

**SUBMITTAL TO THE BOARD OF SUPERVISORS
COUNTY OF RIVERSIDE, STATE OF CALIFORNIA**

206



FROM: Auditor-Controller

SUBMITTAL DATE:
September 30, 2014

SUBJECT: Internal Audit Report 2013-013: Riverside County Flood Control and Water Conservation District, [District: All]; [\$0].

RECOMMENDED MOTION: That the Board of Supervisors:

1. Receive and file Internal Audit Report 2013-013: Riverside County Flood Control and Water Conservation District.

BACKGROUND:

Summary

We have completed an audit of the Riverside County Flood Control and Water Conservation District to provide management and the Board of Supervisors with an independent assessment of internal controls over capital assets, information security, internal service fund rates, and working capital requirements. We conducted the audit during February 6, 2013 through June 17, 2013, for operations of July 1, 2010 through June 30, 2012.

(Continued on page 2)

Paul Angulo

Paul Angulo, CPA, CGMA, MA
County Auditor-Controller

FINANCIAL DATA	Current Fiscal Year:	Next Fiscal Year:	Total Cost:	Ongoing Cost:	POLICY/CONSENT (per Exec. Office)
COST	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.0	
NET COUNTY COST	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.0	Consent <input checked="" type="checkbox"/> Policy <input type="checkbox"/>

SOURCE OF FUNDS: N/A

Budget Adjustment: No

For Fiscal Year: n/a

C.E.O. RECOMMENDATION:

APPROVE

BY:

Karen L. Johnson
Karen L. Johnson

County Executive Office Signature

MINUTES OF THE BOARD OF SUPERVISORS

Positions Added

Change Order

A-30

4/5 Vote

Prev. Agn. Ref.:

District: ALL

Agenda Number:

SUBMITTAL TO THE BOARD OF SUPERVISORS, COUNTY OF RIVERSIDE, STATE OF CALIFORNIA
FORM 11: Internal Audit Report 2013-013: Riverside County Flood Control and Water Conservation District,
[District: All]; [\$0]

DATE: September 30, 2014

PAGE: Page 2 of 2

BACKGROUND:

Summary (continued)

Based upon the results of our audit, we identified significant opportunities for improvement in calculating internal service fund rates and working capital requirements, as well as opportunity for improvement of controls over information security. We determined the District's internal controls provide reasonable assurance that the District will achieve its objectives. Reasonable assurance recognizes internal control has inherent limitations, including cost, mistakes, and intentional efforts to bypass internal controls. We will follow-up in one year to verify that management implemented the corrective action.

Impact on Citizens and Businesses

Provide an assessment of internal controls over the audited areas.

SUPPLEMENTAL:

Additional Fiscal Information

Not applicable

ATTACHMENTS:

- A: County of Riverside Auditor-Controller's Office - Internal Audit Report 2013-013: Riverside County Flood Control and Water Conservation District.

Internal Audit Report 2013-013

**Riverside County Flood Control and Water
Conservation District**

Report Date: September 25, 2014



**Office of Paul Angulo, CPA, CGMA, MA
County of Riverside Auditor-Controller
4080 Lemon Street, 11th Floor
Riverside, CA 92509
(951) 955-3800**

www.auditorcontroller.org



COUNTY OF RIVERSIDE
OFFICE OF THE
AUDITOR-CONTROLLER

County Administrative Center
4080 Lemon Street, 11th Floor
P.O. Box 1326
Riverside, CA 92502-1326
(951) 955-3800
Fax (951) 955-3802

ACC | **AUDITOR**
CONTROLLER
COUNTY OF RIVERSIDE

Paul Angulo, CPA, CGMA, MA
AUDITOR-CONTROLLER

October 2, 2014

Warren B. Williams
General Manager-Chief Engineer
Riverside County Flood and Water Conservation District
1995 Market St
Riverside, CA 92501

Subject: Internal Audit Report 2013-013: Riverside County Flood Control and Water Conservation District.

Dear Mr. Williams:

The Internal Audit Division of the Auditor-Controller's Office has completed an audit of Riverside County Flood Control Conservation District (District). The audit objective is to provide management and the Board of Supervisors with an independent assessment of internal controls over capital assets, information security, internal service fund rates, and working capital requirements. We conducted the audit during February 6, 2013 through June 17, 2013, for operations of July 1, 2010 through June 30, 2012.

We conducted our audit in accordance with the International Standards for the Professional Practice of Internal Auditing. These standards require that we plan and perform the audit to obtain sufficient, reliable, relevant and useful information to provide reasonable assurance that our objective as described above is achieved. An internal audit includes the systematic analysis of information to evaluate and improve the effectiveness of internal controls. We believe this audit provides a reasonable basis for our conclusion.

Internal controls are processes designed to provide management reasonable assurance of achieving efficiency of operations, compliance with laws and regulations, and reliability of financial and non-financial information. Management is responsible for establishing and maintaining adequate internal controls; our responsibility is to assess the adequacy of internal controls based upon our audit.

Based upon the results of our audit, we identified significant opportunities for improvement in calculating internal service fund rates and working capital requirements, as well as opportunity for improvement of controls over information security. We determined the District's internal controls provide reasonable assurance that the District will achieve its objectives. Reasonable assurance recognizes internal control has inherent limitations, including cost, mistakes, and intentional efforts to bypass internal controls.

Internal Audit Report 2013-013: Riverside County Flood Control and Water Conservation District

As requested, and in accordance with paragraph IIC of the Board of Supervisors Resolution 83-338, management responded to each reported condition and recommendation contained in our report. Management's responses are included in the report. We will follow-up in one year to verify that management implemented the corrective action.

We thank the District's management and staff for their cooperation; their assistance contributed significantly to the successful completion of this audit.

Paul Angulo, CPA, CGMA, MA
County Auditor-Controller

Mark W. Cousineau

By: Mark Cousineau, CPA, CIA, CFE
Chief Internal Auditor

cc: Board of Supervisors
Executive Office
District Attorney
Grand Jury

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Executive Summary

Overview

Riverside County Flood and Water Conservation District (District) was created in 1945 by an Act of the State Legislature in response to a County of Riverside petition to create a regional drainage authority to prevent damage or destruction from floods. The District is divided into seven zones that include all the territory and area of the County of Riverside and is empowered to levy property or special assessment tax on all taxable property located within the boundaries of each zone. Each zone's tax proceeds are restricted for use within that zone. Developer fees and cost sharing arrangements with other entities help support the District's \$150 million annual budget and assets of nearly \$1 billion.

The County of Riverside Board of Supervisors act as the ex officio board of supervisors of the District ("Board of Supervisors"). Twenty-one appointed zone commissioners, three from each zone, advise the Board of Supervisors. The District's staff of 235 is organized in eight divisions: Planning, Design, and Construction; Regulatory; Surveying and Mapping; Operations; Information Technology; Finance; and Watershed Protection.

The District's mission is to protect people, property, and watersheds from flood and storm waters; and to conserve, reclaim, and save such waters for beneficial use. To carry out its mission, the District:

- Identifies flood hazards and problems;
- Regulates flood plain development;
- Regulates drainage and development;
- Plans watercourse and drainage;
- Conducts education for flood prevention and safety; and
- Constructs and maintains flood control structures and facilities.

Audit Objective

Our audit objective is to provide management and the Board of Supervisors with an independent assessment of internal controls over capital assets, information security, internal service fund rates, and working capital requirements.

Audit Conclusion

Based upon the results of our audit, we identified significant opportunities for improvement in calculating internal service fund rates and working capital requirements, as well as opportunity for improvement of controls over information security. We determined the District's internal controls provide reasonable assurance that the District will achieve its objectives. Reasonable assurance recognizes internal control has inherent limitations, including cost, mistakes, and intentional efforts to bypass internal controls.

Internal Service Funds

Background

The District has five internal service funds, (ISF), Hydrology Services, Garage Services, Project Maintenance, Mapping Services and Data Processing that are used to recover cost of services provided to the District zones.

Board of Supervisors Policy B-4, *Rates Charged for Current Services*, (B-4) states that where a charge is necessary and/or appropriate to recover the actual cost of providing services by a county department to other county departments, other public agencies or various organizations or individuals, rates for such charges shall be established from time to time by Resolution or Minute Order adopted by the Board of Supervisors upon recommendation of the County Auditor-Controller, (ACO), and the Executive Officer.

The policy also requires all County departments and districts to review their fee schedules on an annual basis and update them when necessary to ensure full recovery of service related costs. Rates are reviewed during the budget process and approved by the Board on an annual basis.

Audit Objective

Our audit objective is to provide management and the Board of Supervisors with an independent assessment of internal controls over internal service fund rates.

Audit Methodology

To accomplish our objectives, we:

- Conducted interviews and observed operating procedures of District personnel.
- Identified and reviewed laws, codes, and regulations, 2 CFR Part 225, Board of Supervisors' ordinances, applicable policies and procedures.
- Selected samples of ISF revenues from the district's financial reports to perform detailed testing on rates.

Finding 1: Consumer Price Index (CPI) used when adjusting ISF rate.

To fund the replacement of the District's equipment, rates are developed to ensure the original acquisition cost of the equipment and price increases are recovered over the estimated useful lives of the equipment. To account for price increases over time (inflation), the District adjusts equipment rates by a national measure of consumer price index (CPI-N) versus a producer price index (PPI) from the United States Bureau of Labor Statistics or California Board of Equalization's Assessors' Handbook, Section 581, Agricultural and

Internal Audit Report 2013-013: Riverside County Flood Control and Water Conservation District

Construction Equipment Index Factors. In addition, the District does not update its replacement cost analysis to reflect investment earnings on non-designated replacement reserves or when equipment lives exceed the estimated lives used in developing its equipment rates. Equipment rates based on estimated lives that are less than actual equipment service lives results in accelerated cost recovery capture. In combination, they can result in rates and replacement reserves in excess of what is needed. Excessive reserves indicate service pricing in excess of costs, which in turn can lead to regulator or third party corrective action.

Recommendation 1.1

The District should determine its rates based on a rationale systematic method of allocating the acquisition cost of its equipment ratably over its useful life.

Management position concerning the recommendation:

“**Partially Concur.** The District concurs that its rates should be based on a rationale systematic method of allocation, which the District currently uses. However, the District does not concur with allocating acquisition cost over its useful life but rather replacement costs.”

Auditor’s Comment:

While the District partially concurs with the finding, they did not address the issue of using a CPI rate to calculate equipment replacement rates. The use of CPI rates can result in rates and replacement reserves in excess of what is needed.

Recommendation 1.2

The District develops written guidance to establish replacement cost with consideration for technological and price changes, as well as investment income from equipment replacement reserves.

Management position concerning the recommendation:

“**Concur.** The District has developed written guidance including assumptions and clarification of terms used in calculating equipment rates. The District factors in fund balance when evaluating increases or decreases in its rates as well as possible refunds or rebates on an annual basis. Available fund balance does include investment earnings based on loss or gain in any given fiscal year.”

Working Capital Requirements

Background

The District has five internal service funds (ISF's), Hydrology Services, Garage Services, Project Maintenance, Mapping Services and Data Processing. Each fund calculates and maintains a working capital reserve following the County's policies.

Working Capital reserve is unrestricted cash that may be used by an ISF department to cover temporary cash flow deficits caused by timing differences between routine collection and payment of normal operating costs. It is important that ISFs fully report their unrestricted net assets and describe any portion of these assets that are designated, so that acceptability of each ISF working capital may be evaluated.

According to 2 CFR Part 225 and the State Controller's Office (SCO) Handbook of Cost Plan Procedures and County Accounting Procedures an ISF may maintain a working capital reserve. The funding level shall be targeted to a level not to exceed the average sixty-day of operating expenses during the previous twelve months. Funds that exceed this limit, or some other lower limit established by the Executive Office, at end of the fiscal year shall be credited to user departments the following year. The credit for each user department shall be proportionate to its charges billed for the fiscal year recently ended.

Internal Service Funds whose working capital chronically exceeds the amount established as allowable by 2 CFR Part 225 will no longer be authorized to claim grant reimbursement.

Audit Objective

Our audit objective is to provide management and the Board with an independent assessment of the internal controls over working capital requirements.

Audit Methodology

To accomplish our objectives, we:

- Identified and reviewed policies, applicable laws, codes, regulations, and board ordinances.
- Calculated a 60-days working capital, and determined the appropriateness of the current funding position.

Finding 2: ISF Working Capital exceeds the maximum requirements

The District's ISF working capital for fiscal year 2011-12 exceeded the 60 days average of operational expenses during the previous twelve months. Our review of the working capital for the ISF's for fiscal year ended June 30, 2012 is reported in the table below.

Internal Service Fund	June 30, 2012 Working Capital Dollars/(Days)	Allowed 60 Days Working Capital	2012 Excess Working Capital
(Dollars in Thousands)			
Garage Services	\$ 783 (140)	\$ 335	\$ 448
Project Maintenance	1,084 (613)	106	978
Mapping Services	507 (633)	48	459
Data Processing	1,004 (166)	361	643
Total	\$ 3,378	\$ 850	\$ 2,528

The District indicated that the working capital requirement includes the 60 day operating requirement as well as a contingency for unforeseen circumstances and equipment replacement. The District has not established allowed reserves, designations and as a result all unrestricted, undesignated monies are working capital. Excess working capital should be credited to the Zones in proportion to the charges billed unless they have been previously reported to the ACO as reserved or designated for a purpose other than working capital.

Recommendation 2:

The District should reduce each ISF's rates to correct the accumulation of additional excess working capital. Further, if the District is a recipient of federal or State grant awards it should seek guidance from the SCO Handbook before changing rates.

Management position concerning the recommendation:

“Partially Concur. The District concurs that ISF's rates should be reduced to correct the accumulation of additional excess working capital when an additional excess of working capital exists. Because the District is a legally separate entity it is not part of the County-wide Cost Allocation Plan and the requirements thereof. Therefore, Management chooses to designate a

Internal Audit Report 2013-013: Riverside County Flood Control and Water Conservation District

minimum of 90-days working capital to specifically address the District's on-going business needs which extend beyond one (1) fiscal year. Further, the District does routinely seek guidance from the State Controller's Office Handbook."

Auditor's Comment:

While the District agrees that the rates should be reduced, no specific action is indicated on how the District plans to reduce their excess working capital reserve. The District's assertion that the 60 days working capital does not apply to them, leaves the County vulnerable to the non-receipt of Federal funding due to unallowable costs. The State Controller's Office, as the designated oversight authority for Federal funding, has established 60 days as a reasonable reserve for working capital. Further Title 2, Part 225 of the Code of Federal Regulations applies to special districts pursuant to Appendix A to Part 225, Section B. Definitions, Subsection 16 Local Government that states: "Local government means a county, municipality, city, town, township, local public authority, school district, **special district** [emphasis added]."

In addition the California State Controller establishes accounting and audit procedures for California special districts and the District has not provided evidence of an exception from the regulatory authority regarding its ISF accounting.

Finally, we note the District is a dependent district of the County of Riverside, not an independently governed special district.

Information Security

Background

The District Information Technology Division has fifteen employees and provides a number of services to District personnel. These services include: Application and Database Development, Geographic Information Services, System Administration and Support and Reproduction. The IT Division follows policies approved by the Riverside County.

Board of Supervisors Policy Number A-58, *Riverside County Enterprise Information Systems Security Policy*, (A-58), is the policy of Riverside County to protect Riverside County information in accordance with all applicable laws, governmental regulations and accepted best practices to minimize information security risk; ensuring the right information is available to the right people at the right time.

A-58 states sensitive information includes personal, medical records or financial information on employees, constituents, citizens, customers, business partners, or anyone else that has not been previously defined in law to be a public record. Sensitive information may also include any other information that could enable an individual to commit identity theft when so defined in law. The District maintains sensitive information including; employees name and addresses, social security and other employee payroll information.

Audit Objective

Our audit objective is to provide management and the Board with an independent assessment of internal controls over information security.

Audit Methodology

To accomplish our objectives, we:

- Conducted interviews and observed operating procedures of District personnel.
- Identified and reviewed laws, codes, and regulations, Board ordinances, applicable policies and procedures.
- Obtained and understood policies and procedures regarding information security and determined the nature of information stored by the department.
- Tested a sample of terminated or transferred employees for timely removal from the system.

Finding 3: System Access for separated employees

The District was unable to provide documentation, either hard copy or in electronic format, that would show the timely removal of terminated or transferred employees from the system. The hard copy documentation that was available showed employees were removed four to five days after the effective termination date. The delayed removal of terminated or transferred employee exposes the Districts' sensitive information to vulnerability.

As of July 2, 2013, the District activated the network auditing feature and plans to retain documentation showing the date the terminated or transferred employee is removed from the system. As a result no recommendation is necessary at this time.