Manager of Internal Audit will be provided written notification and an agenda at least 72 hours before quarterly and special Committee meetings. These parties will be provided an opportunity to attend and speak at all Committee meetings but are not considered members of the Committee and have no voting rights.

The Board or the General Manager will provide administrative support to the Audit Committee and its meetings, including agenda preparation, participant notification, and documentation of meeting minutes.



INLAND EMPIRE UTILITIES AGENCY

Internal Audit Department Charter

Reconfirmed on December 20, 2017

PURPOSE

This Charter establishes the authority and responsibilities of the Inland Empire Utilities Agency (IEUA or Agency) Internal Audit Department.

The purpose of the Internal Audit Department (Internal Audit or IA) is to assist the Board of Directors (Board) and the Audit Committee (Committee) in fulfilling their oversight responsibilities for financial reporting, internal controls, and compliance with legal and regulatory requirements applicable to Agency operations and to provide objective assurance about the Agency's operations. The purpose of the Internal Audit Department is also to provide as a service to management and as a way of adding value to improve the operations of the Agency, consulting services, analyses, recommendations, and information concerning operations.

The Internal Audit Department reports to the Board through the Committee and is an independent function from management. The responsibilities of the Internal Audit Department are defined in this Charter.

MISSION

The Internal Audit Department seeks to improve the operations of the Agency by providing unbiased and objective assessments and recommendations to ensure Agency resources are efficiently and effectively managed in order to achieve Agency goals and objectives. The Internal Audit Department will help the Agency achieve its goals and objectives, improve operations, and instill confidence among its employees and the citizens it serves by providing independent, objective assurance and consulting services and provide management and the Board of Directors with recommendations to:

- Promote and strengthen a sound control environment.
- Improve Agency risk management, control and governance.
- Promote the Agency's vision and mission through a high degree of professionalism.
- Establish adequate policies and procedures and to comply with them.
- Encourage efficient use of Agency resources.
- Protect and safeguard Agency assets.
- Mitigate risks related to fraud, waste and abuse.
- Hold staff accountable for the resolution of audit recommendations.

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VALUES

The Internal Audit Department has adopted the following value statements that form the foundation for the Internal Audit Department.

Independence

As documented in this Charter, the Internal Audit Department is an independent function of the Agency for the purpose of providing independent, objective, unbiased opinions.

Integrity

The Internal Audit Department staff is required to maintain the highest degree of integrity in conducting its audit work.

Professionalism

The Internal Audit Department will perform its work with due professional care at all times.

Collaboration

The Internal Audit Department will foster collaboration with all Agency personnel to promote teamwork within the various business units.

ACCOUNTABILITY

The Internal Auditor is the Manager of the Internal Audit Department. The Internal Auditor is accountable and reports to the Board of Directors, through the Audit Committee appointed by the Board. The intent of this reporting relationship is to establish the Internal Audit Department's independence to function effectively and in accordance with best practices.

Annually, the Internal Auditor will submit an Audit Plan for the following fiscal year to the Committee for review and approval by the Board. Quarterly status reports of significant Internal Audit activities shall be presented at Committee meetings and shall include a status of major activities and any changes or deviations from the approved audit plan. The Internal Auditor has the authority to deviate from the approved annual Audit Plan, when necessary and if warranted by unforeseen issues that require immediate attention. Significant changes to the annual Audit Plan shall be reported to the Committee and to the Board.

Annually, a listing of audit recommendations provided by the Internal Audit Department and the corresponding corrective actions taken by Agency management will be presented to the Committee.

The Internal Auditor shall inform the Committee on the sufficiency of department staffing and resources.

Annually, the Internal Audit Department must also ensure the Committee fulfills their responsibilities as required under the Audit Committee Charter. Additionally, IA must ensure the

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Internal Audit Department Charter and the Audit Committee Charter are reviewed annually and updated as necessary.

INDEPENDENCE

Independence is essential to the effectiveness of internal auditing and is strongly emphasized by the Institute of Internal Auditors (IIA), the American Institute of Certified Public Accountants (AICPA), and the U. S. General Accountability Office (GAO). The Internal Audit Department should be free, both in fact and appearance, from impairments to independence.

The Internal Auditor and the Internal Audit Department shall have no direct responsibility or authority over the day-to-day operations of the Agency or any activities they would audit. The Internal Audit Department shall not engage in any activities that would compromise their independence or would appear to be a conflict of interest.

To ensure independence is maintained, the Internal Audit Department shall report administratively to the Agency's General Manager or his designee and functionally to the Board through the Audit Committee, as stated under "Accountability".

AUTHORITY

The Internal Audit Department's authority is derived from the direction of management and the Agency's Board through the Committee as set forth in this Charter. Specifically, the Internal Audit Department is authorized to:

- Audit all areas of the Agency's operations. Perform audits of the Regional Sewage Service Contract agreement between the Agency and the Regional Contracting Agencies (RCA), including performing necessary audit field work and review of required supporting information and documents of the RCA's.
- Have unrestricted access to all Agency functions, records, information, property, and personnel.
- Have full and free access to Agency management, the Board of Directors and the Audit Committee.
- Allocate resources, set frequencies, select subjects and set objectives, determine the scope of work, and apply the techniques required to accomplish audit objectives, without interference from management.
- Obtain the necessary assistance of Agency staff where Internal Audit performs audits, as well as other specialized services from within or outside the organization.
- Obtain regular updates from management and Agency legal counsel regarding compliance matters affecting operations.

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- Establish procedures for the receipt, retention, and treatment of comments or complaints received regarding Agency accounting, operations, or internal controls, including those matters received through Ethics Point or other channels.
- Investigate and make recommendations to the Board, Audit Committee, Executive Management and/or Human Resources, as appropriate about reported instances of inappropriate activities, misappropriation of funds or fraud, including those matters received through Ethics Point or other channels.
- Obtain additional internal or external resources when the Internal Audit Department does not possess all the necessary skills or experience to complete an audit or review, subject to the approval of the Audit Committee and when necessary from the Board.

The Internal Auditor and the Internal Audit Department staff are **not** authorized to:

- Have any responsibilities or authority for any of the activities they audit or perform any operational duties for the Agency or its affiliates.
- Initiate or approve accounting transactions external to the Internal Audit Department.
- Direct the activities of any organization employee not employed by the Internal Audit Department, except to the extent such employees have been appropriately assigned to auditing teams or to otherwise assist the Internal Auditor in audit activities.
- Participate in any activities that would compromise their objectivity and independence or any activities that would appear to be a conflict of interest.
- Draft or write any Agency Policies and Procedures, or Standard Operating Procedures outside the Internal Audit Department.

RESPONSIBILITIES

The responsibilities of the Internal Audit Department consist of the examination, review and evaluation of the reliability and effectiveness of the Agency's governance, risk management, internal controls, and the quality of operations and systems utilized in carrying out the Agency's goals and objectives. The Internal Audit Department has the responsibility to perform its work with due professional care.

The Internal Auditor and audit staff shall be responsible for, but not limited to, incorporating periodically, as deemed necessary and/or in agreement with the annual audit plan, activities in the following key areas:

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Internal Controls

- Assess the adequacy of internal controls in place and determine if they are operating effectively.
- Review the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information.
- Review compliance with Agency policies and procedures, and with applicable laws and regulations which could have a significant impact on the operations of the Agency.
- Evaluate the means implemented and the extent Agency assets are identified, tracked, and safeguarded against misuse, unauthorized use, theft and loss.
- Review operations, programs or projects to determine if results are consistent with established objectives and goals.
- Assess the efficient and effective use of Agency resources and the controls over those resources.
- Provide consulting services on current and proposed policies, procedures, and systems to ensure adequate internal controls are considered and maintained.
- Provide consulting services to evaluate contractual agreements and determine if compliance exists.
- Use documents and information obtained from Departments in the same prudent manner as by those employees who are normally accountable for them.
- Perform “Follow-up Procedures” on all management responses to audit findings and recommendations to determine if internal control improvements and/or corrective actions have been implemented.
- Perform “Follow-up Procedures” on known external auditor’s or regulatory agency’s reported findings and recommendations to determine if internal control improvements and/or corrective actions have been implemented.
- Conduct special projects, studies, or audits as requested by management, the Audit Committee and the Board of Directors.
- Ensure known or suspected acts of fraud or improprieties involving Agency funds, property and employees are investigated in coordination with the Agency’s legal counsel, Human Resources and senior management.

Audit

- Conduct work in accordance with the *International Standards for the Professional Practice of Internal Auditing (Standards)* and Code of Ethics as required by the Institute of Internal Auditors (IIA).
- Develop a comprehensive and flexible annual audit plan using an appropriate risk-based methodology, including consideration of any risks or control concerns identified by management, the Audit Committee, the Board or the external auditor and submit that plan, as well as any periodic updates, to the Audit Committee and the Board for review and approval.
- Implement the annual audit plan, as approved, including as appropriate, any special tasks or projects requested by management, the Audit Committee, or the Board.

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- Provide Agency management with reasonable notice of intent to audit and with information about the audit process, except in those situations that warrant an unannounced audit.
- Consider the scope of work of the external auditors for the purpose of providing optimal audit coverage, at a reasonable cost, without redundancy or omission.
- Perform advisory services to assist the Agency in achieving its objectives; for example, reviewing controls, systems or process designs prior to implementation and providing recommendations to improve and enhance the effectiveness of controls and operations.
- Maintain a professional audit staff with sufficient knowledge, skills, experience, and professional certifications to meet the requirements of this Charter.
- Maintain technical competence through continuing education supported by Department goals and budgets.
- Maintain a quality assurance program whereby the Internal Auditor assures the operations of the Internal Audit Department.
- Perform a periodic review of the Internal Audit Department Charter and the Audit Committee Charter. Additions, deletions, or other changes to the Charters are subject to the approval of the Board of Directors.

Reporting

- Issue quarterly reports to and meet with the Audit Committee and management to summarize results of audit activities and status of findings and recommendations.
- Provide written status reports of Audit Department activity to the Audit Committee quarterly. The Quarterly Audit Committee Status Report will include a summary of significant internal and external audit activities for the reporting period. The Status Report will be submitted for approval by the Committee and the approved Status Report will be presented at the next regularly scheduled IEUA Board of Directors meeting.
- Provide a written report listing all outstanding recommendations with expected resolution dates annually. The report of all outstanding recommendations will be submitted for approval by the Audit Committee and provided at the next regularly scheduled IEUA Board of Directors meeting.
- Keep the Audit Committee informed of emerging trends and successful practices in internal auditing, as well as new audit requirements, when applicable.
- Immediately report any reservations concerning control risks, accounting or disclosure practices to the Audit Committee.
- If during the scope and progress of its reviews and audits, the Internal Audit Department identifies opportunities for improving the Agency's control environment, processes and procedures to ensure an environment where assets are safeguarded, internal controls are in place and risk is mitigated, these recommendations will be communicated to the appropriate level of management and the Audit Committee as timely as necessary and in the written report.
- When deemed appropriate and necessary, provide responsible unit management with a preliminary written report of the results and recommendations of each audit, analysis, review, or investigation performed and sufficient time to respond in writing with a plan of

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corrective actions. Sufficient time to reply would be 30 to 60 days from the date of the final report.

- Provide final reports of results and recommendations for each review and audit performed, including the responsible management's responses to the Audit Committee, Executive management and responsible management. All final reports with any responses will be submitted to the Committee for discussion and to the Board for approval. However, in cases where the auditee does not provide a response that is timely or deemed responsive, the final report will not be held up pending a response and will be submitted for discussion during the next scheduled Audit Committee meeting.

STANDARDS OF ETHICAL CONDUCT

The Internal Audit Department staff have a responsibility to govern themselves so that their independence is not open to question. To this end, adherence to the Institute of Internal Auditor's "Code of Ethics" will ensure integrity, objectivity, confidentiality and competency in Internal Audit work performed on behalf of the Agency's Board and Audit Committee. These principles include:

- Performing internal auditing services in accordance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*.
- Exercising honesty, diligence, and responsibility in performing duties.
- Observing the law and making disclosures expected by the law and the profession.
- Not knowingly being a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the Agency.
- Respect and contribute to the legitimate and ethical objectives of the Agency.
- Not participating in any activity or relationship that may impair, or be presumed to impair, unbiased assessments, including activities or relationships that may be in conflict with the interests of the Agency.
- Not accepting anything that may impair or be presumed to impair professional judgment.
- Disclosing all material facts known that, if not disclosed, may distort the reporting of activities under review.
- Being prudent in the use and protection of information acquired in the course of duties.
- Not using information for personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the Agency.
- Engaging in only those services or audit activities for which Internal Audit staff have the necessary knowledge, skills, and experience.
- Continually improving staff proficiency, and the effectiveness and quality of services.

MANAGEMENT RESPONSIBILITIES

It is the responsibility of the Board of Directors and senior management to foster a control environment that supports the Internal Audit Department's objectives and independence within the

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Inland Empire Utilities Agency. The existence of the Internal Audit Department does not diminish Agency management's financial and operational responsibilities for prudent execution and control of activities, including their responsibilities for the periodic evaluation of risk, control, and governance systems.

Management's responsibilities include:


- Providing Internal Audit with its full support and cooperation at all operating levels, including full and complete access to all records, property, and staff relative to their assigned areas of responsibility, and active participation in the audit process.
- Immediately notifying the Manager of Internal Audit and the Audit Committee of any known or suspected cases of illegal, criminal or unethical activity involving Agency funds, property, employees, or any activity which appears to present a conflict of interest.
- Timely notification to Internal Audit of any new or proposed modifications to Agency systems, procedures, operations or services, ensuring controls are built into the new or modified processes.
- Providing the Internal Audit Department with written responses to all audit findings and recommendations, including action plans, responsible employees, and targeted resolution dates or the acceptance of the risks identified.
- Providing the Internal Audit Department with adequate budget, staffing, assistance from staff of audited Departments, and the tools needed for the Internal Audit Department to execute its duties as defined in this Charter.

INFORMATION
ITEM
2A

Date: December 20, 2017

To: The Honorable Board of Directors

Committee: Audit

 for
From: Halla Razak, General Manager

12/11/17

Executive Contact: Teresa Velarde, Manager of Internal Audit

Subject: Payroll Operations Audit & Comparable Agencies' Survey

Executive Summary:

Internal Audit (IA) completed the Payroll Operations Audit on August 30, 2017, to evaluate controls over payroll activities. The report provided six recommendations to improve internal controls and practices:

- transition manual personnel files to automated files to back-up and safeguard information
- consider investing in fire proof/water proof cabinets
- update department policies and procedures
- ensure bank reconciliations are completed on a timely basis
- move towards a paperless environment by issuing all payroll payments through direct deposit
- encourage all staff to regularly attend ethics and fraud awareness training related to their jobs

As a follow up procedure, IA surveyed nine comparable agencies about their payroll activities to gather information about current trends and "best practices". Attached are the survey results. Also attached, is the original Payroll Operations Audit report. Follow up review on the six original audit recommendations will be scheduled through the Annual Audit Plan.

Staff's Recommendation:

Receive the Payroll Operations Audit & Comparable Agencies' Survey report as an information item for the Board of Directors and instruct Agency staff to implement/resolve the audit recommendations.

Budget Impact Budgeted (Y/N): Y Amendment (Y/N): Y Amount for Requested Approval:

Account/Project Name:

N/A

Fiscal Impact (explain if not budgeted):

N/A

Prior Board Action:

On September 20, 2017, the Board of Directors received the Payroll Operations Audit Report as an information item.

On June 21, 2017, the Board of Directors approved the Annual Audit Plan for Fiscal Year 2017/18.

On March 15, 2017, the Board of Directors reconfirmed the approved Audit Committee and the Internal Audit Department Charters.

Environmental Determination:

Not Applicable

Business Goal:

The Payroll Operations Audit & Comparable Agencies' Survey report is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by ensuring that the recommendations foster a strong control environment, and assist management in achieving organizational goals.

Attachments:

Attachment 1 - Payroll Operations Audit & Comparable Agencies' Survey report

Attachment 2 - Detailed Survey Results

Attachment 3 - Payroll Operations Audit, dated August 30, 2017

Attachment 4 - PowerPoint



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www.ieua.org

DATE: November 28, 2017

TO: Halla Razak
General Manager

A handwritten signature in blue ink that reads "Teresa V. Velarde".

FROM: Teresa V. Velarde
Manager of Internal Audit

SUBJECT: Payroll Operations Audit & Comparable Agencies' Survey

Audit Authority

The Inland Empire Utilities Agency (IEUA or Agency) Internal Audit Department (IA) performed a follow-up to the Payroll Operations audit by performing a survey of human resource and payroll policies and practices with 9 other comparable agencies. The review was performed under the authority given by the IEUA Board of Directors as documented in the Board-approved Charter.

Audit Objective and Scope

Internal Audit (IA) completed the Payroll Operations Audit on August 30, 2017, to evaluate controls over payroll activities. The report provided six recommendations to improve internal controls and practices:

- transition manual personnel files to automated files to back-up and safeguard information
- consider investing in fire proof/water proof cabinets
- update department policies and procedures
- ensure bank reconciliations are completed on a timely basis
- move towards a paperless environment by issuing all payroll payments through direct deposit
- encourage all staff to regularly attend ethics and fraud awareness training related to their jobs

As a follow up audit procedure, IA surveyed comparable agencies about their payroll activities to gather information about current trends and "best practices". IA surveyed nine comparable agencies. Attached are the survey results in summary and detail form for reference by the Agency departments responsible for payroll activities. Also attached is the original Payroll Operations Audit with the six recommendations.

Executive Summary

The attachments provide information about IA's findings:

- Attachment 1: Comparable Agency Survey in Summary format
- Attachment 2: Detailed responses from surveyed agencies
- Attachment 3: Original Payroll Audit report with the six recommendations

Follow Up Review

We provided the results of this review to HR and Payroll department management for their review and comments. Follow up action will be scheduled through the Annual Audit Plan. IA appreciates internal and external staff for their assistance during this review.

TV:ps

Water Smart – Thinking in Terms of Tomorrow

Steven J. Elie
President

Michael E. Camacho
Vice President

Jasmin A Hall
Secretary/Treasurer

Paul Hofer
Director

Kati Parker
Director

Halla Razak
General Manager

**Attachment 1 – Comparable Survey with External Organizations
Human Resources and Payroll Policies and Practices**

| QUESTION | IEUA | SURVEY RESULTS | ISSUE | RISK | RECOMMENDATION |
|---|---|---|--|---|--|
| How are manual files stored? | Standard, non-fire-proof or earthquake proof filing cabinets for HR records. | 67%: 6 of 9 Agencies surveyed utilize fire-proof storage. | Security of employee records. | Loss of employee information and history due to fire, earthquake or other disaster. | Move toward automating personnel records or at a minimum invest in secure, fireproof cabinets |
| Has Personnel recordkeeping been automated? | Some files are scanned and included in the Agency HR subfolders. Most files are maintained manually. | 89%: 8 of 9 Agencies surveyed have some automated processes ranging from online performance evaluation to scanned files in managed folders to fully automated system using "MyHR" | Security of employee records. | Loss of employee information and history due to fire, earthquake or other disaster. | Move toward automating personnel records or at a minimum invest in secure, fireproof cabinets |
| How are automated records stored? | On the Agency's file servers and backed-up in accordance with the Agency's back-up procedures. | 56%: 5 of 9 Agencies surveyed maintain some automated employee records. 4 of these are limited to scanned documents maintained on the Agency's file servers & back-ups. | Security of employee records. | Loss of employee information and history due to fire, earthquake or other disaster | Move toward automating personnel records or at a minimum invest in secure, fireproof cabinets |
| How are employee changes processed? | Currently using a paper process and then information is entered to SAP for updating payroll information. | 89%: 8 of 9 Agencies surveyed utilize some level of automation ranging from online form access to complete integration. | Security and accuracy of employee records and changes to them. | Manual data entry by Agency HR personnel can result in issues of timeliness, inaccuracies, & employee complaints. | Utilizing an automated process for employees to process their employee changes makes them responsible for the accuracy of their own information. |
| Does Agency require direct deposit? | Although the Agency encourages direct deposit there are no plans to make it mandatory. There are just a very few employees who prefer a printed check. | 1 Agency surveyed (1,750 employees) required direct for all employees. All other Agencies encourage direct deposit but for all others a few employees still receive manual checks. | Having to process manual payments adds to the Agency workload, from the processing and printing process to the segregation and utilization of payroll check stock. | Cost of manual processing; potential for data entry errors; additional storage of manual records. | Require direct deposit. |
| How are nonroutine payments processed (buy-backs, etc.)? | Vacation and Sick Time Buybacks and other nonroutine payments (wellness and education reimbursements) are processed with manual checks. | 67%: 6 of 9 Agencies surveyed process buybacks and other nonroutine payments using the same processes as regular payroll payments. 3 Agencies either prepare manual payments or provide employees with a choice. | Allowing employees to continue to receive manually processed checks adds to the Agency workload, from the processing and printing process to the segregation and utilization of payroll check stock. | Cost of manual processing; potential for data entry errors; additional storage of manual records. | Require direct deposit. |
| Is there an ethics policy? | Yes, A-28 | 67%: 6 of 9 Agencies surveyed have an ethics policy and the other 3 refer to the need for Board ethics training every other year. | Not reinforcing the need for strong ethical standards can lead to ethical lapses and lax consideration of consequences. | Fraud or other ethical lapses; unclear or inconsistent ethical standards. | None. Implemented. Take the lead to update and maintain an up to date policy. |
| Is there a confidentiality policy? | Yes. Requires certain employees sign confidentiality agreement. | 33%: 3 of 9 Agencies surveyed have a confidentiality policy. | Human Resource records require discretion and confidentiality. | Medical or other private employee information might be compromised. | Recommend Confidentiality Agreement be signed by all or none of employees since Policy applies to all employees. |
| What resources does the Agency utilize for training in ethics, fraud and confidentiality? | HR & Payroll participate in professional organizations and online training and review the Ethics Resolution every year. | Agencies utilize various professional resources: LCW Consortium; BBK; ACWA; JPIA "Partnership of Public Water Agencies" CalPers; online training | HR and Payroll professionals need to be up-to-date on issues in ethics, fraud and confidentiality. | Lack of training can compromise Agency information and finances. | Continue to encourage/look for additional training opportunities specific to risk areas within the HR and Payroll processes. |
| What is the timing of payroll process? | Payroll is paid biweekly one week after the end of the pay period (following Friday). Time approvals are due the | All Agencies surveyed utilize a bi-weekly payroll period, generally with time approval on the Monday after the end of the pay period and | Fast deadlines and turn-around times for approvals can result in faulty estimates and over- or underpayments. | Estimates may not be subsequently corrected and faulty payments can occur. Rushed reviews during payroll cycle. | Consider alternatives including a longer period between the end of the pay period and the payment date. |

**Attachment 1 – Comparable Survey with External Organizations
Human Resources and Payroll Policies and Practices**

| QUESTION | IEUA | SURVEY RESULTS | ISSUE | RISK | RECOMMENDATION |
|----------|---|---|-------|------|----------------|
| | Monday after the end of the pay period. | payment sometime later in that same week. | | | |

Attachment 2 – Comparable Survey of Human Resources and Payroll Policies and Practices

| | IEUA | District 1 | District 2 | District 3 | District 4 | District 5 | District 6 | District 7 | District 8 | District 9 |
|--|------------------------------------|--|-------------------------|--|---|--|--|---|--|---|
| Approximate Budget (Operating & Capital) | \$192 million | \$449 million | \$375 million | \$225 million | \$1,711 million | \$89 million | \$425 million | \$195 million | \$150 million | \$115 million |
| Approximate Number of Employees | 290 | 531 | 629 | 325 | 1,752 | 129 | 624 | 220 | 140 | 140 |
| How are manual files stored? | Regular filing cabinets within HR. | Fireproof filing cabinets in separate room in HR. | Fireproof vault. | Personnel files are maintained in an "Electriever" mechanical storage filing cabinet system in a separate room in the HR Department. accessible only to the HR staff, separated from the rest of the Agency by three locking doors: Entrance to HR waiting room, entrance to HR staff area and entrance to the filing storage room. Electriever is a little like a mechanical ferris wheel for files inside a cabinet with two locking doors in front. Cabinets have fire suppression capability. | Printed copies and electronic versions. Printed copies are locked in a file room. | Fireproof filing cabinets in a separate storage room accessible only to HR staff. | Fireproof filing cabinets in separate room in HR accessible only to HR staff. | Locked files. Older records are at offsite storage. | Fire-safe, impact-resistant cabinets in a separate locked storage room accessible only to the HR staff. | Regular filing cabinets in secure location within HR. |

Bold type means cited in report as having some or more implementation

**Attachment 2 – Comparable Survey with External Organizations
Human Resources and Payroll Policies and Practices**

| | IEUA | District 1 | District 2 | District 3 | District 4 | District 5 | District 6 | District 7 | District 8 | District 9 |
|---|---|--|--|---|---|--|--|--|---|---|
| Has Personnel recordkeeping been automated? | Some files are scanned and included in the Agency HR subfolders. Most files are maintained manually. | Files are scanned and sorted with an individual folder per employee in Agency-wide automated recordkeeping system called "FileNet". | <i>In-process. Images of personnel records are being created and stored with Bentley Systems Document Imaging System.</i> | Some automation: Recruitment and Performance evaluation and review are managed through the NeoGov system. The annual open enrollment process is managed through "Self-Service" part of the Agency's Oracle ERP system. | Yes, utilize MyHR & PeopleSoft. | Some files, such as Performance Appraisals & Employee Action Forms are scanned so they can easily be e-mailed to supervisors. These are included in the Agency HR subfolders. Most files are maintained manually. | Some automation: Recruitment is automated through the NeoGov system. Performance Management and Employee training videos and monitoring is automated with the Cornerstone online cloud platform. Annual open enrollment process and benefits administration is managed through WorkTerra an online cloud-based Benefits Administration application. | Ciridian Dayforce is used for HR/Payroll system. System is web based and security is set for each user. Most files are maintained manually. | <i>N/A. HR records are not fully digital. Do use Lawson for financial accounting and payroll processing. Scanning is only for records retention purposes.</i> | Documents are scanned and kept in a "folders" system on shared HR secured drive with an individual folder for each employee. Considering implementing "Laserfiche" and including HR records there. |
| How are automated records stored? | <i>Some files are scanned and included in the Agency HR subfolders, maintained on the Agency's file servers and backed-up in accordance with the Agency's back-up procedures.</i> | Files are scanned and sorted with an individual folder per employee Back-up on site and additional back-up at second Agency location. | Images of personnel records are being created and stored with Bentley Systems Document Imaging System. Cloud-based back-up. | <i>No response.</i> | MyHR and PeopleSoft are pass word protected. User privileges are reviewed annually based on need. Back-ups are made and retained off-site. | <i>Business critical data and documents are backed up to disk on-site, then transferred weekly to tape and kept in an offsite storage facility. Offsite electronic records are maintained in accordance with the records retention policy.</i> | <i>Although HR files are not automated and remain within the HR department, for other automated records OCSD practices a 3-2-1 backup strategy: 3-keep three copies of critical data, 2-have your data on two types of media, 1-One copy must be offsite and offline.</i> | <i>The printed copies of employee files are the back-ups.</i> | <i>No HR file backups are maintained offsite. Payroll records are backed up and also saved at a separate location.</i> | Documents are scanned and kept in a "folders" system on shared HR secured drive with an individual folder for each employee. Access to automated HR information is limited to HR staff. IT has cloud based back-up system. |

Bold type means cited in report as having some or more implementation

**Attachment 2 – Comparable Survey with External Organizations
Human Resources and Payroll Policies and Practices**

| | IEUA | District 1 | District 2 | District 3 | District 4 | District 5 | District 6 | District 7 | District 8 | District 9 |
|-------------------------------------|--|---|---|---|--|--|--|---|---|---|
| How are employee changes processed? | Currently using a paper process and then information is entered to SAP for updating payroll information. | Use automated portal called "Employee Self-Service" in Sungard financial system for changes such as addresses, beneficiaries, emergency contacts. Employees can make changes to benefits & withholdings in HRIS (Human Resources Information System) module. | Currently using a paper process and then information is entered to Oracle Fusion application. With complete implementation on in February 2018, all employee changes will be processed electronically. | The annual benefits open enrollment process is automated online through Oracle's "Self-Serve" portal. Other than open enrollment, all HR employee and benefit changes are handled through forms filled out by the employee and submitted to HR. An old HR quote states: "Forms are our friends." | Depends on the type of change. Address, phone #, retirement contributions etc., can be changed online by employee. Pay changes, promotions, separations, etc. require employee data change form prepared by supervisor and signed by manager. HR then processes. Change request is kept with employee's file. | HR maintains a page on the Agency's SharePoint site that includes forms that employees can access. Address changes are handled with an e-mail. Beneficiary changes require specific forms. | The annual open enrollment process and benefits administration is managed through WorkTerra an online cloud-based Benefits Administration application, online and automatically uploaded. SharePoint workflows are utilized for employee address changes. | The system has self-service forms with workflows for approvals by HR. HR processes the paperwork and enters it into the system. Payroll processes any pay related items. | Employees complete manual forms for HR for things like address changes, beneficiary changes and the annual benefits open enrollment. | Employees make changes to benefits & withholdings in ADP electronically, HR is then notified by e-mail. Upgrading ADP to also have online process for annual Open Enrollment. Also use "NeoGov" as online onboarding system that provides links to policies and forms during recruitment and onboarding so information can be accessed in advance of coming to the office. |
| Does Agency require direct deposit? | Although the Agency encourages direct deposit there are no plans to make it mandatory. There are just a very few employees who prefer a printed check. | Agency uses direct deposit for almost all employees. Approximately 5 long-term employees still prefer manual checks. | Agency implemented direct deposit process as of 10/31/2016 although approximately 10 employees still receive printed checks. | About 95% of employees are paid with direct deposit. There are just a few employees who prefer a printed check. Although the Agency strongly encourages direct deposit there are no plans to make it mandatory. | Direct deposit is required. | Most employees have direct deposit, but there are still 12 or so long-term employees that prefer a printed check. There are currently no plans to require direct deposit. | Although the Agency strongly encourages direct deposit there are no plans to make it mandatory. There are just a very few employees who prefer a printed check. | Direct deposit is not mandatory. Only 7 employees still receive printed checks. There are no plans to require direct deposit. | Employees enter time into financial system and is approved by supervisor on the Monday following the end of pay period. 99% of employees are on direct deposit. Only a few receive printed check. | Most employees are paid through direct deposit and it has been required for all new employees for a while. There are still a handful of long-term employees that prefer a printed check. |

Bold type means cited in report as having some or more implementation

**Attachment 2 – Comparable Survey with External Organizations
Human Resources and Payroll Policies and Practices**

| | IEUA | District 1 | District 2 | District 3 | District 4 | District 5 | District 6 | District 7 | District 8 | District 9 |
|--|--|--|---|--|---|---|---|---|---|--|
| <p><i>How are nonroutine payments processed (buy-backs, etc.)? 7 of 9 Agencies surveyed process buybacks and other nonroutine payments through the same payment processes as regular payroll payments. 3 Agencies either prepare manual payments or provide employees with a choice.</i></p> | <p><i>Buybacks and other nonroutine payments are processed with manual checks.</i></p> | <p>The same manner as ordinary payroll payments.</p> | <p>The same manner as ordinary payroll payments.</p> | <p><i>Special payments such as buybacks and bonuses are paid in the same manner as regular paychecks (direct deposit vs printed check). Certain performance recognition and year-end bonuses are paid with manual checks for recognition so something can be handed to the employee.</i></p> | <p>The same manner as ordinary payroll payments.</p> | <p><i>Special payments such as buybacks can be customized for each employee, so employees can request a manual check.</i></p> | <p><i>Special payments such as paid leave payouts and retro checks are a separate payment made via a printed check.</i></p> | <p>Everything is processed through the Ceridian system, so the same manner as ordinary payroll payments.</p> | <p>Special payments such as buybacks and bonuses are imbedded into the payroll system in the same manner as regular paychecks and paid out in the same manner (direct deposit vs printed check).</p> | <p><i>Buybacks and other nonroutine payments are processed with manual checks.</i></p> |
| <p><i>Is there an ethics policy?</i></p> | <p>Yes, A-28</p> | <p><i>Policies on Conflict of Interest, Sensitive Non-Public Information, Internet & E-mail communications and Sexual Harassment. No separate policy for Ethics.</i></p> | <p>Yes</p> | <p>Yes, Policy #45: Conflict of Interest; Policy #47: Sensitive and Non-Public Information and Policy #48: Business Conduct Standards.</p> | <p>Yes</p> | <p>Yes</p> | <p>Yes</p> | <p><i>The need for Board ethics training is included in the Board of Directors (Agency) Policies & Procedures Manual.</i></p> | <p><i>The Administrative Manual has a policy requiring every other year ethics training for a specific list of employees and for the Board.</i></p> | <p>Yes</p> |

Bold type means cited in report as having some or more implementation

**Attachment 2 – Comparable Survey with External Organizations
Human Resources and Payroll Policies and Practices**

| | IEUA | District 1 | District 2 | District 3 | District 4 | District 5 | District 6 | District 7 | District 8 | District 9 |
|---|---|--|--|--|---|--|--|---|---|---|
| Is there a confidentiality policy? | Yes, but Policies only show: A-58 Medical Info Confidentiality | Agency has policies on Conflict of Interest, Sensitive Non-Public Information, Internet & E-mail communication & Sexual Harassment which include confidentiality. | Not a separate policy. There is an HR expectation of confidentiality with employee records and it is part of their job descriptions. | Yes, relevant policies include: Policy #45: Conflict of Interest; Policy #47: Sensitive and Non-Public Information and Policy #48: Business Conduct Standards. | Not written, but HR info is limited to authorized personnel. Hard copies are maintained in locked file room and locked cabinets. Only HR personnel have access. | Not a separate policy, but a general expectation organization-wide. | Yes, it is a broader policy addressing Privacy and HR Records which includes confidentiality provisions. | No, but do have Conflict of Interest policy and list of employment titles required to file disclosures. | The Administrative Manual also includes a Conflict of Interest Policy (chapter 5) for a specific list of employees and for the Board. | Not a separate policy. There is an HR expectation of confidentiality with employee records. |
| What resources does the Agency utilize for ethics, fraud, and confidentiality training? | HR & Payroll staff participate in professional organizations and online training. | Participate in professional updates through Liebert, Cassidy, Whitmore (LCW) Consortium, a law firm that provides regular seminars and webinars. | Navex, BLR are training resources. | Participate in professional updates through Liebert, Cassidy, Whitmore (LCW) Consortium. Also use CALPERS & Professionals in Human Resources Association (PIHR), training programs. Safety, and similar training provided through "Target Solutions" an online resource. | No response. | Participate in professional updates through Liebert, Cassidy, Whitmore (LCW) Consortium, a law firm that provides regular seminars and webinars. Also participate in annual CalPers HR updates & training. | Participate in professional updates through Liebert, Cassidy, Whitmore (LCW) Consortium, a law firm that provides regular seminars and webinars. Also use CALPERS & Professionals in Human Resources Association (PIHR) training programs. Safety, and similar training provided through "Cornerstone" an online resource. | There is online training through ACWA JPIA, "a Partnership of Public Water Agencies". | Participate in professional updates through Best, Best & Krieger (BBK) a Labor, Employment and Education law firm that provides regular training. Participate in professional updates through Liebert, Cassidy, Whitmore (LCW) Consortium. Participate in professional organizations in Human Resources annual conferences, trainings, and seminars regarding HR updates. | There is online training through ACWA JPIA, "a Partnership of Public Water Agencies". Also use "Target Solutions" for training. |

Bold type means cited in report as having some or more implementation

**Attachment 2 – Comparable Survey with External Organizations
Human Resources and Payroll Policies and Practices**

| | IEUA | District 1 | District 2 | District 3 | District 4 | District 5 | District 6 | District 7 | District 8 | District 9 |
|---|---|---|---|---|--|--|--|---|---|--|
| <i>What is the timing of payroll process?</i> | <i>Payroll is paid biweekly one week after the end of the pay period (following Friday). Time approvals are due the Monday of the week after the end of the pay period.</i> | <i>Payroll is paid on the Thursday following the Friday that ends the biweekly pay period. Approvals are due by Monday noon or if a holiday the end of the day the previous Friday.</i> | <i>Timesheets with estimates for the coming weekend are submitted on Thursday of the second week of the biweekly pay period. Approvals & corrections must be entered by 10am on the following Monday. Payroll is disbursed on Thursday.</i> | <i>Payroll paid biweekly on the Friday following the Friday that ends the pay period. Employees enter time directly into Agency Oracle financial systems. To meet processing deadlines, time at the end of the week can be estimated to allow for Supervisor approval on Friday afternoon or by the Monday deadline for the pay period.</i> | <i>Payroll period begins on Sunday and ends on a Saturday. There is a 1 week lag for payment. Approvals are due on Monday.</i> | <i>Payroll is paid on the Thursday following the Friday that ends the biweekly pay period.</i> | <i>Payroll is paid biweekly on the Friday following the Friday that ends the pay period. Entered time must be approved by the supervisor on the Monday following the end of the pay period the previous Friday. If time is not completed and submitted when due, an automated message is sent.</i> | <i>Payroll is paid biweekly 1.5 weeks after the end of the pay period on Wednesdays. There are 5 pay groups each with a different pay period end date: Friday, Saturday, Monday or Wednesday. Supervisor approval is due on every other Monday by 10am.</i> | <i>Employees enter time directly into the Agency's Lawson financial systems. The entered time must be approved by their supervisor on the Monday following the end of the pay period the previous Friday. Payroll is paid biweekly on the Thursday following the Friday that ends the pay period.</i> | <i>Payroll is paid biweekly one week after the end of the pay period. Time approvals are due the Monday of the week after the end of the pay period.</i> |

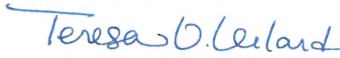
Bold type means cited in report as having some or more implementation



Inland Empire Utilities Agency

A MUNICIPAL WATER DISTRICT

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DATE: August 30, 2017
TO: P. Joseph Grindstaff
General Manager

FROM: Teresa V. Velarde
Manager of Internal Audit

SUBJECT: Payroll Operations Audit

Audit Authority

The Inland Empire Utilities Agency (IEUA or Agency) Internal Audit Department (IA) performed an audit of Payroll operations. This audit was performed under the authority given by the IEUA Board of Directors and the Fiscal Year 2017/18 Annual Audit Plan. Attached is the report that discusses the results of the audit and includes IA's observations and recommendations.

Audit Scope

The Payroll Operations Audit objectives were to ensure adequate payroll and personnel internal controls are in place and functioning as intended, including:

- To evaluate internal controls regarding adding, modifying and removing employee information in the payroll and human resources systems.
- To verify that employee earnings, special payments, taxes, all deductions are accurate, complete and paid or deducted in a timely manner.
- To ensure that employment taxes, tax and non-tax reporting requirements comply with applicable federal/state laws.
- To ensure payroll transactions are properly classified, reconciled and posted to the appropriate general ledger accounts.
- To verify that payroll bank accounts are reconciled monthly, open items resolved timely and that the reconciliations have been reviewed by a supervisor.
- To identify improvements for the effectiveness and efficiency of operations.

Water Smart – Thinking in Terms of Tomorrow

Steven J. Elie
President

Michael E. Camacho
Vice President

Jasmin A. Hall
Secretary/Treasurer

Katie Parker
Director

Paul Hofer
Director

P. Joseph Grindstaff
General Manager

Audit Techniques Applied

Audit techniques applied during the audit included:

- Interviews of payroll, human resources, and other Agency staff
- Walkthroughs of processes and transactions
- Analysis of financial transactions and reports
- Review of supporting documents in SAP
- Review of policies and procedures
- Review of employee personnel data
- Review of payroll disbursements
- Review of bank reconciliations

Audit Results - Executive Summary

Payroll functions are shared between the Human Resources (HR) and the Finance and Accounting (FAD) departments. HR performs the new hire and separation timing and documentation as well as processes pay, deduction and benefit changes, which includes ensuring that pay rates are documented and all applicable payroll deduction documentation is signed by the employee. FAD processes biweekly and final payroll payments to employees which involves receiving employee timesheets electronically, resolving time entry and other payroll processing issues, processing payroll and ensuring all tax filing requirements and employee contribution designations are met. The audit noted that the HR and FAD departments provide effective and valuable payroll services to the Agency. We identified opportunities to further strengthen internal controls and the effectiveness of the payroll functions. The details of the observations and recommendations are included in the attached report.

- IA recommends that HR consider evaluating alternatives to automate some of the forms and the manual files used to maintain employee information, for example:
 - As discussed with HR, HR has already been working with Business Information Systems (BIS) to develop a self-service portal for employees to make direct changes and updates to certain information that currently requires a hard-copy document, such as withholding information, beneficiary information, address changes, or adding/deleting a family member from their policies, and changing contribution amounts to various plans.
 - The Agency is in the process of implementing a new enterprise content management system ("ECMS") using Laser-fiche. HR may want to consider whether the new ECMS would provide an automated approach to maintaining and updating employee information or whether another automated approach would be possible.
- As part of the Agency's disaster preparedness effort, HR should consider maintaining manual/hard-copy files in fire proof and water proof cabinets.

- As part of moving into a paperless, automated environment, HR should promote and encourage all employees to have their payroll related payments, including vacation and sick buy-backs made through direct deposits instead of manually writing paper checks.
- FAD should update Standard Operating Procedure No. CR PR-08 to reflect the new payroll bank reconciliation process, communicate the procedure to all department employees, and ensure the SOP is in the format outlined in accordance with Agency Policy A-51.
- FAD should ensure bank reconciliations are prepared monthly and supervisory review occurs in a timely manner to ensure any outstanding and reconciling items are researched and resolved.
- Both HR and FAD should encourage employees with payroll related functions to attend ethics and fraud awareness/prevention training specific to their job responsibilities to stay informed about new developments, risks and safeguards.

As a “next steps” plan, IA will survey comparable agencies to obtain independent insight into potential “best practices”. IA intends to work with HR and FAD to survey gather feedback related to items discussed in the audit report as recommendations for consideration. For example, items will include human resource and payroll automation tools, policies and procedures, direct deposit requirements and ethics/fraud prevention/awareness training. Information gathered will provide ideas and different methodologies employed by other agencies and provide options and direction for the Agency in implementing the recommendations in this report.

The Payroll Operations Audit is consistent with the Agency’s Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by providing an independent evaluation of IEUA’s payroll operations and making recommendations for improvements.

Acknowledgements

We would like to extend our appreciation to both the Finance and Accounting and the Human Resources departments for their cooperation and assistance during this review.

Discussion with Management

We provided drafts of this report and discussed the results of this audit with representatives of HR and FAD and have incorporated their comments into the report.

TV:ps

cc: Christina Valencia, Chief Financial Officer/Assistant General Manager
Sharmeen Bhojani, Manager of Human Resources
Javier Chagoyen-Lazaro, Manager of Finance and Accounting
Blanca Arambula, Deputy Manager of Human Resources
Suresh Malkani, Principal Accountant
Michael Arana, Payroll Accountant

Background Information

Internal Audit (IA) performed an audit of the Payroll function in 2010 and issued a report dated August 26, 2010 and performed a follow-up review in 2012 and issued a report dated August 6, 2012. Since the original audits, the Agency has implemented payroll/timesheet module in SAP. However, concerns associated with having up-to-date employee files and concerns about the timeliness of bank reconciliations that IA expressed in those reports continue to be an issue.

The Agency implemented the current payroll system in SAP in April 2013. The SAP payroll system made it possible for the Agency to eliminate paper timesheets and the manual recording and upload of employee time. Additionally, the SAP payroll system has improved labor cost reporting.

Payroll functions are shared between the Human Resources (HR) and the Finance and Accounting (FAD) departments. HR performs the new hire and separation processes which includes ensuring that pay rates are documented and all applicable payroll deduction documentation is signed by the employee. FAD is responsible for the recording, maintenance, and safekeeping of the Agency's assets and financial information. The payroll section is responsible for processing the biweekly payroll which involves receiving the supervisor approved, employee timesheets electronically, resolving time entry and other payroll processing issues, processing pay and ensuring all tax filing requirements and employee contribution designations are met. The Agency's payroll process is complex by nature, particularly with the many different bargaining units Memorandums of Understanding and the personnel manuals that apply and affect payroll.

All employee wage deductions must be authorized by the employee and/or are required by law. For tax deductions, the employee is responsible to elect the appropriate tax rate deduction based on marital status and other criteria. Payroll and deduction information is obtained by the HR department and should be filed in the employee's personnel file.

Payroll is distributed bi-weekly, with 26 payroll periods. There were 299 active employees paid on the Agency payroll as of January 6, 2017. During calendar year 2015-16, the Agency's gross payroll as reported to the Board of Directors was \$32,413,000. The Agency also paid employer and employee amounts of \$3,441,000 in Social Security and \$857,000 in Medicare taxes.

FAD and HR have documented Standard Operating Procedures (SOPs) for various activities related to payroll processes. The SOPs provide a manual to train and cross-train staff on the functions of the departments and to maintain consistency in operations. All SOPs are available to the employees in the department.

Report of Observations & Recommendations

Payroll Disbursement Testing

IA selected 25 employee's payroll disbursements from calendar year 2016 for pay period #1-2016, dated January 8, 2016. The sample was taken from a total population size of 287 employees in January with total gross wages paid of \$1,305,000. The sample represents approximately 10% of the gross wages paid, and over 8% of the employees on payroll. The sampled items included employees from each of the various bargaining units at the Agency. We reviewed transactions to ensure that:

- The pay rate on the payroll register/run matches the pay rate documented in the employees' personnel file,
- The pay rate paid agrees with the pay rate as documented in the corresponding MOU/Personnel Manual,
- Overtime, shift differentials, etc. were calculated correctly,
- Employee benefits were accurately calculated,
- Employee taxes were accurately calculated,
- Employee voluntary deductions were authorized by the employee and properly calculated (i.e. 401/457 contributions, etc.)

Manual files

Observation #1: The manual filing system used by HR has remained substantially the same since the payroll audit of 2010 while other Agency systems have been upgraded and/or automated to improve processes and increase effectiveness and efficiency. Manual files require, what can be seen as, a lot of paper and can be less efficient and are not currently maintained in fire proof or water proof cabinets.

Since the original Payroll audit, the Agency has undertaken multiple automation efforts that have increased the efficiency and effectiveness of processes and systems, for example with the Agency-wide Enterprise Resource Planning (ERP) and the implementation of SAP for most financial and timesheet processes, updated desktop software, the ongoing implementation of the SCADA systems for operations, project management with Primavera and Agency recordkeeping and public records requests with the rollout of the Laserfiche Enterprise Content Management System (ECMS).

HR continues to maintain manual personnel files for each employee that include information from the hiring process, all merit and cost of living increase information, including any employee reviews, employee federal and state tax withholding elections, and health and other benefit elections made by the employee, as well as personal and confidential information related to medical leave, and other.

In reviewing the HR files IA noted:

- Instances where information was misfiled in a different employee's file
- Instances where, for long-term employees, the files appeared to be large
- Instances where employee deduction elections were not up-to-date
- Instances where the employee reviews and merit increases were not completed or processed until after the employee's anniversary date resulting in the need to process retroactive payroll payments (In addition, retroactive payments resulted from the class and compensation study)
- Personnel files are not maintained in fire-proof or water-proof cabinets

Manual filing systems are prone to potential misfiling and are difficult to search, obtain and track information and to develop statistical summaries and overviews. It is also difficult to create back-ups of manual filing systems or house them offsite for safekeeping from potential disasters. Storing manual files requires having adequate space, and it can be costly to ensure fire proof and water proof security.

An automated system can provide multiple benefits, including back-up filing systems and security, having search and retrieve features and the ability to export summaries and analysis. Automation can provide additional tools for personnel activities, such as employee self-service for personnel changes, automated reminders of upcoming deadlines, automated entry of the annual benefits elections and new types of reports and potential comparative information. It would simplify the administrative processes for HR staff, allow changes to be processed more quickly and accurately and forms would not need to be routed, completed and potentially be delayed or misplaced manually.

Just as there are risks to manual files, an automated environment also comes with new risks, particularly for data security and the cost of implementation and maintenance. With HR data, there are also legal requirements to consider.

HR staff stated that public agencies generally rely on maintaining physical/manual files for personnel records that include all historical information for each employee. In discussing automating personnel records, HR stated having concerns about potential privacy issues with automated files. Further, HR staff indicated that Worker's Compensation litigation requires access to complete personnel files for review (complete meaning since the employee was hired). The department already scans appraisals and employee fact sheets as a type of electronic filing system however, most of the personnel files are maintained with manual/physical records.

IA recommends that, while keeping legal requirements in mind, HR consider transitioning hard-copy paper documents to an electronic management system for HR activities. The department could survey similar public service agencies and/or consult with professional organizations and government personnel attorneys to evaluate options and consider potential automated approaches (including the new enterprise content management system ("ECMS") using Laser-fiche the Agency is implementing) that could be more efficient, effective and secure for the Agency.

Recommendations:

1. IA recommends that HR consider evaluating alternatives to the manual files used to maintain employee information, for example:

- *Working with Business Information Systems (BIS) to develop or acquire a self-service portal for employees to make updates and changes to certain information that currently requires a hard-copy document, such as withholding information, beneficiary information, address changes, or for adding or deleting a family member from their policies, and contribution amounts to various accounts.*
- *The Agency is in the process of implementing ECMS. HR may want to consider whether the new ECMS would provide an automated approach to maintaining and updating employee information or whether another automated approach would be possible.*

Department Response: *HR stated they have already been working with BIS to determine personnel information that can be automated, for routine items such as changes to withholdings, beneficiary information or for adding or deleting a family member from their policies, address changes, contribution or banking changes. HR indicated that they have discussed with BIS the possibility of developing a self-service portal for employees. The costs to enhance the functionality of the system were considered to outweigh the benefits, however staff will continue to monitor this option.*

HR already scans the annual performance evaluations and Fact Sheets (checklist of changes) to create an electronic record and will continue to evaluate options, including the new ECMS system. As noted, HR has concerns about safeguarding the confidentiality of employee data and compliance with legal requirements.

Fire proof/water proof storage

IA noted that personnel files are maintained in steel cabinets, they are kept locked with key and are situated inside the Deputy Manager's office. The entire HR department is secured and not open/accessible to just anyone. While the files appear to be kept locked and in a secured location, the cabinets are not fire proof nor water proof. As part of the Agency's disaster preparedness efforts, HR should consider placing personnel records in fire proof and water proof file cabinets since some of the personnel hard-copy records are the only record available because most HR files are not automated. It is important to safeguard the only copy of the documents on hand.

Recommendation:

- 2. As part of the Agency's disaster preparedness effort, IA recommends that HR consider maintaining manual/hard-copy files in fire proof/water proof cabinets.**

Bank Reconciliation Controls

Good business practices require that timely bank account reconciliations be performed monthly to ensure the bank statement issued by the financial institution matches the organization's internal financial records. The reconciliation is also a useful tool to identify any deposits, disbursements, outstanding checks, service fees, reconciling items and/or unusual activity that require further attention. Reconciliations should be reviewed and approved by a supervisor to ensure outstanding items are addressed and resolved appropriately.

During period under audit, the Agency used Bank of America (BoFA) for payroll banking activities. The activities included employee's payroll (paid biweekly via direct deposit), Board of Director's payments, and employee buybacks of unused sick leave and/or vacation hours. All payroll banking activities were processed through one bank account. Employee payroll taxes were paid through a separate BoFA bank account.

Below is a table showing the financial information related to the Payroll Bank Account only, it does not include taxes, CalPERS payments, and/or any other Agency-related benefits:

Bank of America - Payroll

| Period | Deposits and Other Credits | Withdrawals and Other Debits | Checks | Service Fees |
|--------------------------------------|----------------------------|------------------------------|----------------|---------------|
| January – December, 2016 (12 months) | \$28,174,063.55 | (\$27,770,106.35) | (\$402,974.17) | (\$14,275.76) |
| January – April, 2017 (4 months) | \$10,189,710.40 | (\$9,899,184.22) | (\$248,962.70) | (\$5,079.86) |

Bank Reconciliations – Standard Operating Procedure (SOP)

Observation #2: FAD SOPs should be updated to reflect current practice.

Due to the recent changes with the Agency's banking institution and the implementation of SAP in 2013, the SOP Procedures No: CR PR-08 should be updated to reflect the new bank reconciliation processes.

In June 2017, the Agency transitioned payroll banking activities from BoFA to Citizens Business Bank (CBB) and began using a Zero Balance Account (ZBA) for all payroll payments. According to FAD, the purpose for changing banks is to streamline banking operations and save on banking fees.

Recommendation:

- FAD should update Standard Operating Procedure No. CR PR-08 to reflect the new payroll bank reconciliation process, communicate the procedure to all department employees and ensure the SOP is in the format outlined in accordance with Agency Policy A-51.***

Department Response: FAD intends to have the SOP updated by the end of the first quarter of Fiscal Year 2017-18.

Bank Reconciliations – Timely Bank Reconciliations

Observation #3: Bank reconciliations are not always prepared and reviewed in a timely manner.

FAD’s documented Standard Operating Procedure (SOP) (*Reconciliation of the Bank of America Payroll Bank Account, Procedures No: CR PR-08, effective July 1, 2012, Section 2.02*), states that the Bank Reconciliation is to be performed monthly, ideally within 30 days after month-end closing. For example, for the month of September, the reconciliation should be completed by October 31st.

IA reviewed the bank reconciliations, along with supporting documentation including the original and downloaded bank statements and reports from the Agency’s financial system (SAP), for Calendar Year 2016 and through April 2017. IA noted the following:

- Six of 16 (37%) reconciliations were not prepared in a timely manner
- Eight of 16 (50%) reconciliations did not have evidence of timely supervisory review

Findings related to the Bank Reconciliation

| Year | Month | Prepared Timely | Reviewed Timely |
|------|-----------|--------------------|--------------------|
| 2016 | January | No – No date noted | No |
| 2016 | February | No – No date noted | No |
| 2016 | March | Yes | Yes |
| 2016 | April | Yes | Yes |
| 2016 | May | Yes | Yes |
| 2016 | June | Yes | Yes |
| 2016 | July | No | No - No date noted |
| 2016 | August | Yes | No |
| 2016 | September | Yes | No |
| 2016 | October | Yes | Yes |
| 2016 | November | Yes | Yes |
| 2016 | December | Yes | Yes |
| 2017 | January | No | No |
| 2017 | February | No – No date noted | No |
| 2017 | March | No – No date noted | No |
| 2017 | April | Yes | Yes |

Previous Audit Observations:

As noted in the August 2010 Payroll Audit and the 2012 Payroll Operations Follow-Up audit, the timeliness of bank reconciliations for the payroll bank account has been an ongoing observation. The department’s procedures and controls still need to be strengthened to ensure bank reconciliations are prepared and reviewed timely.

A comparison of the timeliness of bank reconciliations from the current and prior audits shows:

Comparison of Bank Reconciliation Findings for three audits:

| | Not Prepared Timely | No Evidence of Timely Supervisory Review |
|-----------------------------------|----------------------------|---|
| Current 2017 Audit | 6 of 16 or 37% | 8 of 16 or 50% |
| 2012 First Follow-Up Audit | 5 of 22 or 23% | 5 of 22 or 23% |
| 2010 Original Audit | 14 of 23 or 61% | 9 of 23 or 39% |

When reconciliations are not performed timely, items that require immediate attention are not resolved. Although no employees went unpaid, reconciliations are an internal control and best practice to ensure questionable items are identified immediately, the lack of timely reconciliations has been noted by IA three times since 2010.

Bank Reconciliations – Outstanding Item Not Resolved Timely

IA noted an outstanding payroll check and an EFT return that both remained outstanding for more than a year. The outstanding check was issued on September 4, 2015 in the amount of \$2,077.77, while the EFT was a reconciling item for \$1,500.00 and was listed on the bank reconciliation since April 2016. IA notes that this was an unusual situation where the former employee could not be reached; however, there are other accounting practices that could have been employed to “resolve” the item and post it more appropriately and timely.

***Department Response:** FAD noted that management approval has been obtained to address and resolve both matters in the May 2017 reconciliation. Agency legal counsel had been contacted several times about resolving the outstanding check since it was not cashed because the Agency was unable to locate the former employee. The outstanding check will be set up as a liability on the Agency’s records. The EFT return was resolved by posting offsetting journal entries to clear the general ledger account.*

Recommendation:

- FAD should ensure bank reconciliations are prepared monthly and supervisory review occurs in a timely manner to ensure all outstanding and reconciling items are researched, investigated and resolved.**

***Department Response:** FAD noted that some of the late reconciliations occurred because the responsible employee was out on FMLA leave and the department had not established a back-up process. FAD now includes the reconciliation deadlines on the department’s automated calendar and a secondary staff member has been assigned to serve as a back-up to ensure timely completion of bank reconciliations.*

Payroll – Manual Checks vs Direct Deposit

Observation #4: Agency uses direct deposits for all normal biweekly payroll transactions. However, manual checks are still prepared for two types of Payroll items: Vacation Leave Cash Out and Sick Leave Buy Back, as well as some members of the Board of Directors. The Agency should continue to move in the direction of paperless and automating processes that can be automated.

Annually, eligible employees may request to convert 70% of their annual vacation accrual into a cash payment. Specifics of this program are defined in each group's Memorandum of Understanding (MOU)/Personnel Manual. Payment for Vacation Leave Cash Out occurs in April of each calendar year. For sick leave, eligible employees may request to convert a specified amount of accrued sick leave hours into a cash payment. The MOU/Personnel Manual defines the requirements of the benefit and it is paid out to employees in December of each year.

In calendar year 2016, these two Payroll runs amounted to 216 checks and over \$370,000 in compensation. In these instances, the employees are paid via a separate, manually prepared check. Manual checks require additional staff time and resources for processing and preparation and can result in employee's losing or misplacing checks. Agency Policy A-54 (Direct Deposits of Net Payroll Checks & Retiree Longevity Payments, effective February 22, 2011) requires only that regular employee payroll and retirees be compensated via direct deposit. Changes to require direct deposit for Vacation Leave Cash Out and/or Sick Leave Buy Back program would require meet/confer processes with the associated Bargaining Units and re-negotiation of the MOU/Personnel Manual, which is in effect until June 30, 2018. IA encourages HR to take the lead and initiate discussions regarding direct deposits for all payroll related checks, in order to move towards a more efficient and paperless environment.

Recommendation:

- 5. As part of moving into a paperless, automated environment, HR should take the lead to promote and encourage having all payments made more efficiently through direct deposits instead of manually writing paper checks.***

Ethics and Fraud Awareness/Prevention Training Specific to Payroll Functions

IA recommends that all employees with payroll-related functions attend ethics and/or fraud awareness/prevention training specifically related to their job duties within payroll. Ethics/fraud awareness/prevention training will reinforce good internal controls and provide an opportunity to stay informed and about the latest potential risks and safeguards. The more informed employees are, the more likely they will be able to identify potential risks and breakdowns in internal controls. IA recommends that HR and FAD identify and share training opportunities for their staff and determine the type and length of time necessary for ethics/fraud awareness/prevention training.

Recommendation:

- 6. Both HR and FAD should encourage employees with payroll related functions to attend ethics/fraud awareness training specific to their job responsibilities to stay informed about new developments, risks and safeguards (for example, safeguards for potential payroll fraud, safeguarding personnel files and employee confidential information, etc.)***

Payroll Audit Follow Up – Best Practices Survey

IA has occasionally conducted surveys of comparable agencies to obtain independent insight into potential “best practices”. As a next step, IA intends to work with HR and FAD to develop questions for a survey of other agencies to better understand how they address their human resource and payroll activities. Items that could be considered for the survey include human resource and payroll automation tools, policies and procedures, direct deposit requirements and ethics training. The information gathered will provide ideas and different methodologies related to payroll processes and is intended to help with providing options or direction for the implementation of the recommendations noted in this report.

As “next steps” IA will begin drafting the survey questions and gather feedback from HR and FAD and gather a list of comparable agencies. Once results are gathered, IA will provide the information to both HR and FAD for their review and evaluation as well as report it separately to the Audit Committee and the Board. IA anticipates completing the survey by December 2017.

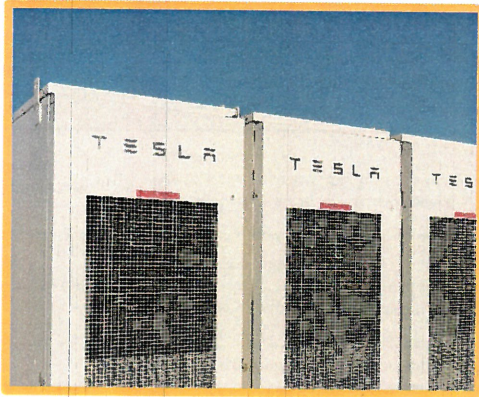
The Payroll Operations Audit and the proposed survey are consistent with the Agency’s Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by providing an independent evaluation of IEUA’s Payroll Operations and suggesting recommendations for improvements.

Attachment 1 – 2017 Payroll Audit Recommendations

| Audit Report Date | Rec # | Recommendations |
|-------------------|-------|--|
| August 30, 2017 | 1 | <p>IA recommends that HR consider evaluating alternatives to the manual files used to maintain employee information, for example:</p> <ul style="list-style-type: none"> • Working with Business Information Systems (BIS) to develop or acquire a self-service portal for employees to make updates and changes to certain information that currently requires a hard-copy document, such as withholding information, beneficiary information, address changes, or for adding or deleting a family member from their policies, and contribution amounts to various accounts. • The Agency is in the process of implementing ECMS. HR may want to consider whether the new ECMS would provide an automated approach to maintaining and updating employee information or whether another automated approach would be possible. |
| | 2 | As part of the Agency's disaster preparedness effort, IA recommends that HR consider maintaining manual/hard-copy files in fire proof/water proof cabinets. |
| | 3 | FAD should update Standard Operating Procedure No. CR PR-08 to reflect the new payroll bank reconciliation process, communicate the procedure to all department employees and ensure the SOP is in the format outlined in accordance with Agency Policy A-51. |
| | 4 | FAD should ensure bank reconciliations are prepared monthly and supervisory review occurs in a timely manner to ensure all outstanding and reconciling items are researched, investigated and resolved. |
| | 5 | As part of moving into a paperless, automated environment, HR should take the lead to promote and encourage having all payments made more efficiently through direct deposits instead of manually writing paper checks. |
| | 6 | Both HR and FAD should encourage employees with payroll related functions to attend ethics/fraud awareness training specific to their job responsibilities to stay informed about new developments, risks and safeguards (for example, safeguards for potential payroll fraud, safeguarding personnel files and employee confidential information, etc.) |

AUDIT COMMITTEE

Payroll Operations Audit & Comparable Agencies' Survey



COMPARABLE AGENCY SURVEY RESULTS:

| QUESTION | IEUA | SURVEY RESULTS | ISSUE | RISK | RECOMMENDATION |
|---|--|--|--|---|--|
| How are manual files stored? | Standard, non-fire-proof or earthquake proof filing cabinets for HR records. | 67%: 6 of 9 Agencies surveyed utilize fire-proof storage. | Security of employee records. | Loss of employee information and history due to fire, earthquake or other disaster. | Move toward automating personnel records or at a minimum invest in secure, fireproof cabinets |
| Has Personnel recordkeeping been automated? | Some files are scanned and included in the Agency HR subfolders. Most files are maintained manually. | 89%: 8 of 9 Agencies surveyed have some automated processes ranging from online performance evaluation to scanned files in managed folders to fully automated system using "MyHR" | Security of employee records. | Loss of employee information and history due to fire, earthquake or other disaster. | Move toward automating personnel records or at a minimum invest in secure, fireproof cabinets |
| How are automated records stored? | On the Agency's file servers and backed-up in accordance with the Agency's back-up procedures. | 56%: 5 of 9 Agencies surveyed maintain some automated employee records. 4 of these are limited to scanned documents maintained on the Agency's file servers & back-ups. | Security of employee records. | Loss of employee information and history due to fire, earthquake or other disaster | Move toward automating personnel records or at a minimum invest in secure, fireproof cabinets |
| How are employee changes processed? | Currently using a paper process and then information is entered to SAP for updating payroll information. | 89%: 8 of 9 Agencies surveyed utilize some level of automation ranging from online form access to complete integration. | Security and accuracy of employee records and changes to them. | Manual data entry by Agency HR personnel can result in issues of timeliness, inaccuracies, & employee complaints. | Utilizing an automated process for employees to process their employee changes makes them responsible for the accuracy of their own information. |
| Does Agency require direct deposit? | Although the Agency encourages direct deposit there are no plans to make it mandatory. There are just a very few employees who prefer a printed check. | 1 Agency surveyed (1,750 employees) required direct for all employees. All other Agencies encourage direct deposit but for all others a few employees still receive manual checks. | Having to process manual payments adds to the Agency workload, from the processing and printing process to the segregation and utilization of payroll check stock. | Cost of manual processing; potential for data entry errors; additional storage of manual records. | Require direct deposit. |
| How are nonroutine payments processed (buybacks, etc.)? | Vacation and Sick Time Buybacks and other nonroutine payments (wellness and education reimbursements) are processed with manual checks. | 78%: 7 of 9 Agencies surveyed process buybacks and other nonroutine payments using the same processes as regular payroll payments. 3 Agencies either prepare manual payments or provide employees with a choice. | Allowing employees to continue to receive manually processed checks adds to the Agency workload, from the processing and printing process to the segregation and utilization of payroll check stock. | Cost of manual processing; potential for data entry errors; additional storage of manual records. | Require direct deposit. |
| Is there an ethics policy? | Yes, A-28 | 67%: 6 of 9 Agencies surveyed have an ethics policy and the other 3 refer to the need for Board ethics training every other year. | Not reinforcing the need for strong ethical standards can lead to ethical lapses and lax consideration of consequences. | Fraud or other ethical lapses; unclear or inconsistent ethical standards. | None. Implemented. Take the lead to update and maintain an up to date policy. |
| Is there a confidentiality policy? | Yes. Requires certain employees sign confidentiality agreement. | 33%: 3 of 9 Agencies surveyed have a confidentiality policy. | Human Resource records require discretion and confidentiality. | Medical or other private employee information might be compromised. | Recommend Confidentiality Agreement be signed by all or none of employees since Policy applies to all employees. |
| What resources does the Agency utilize for training in ethics, fraud and confidentiality? | HR & Payroll participate in professional organizations and online training and review the Ethics Resolution every year. | Agencies utilize various professional resources: LCW Consortium; BBK; ACWA; JPIA "Partnership of Public Water Agencies" CalPers; online training | HR and Payroll professionals need to be up-to-date on issues in ethics, fraud and confidentiality. | Lack of training can compromise Agency information and finances. | Continue to encourage/look for additional training opportunities specific to risk areas within the HR and Payroll processes. |
| What is the timing of payroll process? | Payroll is paid biweekly one week after the end of the pay period (following Friday). Time approvals are due the Monday after the end of the pay period. | All Agencies surveyed utilize a bi-weekly payroll period, generally with time approval on the Monday after the end of the pay period and payment sometime later in that same week. | Fast deadlines and turn-around times for approvals can result in faulty estimates and over- or underpayments. | Estimates may not be subsequently corrected and faulty payments can occur. Rushed reviews during payroll cycle. | Consider alternatives including a longer period between the end of the pay period and the payment date. |

Top Three Recommendations from Comparable Agencies

| QUESTION | Has Personnel recordkeeping been automated? | How are employee changes processed? | How are nonroutine payments processed (buy-backs, etc.)? |
|----------------|---|--|--|
| IEUA | Some files are scanned and included in the Agency HR subfolders. Most files are maintained manually. | Currently using a paper process and then information is entered to SAP for updating payroll information. | Vacation and Sick Time Buybacks and other nonroutine payments (wellness and education reimbursements) are processed with manual checks. |
| SURVEY RESULTS | 89%: 8 of 9 Agencies surveyed have some automated processes ranging from online performance evaluation to scanned files in managed folders to fully automated system using "MyHR" | 89%: 8 of 9 Agencies surveyed utilize some level of automation ranging from online form access to complete integration. | 67%: 6 of 9 Agencies surveyed process buybacks and other nonroutine payments using the same processes as regular payroll payments. 3 Agencies either prepare manual payments or provide employees with a choice. |
| ISSUE | Security of employee records. | Security and accuracy of employee records and changes to them. | Allowing employees to continue to receive manually processed checks adds to the Agency workload, from the processing and printing process to the segregation and utilization of payroll check stock. |
| RISK | Loss of employee information and history due to fire, earthquake or other disaster. | Manual data entry by Agency HR personnel can result in issues of timeliness, inaccuracies, & employee complaints. | Cost of manual processing; potential for data entry errors; additional storage of manual records. |
| RECOMMENDATION | Move toward automating personnel records or at a minimum invest in secure, fireproof cabinets | Utilizing an automated process for employees to process their employee changes makes them responsible for the accuracy of their own information. | Require direct deposit. |

Recommendations provided in the Payroll Operations Audit report

Recommendations for Human Resources:

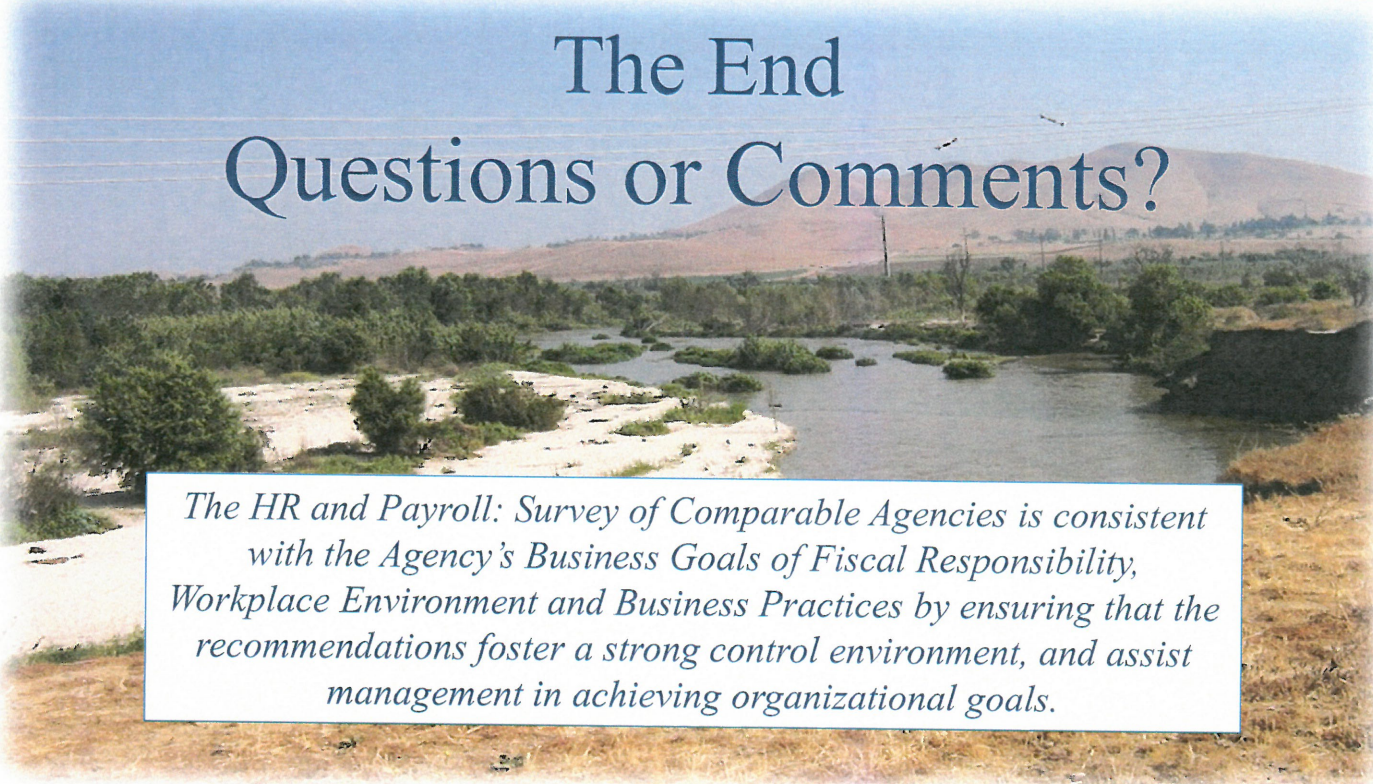
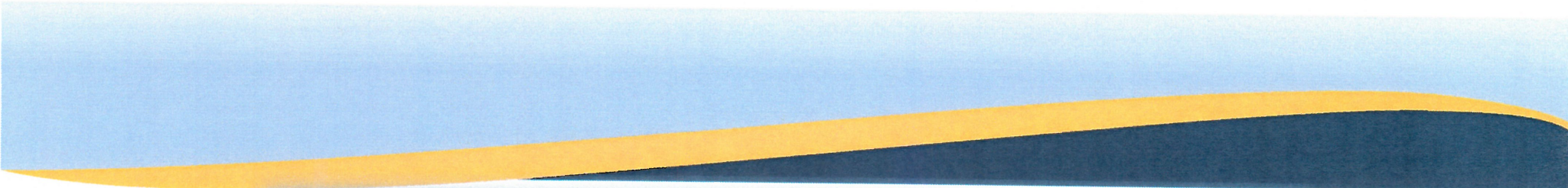
- Automate personnel records
- Self-service portal for employees to make direct changes and updates to information
- All payroll related payments through direct deposit not manual checks
- Safeguard all manual files in fire proof and/or water proof cabinets

Recommendations for Finance & Accounting:

- Update Standard Operating Procedures to reflect the new payroll bank reconciliation process
- Bank reconciliations should be prepared monthly and reviewed by a supervisor and outstanding issues should be resolved timely.

Recommendation re Ethics Training

- Both HR and FAD should encourage employees with payroll related functions to attend ethics/fraud awareness training specific to their job responsibilities to stay informed about new developments, risks and safeguards in those specific areas.



The End Questions or Comments?

The HR and Payroll: Survey of Comparable Agencies is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by ensuring that the recommendations foster a strong control environment, and assist management in achieving organizational goals.

Audit Committee

INFORMATION


ITEM

2B

Date: December 20, 2017

To: The Honorable Board of Directors

Committee: Audit

 for
From: Halla Razak, General Manager

12/11/17

Executive Contact: Teresa Velarde, Manager of Internal Audit

Subject: Southern California Edison Utility Payments Follow-Up Audit

Executive Summary:

The Internal Audit Department Charter, requires Internal Audit (IA) follow-up on outstanding recommendations to determine if corrective actions have been taken. The follow-up reviews are scheduled through the Board-approved Annual Audit Plan and Executive Management supports the implementation efforts of the recommendations previously provided or development of alternative controls to address the original risks identified.

IA performed a follow-up review of the three outstanding recommendations from the Southern California Edison (SCE) Utility Payments Audit report completed in 2013. This review found that one recommendation regarding updating Agency policies has been now implemented. A second recommendation, related to user roles assigned in the Agency's enterprise resource system is no longer applicable due to a recent staff retirement. The final recommendation related to SCE charges requires additional time to resolve. Staff is working to meet the final recommendation and IA will follow up at a later date. The attached audit report provides additional details of the original observations and results of the follow-up review.

Staff's Recommendation:

Receive the SCE Utility Payments Follow-Up Audit as an information item for the Board of Directors, provide direction to resolve the outstanding recommendation.

Budget Impact Budgeted (Y/N): N Amendment (Y/N): N Amount for Requested Approval:

Account/Project Name:

N/A

Fiscal Impact (explain if not budgeted):

N/A

Prior Board Action:

On June 21, 2017, the Board of Directors approved the Annual Audit Plan for Fiscal Year 2017/18.

On March 15, 2017, the Board of Directors reconfirmed the approved Audit Committee and the Internal Audit Charter.

On November 20, 2013, the Board received and filed the original SCE Utility Payments Audit Report.

Environmental Determination:

Not Applicable

Business Goal:

The SCE Utility Payments Follow-Up Audit is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by ensuring that the recommendations foster a strong control environment, and assist management in achieving organizational goals.

Attachments:

Attachment 1 - Southern California Edison Utility Payments Follow-Up Audit Report



Inland Empire Utilities Agency

A MUNICIPAL WATER DISTRICT

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P.O. Box 9020 • Chino Hills, CA 91709
TEL (909) 993-1600 • FAX (909) 993-1985
www.ieua.org

DATE: November 29, 2017

TO: Halla Razak
General Manager

FROM: Teresa V. Velarde
Manager of Internal Audit

SUBJECT: Southern California Edison Utility Payments Follow-Up Audit

Audit Authority

The follow-up review was performed under the authority provided by the Inland Empire Utilities Agency (IEUA or Agency) Board of Directors. The Internal Audit (IA) Department's Charter and the Annual Audit Plan require that IA follow up on the status of audit recommendations to determine if corrective actions were implemented. IA completed a follow-up review of the three outstanding recommendations related to the Southern California Edison (SCE) Utility Payments Audit, dated August 29, 2013.

Audit Objective and Scope

The purpose of this follow-up review was to evaluate the implementation status for the three outstanding recommendations provided in the original audit. IA did not expand the scope of the review to evaluate additional areas or operations, further reviews will be scheduled through the Board-approved Annual Audit Plan. The attached report provides details of our review.

Audit Techniques:

Audit techniques included:

- Discussions with Agency Staff
- Review of policies and procedures
- Review of supporting documents
- Analysis of SAP roles

Water Smart – Thinking in Terms of Tomorrow

Steven J. Elie
President

Michael E. Camacho
Vice President

Jasmin A. Hall
Secretary/Treasurer

Paul Hofer
Director

Kati Parker
Director

Halla Razak
General Manager

Audit Results – Executive Summary

Of the three open recommendations, one recommendation has been implemented, one recommendation is no longer applicable, and one recommendation continues to remain outstanding. The bullet points below provide a brief summary:

- **Headquarters' Building Street lights** : The original audit identified a street light expense was the responsibility of the City of Chino, not IEUA (fees are approximately \$900/year). Staff requires additional time to address this issue. IA continue to follow up and report separately.
- **Segregation of Duties and SAP Roles**: The original audit noted one employee had inadequate segregation of duties. This observation had also been identified by the External Auditors and stated in prior IA reports (May 2010 and August 2012), regarding the internal control weaknesses. This risk no longer exists because the employee has retired from the Agency and the role was not reassigned. This recommendation is no longer applicable. This item was also discussed in the Contracts and Procurement Follow-Up Audit report (dated August 30, 2017).

The audit identified an inactive and unneeded SAP role assigned to several employees. As a result of this audit, the role was removed, IA confirmed with the Business Information Services (BIS) department that this SAP role is no longer assigned to any employee.

- **Agency Policies and Standard Operating Procedures**: The original audit found Agency Policies and Department-specific Standard Operating Procedures (SOPs) related to processing payments for SCE services made reference to outdated information. Revisions/Updates to Agency Policy A-32 (Authority to Contractually Commit The Agency), A-33 (Solicitations, Evaluation and Award Protocols), and department SOP's have been completed and are available to all staff.

The SCE Utility Payments Follow-Up review is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by ensuring that the recommendations foster a strong control environment, and assist management in achieving organizational goals.

Acknowledgements

We would like to extend our appreciation to CAP and BIS staff for their cooperation and assistance during this follow-up review.

Discussions with Management

We provided the results of this follow-up review to IEUA Managers and staff for their review and comments prior to finalizing this report.

Background

IEUA obtains electricity service from Southern California Edison (SCE) to power the Agency's Headquarters buildings, treatment plants, and composting facility. To pay for the services billed by SCE, the payment process involves various Agency departments, including Planning and Environmental Resources (P&ER), Maintenance, Contracts and Procurement Department (CAP or CFS), and Finance and Accounting Department.

The original SCE Utility Payments Audit report issued in August 2013 provided a total of four recommendations to further enhance operations and strengthen internal controls for SCE services and billing. After 2014, one recommendation was resolved/no longer applicable and three recommendations remained outstanding.

This report provides an update on the three outstanding recommendations.

Utility Bill

2013 Follow-up recommendation # 1: Street Lights

IA recommends that Planning & Environmental Compliance and Maintenance Department management work with the City of Chino and SCE to resolve the billing issue related to the street lights in front of IEUA's HQ-A building as the street lights have been identified as the financial responsibility of the City of Chino.

Status: In Progress

The original audit report noted SCE billed IEUA for electricity used to power the street lights located in front of the Headquarters Buildings; however, staff confirmed the responsibility for the lighting falls under the jurisdiction of the City of Chino. The average monthly expense is approximately \$77 per month or \$900 or more a year, for SCE Service Account # 3-026-1435-32.

In 2013, Agency staff had already initiated discussions and the process to transfer the utility account and related expense to the City of Chino. The City of Chino planned to take this item to the City Council for approval and take over future billings.

As of the date of this report, the Headquarters street lighting expense is still billed to and paid for by IEUA. Agency staff will review and determine the resolution of this item. The status of this recommendation will be discussed in a separate report.

Segregation of Duties

2013 Follow-up recommendation # 2: User authorization roles

IA recommends that CAP management evaluate the entire CAP Department staff's responsibilities and leverage all department resources to achieve all tasks and at the same time avoid internal control conflicts. In addition, IA recommends that access be modified for employees as noted in report section "SAP Segregation of Duties – Contracts and Procurement Department" to alleviate existing internal control conflicts due to present access granted to each employee.

Status: No Longer Applicable

Below are the original findings identified and the resolutions noted during this review:

1. Inadequate Segregation of duties –

Original Observation:

One CAP staff member had the ability create and process changes to vendors, create and approve Purchase Requests, and create Purchase Orders. (SAP Role: RP_S_MM_TECH and RP_S_MM_Approver)

The Agency's external auditors had also raised a concern related to the individuals in the CAP department having conflicting duties in the procurement process. The issues listed in this section have been discussed in other IA reports, dated in 2010 and 2012, with recommendations provided.

Resolution:

The CAP employee retired; therefore, the conflict no longer exists, and the recommendation is no longer applicable. IA already discussed this item during a CAP Follow Up audit report, dated August 30, 2017. IA encourages staff to take prompt action when control weaknesses are identified.

2. Incorrect assignment of SAP Role –

Original Observation:

One CAP staff member had a SAP transaction code that was incorrectly assigned to them and provided access to create, review and approve contract/procurement documents, which was usually assigned to a department manager. (SAP Role: RP_S_WF_APPROVAL_DM)

Resolution:

The CAP employee recently retired. No further action is required.

3. SAP Role assigned, but Inactive –

Original Observation:

Fifty-four (54) Agency employees were assigned the SAP role/transaction code, which was created with the implementation of SAP 2007. Five CAP staff members had this role assigned to them. (SAP Role: RP_S_WF_PM)

Resolution:

According to BIS, the SAP Role (RP_S_WF_PM) was designed for Project Managers to be included in the Purchase Request (PR) workflow process. However, at the time of full implementation in 2007, this role was not implemented after all. Currently, this role is no longer active, no transaction codes are assigned, and no users are assigned. BIS stated this role will continue to be inactive. No additional work is required.

The observations noted above have been resolved, therefore, the recommendation is no longer applicable. IA will continue to evaluate and review SAP user role assignments through the various audits.

Policies and Procedures

2013 Follow-up recommendation # 3: Agency Policies and Standard Operating Procedures (SOPs)

IA recommends that Contracts and Procurement Department personnel take the lead in working with the responsible Agency personnel to make the necessary updates to Agency Policies A-32 “Authority to Contractually Commit the Agency” and A-33 “Request for Proposal (RFP) Protocols”, and department specific SOP’s.

Status: Implemented


During the 2013 SCE Utility Payments audit, IA identified Agency policies and Department-specific SOPs that needed revisions and updates. This review found that suggested revisions have been incorporated into the current version of Agency Policies and department SOPs, which were updated in 2013. No further action is required.

Audit Committee

INFORMATION
ITEM
2C

Date: December 20, 2017

To: The Honorable Board of Directors


From: Halja Razak, General Manager

Committee: Audit

12/11/17

Executive Contact: Teresa Velarde, Manager of Internal Audit

Subject: Internal Audit Department Standard Operating Procedures (SOP)

Executive Summary:

The Internal Audit Department (IA) Charter requires that the audit work be completed in accordance with the Institute of Internal Auditors (IIA) International Professional Practices Framework (IPPF) Standards. The IIA requires that internal audit activities maintain formal, written procedures that document the requirements for the audit activities performed.

IA formally documented seven Standard Operating Procedures (SOP's) in 2008 and they have been periodically updated. All SOPs have been revised to the most current format as required by Agency Policy A-51. The objectives of the SOPs are to:

- provide consistency in the audit methodology utilized in preparing for, performing audit fieldwork, and closing audits;
- serve as a useful training tool and reference manual for all members of the IA Department;
- establish rules for professional conduct and responsibilities for auditors; and,
- provide a system to establish continuity of the Department when staff changes.

The SOPs are posted on the intranet webpage for reference by staff and follow the Agency's most current policy format requirement. Attached for your information are the seven IA SOPs.

Staff's Recommendation:

Receive IA's SOPs as an information item for the Board of Directors.

Budget Impact Budgeted (Y/N): N Amendment (Y/N): N Amount for Requested Approval:

Account/Project Name:

N/A

Fiscal Impact (explain if not budgeted):

N/A

Prior Board Action:

On June 21, 2017, the Board of Directors approved the Annual Audit Plan for Fiscal Year 2017/18.

On March 15, 2017, the Board of Directors reconfirmed the approved Audit Committee and the Internal Audit Charter.

Environmental Determination:


Not Applicable

Business Goal:

IA's SOPs are consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by ensuring that the IAD follows a disciplined and systematic method and approach for providing professional audit services.

Attachments:

- Attachment 1 - Standard Operating Procedures IA-001 Code of Ethics and Responsibilities
- Attachment 2 - Standard Operating Procedures IA-002 Types of Audits and the Audit Process
- Attachment 3 - Standard Operating Procedures IA-003 Audit Workpapers
- Attachment 4 - Standard Operating Procedures IA-004 Annual Audit Plan
- Attachment 5 - Standard Operating Procedures IA-005 Release of Audit Information to Agency Staff
- Attachment 6 - Standard Operating Procedures IA-006 Business Continuity and Disaster Recovery
- Attachment 7 - Standard Operating Procedures IA-007 Handling Claims, Allegations, Special Investigations, Special Projects and Management Requests

| | | | |
|--|--|------------------|-------------------|
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[CODE OF ETHICS AND RESPONSIBILITIES]

REVISION HISTORY

| <i>REVIEWED BY</i> | <i>REVISED SECTION / PARAGRAPH / PAGE</i> | <i>REVISION</i> | <i>REVIEW DATE</i> | <i>RELEASED DATE</i> | <i>APPROVED BY</i> |
|--------------------------|--|-----------------|------------------------|--------------------------|--------------------------|
| <u>[First Last Name]</u> | <u>Initial Release, Revised Section 2, etc.]</u> | XX | MM/DD/YYYY | MM/DD/YYYY | <u>[First Last Name]</u> |
| Teresa Velarde | Updated: 12/17/08; 11/13/13; 11/20/2017 | 4 | 11/20/2017 | 12/11/2017 | Teresa Velarde |
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*Draft and Archived/Obsolete revisions are not to be used.
Access [Document Control System] system to verify revision.*


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|  | Inland Empire Utilities Agency Standard Operating Procedure Code of Ethics and Responsibilities | | Pg. 2 of 8 |
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**Inland Empire Utilities Agency Standard Operating
Procedure
Code of Ethics and Responsibilities**

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Doc Number: [IA-001]

Rev: [#4]

1. PURPOSE

The purpose of the Standard of Operating Procedure (SOP) is to document the auditor's responsibility to adhere to The Institute of Internal Auditors' (IIA) Code of Ethics.

2. SCOPE

This SOP does not provide "procedures", only requirements for Internal Audit Department personnel. The scope of this SOP is to document the IIA's Code of Ethics to ensure it is documented for staff and to ensure this is a requirement for Internal Audit staff. The Code of Ethics has been reprinted with permission from the Institute of Internal Auditors, see Exhibit attached.

3. DEFINITIONS

NONE

4. SAFETY CONSIDERATION

NONE

5. PROCEDURE

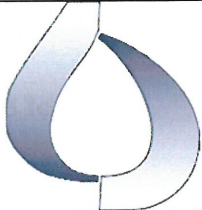
Consistent with the required responsibilities outlined in the Internal Audit Department Charter, the Internal Audit Department personnel are expected to abide by, follow, and apply the principles under the Institute of IIA's Code of Ethics.

The IIA's **Code of Ethics** outlines the principles and expectations governing behavior of individuals and organizations in the conduct of internal auditing. It describes minimum requirements for conduct, and behavioral expectations rather than specific activities. The purpose of the IIA's Code of Ethics is to promote an ethical culture in the profession of internal auditing.

The IIA's Code of Ethics includes Rules of Conduct that describe behavior norms expected of internal auditors. These rules are an aid to interpreting the Principles into practical applications and are intended to guide ethical conduct of internal auditors.

The Code of Ethics applies to both entities and individuals that perform internal audit services within the **IIA's Definition of Internal Auditing**. The Board of Directors' approved Internal Audit Department Charter adopts the IIA's Definition of Internal Auditing which defines internal auditing as follows:

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization

| | | | |
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accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance.

6. RESPONSIBILITIES

(reprinted with permission from The Institute of Internal Auditors, see Exhibit 2).

Principles

Internal auditors are expected to apply and uphold the following principles:

1. Integrity

The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.

2. Objectivity

Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.

3. Confidentiality

Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

4. Competency


Internal auditors apply the knowledge, skills, and experience needed in the performance of internal auditing services.

Rules of Conduct

1. Integrity

Internal auditors:

- 1.1. *Shall perform their work with honesty, diligence, and responsibility.*
- 1.2. *Shall observe the law and make disclosures expected by the law and the profession.*

| | | | |
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- 1.3. *Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.*
- 1.4. *Shall respect and contribute to the legitimate and ethical objectives of the organization.*

2. Objectivity

Internal auditors:

- 2.1. *Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.*
- 2.2. *Shall not accept anything that may impair or be presumed to impair their professional judgment.*
- 2.3. *Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.*

3. Confidentiality


Internal auditors:

- 3.1. *Shall be prudent in the use and protection of information acquire in the course of their duties.*
- 3.2. *Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.*


4. Competency

Internal auditors:

- 4.1. *Shall engage only in those services for which they have the necessary knowledge, skills, and experience.*
- 4.2. *Shall perform internal auditing services in accordance with the International Standards for the Professional Practice of Internal Auditing.*

| | | | |
|--|--|------------------|-------------------|
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- 4.3. *Shall continually improve their proficiency and the effectiveness and quality of their services.*

| | | | |
|--|--|------------------|-------------------|
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| | Doc Number: [IA-001] | Rev: [#4] | |

INDEPENDENCE

Independence is essential to the effectiveness of internal auditing, and is strongly emphasized by The Institute of Internal Auditors (IIA), the American Institute of Certified Public Accountants (AICPA), and the U. S. General Accounting Office (GAO). The Internal Audit Department should be free, both in fact and appearance, from impairments to independence.


The Internal Auditor and the Internal Audit Department shall have no direct responsibility or authority over the day-to-day operations of the Agency or any activities they would audit. The Internal Audit Department shall not engage in any activities that would compromise their independence or would appear to be a conflict of interest.

Since independence and objectivity are essential to internal auditing, Internal Audit shall be independent of the activities audited and shall assert no direct responsibility or authority over activities reviewed. To ensure independence is maintained, the Internal Audit Department shall report functionally to the Board through the Audit Committee and only administratively to the Agency's General Manager or his designee. Internal Auditors should not develop and install procedures, prepare records, or engage in activities that would normally be reviewed by Internal Audit. Recommendations to improve internal controls, compliance with established policy, and increase efficiency are included in the written audit report, which is given to management for review and implementation.

Any illegal activity or the legality that is questioned by the audit staff (e.g. conflict of interest, embezzlement, or theft) shall be reported to the appropriate senior management and the GM immediately upon discovery by the audit staff.

In performance of their functions, internal audit staff should have neither direct responsibility for, nor authority over, any of the activities and operations reviewed.


Management is responsible for establishing and maintaining controls to discourage the perpetration of fraud. Internal Audit is responsible for examining and evaluating the adequacy and the effectiveness of management's actions to fulfill this obligation. Internal Auditors should be able to identify indicators that fraud might have been committed. However, Internal Auditors are not expected to have the knowledge equivalent to a person whose primary responsibility is to detect and investigate fraud. Audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected. Further, it is recognized that the performance of audits and other reviews may include the assistance of other professionals with specific expertise.

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7. REFERENCES

This procedure must be consistent with the practices prescribed by the IIA's International Professional Practices Framework (IPPF).

Overall daily administration, application, and periodic review of this Procedure shall be the responsibility of the Manager of Internal Audit.

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[TYPES OF AUDITS AND THE AUDIT PROCESS]

REVISION HISTORY

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1. PURPOSE

The purpose of this Standard of Operating Procedure (SOP) is to provide internal auditing staff with an understanding of the various types of audit projects he/she may be responsible for performing. The purpose of conducting an audit project is to provide Agency management, the Audit Committee, and the Board with an objective evaluation, factual information, and recommendations to improve the efficiency of Agency operations and ensure compliance with required policies.

The purpose of this SOP is also to provide an overview the audit process for the Internal Audit Department (IA). The purpose of establishing an audit process is to provide a systematic, disciplined, and professional approach to the performance of audit projects.

2. SCOPE

The scope of this SOP covers all routine audit projects conducted by IA staff. The purpose of establishing an audit process is to provide a systematic, disciplined, and professional approach to the performance of audit projects.

3. DEFINITIONS

None


4. SAFETY CONSIDERATION

None

5. PROCEDURE

A. With guidance established by the IIA IPPF and the *International Standards for the Professional Practice of Internal Auditing Standards (Standards)*, and as charged with under the Board of Directors approved Internal Audit Department Charter and the Audit Committee Charter, the Internal Audit Department (IA) uses a variety of audit techniques in the process of completing various audit projects. Various types of audit services can and will be performed, for example, the most common type of audit services include the following:

1. **Operational Audits** - examine the use of department resources to evaluate whether those resources are being used in the most effective and efficient manner to fulfill the Agency's mission and objectives. An operational audit includes elements of the other audit types, as deemed necessary and appropriate based on the risk assessment.
2. **Financial Audits** - accounting and reporting of financial transactions, including commitments, authorizations, estimates, allocations, receipt, and disbursement of funds. The purpose of this type of audit is to verify that there are sufficient controls over cash and cash-like assets, and there are adequate process controls over the


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acquisition and use of resources. Unlike external financial audits, internal financial audits do not prepare or express professional opinions on the fairness of the presentation of financial statements.

3. **Compliance Audits** - adherence to laws, regulations, policies and procedures. Examples include federal and state law, agency policies and procedures, and regulatory agency requirement. Recommendations typically call for improvements in processes and controls intended to ensure compliance with policies and regulations.
4. **Internal Control Reviews** - focus on the components of the Agency's major business activities. Areas such as payroll and benefits, procurement, accounts receivable and payable, inventory and equipment and their physical security, grants and contracts, and financial reporting are usually subject to review.
5. **Fraud Audits** – where fraudulent activity is present or suspected, specialized audit activities may be performed to assist management in detecting or confirming the presence and extent of the fraud and in providing necessary evidence for legal purposes. The expertise of a professional Fraud investigator may be hired to ensure a thorough investigation.
6. **Information Technology/Information Systems (IT/IS) Audits** - internal control environment of automated information processing systems and how people use those systems. IS audits typically evaluate system input, output, and processing controls, backup and recovery plan, system security, and computer facility reviews. IS auditing projects can focus on existing systems, as well as systems in the development stage.
7. **Follow Up Audits** – these are limited scope reviews to verify management has implemented corrective action for a recommendation made during a previous audit. Follow up Audits are conducted until recommendations are fully implemented or management accepts the risk of non-compliance. A report of all outstanding recommendations and the status of each (i.e. in progress, not implemented, deferred, etc.) is presented to the Audit Committee and Board annually.
8. **Miscellaneous audit projects** or special requests and projects as requested by the Manager of Internal Audit, the Audit Committee, the Board of Directors, General Manager, or Executive Manager. These requests will require a combination of the types of audits, innovative techniques and resources to meet the desired objective of each project. (More information related to special projects is described in SOP No. IA-007 Handling Claims, Allegations and Special Investigations).

B. Audit Process

The process of each audit will have similarities and differences among the various audits performed. This procedure establishes the recommended steps to conduct the audit.

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The auditor should use professional judgment to determine if additional steps or limited steps of the audit process are necessary to accomplish the objectives and scope of work of the assigned audit project. The audit process should be flexible but should also be disciplined and systematic that any prudent auditor would take a very similar approach. All changes, supplements, and additions should be provided to and cleared by the Manager of Internal Audit.

During each stage in the audit process, the auditee or clients (those responsible over the area being audited) have the opportunity to participate. The most successful audit project is when the audit team and auditee consider themselves consultant and client, respectively, and work as a team to ensure the best product (audit observations and audit recommendations) are corroborated and agreed upon before the audit is completed. The best audit project is delivered when the expectations of all stakeholders are met with objective, unbiased, professional opinions and recommendations. Understanding and applying this concept tends to foster a more constructive working relationship and can result in improved operations for the department under review. Although every audit is unique, similarities can be found in each one.

The typical audit process consists of the following suggested steps (see Exhibit 1)


1. Planning

Prior to meeting with the client, the Internal Audit team discusses with the Manager of Internal Audit the upcoming audit and determines the audit's objectives, scope, timeline, budgeted hours, and staff assignments. If the area has been previously audited, the prior audit file should be reviewed to re-familiarize with the department's unique operations, prior audit findings, and areas of concern. The audit team should determine the audit objectives and develop a list of preliminary auditable areas and/or a draft Audit Program. Planning should always include an internal control review, expenditure examination, and determining the compliance requirements (with the Agency's policies and procedures, department SOPs/manuals, and/or other rules, regulations, laws, etc.). During the entrance meeting, the audit team will inquire with senior management and the auditee any areas they may want to see evaluated and these should be incorporated into the audit whenever feasible and appropriate.

2. Information on Gathering

Research and gather information for the department area under review. The Agency's Intranet, Budget Book, CAFR and other internal sources provide sufficient information. Additional information shall be gathered through interviews of key personnel, surveys, and other areas and methods.

3. Notice of Intent to Audit

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The client must be informed of the audit through an announcement or engagement letter from the Manager of Internal Audit, this can be done formally as an internal memo or through an e-mail. This Notice of Intent to Audit communicates the scope and objectives of the audit, the auditor(s) assigned to the project, the date to begin the audit and other relevant information. When possible, provide a two week notice or longer unless the audit is intended to be an unannounced surprise audit.

It should also be noted that audits are “advertised” through the submission and approval of the Annual Audit Plan prepared and submitted by the Manager of Internal Audit to the Board of Directors, through the Audit Committee. The Annual Audit Plan lists the audit projects planned for completion for the corresponding fiscal year. Any amendments to the Annual Audit Plan are also submitted through the Audit Committee for Board approval. Therefore, there should be no element of surprise to the business units about the upcoming/scheduled audits, as these are usually “advertised” well in advanced, at times over six months.

4. Entrance Conference


The entrance conference, provides the opportunity for the audit team to meet with department management to outline the audit objectives, approximate time schedule, required data, types of auditing tests, and the reporting process. Any areas of concern the client would like to have reviewed by the audit team should be brought up at this stage. The audit team will make an effort to minimize any disruption of regular departmental routines and avoid seasonal busy periods. The client may designate a member of the department staff as the primary contact person to respond to audit team questions and provide assistance.

It is appropriate to also schedule a brief tour of the facilities following the entrance conference, when necessary and feasible.

5. Final Audit Program

Using the draft Audit Program and after all key staff personnel have been interviewed and the risk assessment completed, the Audit Program incorporating any additional steps deemed necessary should be finalized. The final Audit Program formally documents all the procedures to be conducted during the audit. These procedures will include steps to perform test work, observations, interviews, or surveys and document exceptions and recommendations. The final Audit Program must be approved by the Manager of Internal Audit and all procedures must be completed unless otherwise instructed by the Manager of Internal Audit.

6. Audit Fieldwork

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Using the approved Audit Program, the audit team will complete each audit step accordingly. This will entail gathering additional information about the auditee's operations. If the unit has not previously been audited, this is a significant effort. The audit team also reviews any changes in operations since the last audit. This work typically results in narratives, flowcharts, and document samples obtained from interviews with key personnel and office manuals and policies. The analysis helps evaluate internal controls relating to business transactions, safeguarding the Agency's assets, compliance with the Agency's policies, and promotion of operational efficiency. The auditor should proceed with all steps in the audit program.

After the survey stage, the audit team will proceed to the transaction testing stage. Transaction testing involves examining documents and other records for evidence that the internal controls described in the survey stage are actually in place and functioning as intended. When evidence of this is found on a sample of transactions or records, it can be concluded that established procedures are being followed and the level of compliance with internal controls is adequate. When a strong system of internal controls is in place and followed, the auditor(s) are confident that the data generated by the transactions can be relied upon as accurate and that administrative policies are being carried out. If the audit team finds one or more opportunities/deficiencies during their transaction testing, these will become audit findings and included in the report.

7. Audit Findings

Once the audit team encounters potential audit findings, they will bring them to the client's attention as they are identified in an attempt to resolve them, if possible, before fieldwork completion and corroborate on an appropriate recommendation. At the end of the fieldwork stage, the audit team will meet with department management and informally review all findings and observations and potential recommendations. If and when an auditee disagrees with the audit findings or determines the level of risk of the observation identified is acceptable, the internal audit final report must reflect both the auditor's finding and the auditee's final disposition of such.

During this closing meeting (Pre-exit Meeting), the audit team will re-inform the auditee of the audit process and the draft audit report. The auditee will be given a reasonable amount of time (approximately 5-10 days) to provide additional support or a response to the observations/findings before audit findings are finalized. Audit findings should be developed, documented, and reported in accordance with the basic five elements of an audit finding, to the extent feasible and practical.

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Each finding/observation should be self-contained, fully supported and it should stand alone. The five elements of an audit finding are (*Source: **AuditNet** - The Global Resources for Auditors*):

- CRITERIA
- CONDITION
- CAUSE
- EFFECT
- RECOMMENDATION

Exceptions - Auditors are expected to use professional judgment and due professional care in obtaining the information needed to report findings according to the above elements. However, situations may occur when it is not feasible or practical to obtain all the elements or when the audit objectives require that the findings be reported in some other manner. These exceptions should be discussed with the Manager of Internal Audit and clearly documented in the working papers. The finding(s) should then be reported, even if one or more of the elements is missing.

Such exceptions may occur where the auditor is unable to determine the cause of a particular condition, or unable to reasonably ascertain its effect in dollars or other terms. There may also be situations where the auditor is unable to cite criteria (i.e., particular law, regulation, or industry standard) for determining that reportable conditions exist (i.e., professional judgment).


Element Descriptions

The development of audit findings is best measured by comparing what exists with some standard of what is acceptable. If the developed finding meets all acceptable standards it will be logical and reasonable, and it will provide a means to motivate corrective action. Findings that properly include these elements will represent a strong argument for corrective action:

Criteria: (what should be)

"Criteria are the standards used to determine whether a program meets or exceeds expectations." The criteria include the goals and objectives that management wishes accomplished, in accordance with the policies, procedures, and standards that management has created, to govern the operation effectively, efficiently, and economically. In our environment these might also include laws, regulations, agency policies and procedures, and industry/other government agencies' standards.

The auditor will also have to determine what is reasonable in those instances where management has not established standards (i.e., there is no written policy,

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or there are no goals/objectives). When there is no criteria, it will also be appropriate to work with management and develop appropriate criteria.

Condition: (What is/what happened)

"Condition is a situation that exists. It has been determined and documented during the audit." The gathered information should be sufficient, competent, and relevant, and it should be able to withstand challenge. It must be representative of the total population or system under review or, if an isolated instance, be a significant defect. The auditee may disagree with an auditor's interpretation, but if the condition is properly identified, the auditee will have no reasonable basis to disagree with the facts that the auditor has gathered.

Cause: (Why the deviation from the criteria occurred)


Cause explains why standards were deviated from, why goals were not met, and why objectives were not attained. Recommendations are most effective when they address an identified condition and cause. The auditor may not be able to easily or always identify the cause, and might consult management for their opinion as to what has caused the observed condition.

Effect: (What happened or could happen because the condition differed from the criteria.) Effect answers the "so what?" question: assuming that all the facts are as represented, what is the result and significance of this? Who or what organization is being harmed, and how badly? Which agency goals and objectives aren't being met, or are costing more money or effort than they should? What is the impact to the Agency? Effect is the element needed to convince management that the undesirable condition, if permitted to continue, will cause harm and would cost more than the action needed to correct the problem.

Recommendations: (What is needed to correct the condition and improve operations) Recommendations describe the course of action management should take to correct the audit-identified condition. "Recommendations are most constructive when they are directed at resolving the cause of identified problems, are action oriented and specific, are addressed to parties that have the authority to act, are feasible, and to the extent practical, are cost-effective." It is appropriate to work with management to develop an appropriate and feasible recommendation.

8. Draft Report and Pre-Exit Conference

The audit team will prepare a draft audit report based on the finding documented in the audit work papers. Upon completion of the draft, the audit team will submit to the Manager of Internal Audit for review. The Manager will make changes as needed and will discuss with audit team to ensure the recommendation still meets the control purpose. The draft report will be stamped "DRAFT" and sent to the audited management for their comments, edits, or questions.

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At the pre-exit conference (if one is requested or scheduled at the request of the auditee), the draft report is discussed with the audited department management. This discussion focuses on findings and recommendations noted. The auditee may request changes to the wording and the Internal Audit will try to accommodate the request as long as the finding and recommendation's objective is not altered. The goal of the meeting is for both parties to agree on the accuracy of the audit finding and the report content. In most cases this will occur; however, it is acceptable for a disagreement regarding the need for corrective action. Executive management will make the final determination in these cases.

9. Final Report and Exit Conference


The purpose of the Exit meeting (if one is requested or scheduled at the request of the auditee) is to review the Final Report and the auditee's response. At this time the audit field work phase officially ends and no additional supporting documents or information should be accepted. Upon receiving the auditee's corrective action plan; the Internal Audit staff will attach the response to the report only if the response is timely and responsive. The Manager of Internal Audit and staff will review the auditee's response and determine if the corrective action to be taken meets the control objective of the recommendations. The responses may, in some instances, be different than the recommendation or may indicate a disagreement with the finding. If the auditee indicates the recommendation will not be implemented, the Manager of Internal Audit's response must restate why the need for corrective action is necessary. The Manager of Internal Audit will then issue the report in "final".

10. Auditee's Response and Corrective Action Plan

The audited business unit must provide a response to the recommendations within 60 days of the date of the Final Report to the Manager of Internal Audit. All replies must include whether the Department agrees or disagrees with each of the recommendations, a corrective action plan addressing each recommendation and the estimated target date for implementation. The audited unit may choose to complete the response before the final report is issued and in that case, if the response is timely and effective, can be attached to the final report.

11. Follow-up Review

Internal Audit will perform a follow up review to determine if department management has implemented the recommendations. The timing of the follow up audit will be partly determined by management's targeted completion date. A final report will be issued to update executive management and the Board of Directors on the status of corrective action plans.

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According to the requirements of the Charter, on an annual basis, Internal Audit will prepare a summary of all audit recommendations and a current status of implementation for the Audit Committee. The Manager of Internal Audit will meet with the committee and discuss the recommendations' status.

12. Presentation of Final Audit Report and Results to the Audit Committee and the Board of Directors

The Manager of Internal Audit must present the Final Audit Report to the Audit Committee during the next regularly scheduled Audit Committee meeting, and if requested by the Audit Committee shall also be presented to the Board of Directors.

- C. All Word documents should be written using Microsoft Word using Arial 12 point font or as similar as possible, be single spaced, fully justified and include page numbers, unless otherwise instructed or approved by the Manager of Internal Audit.
- D. All workpapers must be signed off by the auditor, include a source, if not auditor prepared. All pages must be numbered appropriately with a system that is self-explanatory and consistently used throughout the audit process. There is flexibility in the style and format of the workpapers, numbering and headers, however, all the information must be included on each of the workpapers.
- E. For questions regarding the types of audits or the audit process, the auditor should refer to the most current version of the Institute of Internal Auditors', International Professional Practices Framework (IPPF) or the "Red Book" for additional guidance and discuss with the Manager of Internal Audit.

6. RESPONSIBILITIES


These procedures must be consistent with the practices prescribed by the IIA Standards.


Responsible Party 1, Title 1 – **The auditor is responsible for staying informed on current IIA Standards. The auditor is responsible for completing professional, factual, accurate audit projects.**

Responsible Party 2, Title 2 – **All audit projects must be reviewed by a an audit supervisor or manager.**

REFERENCES

IIA Standards

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1. PURPOSE

The purpose of this Standard Operating Procedure (SOP) is to provide guidance in preparing and documenting audit workpapers.

2. SCOPE

The scope of this SOP covers all routine audit workpapers to support audits performed by IA staff. The purpose is to ensure audit workpapers follow the guidance provided by the Institute of Internal Auditor’s (IIA) guidelines.

A record of the auditors' work should be retained in the form of audit working papers. The workpapers serve as the connecting link between the audit assignment, the auditor’s fieldwork and the final report. Workpapers contain the planning records and preliminary surveys, the audit program, audit procedures, fieldwork, supporting documents, such as spreadsheets, testwork schedules, and other documents relating to the audit. Most importantly, the workpapers document the auditor’s conclusions and the reasons those conclusions were reached. Workpapers must be handled with confidentiality, be secured at all times, and retrievable by internal audit staff.


Internal audit staff is required to be familiar with Standard 2330 and Practice Advisory 2330-1 “Documenting Information” of the Institute of Internal Auditors (IIA) International Professional Practices Framework (IPPF) which provides guidance related to the auditors responsibility to document relevant information to support the conclusions and engagement results.

Workpaper preparation and referencing facilitate the documentation that the audit objectives were followed, audit observations were concluded with sufficient supporting information, and provides the final record of the auditors’ work. Workpaper preparation and referencing allows supervisors and managers review the work done, it also allows other auditors follow the work completed and follow-up on any questions that may arise. Workpaper preparation and referencing should be simple and understandable that any prudent auditor is able to follow the referencing.

Workpaper format, style, indexing, numbering, etc should be in such a way that it will be straightforward and unproblematic for any knowledgeable, prudent auditor to be able to follow and understand the process of the audit documented. Therefore, the procedures are not made so strict that there is no room for flexibility but should follow general, acceptable workpaper practices.

These workpaper procedures apply to both manual and electronic workpapers.

See also IA-005 The Release of Audit Information to Agency Staff for additional information related to the importance of audit workpapers and the process for releasing.

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3. DEFINITIONS

None

4. SAFETY CONSIDERATION


None

5. PROCEDURE

A. Audit Workpaper Standards

The content of workpapers should contain the following:

1. **Audit Objective Relevance**
The workpaper must be relevant to both the specific audit objective and the total audit assignment. Only include other materials or data that support the testing performed.
2. **Condensation of Detail**
The workpaper should be condensed and carefully summarized to make their later use more efficient.
3. **Presentation Clarity**
The workpaper should be presented in a clear and understandable manner. The workpaper should be able to “stand alone” so the reviewer can determine the testing and results without the need to discuss with the preparer. The workpaper should support all Findings/Observations and Recommendations made. This is critical, since the workpaper may be used in the future to substantiate Internal Audit’s work performed and the original preparer may no longer be an Internal Audit Department employee. The workpaper should be prepared “neatly” and provide only needed and relevant information.
4. **Accuracy**
The workpaper must contain statements and quantitative data that are accurate. This is essential because the workpaper may be used in the future to answer questions and support the Internal Audit Department’s representations. All auditing workpaper information must be factual, accurate, relevant and reliable.
5. **Sampling Procedure**
The workpaper should include the method to select the audit sample. The description of the sampling method should be sufficiently definitive so that each item can be identified by the method description.

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B. Preparation Standards

Technical preparation standards are necessary to ensure consistency and professionalism in creating the audit workpaper. Workpaper preparation and referencing allows supervisors, managers review the work done, it also allows other auditors follow the work completed and follow-up on any questions that may arise. Workpaper preparation and referencing should be simple and understandable that any auditor is able to follow the referencing.

1. Place a title on each workpaper. The following identifying information should be documented on the workpaper (any order is acceptable)
 - a. Internal Audit Department or IEUA or both
 - b. Audit name
 - c. Year under review
 - d. Purpose of workpaper (title)


2. Include the preparer's initials and date on the workpaper.

3. Include an objective on each workpaper with sufficient detail to clarify how it relates to achieving overall audit objectives.

4. Indicate the source of data on the workpaper with sufficient detail to ensure a different auditor is able to follow-up with the source. For example, sufficient identifying information may contain:
 - a. Name, title, department, phone number (if readily available)
 - b. Date MM/DD/YY of the interview r information was provided
 - c. Auditor initials

5. Tickmarks: When possible use red for tickmarks. Always include a "tickmark legend" or detailed footnotes on the workpaper to explain/define the tickmarks used. Initial and date the tickmarks to acknowledge the work done. For example, tickmarks are used to indicate:
 - a. An item has verified attributes.
 - b. A column of numbers foots (use an f or F or other).
 - c. A series of numbers cross-foots = adds across (use an cf).
 - d. Calculations made are correct (c).
 - e. Information has been Traced or Agreed .

6. Include a conclusion for work conducted on each workpaper. Reference to other test/summary or findings or report when necessary.

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7. Prepare a separate workpaper for each supporting schedule/test.
8. Numbering pages, spreadsheets, folders, pockets or other workpapers: Each page should be given a unique reference number that identifies its location. The number assigned should follow the audit program and/or index and/or table of content and a logical sequence. It is preferred that each workpaper be indexed/numbered at the middle bottom of each page, preferably in "RED".
9. Referencing should be done so that any auditor is able to follow the order of the workpapers and locate both manual and electronic workpapers. Indicate either in the index or table of content or the audit program where the workpapers are located and if they are manual or electronic – identifying the section and or file. Workpaper referencing should be simple and understandable that any auditor is able to follow the referencing.
10. Pockets should be labeled, indicating what it contains, preparer's initials and date MM/DD/YY.
11. Cross reference the final audit report to the workpapers, preferably in "RED" to the extent possible and necessary for the reviewer to be able to locate the totals/numbers and conclusions through the audit process. At a minimum, the draft audit report should include references to the summary workpapers, the summary workpapers should include references to the lead schedules, and the lead schedules should include references to supporting documents.
12. Prepare the workpaper in a neat, legible manner. All working papers should be of uniform size and appearance. Smaller and landscape papers should be fastened or stapled to a page containing a header. Larger papers should be folded to conform to size restrictions.
13. Use only one side of the workpaper. If a document is double-sided, indicate the document is double sided with a footnote or a "d/s" tickmark. Always indicate the total number of pages each document contains to ensure the reader can verify the total number of pages.
14. Do not include insignificant or irrelevant material and information. Avoid long hand-written documents or notes only the auditor would understand. Significant notes should be summarized as a typed document. If meeting notes have been typed, it is acceptable to remove the hand-written notes.
15. Bind all workpapers in the appropriate sequence.

16. Permanent files or binders may include SOPs and employee handbooks and can be referenced in future audits. Documents should be sorted by date order and by the order listed in e.g. the Audit Program.
17. All final documents and all supporting information to findings should be retained. It is not necessary to keep all items reviewed during the audit. Professional auditor judgment should be used to determine what audit workpapers are essential and those that substantiate the audit conclusions.

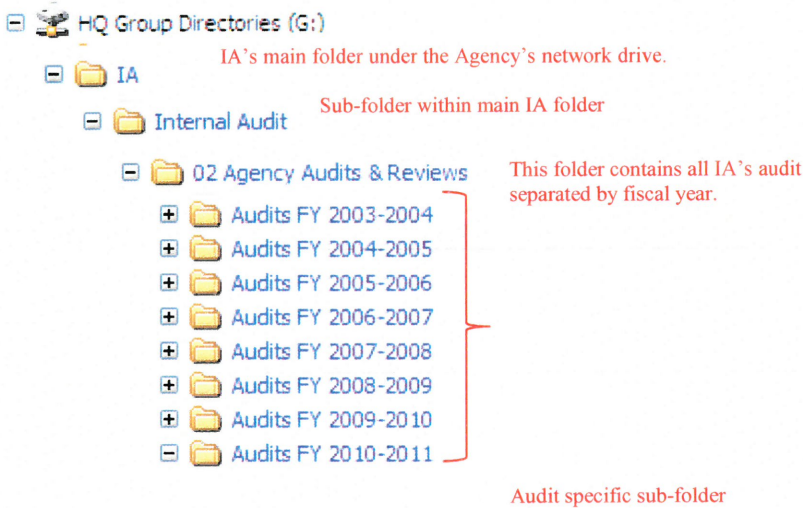
C. Review of Workpapers


The supervisor or Manager of Internal Audit will review the workpapers. The reviewer will initial and date the workpaper as evidence that the review was conducted. Any review comments must be cleared and included in the audit file.

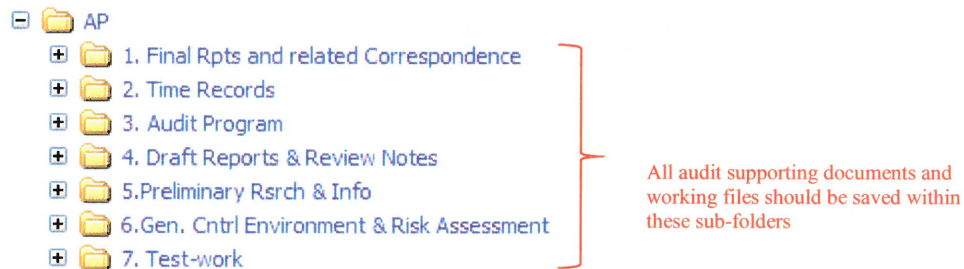
D. Electronic Audit Files

1. All audit work files that are part of the final product and included in the audit files should be maintained in electronic format and saved on the Agency's network drive. Key documents (such as audit exceptions) that are obtained in hard copy format should be scanned; however, it is not necessary to scan all source documents. Files are to be separated out by fiscal year and audit. Within each audit folder, the files/folders saved should mirror the organization of the physical folders which usually mirrors the audit program, or by audit sections.

This is an example:



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|  | Inland Empire Utilities Agency Standard Operating Procedure <u>AUDIT WORKPAPERS</u> | | Pg. 8 of 8 |
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2. Electronic files created by the auditor, such as Microsoft Word and Excel files, should include a footer that shows the electronic path and file name or a hyperlink to assist reviewers of hard copy workpapers with locating the electronic file. Whenever possible and to create efficiencies, hyperlink electronic workpapers.
3. For electronic files, auditors should print out the summaries of the audit program sections and key test work schedules to assist the reviewer. It is not necessary to print out all workpapers; however references to the location of the workpapers (manual or electronic) should be made for reference and cross-reference purpose.

6. RESPONSIBILITIES


These procedures must be consistent with the practices prescribed by the IIA Standards.

Responsible Party 1, Title 1 – The auditor is responsible for staying informed on current IIA Standards. The auditor is responsible for completing professional, factual, accurate audit projects and maintain records that support the audit work.

Responsible Party 2, Title 2 – All audit projects must be reviewed by an audit supervisor or manager.

REFERENCES

IIA Standards

| | | | |
|---|--|-----------|-------------------|
|  | Inland Empire Utilities Agency Standard Operating Procedure ANNUAL AUDIT PLAN | | Pg. 1 of 4 |
| | Doc Number: [IA-004] | Rev: [#4] | |

[ANNUAL AUDIT PLAN]

REVISION HISTORY

| <i>REVIEWED BY</i> | <i>REVISED SECTION / PARAGRAPH / PAGE</i> | <i>REVISION</i> | <i>REVIEW DATE</i> | <i>RELEASED DATE</i> | <i>APPROVED BY</i> |
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| | Doc Number: [IA-004] | Rev: [#4] | |

1. PURPOSE

The purpose of this Standard Operating Procedure (SOP) is to establish the procedure for developing the Internal Audit Department's Annual Audit Plan.

The Internal Audit Department Charter, requires that annually, the Manager of IA develop a comprehensive, flexible Annual Audit Plan to determine the priorities of the Internal Audit Department and the audit projects for the year. The Annual Audit Plan must be developed using an appropriate risk-based methodology to identify Agency areas subject to an audit, audit projects should also be aligned to the Agency's goals.

The Annual Audit Plan must be submitted to the Board of Directors, through the Audit Committee for final approval. Significant changes to the Annual Audit Plan must be reported to the Audit Committee and the Board, as well as periodic status reports reporting on the progress of the audit projects.

2. SCOPE

The scope of this SOP covers Annual Audit Plans and required updates.

3. DEFINITIONS

None

4. SAFETY CONSIDERATION


None

5. PROCEDURE

The Annual Audit Plan is presented to the Audit Committee at the beginning of each Fiscal Year for discussion and request it be submitted to the Board of Directors for final approval and request the Board direct the Manager of Internal Audit to implement the Annual Audit Plan.

Development Process

- A. Each year, the Manager of Internal Audit will develop a comprehensive Audit Plan for the given fiscal year. This plan is based on a risk assessment approach to review the audit universe. Audit frequency is determined by the risk associated with the audit area, consideration must be given to any special tasks or projects requested by Management, the Audit Committee or the Board of Directors, and any areas deemed appropriate by the Manager of Internal Audit.

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- B. The risk assessment is done by assessing/evaluating the audit universe. The audit universe includes all auditable areas of the Agency, including but not limited to: Agency departments, processes, functions, operations, funds, accounts, activities, contracts, policies, rules, inventory, assets, facilities and anything that is mentioned or pertains to Agency goals and objectives.
- C. The risk assessment is completed through interviews of key personnel, an evaluation of total costs or revenues and using professional auditor judgment.
- D. The annual audit plan should be flexible to allow for performing special projects and/or management requests, or special investigations as deemed necessary by the Manager of Internal Audit and/or senior management and/or the Audit Committee Chair. .

In the event there are significant deviations from the Annual Audit Plan or there is an anticipated need for an Annual Audit Plan Amendment, a formal Amended Annual Audit Plan must be submitted for review and approval at the next regularly scheduled Audit Committee Meeting, noting the addition or postponement of projects and audits from the originally approved Audit Plan with information related to the benefits/risks for the delay in the originally planned audits.

6. RESPONSIBILITIES


These procedures must be consistent with the practices prescribed by the IIA Standards and the Internal Audit Department Charter and the Audit Committee Charter requirements.

Responsible Party 1, Title 1 – The Manager of Internal Audit is responsible for preparing and submitting for Board approval an Annual Audit Plan and any subsequent amendments and updates, consistent with Agency goals and according to IIA’s best practices.

Responsible Party 2, Title 2 – The Audit Committee and the Board of Directors review and approve the Annual Audit Plan and subsequent amendments.

REFERENCES

IIA Standards

| | | | |
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|  | Inland Empire Utilities Agency Standard Operating Procedure <u>RELEASE OF AUDIT INFORMATION TO AGENCY STAFF</u> | | Pg. 1 of 4 |
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[RELEASE OF AUDIT INFORMATION TO AGENCY STAFF]

REVISION HISTORY

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1. PURPOSE

The purpose of this Standard Operating Procedure (SOP) is to provide procedures for requests for Internal Audit Department (IAD) workpapers from Agency staff.

Workpapers serve as the connecting link between the audit assignment, the auditor's fieldwork and the final report. Workpapers contain the planning records, preliminary surveys, audit procedures, supporting documents, spreadsheets, preliminary risk assessments, and other documents relating to the audit. Most importantly, the workpapers document the auditor's conclusions and the facts in reaching conclusions to audit observations.

Final Audit reports provide a summary of the conclusions that were reached and the audit work completed. All final, approved and published Audit Reports are available on the Agency intranet site (PIPES) and also available through the public Board Agendas from the main IEUA web page.

In an event of a request for audit workpapers, IAD staff should make every effort to assist and cooperate in providing needed information to Agency staff when possible, and as deemed appropriate.

2. SCOPE

The scope of this SOP covers all workpapers and information retained to support audit reports.

3. DEFINITIONS

None


4. SAFETY CONSIDERATION

None

5. PROCEDURE

- A. When a request for audit workpapers or supporting documents is received, Audit staff must notify the Manager of Internal Audit the nature of the request.
- B. Requests made by Agency staff for information that is not available on the Agency intranet or through published records, require a request made through and by the General Manager, and approved by the Audit Committee. Requests will be considered only for information related to completed audits.

At the discretion of the Manager of IA, information will be released only after the Manager of IA determines that information requested does not violate the Audit

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Committee Charter, the Internal Audit Department Charter, the Institute of Internal Auditing (IIA) International Standards for the Professional Practice

of Internal Auditing (*Standards*), and/or anything that would compromise the independence, integrity, and professionalism of the Internal Audit Department and the image of the Agency.

- C. When a request for audit workpapers or audit supporting documentation is approved for Agency staff review, and made through the General Manager, approved by the Manager of IA and the Audit Committee, the requestor may coordinate with IAD staff and sit in a nearby workstation to review files under the supervision of IAD staff.
- D. Copies of requested information may only be made upon approval by the Manager of IA and if necessary by the Audit Committee Chair. Removing files from the IAD designated work area is not permissible.
- E. This procedure addresses only requests from IEUA staff. External access to IAD files will be granted if the request is made from the Agency's legal counsel or a higher authority.

6. RESPONSIBILITIES

These procedures must be consistent with the practices prescribed by the IIA *Standards* and the Internal Audit Department Charter and the Audit Committee Charter requirements.

Responsible Party 1, Manager of Internal Audit – The Manager of Internal Audit is responsible for approving the release of audit workpapers.

Responsible Party 2, IEUA General Manager – The IEUA General Manager is responsible for authorizing staff's request for audit workpapers and documentation.

REFERENCES

IIA Standards

[BUSINESS CONTINUITY AND DISASTER RECOVERY]

REVISION HISTORY

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1. PURPOSE

The purpose of this Standard Operating Procedure (SOP) is to document the Internal Audit Department's role, function, and processes during a disaster or business disruption event. The primary responsibilities of the Internal Audit Department (IAD or IA) include to assist in the continuance of critical activities and to reduce the impact of the incident to the Agency and its core operations.

2. SCOPE

The scope of this SOP covers any Agency related disaster or business disruption.

3. DEFINITIONS

None

4. SAFETY CONSIDERATION

None

5. PROCEDURE


A. Contact Information

Disaster, Safety and Emergency phone numbers are located in the Safety Manual and accessible on the Safety & Risk Department website located on the Agency's intranet website. Each IAD employee is required to post the emergency contact phone numbers in their workstation. In the event of an emergency/disaster, Internal Audit staff should contact the appropriate personnel for emergency response information and instructions.

B. Role of the Internal Audit Department during an incident

The Internal Audit Department is not considered a critical business function where the immediate continuance of audit projects is required. During an incident, Internal Audit staff will act as support and/or backup personnel to assist in the recovery of time-critical Agency activities and operations. Additionally, Internal Audit staff will perform necessary tasks to ensure the safety of personnel, security of assets, internal controls and segregation of duties when viable and appropriate.

Upon reporting for emergency response, IAD staff should take the necessary steps to assist the critical departments and functions, which may include, but are not limited to Finance and Accounting, Business Information Systems, Safety, and the Human Resources departments. The IAD Business Continuity and Disaster Recovery procedure will acknowledge and be secondary priority to the Agency-wide Business Continuity Plan or the Business Continuity & Disaster Recovery plans for the time-critical Agency-activities or departments.

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C. Disaster Assessment

A disaster is defined as an event that results in the loss or compromise of personnel, systems, processes, or infrastructure. Events that can lead to a disaster may come from or be caused by, but not limited to: earthquakes, internal/external fire, internal/external flooding, human error, weather, a nearby company disaster, physical or any form of attack, and anything declared as an emergency or disaster by Executive Management.

If a disaster occurs, at the request of the Board, Audit Committee, and/or the General Manager, the Internal Audit Department Manager will assist in disaster assessment and recovery in conjunction with Agency management. Based upon the disaster scope, the Manager of Internal Audit will direct Audit Staff to the appropriate recovery plan and assist Agency staff in the strategy to restore appropriate business functions.

D. Assignments and Responsibilities


The Manager of Internal Audit will assist in ensuring the safety of personnel, coordinate with the appropriate department manager(s) to discuss the continuity plan, recovery of information and safeguarding of crucial information and assets, direct Audit Staff accordingly; and communicate/develop plans to safeguard assets, maintain security of critical information and verify information. The role of the Manager of the Internal Audit Department is also to inform the Audit Committee and Board of its role and responsibilities during the disaster/emergency.

E. Recovery Capability of Audit Records

Audit files and all final reports are stored in electronic form in the Agency's shared directories. In the event of a disaster that affects network files, IA electronic files may be retrieved upon recovery of Agency network information by the ESS and ISS departments.

Hard-copy/paper audit workpapers are located in the IAD storage cabinets located outside the Internal Audit Department Manager's office, as well as in Audit staff cubicles. Workpapers contain supporting documents related to the audit conclusions made. The work-papers represent the justification for the audit observations and recommendations provided to the audited business units and as communicated to the Audit Committee and the Board of Directors in the final audit reports.

In the event that hard-copy workpapers are destroyed during a disaster, most of the files may be retrieved from the electronic files in the network or from the appropriate

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department for which they belong. Some of the audit work-papers are original working documents that may not be retrievable through any other channel and would take a considerable amount of audit resources to recreate, if at all possible. In the event of a disaster where workpapers are destroyed, effort to re-create or restore hard-copy workpapers for completed audits, will not be a priority.

The final audit report is documented and issued through regularly scheduled Audit Committee and Board Meetings available through different Agency electronic sources. The final audit reports represent the end-product of the audit procedures. Audit reports also represent final agreement between the auditors and the auditee, and stand alone even if back-up workpapers are misplaced or destroyed. Audit reports are prepared following audit standards recommended by the Institute of Internal Auditors in the International Professional Practices Framework guide.

- F. Procedure Review - Overall daily administration, application, and periodic review of this Standard Operating Procedure shall be the responsibility of the Internal Audit Manager.

6. RESPONSIBILITIES

These procedures must be consistent with the practices prescribed by the IIA *Standards* and the Internal Audit Department Charter and the Audit Committee Charter requirements.

Responsible Party 1, Manager of Internal Audit – **The Manager of Internal Audit is responsible for approving the release of audit workpapers.**

Responsible Party 2, IEUA General Manager – **The IEUA General Manager is responsible for authorizing staff's request for audit workpapers and documentation.**

REFERENCES

IIA Standards

[HANDLING CLAIMS, ALLEGATIONS, SPECIAL INVESTIGATIONS, SPECIAL PROJECTS AND MANAGEMENT REQUESTS]

REVISION HISTORY

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|  | Inland Empire Utilities Agency Standard Operating Procedure <u>HANDLING CLAIMS, ALLEGATIONS, SPECIAL INVESTIGATIONS, SPECIAL PROJECTS AND MANAGEMENT REQUESTS</u> | | Pg. 2 of 6 |
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1. PURPOSE

The purpose of this Standard Operating Procedure (SOP) is to document the Internal Audit Department's (IA) role, responsibilities and processes for handling and investigating internal or external reported claims, allegations, and accusations of alleged waste, fraud and abuse or serious non-compliances with policies or procedures. The primary responsibilities of IA include to evaluate the reported claim, gather facts, assess the risk and impact to the organization, determine whether IA has the necessary skills and expertise to conduct the necessary investigation, determine the required level of review, and determine the requirement and method for reporting to the appropriate personnel.

This SOP also documents IA's role, responsibilities and processes for handling and conducting, special projects and management requests, including requests by the Audit Committee and the Board of Directors. The primary responsibility of IA is to add value by providing Agency management consulting services, analyses, evaluations, recommendations, and information about the operations under review from an independent and objective perspective. IA will work closely with the requesting management personnel and determine the necessary level of audit work

2. SCOPE


The scope of this SOP covers IA's role and responsibilities in handling claims, allegations, special projects, and management requests.

3. DEFINITIONS

For purposes of this procedure, a **claim, allegation, or reported accusation** can be reported by an employee, Director, the Agency's legal counsel, a contractor or vendor of the Agency or by an external and/or anonymous member or party of the public. A claim, allegation, or accusation is most often related to non-compliance with Agency policies/procedures, misappropriation of assets, falsification of records, bribery, fraud, waste, or abuse for the benefit of an individual(s) or the Agency.

For purposes of this procedure, **special investigations** are an assessment conducted by IA in response to a reported claim. The role of IA during a special investigation is to gather the facts, assess potential risks, determine if the claim has merit to perform an investigation and/or if further investigation or reporting is necessary, and whether the investigation is within the scope of work for IA.

For purposes of this procedure, a **special project or management request** are an assessment, evaluation, analysis, or audit requested by senior management, the Audit Committee and/or the Board of Directors, which was not scheduled through the Board approved Annual Audit Plan. Special projects or management requests are considered short-term projects, where IA determines it has the necessary staff, skills and resources to

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provide assistance without having to delay/defer scheduled audits and priority projects. The scope of each review is determined and agreed upon by and between the requesting department manager and the Manager of the IA and, when deemed appropriate by Executive Management, the Audit Committee and/or the Board. The purpose of a special project or a management request is to add value by providing Agency management with: consulting services, analyses, evaluations, recommendations, and information concerning operations from an independent and objective perspective.

4. SAFETY CONSIDERATION

None

5. PROCEDURE


A. Cataloging/Recording a Claim, Allegation or Request

When a claim or request is reported to any member of IA, the Manager of IA must be notified immediately. The Manager of IA must assess the claim or request and determine the appropriate level of review it will require. The Manager of IA must consider all IA projects, the Board-approved Annual Audit Plan requirements and responsibilities under the IA Charter, to determine the urgency/priority of the claim or request and determine how best to schedule appropriate resources for the required/requested review.

IA personnel will gather additional information as needed through interviews, discussions, or examination of records and determine the need for reporting to senior management and/or the Audit Committee Chair and/or the Agency's legal counsel. If and when the special investigation is outside the scope of work for IA or beyond the expertise of IA, the Manager of IA will determine the appropriate reporting procedure. It may be necessary to report to senior management and/or the Audit Committee Chair, the Board of Directors, and/or the Agency's legal counsel and recommend further investigation by an outside expert, or recommend reporting to appropriate legal authorities. In most cases, it is not the responsibility of IA to report outside of the organization, unless there is an obvious, apparent, severe posed threat, actual abuse or danger.

Depending on the claim/request and the assessment of the required investigation or project, the reporting party/informant of the claim may or may not be involved further in the investigation and may or may not be privy to the final report or outcome of the investigation. The Manager of IA will determine the appropriate method and distribution of the final communication or report.

In the case of a special project or management request, the requesting department manager and/or the respective Executive Manager will be involved during the process of the review/evaluation. A final communication will be provided to the

| | | |
|--|--|-------------------|
|  | Inland Empire Utilities Agency Standard Operating Procedure <u>HANDLING CLAIMS, ALLEGATIONS, SPECIAL INVESTIGATIONS, SPECIAL PROJECTS AND MANAGEMENT REQUESTS</u> | Pg. 5 of 6 |
| | Doc Number: [IA-007] | Rev: [#3] |

requesting manager. The Manager of IA will determine the appropriate method and distribution of the final communication or report.


B. Responsibilities & Reporting

All IA projects, including a special investigations, special projects, or management requests should be treated with the same level of confidentiality, objectivity and professionalism expected during any and all IA projects and as directed under the Board of Directors' approved Internal Audit Department Charter.

In performing any audit project, including special investigations, special projects, or management requests, auditors are required to consistently follow and apply the International Professional Practices Framework (IPPF) issued by the Institute of Internal Auditors (IIA), including the *International Standards for the Professional Practice of Internal Auditing Standards* and the Code of Ethics, and the Board-approved Internal Audit Department Charter and Board-approved Audit Committee Charter. Auditors are expected to apply professional judgment and objectivity at all times, and uphold IA's values: independence, integrity, professionalism, and collaboration.

C. Procedure Review

Overall daily administration, application, and periodic review of this Standard Operating Procedure shall be the responsibility of the Manager of Internal Audit.

| | | | |
|--|--|-----------|------------|
|  | Inland Empire Utilities Agency Standard Operating Procedure <u>HANDLING CLAIMS, ALLEGATIONS, SPECIAL INVESTIGATIONS, SPECIAL PROJECTS AND MANAGEMENT REQUESTS</u> | | Pg. 6 of 6 |
| | Doc Number: [IA-007] | Rev: [#3] | |

6. RESPONSIBILITIES

These procedures must be consistent with the practices prescribed by the IIA *Standards* and the Internal Audit Department Charter and the Audit Committee Charter requirements.

Responsible Party 1, Manager of Internal Audit – The Manager of Internal Audit is responsible for approving the release of audit workpapers.

Responsible Party 2, IEUA General Manager – The IEUA General Manager is responsible for authorizing staff's request for audit workpapers and documentation.

REFERENCES

IIA Standards

Audit Committee

INFORMATION
ITEM
2D



Date: December 20, 2017

To: The Honorable Board of Directors

From: Halla Razak, General Manager

Committee: Audit

12/11/17

Manager Contact: Teresa Velarde, Manager of Internal Audit

Subject: Internal Audit Department Quarterly Status Report

Executive Summary:

The Audit Committee Charter requires that a written status report be prepared and submitted each quarter. The Internal Audit Department Status Report includes a summary of significant internal and external audit activities for the reporting period. During this quarter, Internal Audit staff worked on the following major projects:

- Quality Control Review of the Comprehensive Annual Financial Review
- Payroll Audit Survey
- SCE Follow-Up Review
- Review of the Charters
- Updates to the Standard Operating Procedures
- P-Card Audit
- Other on-going audit projects and requests

IA continues to assist with any requests for audit work, review of Agency policies and procedures and recommendations for internal controls as well as work on routine audit projects as specified in the Annual Audit Plan. The attached report provides details and information.

Staff's Recommendation:

This is an information item for the Board of Directors.
Provide direction for future IA projects and reviews.

Budget Impact Budgeted (Y/N): N Amendment (Y/N): N Amount for Requested Approval:

Account/Project Name:

N/A

Fiscal Impact (explain if not budgeted):

N/A

Prior Board Action:

On March 15, 2017, the Board of Directors reconfirmed the approved Audit Committee and the Internal Audit Department Charter.

On June 21, 2017, the Board of Directors approved the Annual Audit Plan for Fiscal Year 2017/18.

Environmental Determination:

Not Applicable

Business Goal:

The Status Report is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by describing IAs progress in providing independent evaluations and audit services of Agency financial and operational activities and making recommendations for improvement and to assist the Agency in achieving organizational goals.

Attachments:

Attachment 1 - Internal Audit Department Status Report for December 2017

Attachment 2 - Results of Internal Audit's Quality Control Review: Fiscal Year 2017
Comprehensive Annual Financial Report (CAFR)

Attachment 3 - IIA Supplemental Guidance: The Role of Auditing in Public Sector Governance

Internal Audit Department Status Report for December 2017

Projects Completed This Period

Audit: **Quality Control Review of the Comprehensive Annual Financial Report & coordination of the External Financial Audit**

Scope: As required by Fiscal Ordinance and State requirement, an Independent Certified Public Accountant should express an opinion on the fair presentation of the financial statements

Status: **Complete**

Lance, Soll & Lunghard, LLP (LSL), the Agency's external audit firm, completed final field work in September/October and began reviewed the financial statements and the CAFR documents. IA coordinates with both Finance and Accounting and the External Auditors to review the financial statements and the Comprehensive Annual Financial Report. The role of IA is one of an added quality control check to check and double check totals, transfer of information and presentation. IA also reviews the requirements of the GFOA for the annual award.

IA's review includes a review of the trial balances for each fund, the individual fund statements, the consolidated financial statements, Management's Discussion and Analysis (MD&A), the Introductory Section, the Financial Statements and Notes, and the Statistical & Supplementary sections of the CAFR. IA applied the following procedures to conduct the quality control review of the CAFR:

- Reviewed for math accuracy and consistency in the referencing of dollar amounts and totals among the narratives, notes and statements, and for overall professional presentation.
- Verified that the FY 2017 amounts and totals on the financial statements were transferred accurately from the FY 2017 Trial Balance.
- Verified that the FY 2016 amounts/totals for all financial statements were transferred accurately from the FY 2016 published CAFR to the FY 2017 CAFR.
- Recalculated for mathematical accuracy the FY 2017 totals on all financial statements.
- Checked titles and years to ensure updates were made for the years they correspond to.
- Reviewed narratives for completeness, spelling and grammatical accuracy.

Additionally, IA reviewed the required bond disclosures for the outstanding bonds owed by IEUA. IA's review was based on the Appendix D information on Continuing Disclosures for the 2010A and 2017A Revenue Bonds and the 2014 consultant's report from "Applied Best Practices". IAs review including verifying that the information was inclusive within the CAFR. IA did not perform a complete review of the various bond documents to determine the completeness of the required disclosures provided. Additionally, IA reviewed the IEUA prepared Supplemental Disclosure filing dated January 12, 2017.

IA provided comments and recommendations to the Finance and Accounting department when items were identified for their review. Various CAFR drafts are circulated and updated to ensure the final project has all required information. The compilation of the CAFR is an Agency-wide team effort.

Internal Audit's full report, with details of the CAFR review is included as an attachment.

Project: **Audit Committee and Internal Audit Department Charter Updates**

Scope:
Review IAD Charter and Audit Committee Charter and make updates according to changes proposed by best practices and professional guidance.

Status: **Complete**

The purpose of the Audit Committee and the Internal Department Charters is to document the purpose, authority and responsibilities of each. The role of the IAD is to further ensure that the responsibilities of the

Internal Audit Department Status Report for December 2017

Audit Committee are fulfilled. According to best practices, the authority of the IAD must be documented in a Charter to ensure the role of the department is aligned in a way to provide independent assurance and assistance to the Board and Executive Management in ensuring organizational goals are achieved. Best practices and both Charters require that annually, IA completes a review of the Charters and makes necessary edits. No changes are proposed at this time. IA requests feedback from the Audit Committee and if any changes in the IAD scope of work, responsibilities and authority is requested, the changes will be made and the charters will be brought back for additional discussion, review and/or approval.

Project: Payroll Audit Survey

Scope:

To gather information on how other similar agencies have incorporated additional controls, similar to those recently provided in audit recommendations to the Human Resources and the Finance and Accounting Departments as they relate to safeguarding records and automating processes

Status: Complete

In September, IA finalized the Payroll Operations Audit and identified opportunities to strengthen the internal controls and effectiveness of payroll operations. Payroll operations fall under both the Human Resources and Finance and Accounting departments. The purpose of the initial audit was to evaluate internal controls and ensure all payroll processes were consistent with Agency policies and procedures and all payments and benefits were approved. During the audit, IA identified areas that could strengthen controls.

As a follow up procedure to the original audit, IA surveyed nine comparable agencies to gather "best practices" in the industry related to internal controls, security of assets and information, paperless environment and disaster preparedness. The results of the survey are provided under separate cover and detailed surveys are held with audit workpaper files and available upon request from the Manager of Internal Audit. The purpose of the survey was to provide HR and Finance with additional information and tools related to the audit recommendations provided in the original report. IA determines that the original recommendations stand and will plan follow up work through the approved Annual Audit Plan.

Project: Southern California Edison (SCE) Utility Payments Follow-Up Audit

Scope:

IA completed a follow-up evaluation to determine the status of the three outstanding recommendations provided in the SCE Utility Payments Follow-Up audit, dated August 29, 2013.

Status: Complete

Two of the three recommendations are fully implemented. The recommendations related to segregation of duties and role assignment within SAP. The two recommendations have been cleared through recent staff retirements; therefore, the segregation of duties conflict has been eliminated and the recommendations are no longer applicable.

The remaining recommendation relates to a SCE charge of approximately \$900/year for monthly street lighting that is technically under the jurisdiction of the City of Chino. During the original audit, August 2013, staff was working with City of Chino to transfer the account billing. At the time, the City was in the process of taking the item for City Council approval. As of the date of this follow up review, the charges are still received and paid for by IEUA. Planning & Environmental Resources staff is revisiting the item to determine if it is of material nature to continue to pursue the request for the transfer of such fees. IA plans to report on this outstanding recommendation in a separate report in March 2018.

Internal Audit Department Status Report for December 2017

Project: **Contract Extension for Audit Committee Advisor/External Financial Expert**

Scope:

Coordinate the contract extension with Rogers, Anderson, Malody & Scott, LLP for a one-year consultant agreement for Mr. Travis Hickey, CPA to serve as the Audit Committee's Financial Expert. The Audit Committee Charter, states that: "The Audit Committee shall also have access to at least one financial expert, an outside party, with no voting rights, who will provide advisory and consulting duties and shall be compensated as agreed upon, in writing with the Audit Committee, the Board, management and its designees." Additionally, the Audit Committee Charter requires the financial expert to possess expertise and experience in understanding generally accepted accounting principles and financial statements; auditing comparable entities; internal controls; and an understanding of audit committee functions.

Status: **Complete**

During the March 2017 Audit Committee Meeting the committee members discussed that the services of the External Financial Expert were consistent with best practices and considered a value to the Agency. The Audit Committee Members provided direction to extend the consulting agreement for an additional calendar year. This is the last single year extension allowable under the Agency's Procurement Ordinance. The Contract falls within the approval authority of the General Manager for \$6,190 and extend the contract services through December 2018. This item is submitted as a separate Information Item in this Agenda.

Projects In-Progress/On-going

Project: **Procurement Cards (P-cards) Audit**

Scope:

To evaluate the effectiveness of internal controls over the P-card program, and to ensure compliance with Procurement Ordinance Number 101, Agency Policy A-89 (Procurement Card Program), department Standard Operating Procedures, and procurement processes. Additionally, to determine opportunities to improve administration of the program. The purpose is to evaluate to determine if purchases comply with the governing policies and procedures, do not circumvent approved procurement programs, and are for Agency related business.

IAs review includes P-Card activity for a 22-month period, January 2016 through October 2017, (the effective date of the most current Agency P-Card Policy as of January 26, 2016 through most current date available at the time we began the audit). Approximately 1,500 P-Card transactions totaling \$475,000 were processed during the 22-month period to procure goods and services by approximately 19 P-Card users.

Status: **IN PROGRESS** - Anticipated completion date: March 2018.

IA met with Finance and Accounting (FAD) and Contracts and Procurement (CAP) in late September 2017. IA has been flexible with both departments as they have recently experienced staff shortages and other priority projects. In November 2017, IA received from both departments the initial Internal Control Questionnaire (ICQ) requested during the initial meeting. The questionnaire contained less than 12 basic questions about the existing processes for each department, there was no requirement to pull any new information or reports. The ICQ provides to the auditors information about how the P-card program is currently administered and the control procedures employed; it is essential for the auditors to understand the program and it provides a starting point for auditors to develop the audit procedures. The purpose of the review is to test that the current Agency practice meets Agency approved policies. Fieldwork is on-going and includes various analysis of financial transactions, and review the supporting documentation. IA has access to US Bank's electronic database of financial transactions. IA will continue to work closely with the P-Card administrator and both CAP and Accounting through the audit process, any items requiring attention will be discussed with the departments before finalizing the audit tests. Once all fieldwork is complete, a report will be documented and submitted through the Audit Committee under separate cover.

Internal Audit Department Status Report for December 2017

Planned/Future/Additional Projects

Project: **Wire Transfers Audit**

Scope:

To evaluate the Agency's Wire Transfer processes and determine if adequate internal controls are in place to ensure the wire transfers are processed according to Agency policies and to ensure all transactions are adequately approved and are for legitimate Agency business. To determine if adequate controls are in place to mitigate potential risks related to electronic payments/transactions.

Status: Planned for beginning in mid-January 2018

IA will work closely with the Finance and Accounting Department. IA has prepared an Internal Control Questionnaire (ICQ) to discuss at the kick-off meeting, the ICQ provides important basic information about the processes and procedures of the activity. IA relies on the ICQ to flowchart the activity under review and initially highlight audit areas. This also provides a good tool to begin discussions about the processes/steps that are currently working or not working or are planned for changes. This will be followed by walk-throughs of the process to evaluate any potential risks. After flow-charting the process, sample transactions will be selected and tested to evaluate the effectiveness of the Agency's controls. Any recommendations resulting from these audit procedures will be included in a final report and discussed with the respective department(s) and submitted under separate cover through the Audit Committee.

Project: **Follow-Up Audits & Outstanding Recommendations**

Status: **On-going Monitoring**

Scope:

The Internal Audit Department Charter requires Internal Audit (IA) to follow-up on the status of outstanding recommendations to determine if corrective actions have been taken. The follow-up reviews are scheduled through the Board-approved Annual Audit Plan. Executive Management supports the implementation efforts of the recommendations previously provided and/or the development of alternative controls to address the original risks identified.

The table below provides the number of recommendations outstanding as of this Status Report. Additional details related to each of the outstanding recommendations is submitted with the Annual Audit Plan in June each year. This summary is to provide an update on the current status of the follow up audits and the related outstanding recommendations. This summary includes new recommendations provided during this calendar year as well as considers any recommendations cleared during the year. Follow up reviews are part of the on-going monitoring activities IA performs according to the requirements of the IAD Charter. Follow up review is typically scheduled between 12 – 18 months from the date of the original audit, to allow time for full implementation. If a recommendation is deemed to be not implemented, the recommendation continues to stand or alternate controls to mitigate any risks are evaluated to determine if the risk has been addressed and the recommendation is longer applicable. Follow up review is also scheduled if requested sooner by the Audit Committee or Executive Management. The audited business units are encouraged to submit for IA review, additional information if they determine the recommendation has been satisfied.

**Internal Audit Department
Status Report for December 2017**

| Area Audited | Report Issued Date | No. of Recs. Remaining to be Verified by IA | Planned Follow-Up |
|--|--------------------|---|--|
| Payroll Audit | August 24, 2010 | 1 | Annually |
| Intercompany Receivables - Watermaster | August 30, 2011 | 1 | FY2018 |
| SCE Utility Payments | August 28, 2013 | 1 | FY2018 |
| Accounts Payable Follow-Up | August 29, 2013 | 9 | FY2018 |
| Automobile Insurance Requirements | March 3, 2014 | 2 | FY2018 |
| Vehicle Security Procedures | March 3, 2014 | 3 | FY2018 |
| Vehicle Inventory Procedures | March 12, 2014 | 13 | FY2018 |
| Follow-Up – IT Equipment Audit – ISS | February 29, 2016 | 2 | FY2019 |
| Master Trade Contracts | September 1, 2016 | 6 | FY2019 |
| Follow-Up – IT Equipment Audit – FAD | December 5, 2016 | 6 | FY2019 |
| Audit of Master Services Contracts | December 5, 2016 | 3 | FY2019 |
| 2017 Petty Cash Audit & Follow-Up Review | June 5, 2017 | 7 | FY2020 |
| Water Use Efficiency Programs Audit | June 5, 2017 | 6 | FY2020 |
| Contracts and Procurement Follow-Up Audit | August 30, 2017 | 1 | FY2020 |
| Payroll Operations Audit | August 30, 2017 | 6 | FY2020 |
| Total Outstanding Audit Recommendations | | 67 | |
| Recommendations related to the Regional Contract Review (these recommendations are planned for full implementation with the renegotiation of the Regional Contract IA will not follow up on these items until the renegotiation has been finalized) | | | |
| Regional Contract Review – Final Audit Report | December 16, 2015 | 31 | Pending – Renegotiation of the Regional Contract |

On-going Projects

Project: Management Requests

Scope:

Assist Agency Management with requests for analysis, evaluations and verification of information, assist with the interpretation of policies and procedures, and/or provide review and feedback on new policies or procedures. These services are provided according to the IA Charter, the Annual Audit Plan, and best practices. The management request projects are short-term projects, typically lasting no more than 60 – 75 hours each where IAD determines it has the necessary staff, skills and resources to provide assistance without having to delay/defer scheduled audits and priority projects. The scope of each review is agreed upon between the department manager requesting the evaluation/review/analysis/assistance and the Manager of IA and when deemed appropriate by Executive Management.

During this quarter, IA was working on the following “Management Requests”:

- Work with Finance and Accounting, the Audit Committee Advisor and the External Auditor with various, non-routine items during the Quality Control Review of the CAFR. Including additional work related to the Disclosure Requirements and information related to the Bond Refinancing and closing journal entries.
 - Assisted meetings and the review of documents related to the Bond Refinancing
 - Participate in IT Security Committee
 - Participate in the Safety Committee
 - Participate in Meetings related to the Network Security/Vulnerability Assessment
 - Reviewed and provided feedback for the Board of Directors Handbook
-

Internal Audit Department Status Report for December 2017

Project: Special Projects

Scope:

Perform special reviews and projects including analyzing transactions, evaluating documents and policies, verifying information, assisting with interpretation of Agency Policies or other required procedures, and providing recommendations and feedback on results of the analysis, engaging necessary assistance if and when necessary, reporting to the General Manager and the Audit Committee. These services are provided according to the IA and Audit Committee Charters, the Annual Audit Plan, and/or best practices.

Special Projects can be short or long-term projects, typically requiring more than 80 hours of staff time and typically requiring setting aside or delaying work on scheduled audit projects. The scope of the review is not typically known and the work must be handled with the highest degree of confidentiality and care, typical of all audit projects. Typically, Special Projects are considered highly confidential.

During this quarter, IA participated in Special Projects and appropriate reports have been made to Executive Management and the Audit Committee.

Additional Discussion Item for the Audit Committee:

Lance Soll Lunghard (LSL) External Auditor Contract

LSL has completed the second year of a three-year contract to perform annual financial audit services of the Agency's financial statements. As part of keeping the Audit Committee informed about the Agency's External Auditor, the following recent information about the firm and the services provided to the Agency is presented below:

During the current fiscal year, IA and Finance & Accounting staff noted press reports about LSL. The firm was responsible for the financial audit of the City of Placentia. That City's former Finance Services Manager was convicted of embezzlement and misappropriation of \$5.16 million. LSL agreed to remit \$500,000 to Placentia in connection with the case. LSL stated that the Placentia fraud was uncovered after their first year as auditors and their request for additional information may have been the trigger for the exposure of the fraud. Audit guidance emphasizes that External Auditors provide an opinion on the fairness of the financial statements taken as a whole, and they do not assume responsibility for detecting fraud.

We would like to give LSL an opportunity to discuss the reason for the settlement payment from LSL to the City of Placentia and/or answer any questions you may have.

Current Trends in Internal Audit

Recently taken from the Association of Local Government Auditor, [The Role of Auditing in Public Sector Governance](#), published by the IIA, this booklet is aimed at public officials and advocates of good governance. It describes the contributions that audit functions can make to government operations; and lists the nine key elements needed for a Public Sector audit function to be effective.

The publication is also attached for your review. The link to view the guide is here:

https://na.theiia.org/standards-guidance/Public%20Documents/Public_Sector_Governance1_1_.pdf

Internal Audit Department Status Report for December 2017

Internal Audit Department

Internal Audit Department Staffing:

The Internal Audit Department is staffed as follows:

- 1 Full-time Manager of Internal Audit
- 2 Full-time Senior Internal Auditors

Internal Audit Staff Professional Development Activities:

As required by the *International Standards for the Professional Practice of Internal Auditing*, auditors should continue to enhance their knowledge, skills, and other competencies through continuing professional development.

The Internal Audit Manager is a member of the governing board of the Inland Empire Chapter of the Institute of Internal Auditors (IIA). The governing board sets direction for the chapter.

During the past quarter, IA staff has continued to stay abreast of industry developments through review of industry periodicals and participation in free IIA sponsored, on-line webinars. Staff also attended a Fraud Seminar with the local IIA Chapter in San Gabriel. Trainings attended this quarter include: Communication Tools for Internal Auditors, Fraud Awareness, Sales Tax training, LA County Auditor Controller's Division Chief provided a 2-hour webinar on "Leading Change: Reinventing Internal Audit to be Faster, Cheaper and Better."

All three IA members are preparing for the third exam of the 3-part Certified Internal Auditor (CIA) certification examination. The CIA is the only globally-recognized certification for internal audit professionals and is the highest certification that can be attained by an internal auditor.


In July, the Manager of IA passed the examination for the Certified Government Auditor Professional designation and was certified by the IIA as a CGAP. The Certified Government Auditing Professional® (CGAP®) certification program is designed for auditors working in the public sector and demonstrates government knowledge and expertise. The Manager of IA also has a Master's degree in Public Administration. One Senior Auditor is a Certified Public Accountant (CPA). One Senior Auditor is a Certified Government Audit Professional (CGAP).

Future Audit Committee Meetings:

- Monday, March 12, 2018 – Regularly Scheduled Audit Committee Meeting
- Monday, June 11, 2018 – Regularly Scheduled Audit Committee Meeting
- Monday, September 10, 2018 – Regularly Scheduled Audit Committee Meeting

Date: November 28, 2017

To: Christina Valencia, CFO/AGM
Javier Chagoyen-Lazaro, Manager of Finance and Accounting
Suresh Malkani, Principal Accountant



From: Teresa V. Velarde, Manager of Internal Audit
Peter Soelter, Senior Internal Auditor
Sapna Nangia, Senior Internal Auditor

Subject: Results of Internal Audit's Quality Control Review:
Fiscal Year 2017 Comprehensive Annual Financial Report (CAFR)

Annually, the Internal Audit Department (IA) performs a quality control review of the Agency's Comprehensive Annual Financial Report (CAFR) prepared by the Finance and Accounting Department (FAD). IA's review is performed on a "working draft" of the CAFR as FAD continues to finalize the information presented in the financial statements and the various sections of the CAFR. For the FY 2017 CAFR, IA completed the initial review prior to the December 11, Audit Committee Meeting and provided comments, edits and recommendations to FAD for consideration prior to finalizing the CAFR. This memo documents IA's quality control review and provides a general summary of the results.

IA's review includes a review of the trial balances for each fund, the individual fund statements, the consolidated financial statements, Management's Discussion and Analysis (MD&A), the Introductory Section, the Financial Statements and Notes, and the Statistical & Supplementary sections of the CAFR. IA applied the following procedures to conduct the quality control review of the CAFR:

- Reviewed for math accuracy and consistency in the referencing of dollar amounts and totals among the narratives, notes and statements, and for overall professional presentation.
- Verified that the FY 2017 amounts and totals on the financial statements were transferred accurately from the FY 2017 Trial Balance.
- Verified that the FY 2016 amounts/totals for all financial statements were transferred accurately from the FY 2016 published CAFR to the FY 2017 CAFR.
- Recalculated for mathematical accuracy the FY 2017 totals on all financial statements.
- Checked titles and years to ensure updates were made for the years they correspond to.
- Reviewed narratives for completeness, spelling and grammatical accuracy.

Additionally, IA reviewed the required bond disclosures for the outstanding bonds owed by IEUA. IA's review was based on the Appendix D information on Continuing Disclosures for the 2010A and 2017A Revenue Bonds and the 2014 consultant's report from "Applied Best Practices". IA's review included reviewing that the requirements were inclusive within the CAFR document. IA did not perform a complete review of the various bond documents to determine the completeness of the required disclosures provided. Additionally, IA reviewed the IEUA prepared Supplemental Disclosure filing dated January 12, 2017.

IA also reviewed comments made by the Government Finance Officers Association (GFOA) on the prior year (FY 2016) CAFR to determine whether those comments had been addressed in the current year (FY 2017) CAFR.

Criteria and Observations

IA did not perform any tests of financial transactions, nor audit the accounts or any financial information and did not assess the reliability or accuracy of the information reported in the financial statements. The Agency relies on the professional work of the External Auditors, Lance, Soll and Lunghard, LLP (LSL), who are the Agency's Certified Public Accountants, contracted to provide reasonable assurance that the financial statements are free of material misstatement. The External Auditors and IA rely on Agency's management for the completeness and reliability of the information presented in the CAFR. Consistent with the requirements of the IA Charter and the Audit Committee Charter requirements, IA's review is intended to provide an additional level of quality control.

During IA's quality control review, observations noted were promptly communicated to FAD staff for appropriate corrective action. IA did not verify that all comments/recommendations were addressed or incorporated because FAD continues to finalize the CAFR. Below is a list of observations IA considers most significant requiring attention prior to finalizing and publishing the CAFR (details have been provided to FAD under separate correspondence, additional copies can be requested from IA):

- Noted instances where 2016 amounts were not carried over from the 2016 CAFR to the 2017 CAFR within the financials and the narratives, including differences in rounding between last year and the current year.
- Noted rounding differences between and among the schedules and in the narratives; rounding should be consistent throughout the documents.
- Noted some presentation differences in the financial statements compared to the prior year.
- Provided edits, made various comments and recommendations to all sections.
- Noted instances where there were differences in amounts between different sections of the CAFR, for example among the schedules.
- Noted some mathematical errors, including percentage calculations.

- Noted that the CAFR documents are reviewed by multiple parties at multiple stages of completion and that there is no formal structure to capture which comments came from which parties and how they were resolved. FAD may want to create a formal structure and deadlines to ensure accurate and complete disposition of all comments, suggestions and edits.

Statistical Section

IA noted there are some pages with information presented with little or no reference/background as to the details of the data or description of the calculations performed. Reference information and citations would be beneficial and helpful to readers.

Prior Period Adjustments

The current year CAFR does not include any prior period adjustments. Discussions with FAD disclosed that prior concerns about the reclassification of project costs between capital and operations had resulted in discovering only an immaterial correction of approximately \$274,000 in the current fiscal year. This amount was adjusted by FAD through the current year's schedule of Revenues, Expenses, and Changes in Net Position.

IA appreciates the progress and efforts that FAD has made in reducing or eliminating the need for prior period adjustments. IA had previously commented on this issue in the 2016 CAFR Quality Control Review report and in the June 2017 Water Use Efficiencies audit report. Additionally, in 2015 the Agency's prior External Auditors, White Nelson Diehl Evans had identified this issue as a significant deficiency over financial reporting.

IA looks forward to continued progress in identifying and appropriately classifying project costs between capital and operations and suggests that FAD consider a mid-year review of the Construction-In-Progress accounts to address the concern early in the 2017-18 fiscal year.

Bond Disclosure Compliance Review

IA performed several steps to consider the Agency's Bond Continuing Disclosure requirements:

1. Compared the disclosure requirements in the Official Statements for all Bonds that had outstanding balances at the end of the fiscal year and prepared a comparative schedule of existing disclosures in the Official Statements.
2. Reviewed the IA findings from the prior year.
3. Reviewed the findings in the Continuing Disclosure Compliance Report issued October 24, 2014 prepared by consultants, Applied Best Practices.
4. Reviewed the "Supplement to Inland Empire Utilities Agency Comprehensive Annual Financial Reports for Fiscal Years 2011, 2012, 2013, 2014, 2015 and 2016 dated January 12, 2017

IA's review noted:

1. Continuing Disclosure Requirements described in Official Statements:
 - a. 2008B Variable Rate Bonds are exempt from Continuing Disclosure requirements.

- b. 2010A Revenue Bonds: Continuing Disclosures are described in Appendix D of the Official Statement.
- c. 2017A Revenue Bonds: Continuing Disclosures are described in Appendix D of the Official Statement.

IA noted the Continuing Disclosures required by 2010A and 2017A Revenue Bonds are substantially similar.

2. Inland Empire Utilities Agency Disclosure Procedures: The 2017A Revenue Bonds Official Statement includes a description about "Disclosure Policies and Procedures":

"The Board adopted an update to the Disclosures Policies and Procedures on December 21, 2016 entitled "Inland Empire Utilities Agency Policy for Disclosure Procedures" (the "Policy for Disclosure Procedures"). A copy of the updated Policy for Disclosure Procedures has been provided to the Underwriter and is available from the Chief Financial Officer of the Agency at . . . "

IA did not find this Policy included in the Agency's policies listing on the Agency's internal website. IA also did not find the Policy approved as a separate action item at the December 21, 2016 Board meeting and did not find it in the Official Statement for the 2017A Bonds. If the Policy has not already been presented to and approved by the IEUA Board, IA suggests that the Agency complete this process.

3. Applied Best Practices consulting report: The only remaining Bonds evaluated in this consultant's report are the 2010A Revenue Bonds. All other Bonds with Continuing Disclosure requirements that were evaluated by this consultant have been retired. The consultant's findings for the 2010A Revenue Bonds were:
- a. Balance in the Debt Service Reserve Fund and a statement of the reserve requirement: *No Debt Service Reserve Fund Requirement.*
 - b. Inland Empire Utilities Agency, Non-Reclaimable Water System Rates and charges set forth on page 28 of the Official Statement under the caption "THE AGENCY" – Non-Reclaimable Water System-Non-Reclaimable Water System Rates and Charges: *Annual Report did not disclose Non-Reclaimable Water System Rates and Charges in the form provided in the Official Statement, dated June 30, 2010.*
4. The "Supplement to Inland Empire Utilities Agency Comprehensive Annual Financial Reports for Fiscal Years 2011, 2012, 2013, 2014, 2015 and 2016 dated January 12, 2017: This Supplement was filed in advance of the 2017A Bond refinancing. It provides additional information about:
- a. Debt Service Reserve Fund Balances and Reserve Requirements for the 2005A and 2008A Bonds that are now retired.
 - b. Non-Reclaimable Water System Rates and Charges in the form provided in the Official Statement for the 2010A Bonds, dated June 30, 2010.

IA notes that Supplement dated January 12, 2017 provides the most comprehensive assessment by the Agency of Continuing Disclosures missing from the Annual CAFR. IA recommends that this Supplement be used as the basis for additional Continuing Disclosures to be added to the 2017 CAFR.

Government Finance Officers Association (GFOA) comments

The GFOA provided only one comment on the FY 2016 CAFR:

Page 46 - Disclose that donated capital assets are reported at acquisition value.

Modify the note disclosure to indicate that donated capital assets, donated works of art and similar items, and capital assets received in a service concession arrangement should be reported at acquisition value rather than fair value. [GASB-S72: 79; Q&A Update 4.54]

The comment refers to the highlighted sentence in the Notes to the 2016 Financial Statements:

Capital Assets (continued):

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset useful lives are not capitalized. Improvements are capitalized and depreciated, as applicable, over the remaining useful life of the related capital assets. Donated capital assets are recorded at estimated fair market value at the date of donation.

The draft Notes to the 2017 Financial Statements reviewed by IA showed revised wording for the current year:

Capital Assets (continued):

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset useful lives are not capitalized. Improvements are capitalized and depreciated as applicable over the remaining useful life of the related capital assets. Donated capital assets, donated works of art and similar items, and capital assets in a service concession arrangement are recorded at acquisition value.

IA notes that the revised wording addresses the GFOA comment.

IA Recommendations

1. IEUA should consider performing a mid-year review of the Construction-In-Progress accounts to eliminate the possibility of a 2017-2018 prior period adjustment early in the 2017-18 fiscal year.
2. IEUA should formally adopt the "Inland Empire Utilities Agency Policy for Disclosure Procedures" (the "Policy for Disclosure Procedures") described in the 2017A Revenue Bonds Official Statement.
3. IEUA should use the information in the Supplement dated January 12, 2017 as the basis for including additional disclosures in the 2017 CAFR.
4. Finance and Accounting staff should prepare/maintain documentation about the disposition of all comments, suggestions and edits proposed by the various reviewers (Internal Audit,

LSL, etc) of the draft CAFR and consider creating a formal structure and deadlines for departments/entities involved in the review of the documents.

Conclusion

IA appreciates the opportunity to provide the quality control review of the draft FY 2017 CAFR and looks forward to the final version of the FY 2017 CAFR that will be presented for Board of Directors' approval on December 20, 2017. IA appreciates staff's cooperation during this review.

IA looks forward to receiving the final CAFR documents for IA's regulatory filing purposes.

Please contact any member of the Internal Audit Department if you have questions.

Supplemental Guidance:
**THE ROLE OF AUDITING IN
PUBLIC SECTOR GOVERNANCE**

2nd Edition

Release Date: Jan. 2012



The Institute of
Internal Auditors

Global

Supplemental Guidance: The Role of Auditing in Public Sector Governance

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Executive Summary

This second edition of “The Role of Auditing in Public Sector Governance” came about as a result of the extraordinary demand for guidance related to auditing in the public sector. Just as the first edition did, this edition presents information on the importance of the public sector audit activity to effective governance and defines the key elements needed to maximize the value the audit activity provides to all levels of the public sector. The guidance is intended to point to the roles of audit (without differentiating between external and internal), methods by which those roles can be fulfilled, and the essential ingredients necessary to support an effective audit function. As such, it may not be fully applicable in every jurisdiction, particularly where public sector audit roles and responsibilities are specifically defined by governing institutes or legal mandates to exclude certain functions or assign them to other entities.

Introduction

This guidance presents the importance of the public sector audit activity to effective governance and defines the key elements needed to maximize the value the public sector audit activity provides to all levels of the public sector. The principles discussed are relevant to national, regional (i.e., state or provincial), and local (i.e., county, city, or village) governments, as well as quasi-governmental and international government organizations. They also may apply to other publicly funded entities. In this guidance, all of these entities will be referred to as public sector organizations or entities.

This guide is addressed primarily to elected and appointed public sector officials, as well as all advocates of good government. Its purpose is to encourage readers to reflect on the public sector audit activities that now serve their jurisdictions and evaluate how those audit activities can be supported to fulfill their highest role in the governance of public sector entities most effectively. In those jurisdictions where a public sector audit activity is needed, this guidance can provide the initial direction for decision-makers on the outcomes and services they should expect and the elements that are needed to establish an effective audit activity.

Detailed guidance on the standards and other tools for creating and improving public sector audit services are available from The Institute of Internal Auditors (IIA).

Internal and External Auditing in a Public Sector Context

This guidance addresses the role of public sector auditing, including both internal and external public sector auditing. Myriad public sector audit activities and reporting relationships exist among different jurisdictions and in different forms of government. The key point, however, is that public sector audit activities must be configured appropriately to enable public sector entities to fulfill their duty to be accountable and transparent to the public while achieving their objectives effectively, efficiently, economically, and ethically.

Public Sector Governance

Governance is defined as the combination of processes and structures implemented by the board to inform, direct, manage, and monitor the organization's activities toward the achievement of its objectives. In the public sector, governance relates to the means by which goals are established and accomplished. It also includes activities that ensure a public sector entity's credibility, establish equitable provision of services, and assure appropriate behavior of government officials — reducing the risk of public corruption.

The Role of Public Sector Auditing

Auditing is a cornerstone of good public sector governance. By providing unbiased, objective assessments of whether public resources are managed responsibly and effectively to achieve intended results, auditors help public sector organizations achieve accountability and integrity, improve operations, and instill confidence among citizens and stakeholders. The public sector auditor's role supports the governance responsibilities of oversight, insight, and foresight. Oversight addresses whether public sector entities are doing what they are supposed to do and serves to detect and deter public corruption. Insight assists decision-makers by providing an independent assessment of public sector programs, policies, operations, and results. Foresight identifies trends and emerging challenges. Auditors use tools such as financial audits, performance audits, investigations, and advisory services to fulfill each of these roles.

Key Elements of an Effective Public Sector Audit Activity

An effective public sector audit activity strengthens governance by materially increasing citizens' ability to hold their public sector entity accountable. Auditors perform an especially important function in those aspects of governance that are crucial for promoting credibility, equity, and appropriate behavior of public sector officials, while reducing

the risk of public corruption. Therefore, it is crucial that audit activities are configured appropriately and have a broad mandate to achieve these objectives. The audit activity must be empowered to act with integrity and produce reliable services, although the specific means by which auditors achieve these goals vary. At a minimum, public sector audit activities need:

Organizational independence. Organizational independence allows the audit activity to conduct work without interference by the entity under audit. The audit activity should have sufficient independence from those it is required to audit so that it can both conduct and be perceived to conduct its work without interference. Coupled with objectivity, organizational independence contributes to the accuracy of the auditors' work and the ability to rely on reported results. Independence is greatly impacted by how a chief audit executive¹(CAE) is appointed and can be terminated. The *International Professional Practices Framework* (IPPF) Practice Advisory 1110-1 states that “the CAE, reporting functionally to the board and administratively to the organization’s chief executive officer, facilitates organizational independence.” Important parts of this independence are the CAE’s ability to be protected from management or political interference or retaliation resulting from carrying out legitimate duties in accordance with the Standards. The CAE also should be free to staff the audit activity without interference from management or undue political influence from public officials.

A formal mandate. The audit activity’s powers and duties should be established by the public sector’s constitution, charter, or other basic legal document. Among other topics, this document would address procedures and requirements of reporting and the obligation of the audited entity to collaborate with the auditor.

Unrestricted access. Audits should be conducted with complete and unrestricted access to employees, property, and records as appropriate for the performance of audit activities.

¹ Chief audit executive (CAE) describes a person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the Definition of Internal Auditing, the Code of Ethics, and The IIA’s *International Standards for the Professional Practice of Internal Auditing* (Standards). Different terminology may be used for the senior person responsible for managing an external audit activity. The term CAE will be used in this publication. However, the concepts generally apply to both internal and external audit activities.

Sufficient funding. The audit activity must have sufficient funding relative to the size of its audit responsibilities. This important element should not be left under the control of the organization being audited because the budget impacts the audit activity's capacity to perform its responsibilities.

Competent leadership. The head of the audit activity must be able to independently and effectively recruit, retain, and manage highly skilled staff without undue managerial or political influence. The leader should be knowledgeable of applicable audit standards, professionally qualified — preferably certified — and competent to oversee and manage an audit function. Moreover, the CAE should be an articulate public spokesperson for the audit activity.

Objective staff. An audit activity's staff must be objective. Audit staff must have impartial attitudes and avoid any conflict of interest. Conflict of interest is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest. A conflict of interest may exist even if no unethical or inappropriate act results. Such a conflict can create an appearance of impropriety that can undermine confidence in the internal auditor, the internal audit activity, and the profession. Moreover, a conflict of interest could impair an individual's ability to perform audit duties and responsibilities objectively.

Competent staff. The audit activity needs a professional staff that collectively has the necessary qualifications and competence to conduct the full range of audits required by its mandate. Auditors must comply with minimum continuing education requirements established by their relevant professional organizations and standards.

Stakeholder support. The legitimacy of the audit activity and its mission should be understood and supported by a broad range of elected and appointed public sector officials, as well as by the media and involved citizens.

Professional audit standards. Professional audit standards, such as the *International Professional Practices Framework* (IPPF) promulgated by The Institute of Internal Auditors, support the implementation of the previous elements and provide a framework to promote quality audit work that is systematic, objective, and based on evidence. Just as many public sector entities have adopted internal control standards — either as requirements or guidance for

public sector managers — audit activities should conduct their work in accordance with recognized standards.

The discussion on the following pages details key public sector governance principles and describes the services and contributions that governments can derive from their audit activities. We invite readers to consider these elements in evaluating current or planned audit activities, to determine whether they are positioned to achieve their objectives of public accountability and service improvement.

KEY POINTS

RECOMMENDATIONS

To protect the public interest, every public sector entity requires independent audit activities providing a range of assurance and advisory services — from financial attestation to performance and operational efficiency — whether through the use of internal or external audit services or a combination of the two. The public sector audit activity's mandate should be as broad as possible to enable it to respond to the full scope of the entity's activities.

Although the means to accomplish them will vary, all public sector audit activities require:

- Organizational independence.
- A formal mandate.
- Unrestricted access.
- Sufficient funding.
- Competent leadership.
- Objective staff.
- Competent staff.
- Stakeholder support.
- Professional audit standards.

The public sector entity must establish protections to ensure that audit activities are empowered to report significant issues to appropriate oversight authorities. One means of accomplishing this protection is through creation of an independent audit committee.

To preserve independence, public sector auditors' advisory services should never assume a management role. Moreover, auditors must maintain independence and objectivity for any subsequent audits conducted where advisory services have been provided previously.

Public Sector Governance

Public sector auditors play an important role in effective public sector governance. The term governance refers to how an organization makes and implements decisions — “the processes by which organizations are directed, controlled, and held to account.” Because public sector entities throughout the world are structured differently — with different and possibly overlapping mandates and jurisdictions — no single governance model applies to all of them. Nevertheless, certain governance principles are common across the public sector. Common principles of corporate governance encompass the policies, processes, and structures used by an organization to direct and control its activities, to achieve its objectives, and to protect the interests of its diverse stakeholder groups ethically.

Principles of Governance

The following basic governance principles are described in terms applicable to the public sector.

Setting direction. Good governance establishes policies to guide an organization’s actions. In the public sector, policy may be directed through broad national goals, strategic plans, performance goals, legislative guidance, designated oversight organizations, or legislative oversight committees. A public sector entity’s policies — or at least its priorities — can generally be found in its strategic plan, operational plan, or budget, which allocates limited resources to specific activities.

“The conventional wisdom is that government cannot be effective in the absence of public trust. Government auditors play a central role in fostering such trust, and have even been referred to as the guardians of public trust. Without them, citizens would lack credible insight into the soundness of the many inner workings of government.”

Richard Chambers
IIA President and CEO
2011

Instilling ethics. Good governance includes clearly articulated ethical values, objectives, and strategies; appropriate tone at the top; and internal control. It should align policies and procedures to encourage employee and public official behavior that is consistent with the public sector organization’s ethics and values. An important element necessary to achieve behavior that is consistent

with good ethics is setting and enforcing clear lines of accountability that hold people responsible for doing the right thing.

Overseeing results. Good governance requires continuing oversight to ensure that policy is implemented as intended, strategies are met, and the overall performance of the public sector entity meets expectations while conforming with policies, laws, and regulations.

Accountability reporting. Because public sector entities act as “agents” to use resources and authority to accomplish established goals, public sector entities must account for how they use the resources and the results they have accomplished. Accordingly, good governance requires regular financial and performance reporting that is validated for accuracy by an independent auditor. Accountability also implies imposing penalties or sanctions against those who have misapplied the resources for purposes other than intended.

Correcting course. When the organization has not achieved its financial or operational performance goals, or when problems are detected in operations or the use of funds, a good governance system will identify the root cause of the problems, determine the corrective actions needed, and follow up to determine whether those actions were implemented effectively. Auditors’ findings and recommendations represent critical input to good governance that can lead organizations to remedy identified weaknesses and deficiencies promptly and appropriately.

Governance Principles Critical To The Public Sector

Unique governance principles arise from the unique nature of the public sector. For example, unique to the public sector is the importance of political forces, the not-for-profit nature, and the ultimate objective of public service for many public sector activities. Simultaneously, public sector entities hold coercive (e.g., police, taxation, and regulatory) powers over citizens and economic enterprises, and thus they must enact protections to ensure fairness and accountability in the use of those powers and in the delivery of the expected services. These protections are fundamental in political systems in which citizens endow the public sector entities with their powers. In general, any form of public sector entity can benefit from accountability measures that ensure officials use resources and authority to meet the mandated goals and objectives. Moreover, good public governance requires fair and impartially enforced laws and regulations. The absence

of good governance structures and lack of adherence to basic governance principles increases the risk of public corruption, which is defined as the misuse of entrusted power for private gain. Therefore, in addition to the basic governance principles described in the previous section, upholding the principles of accountability, transparency, integrity, and equity are essential in the public sector.

Accountability. “Accountability is the process whereby public sector entities, and the individuals within them, are responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance, and submit themselves to appropriate external scrutiny. It is achieved by all parties having a clear understanding of those responsibilities, and having clearly defined roles through a robust structure. In effect, accountability is the obligation to answer for responsibility conferred.” (Source: IFAC, *Governance in the Public Sector: A Governing Body Perspective*, 2001).

Transparency. The principle of transparency relates to the openness of a public sector entity to its constituents. Good governance includes appropriate disclosure of key information to stakeholders so that they have the relevant facts about the public sector entity’s performance and operations necessary to clearly understand motives and reach correct conclusions about the impacts of its actions. Accordingly, the public sector’s decisions, actions, and transactions must be conducted in the open. Many public sector entities are required by law to make public documents available upon request. Additionally, many public sector entities are required by law to publish meetings notices including specific agenda items. Although the public’s interest is sometimes served by protecting information from disclosure — such as instances where national security, criminal investigations, or the proprietary information of a private company would be compromised — the transparency of public sector actions and information plays a significant role in public oversight.

Auditors can provide a direct link between transparency and the credibility of the public sector entity. Lawmakers and the public look to audits for assurance that public sector actions are ethical and legal, and that financial and performance reporting accurately reflect the true measure of operations.

Integrity. The principle of integrity calls for public officials to act consistently with the ethical principles and the values, expectations, policies, and outcomes of the public sector entity. The erosion of public trust if public information and

actions are not credible and reliable undermines the public sector's legitimacy and ability to govern. The political, social, economic, and environmental costs to society can be extensive. The principle of integrity also applies when information is disseminated to lending authorities or other principals who have an interest other than an ownership share. The consequences of violating the expectation of the highest integrity can be swift and shattering when the people's trust in the public sector, its institutions, and leadership is undermined.

Equity. The principle of equity relates to how fairly public sector officials exercise the power entrusted to them. The public grants its agents — public sector officials — both money and power to carry out their responsibilities. However, it is concerned with the misuse of public sector power, waste of resources, and any other issues involving corruption or poor management that could negatively impact the entity's obligations and service delivery to citizens.

Public sector equity can be measured and evaluated across four dimensions:

1. **Service costs** are paid using taxes and fees charged by the public sector entity and borrowed funds that will be paid from future taxes. Service costs also may include indirect or future costs resulting from current public sector action or inaction.
2. **Service delivery** includes direct services, such as transportation infrastructure, public education, and health, as well as indirect services such as financial stewardship and human capital management.
3. **Police and regulatory power** concerns the public sector entity's use of its coercive powers: arrest, property seizure, eminent domain, and regulatory processes such as granting liquor licenses or building permits.
4. **Exchange of information** relates to transparent decision-making, including access to public sector officials and records, and the ability to be heard.

Public Sector Auditing

Definitions and Origins of Auditing

“The need for financial accountability has existed ever since it became necessary for one individual to entrust the care of his possessions or business to another.” — Committee to Review the Functioning of Financial Institutions (Wilson Committee), 1980.

The public sector represents a principal-agent relationship (see Figure 1). The officials — acting as the principal’s (the public) agent — must periodically account to the principal for their use and stewardship of resources and the extent to which the public’s objectives have been accomplished. An effective audit activity reduces the risks inherent in a principal-agent relationship. The principal relies on the auditor to provide an independent, objective evaluation of the accuracy of the agent’s accounting and to report on whether the agent uses the resources in accordance with the principal’s wishes.

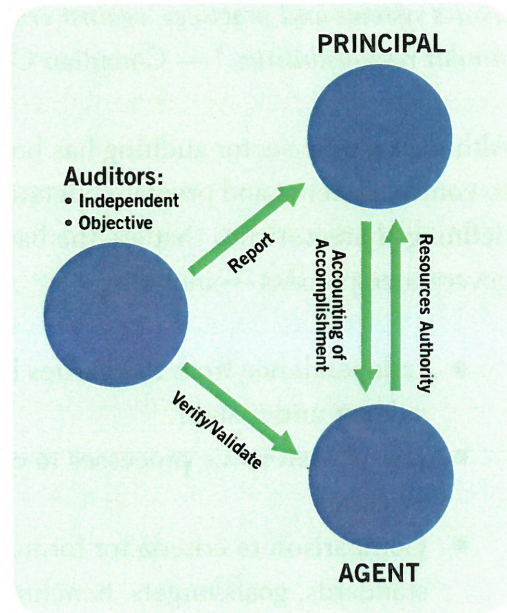


Figure 1 – 3 Party Relationship

The need for a third party to attest to the believability (credibility) of the financial reporting, performance results, compliance, and other measures arises from several factors inherent in the relationship between the principal and its agent:

1. **Conflicts of interest** – Agents may use their resources and authority to benefit their own interests rather than the principal’s interests.
2. **Remoteness** – Operations may be physically removed from the principal’s direct oversight.
3. **Complexity** – The principal may not possess the technical expertise needed to oversee the activity.
4. **Consequence of error** – Errors may be costly when agents are stewards of large amounts of resources and are responsible for programs affecting citizens’ lives and health.

Some current definitions of auditing illustrate the variability in the roles of auditors, while underscoring the fundamental elements of the profession. For example:

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.” — The IIA, 2011

“Audit serves an accountability relationship. It is the independent, objective assessment of the fairness of management’s representations on performance or the assessment of management’s systems and practices, against criteria, reported to a governing body or others with similar responsibilities.” — Canadian Comprehensive Audit Foundation, 1991

Although public sector auditing has broadened its focus from individual transactions to control systems and program operations, public sector auditing should retain the defining characteristics that are the basis of its credibility — the value it provides to the governance process — including:

- Independence from the parties being audited and an objective attitude toward the subject under audit.
- Use of systematic processes to collect and analyze substantial and appropriate evidence.
- Comparison to criteria for formulating conclusions. Examples of criteria include standards, goals/targets, benchmarks, and laws.
- Use of widely accepted professional audit standards. The credibility of the audit activity strengthens public governance by providing for accountability and protecting the core values of the public sector, which it does by assessing whether managers and officials conduct the public’s business transparently, fairly, honestly, and in accordance with laws and regulations.

Audit Roles

As an essential element of a strong public sector governance structure, auditing supports the governance roles of oversight, insight, and foresight. Because the public sector’s success is measured primarily by its ability to deliver services successfully and carry out programs in an equitable and appropriate manner, public sector audit activities should have the authority and the competency to evaluate financial and program compliance, effectiveness, economy, and efficiency. Moreover, auditors also must protect the core values of the public sector, as it serves all citizens.

Oversight. Auditors assist decision-makers in exercising oversight by evaluating whether public sector entities are doing what they are supposed to do, spending funds for the intended purpose, and complying with laws and regulations. Audits focusing on oversight answer the questions, “Has the policy been implemented as intended?” and “Are managers implementing effective controls to minimize risks?” Auditing supports the governance structure by verifying agencies’ and programs’ reports of financial and programmatic performance and by testing their adherence to the organization’s rules and aims. Moreover, oversight audits contribute to public accountability by providing access to this performance information to stakeholders within and outside of the organization under audit. Elected and appointed officials as well as public sector managers are responsible for setting direction and defining organizational objectives. In addition, managers have the duty to assess risks and establish effective controls to achieve objectives and avert risks. In their oversight role, government auditors assess and report on the success of these efforts.

Oversight also describes the role many public sector auditors have to detect and deter public corruption, including fraud, waste, or abuse, and other misuses of the power and resources entrusted to government officials. Auditors monitor the effectiveness of management’s internal control structure to identify and reduce the conditions that breed corruption. In many areas of the world, public sector auditors also are responsible for responding to allegations of corruption in the public sector organizations they serve through detection and deterrence.

“Auditing has evolved as systems, transactions, and operations have become more complex. In its earliest origins (evidence points to audits conducted in Babylonia and Mesopotamia as early as 3,000 B.C.), auditing verified the existence of assets. Over time, auditing shifted from a detailed focus on confirming or validating individual transactions to evaluating the effectiveness of systems that control transactions. In the 20th century, public sector auditors also moved well beyond economic and financial transactions and conditions. Since the introduction of social programs, some government auditors have been called upon to validate the effectiveness of the government services themselves. Or, they may be required to determine whether the organization has established mechanisms to measure and report on its effectiveness.”

Colleen G. Waring, CIA, CGAP
Performance Auditing Training
Course manual

Detection. Detection is intended to identify inappropriate, inefficient, illegal, fraudulent, or abusive acts that have already transpired and to collect evidence to support decisions regarding criminal prosecutions, disciplinary actions, or other remedies. Detection efforts can take many forms including:

- Audits or investigations based on suspicious circumstances or complaints that include specific procedures and tests to identify fraudulent, wasteful, or abusive activity. Alternatively, red flags that appear during the course of an audit initiated for unrelated reasons may result in added procedures to specifically identify acts of fraud, waste, or abuse.
- Audits such as payroll, accounts payable, or information systems security audits, that test an organization's disbursements and related internal controls.
- Audits requested by law enforcement officials that analyze and interpret complex financial statements and transactions for use in investigating and building evidentiary cases against perpetrators.
- Reviews of potential conflicts of interest during the development and implementation of laws, rules, and procedures.

Deterrence. Deterrence is intended to identify and reduce the conditions that allow corruption. Auditors seek to deter fraud, abuse, and other breaches of public trust by:

- Assessing controls for existing or proposed functions.
- Assessing organizational or audit-specific risks.
- Reviewing proposed changes to existing laws, rules, and implementation procedures.
- Reviewing contracts for potential conflicts of interest.

Successful detection efforts may also have a deterrent effect.

Insight. Auditors provide insight to assist decision-makers by assessing which programs and policies are working and which are not, sharing best practices and benchmarking information, and looking horizontally across public sector entities and vertically among the levels of the public sector to find opportunities to borrow, adapt, or reengineer management practices. The audit activity helps institutionalize organizational learning by providing ongoing feedback to adjust policies. Auditors conduct their work systematically and objectively to develop a

detailed understanding of operations and draw conclusions based on evidence. Therefore, audits can provide an insightful description of problems, resources, roles, and responsibilities that, combined with understanding of the root cause of the problem and useful recommendations, can encourage stakeholders to rethink solutions to problems. Not only can the performance of the specific program under audit be improved, but working through the issues brought to light by a particular audit can enhance the capacity of the public sector and the public to deal with similar problems. Audits focusing on insight contribute importantly to answering the broader question, “Has the policy brought about the intended results?” Concurrently with the accountability function, audits contribute to improving the operations of the public sector.

Foresight. Auditors also help their organizations look forward by identifying trends and bringing attention to emerging challenges before they become crises. The audit activity can highlight challenges to come — such as from demographic trends, economic conditions, or changing security threats — and identify risks and opportunities arising from rapidly evolving science and technology, the complexities of modern society, international events, and changes in the nature of the economy. These issues often represent long-term risks that may far exceed the terms of office for most elected or appointed officials, and can sometimes receive low priority for attention where scarce resources drive more short-term focus on urgent concerns. Additionally, a common audit approach — risk-based auditing — focuses the audit on the organization’s overall risk management framework, which can help identify and deter unacceptable risks. Through risk-based auditing, the audit activity provides useful and relevant information to the organization for managing its risks.

Audits focusing on foresight help answer the question: “What policy revisions or implementation would meet a future need or risk?” When public sector auditors focus on trends and look forward, they support decision making. Auditors also play a key role in helping managers understand and initiate risk assessments. Additionally, auditing’s own risk assessment ensures that audit resources are used effectively to address the areas of greatest exposure.

Through these roles, auditors protect core public values. By providing oversight, insight, and foresight services, public sector auditors help ensure that managers and officials conduct the public’s business transparently, fairly, and honestly, with equity and integrity, while performing their own work using the highest

standards of integrity. Auditors should not only assess the potential abuse of power, but also should be cognizant of their own power within an organization.

Auditors can serve as a check on abuse of power. Public sector auditors — whether appointed by the legislature or the executive or elected by the voters — must be prepared to recognize and report corruption, abuse of authority, or failure to provide equity or due process in the exercise of a governmental police or regulatory activity. Because such reporting may challenge powerful or entrenched interests, auditors require some measure of job protection to be able to report independently.

Auditors must not abuse their own power. The auditor's unique role in the public sector confers power that could be susceptible to abuse. Therefore, the auditor's own work must reflect the same principles of transparency, equity, and integrity that are expected of the public sector. This means auditing issues that matter to people, writing accurate and balanced reports, and making audit reports available for public examination. Some public sector auditors may even find themselves presenting their audit findings in televised hearings or committee meetings. And certainly, public sector auditors must conduct their work with integrity and in full compliance with laws and regulations.

Reporting Line of Public Sector Auditors

Reporting relationships affect the audit activity's independence and scope of work. Reporting line refers to the organizational structure under which the CAE is appointed and controlled relative to the activities subject to audit.

Public sector entities around the globe are complex and diverse. A single governance model for support and oversight of the audit activity will not serve all public sector entities. Many structures rely on some combination of external and internal audit activities - based on needs and circumstances. Regardless of the public sector entity's structure, the organizational placement of the audit activity should provide sufficient safeguards to prevent the audited entity from interfering with audit's ability to perform its work and report the results objectively.

Globally, public sector entities at all levels have created internal audit activities to serve organizations through their focused, real-time presence within the organization.

Although the internal audit activity can add significant value to the organization because of its detailed familiarity and understanding of operational conditions, it may be hampered in upholding the public trust if protections to its independence are not established and cannot be maintained. Public sector entities must establish protections to ensure that internal audit activities are empowered to report significant issues to appropriate oversight authorities. Safeguarding auditor independence is particularly needed when the internal audit activity reports to officials who also may be held accountable for any significant problems. Examples of such protections include statutory requirements that:

- Prevent the audited organization from interfering with the conduct of audit work, staffing of the audit activity, and publication of the audit report.
- Ensure the CAE reports to the highest executive level in the public sector entity and that report distribution requirements ensure the transparency of audit results.
- Require notification to an external oversight entity in the event of plans to dismiss the CAE.
- Require that completed audit reports be made available to the public.

The reporting line of the auditor is tied to the function's independence, which is the most fundamental element of an effective and credible public sector audit activity. Because the public sector auditor's role is to provide unbiased and accurate information on the use and results of public resources, auditors must be able to conduct and report on their work without interference or the appearance of interference. Independence is achieved when the audit activity reports outside the hierarchy of the organization and activities under audit and when auditors are free to conduct their work without interference, restrictions, or pressures from the organization being audited. Such interference can occur if the audited entity limits access to records or employees, controls budget or staffing for engagements, or has authority to overrule or modify audit reports. Individual auditors also need to have independence, which means that the auditors are free from conflicts of interest or biases that could affect their impartiality, the appearance of impartiality, or how the auditor conducts the work or reports results.

"The professionals who audit federal, state, and local governments or other public entities must cope daily with career-threatening political risks from which private-sector internal auditors are largely immune."

Richard Chambers
IIA President and CEO
2011

Types of Audits and Other Services

Public sector auditors conduct audits with different types of objectives. Financial reporting requirements, compliance requirements, and performance indicators for public sector functions vary between jurisdictions and types of activity (e.g., public health, law enforcement, national security, and environmental protection) and results may take years to materialize. Consequently, the means to assess public sector financial regularity and performance vary widely. Accordingly, individual public sector auditors demonstrate different types of skills, competencies, and specializations. For instance, public sector auditors need to understand accounting standards and systems to examine financial accountability; program operations and performance measurements to assess the compliance, success, or progress of government activities; and standards and good practices for public sector governance, management, and internal control. In some cases, auditors can assess the reliability of existing indicators, but they also must be able to measure performance to independently evaluate achievements of a variety of public programs. Moreover, to make useful recommendations on how to improve operations, they must be able to apply standards and good practices specific to managing the type of operation being examined.

Selection of the type of audit or service to be performed is based on the audit activity's authority and purpose, as well as the needs and issues to be addressed. The audit activity's scope of work depends on the authority granted to it by its enabling legislation and the needs or risks the organization faces. A broader focus allows the audit activity flexibility to use a risk-based approach to auditing, focusing on the areas of greatest concern or risk, while contributing value across the entire organization. The broadest audit focus also considers the organization's governance activities, which can help the organization achieve its objectives and priority goals and improve its governance framework, including its ethical code. The narrowest audit focus involves testing individual transactions for errors or for compliance with contract terms, policies, regulations, or laws. The auditors' scope of work can vary between these extremes, and include activities such as reviewing internal controls, processes, and systems to identify systemic weaknesses and propose operational improvements. Usually, both types of focus are necessary to varying extents to achieve the most effective impact from a public sector audit activity.

Risk management systems and controls. Auditors assess the adequacy of corporate governance and the control environment; the effectiveness of processes to identify, assess, and manage risks; the assurance provided by control policies, procedures, and activities; the completeness and accuracy of information and communication systems and practices; and the effectiveness

of management's monitoring and evaluation activities. Many jurisdictions have developed a systems audit to assess the full scope of the organization's financial and performance control systems and to identify deficiencies and recommend corrective actions.

Performance. Auditors systematically gather evidence to assess aspects of program performance beyond financial reporting. Because the types of public sector services are broad, the types of objectives appropriate for performance auditing will vary. Also, depending on the jurisdiction, the range and focus of performance auditing will vary. In its broadest context, performance audit objectives might assess:

- **Effectiveness** – evaluates program accomplishments. Has a program achieved its objectives? What are the program's outcomes or results, both intended and unintended?
- **Efficiency** – examines productivity, unit cost, or indicators such as utilization rates, backlogs, or service wait times. Do operations maximize outputs in relation to costs and other resource inputs (e.g., number of license renewals per staff hour)?
- **Economy** – examines the extent to which a public sector operation has minimized its use of inputs (e.g., money, staff resources, equipment, or facilities) consistent with the quality needs of the program. For example, an economy audit may evaluate the validity of a competitive procurement process to ensure that costs were controlled.
- **Compliance** – tests the organization's conformity with objective requirements, standards, or criteria. These types of audits typically assess compliance with laws and regulations, contract requirements, grant requirements, and organizational policies and procedures. A relatively new service, environmental auditing, helps to examine compliance with environmental regulations.
- **Data reliability** – assesses internal controls and reporting for nonfinancial matters, such as performance measures.
- **Policy and other prospective (forward-looking) evaluation** – assesses program or policy alternatives, forecasts potential program outcomes under various assumptions, or evaluates the advantages or disadvantages of various legislative proposals. Auditors also may compile benchmarking or best practice information to assist in evaluating program design or management practices.

- **Risk assessment** – identifies risks that may affect achievement of an organization’s strategic and financial goals and objectives and assesses management’s response to those risks. In the public sector, risks go beyond normal financial and operational risks, and can include political and societal risks. For instance, some public sector risks involve the political and economic consequences of the public’s perception of fair and equitable treatment of citizens, animals, the environment, and others. Auditors also conduct risk assessments to select and plan audits.

Financial/regularity. Auditors express an opinion on the presentation of the financial statements in accordance with established or accepted accounting principles (regularity). Often performed by external auditors — either commercial auditors or auditors from another branch of the public sector — this type of audit focuses on accounting appropriately for assets and expenditures as reported by the public sector entity. In addition to the financial statement opinion, financial audits also can examine the reliability of specific financial information, compliance with relevant procedures and rules, or the safeguarding of assets.

Advisory, assistance, or investigative services. Auditors may provide objective, expert advice in a range of areas in which they possess expertise. Based on their knowledge and expertise, they may provide technical advice on issues related to good governance, accountability, ethical practices, and anticorruption programs; effective risk assessment and management; internal controls; sound business processes; information technology systems development and operations; project management; program evaluation; and other areas affecting the effectiveness, efficiency, and economy of operations. In addition, auditors may provide services (e.g., control and risk assessment workshops) and training in areas such as fraud awareness, performance measurement, and control design. They also may provide advice on implementing audit recommendations.

In providing advisory/assistance services, auditors should remain independent. Although auditors may, in an advisory role, provide technical advice and make recommendations to management, they may not make management decisions or assume a management role. Moreover, they must maintain independence and objectivity for subsequent audits conducted in any program that has received significant levels of advice or assistance in its formative stages. In other words, auditors should not audit their own work.

Audit And Other Oversight Committees in the Public Sector

A corporate governance practice common in the private sector is the use of audit committees to provide strengthened oversight of the financial and ethical integrity of publicly held companies. Because this oversight responsibility is essential to effective governance, public sector entities also may look to the audit committee to play a similar role. Moreover, depending on the specific circumstances of these entities, audit committees operate within a variety of governance arrangements. Notwithstanding, many public sector entities have found alternative means to fill the audit committee's role.

The Audit Committee's Role

The audit committee can greatly strengthen the independence, integrity, and effectiveness of public sector audit activities by providing independent oversight of the internal and external audit work plans and results, assessing audit resource needs, and mediating the auditors' relationship with the organization. Audit committees also ensure that audit results are aired and any recommended improvements or corrective actions are addressed or resolved.

Every public sector organization should evaluate its governance structure to determine whether an audit committee is appropriate for its particular situation. In some public sector entities, audit committees are formed as subcommittees of the legislative branch or board of directors. Other entities may form audit committees comprising members of the public who are selected by the legislative or executive branches. Some public sector entities have formed audit committees composed of ministers or managers of outside oversight agencies, members of the management hierarchy under audit, or a combination. An example of the former approach is the central harmonization units within the Finance Directorates of certain European Union countries, which oversee the audit activities within other agencies and may form an audit committee to which other agencies' internal auditors provide reports.

The need for, and composition of, the audit committee will depend on individual circumstances, the nature of the audit activity, and the decision of the legislative or governing body.

Audit Committee Best Practices

Where an audit committee is established, depending on the characteristics of the jurisdiction, it should strive to:

1. Operate under a formal mandate, preferably legislation, with sufficient authority to complete its mandate.
2. Include independent members who collectively possess sufficient knowledge of audit, finance, risk, and control.
3. Be chaired by a member who is not the individual to whom a CAE reports administratively.
4. Assess the effectiveness of the organization's governance, risk management, and control frameworks and legislative and regulatory compliance.
5. Provide oversight to the organization's internal and external audit activities, including ensuring adequate coverage and resources, approving the internal audit charter and audit plans, reviewing the audit activity's performance, and approving the appointment or termination of internal and external auditors.
6. Oversee the organization's financial reporting and accounting standards.
7. Provide a direct link and regular reporting to the organization's governing board, council, or other authority.

Conclusion

Because public sector auditing is key to good public governance, it is crucial that it maintain the right resources for the right amount of time with an appropriately broad mandate to achieve the organization's governance objectives. The public sector audit activity's mandate should be sufficiently broad to enable it to respond to the full scope of the entity's activities. Although auditors may be able to add value to any segment of the organization for which they can provide independent, objective assurance at a minimum, every public sector entity requires some form of independent audit activity that has authority to evaluate the full range of public sector activities.

Full audit coverage is frequently provided by complementary external and internal audit entities. However, in some smaller public sector entities, one audit entity alone, or an entity that is a hybrid of internal and external audit characteristics, may be appropriate.

Ultimately, public sector auditing strengthens public governance by providing for accountability and protecting the core values of the public sector entity, ensuring managers and officials conduct the public's business transparently, fairly, and honestly, as well as with equity and integrity. Elected and appointed officials at all levels of the public sector should support effective audit activities by establishing independent audit functions that meet all of the key elements.

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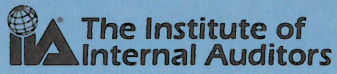
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Audit Committee

INFORMATION
ITEM
2E

Date: December 20, 2017

To: The Honorable Board of Directors


From: Halla Razak, General Manager

Committee: Audit

12/11/17

Manager Contact: Teresa Velarde, Manager of Internal Audit

Subject: Audit Committee Financial Advisor Contract Extension

Executive Summary:

During the March 2017 Audit Committee Meeting, the committee members discussed that the services of Audit Committee Advisor were consistent with best practices and considered a value to the Agency. The Audit Committee members provided direction to extend the consulting agreement for an additional calendar year. This is the last single year extension allowable under the Agency's Procurement Ordinance. The contract falls within the approval authority of the General Manager for \$6,190 and extend the contract services through December 2018.

Since 2008, Mr. Travis C. Hickey, CPA and consultant with Rogers, Anderson, Malody & Scott, LLP has been the Audit Committee Financial Advisor. Mr. Hickey has provided accounting and auditing services to governmental agencies since 1997, including experience with water and wastewater activities. Mr. Hickey attends the Agency's Audit Committee Meetings and provides advisory services to both the Audit Committee and the Internal Audit Department to ensure their responsibilities, as outlined in the Board approved Charters, are fulfilled. Mr. Hickey has gained extensive knowledge of the Agency's operations, and is a valuable asset to the organization.

Staff's Recommendation:

Information item for the Board of Directors about the Audit Committee Financial Advisor.

Budget Impact Budgeted (Y/N): N Amendment (Y/N): N Amount for Requested Approval:

Account/Project Name:

N/A

Fiscal Impact (explain if not budgeted):

N/A

Prior Board Action:

On March 15, 2017, the Board of Directors reconfirmed the approved Audit Committee and the Internal Audit Charters. The Audit Committee Charter describes the composition of the Audit Committee which includes the requirement to have an External Financial Audit Committee Advisor.

Environmental Determination:

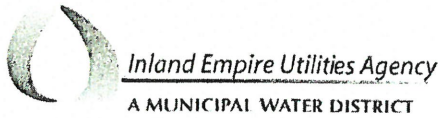
Not Applicable

Business Goal:

The Contract for Audit Committee Financial Advisor services is consistent with the Agency's Business Goals of Fiscal Responsibility, Workplace Environment and Business Practices by ensuring that best practices as recommended by audit and accounting guidance are followed and the Board has a team of professionals to assist with fulfilling their oversight and governance responsibilities.

Attachments:

Attachment 1 - Contract Amendment Number 4600000886-006



CONTRACT AMENDMENT NUMBER: 4600000886-006
FOR
AUDIT ADVISORY SERVICES

THIS AMENDMENT SIX is made and entered into this 29th day of NOV, 2017, by and between the Inland Empire Utilities Agency, a Municipal Water District, organized and existing in the County of San Bernardino under and by virtue of the laws of the State of California (hereinafter referred to interchangeably as "Agency" and "IEUA") and Rogers, Anderson, Malody & Scott LLP with offices located in San Bernardino, California (hereinafter referred to as "Consultant"), to provide audit advisory services and shall revise the Contract as amended:

REVISE SECTION 4, SCOPE OF WORK AND SERVICES TO ADD THE FOLLOWING PARAGRAPH:

Agency hereby exercises the third of the three additional "one-year" option periods for calendar year 2018.

REVISE SECTION 5, TERM TO READ AS FOLLOWS:

The term of this Contract shall extend from the date of Notice to Proceed and terminate on December 31, 2018, unless agreed to by both parties, reduced to writing, and amended to this Contract.

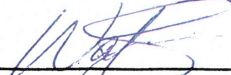
REVISE SECTION 6, PAYMENT, INVOICING AND COMPENSATION, TO ADD:

This amendment represents a net increase of \$6,190.00 for a maximum contract total of \$52,370.00 for all services provided throughout the Contract duration.

ALL OTHER PROVISIONS OF THIS CONTRACT REMAIN UNCHANGED.


WITNESSETH, that the parties hereto have mutually covenanted and agreed as per the above amendment item(s), and in doing so have caused this document to become incorporated into the Contract Documents.

INLAND EMPIRE UTILITIES AGENCY:



Warren T. Green
Manager of Contracts
11-29-2017
(Date)

ROGERS, ANDERSON, MALODY & SCOTT LLP:



Terry Shea
Partner
11-29-17
(Date)