

LOS ANGELES DEPARTMENT OF WATER AND POWER

Its Transfers of Funds to the City Comply With the City Charter; However, It Needs to Improve Its Controls Over Contracts, Expenditures, and Personnel Records

Audit Highlights . . .

Our review of certain aspects of the operations of the Los Angeles Department of Water and Power (department) revealed the following:

- The department followed the requirements of the City Charter of the city of Los Angeles (city) and the terms and conditions of its bond debt when it transferred more than \$82 million from its water fund and almost \$575 million from its power fund to the city's reserve fund since fiscal year 2001–02.***
- The department did not always award contracts in compliance with city and department competitive bidding requirements, ensure that staff signed contracts only when authorized, and did not always seek required approvals from the Board of Water and Power Commissioners.***

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Los Angeles Department of Water and Power's response as of January 2006

The Joint Legislative Audit Committee requested that the Bureau of State Audits (bureau) review certain aspects of the Department of Water and Power's (department) operations. Specifically, the audit committee requested that the bureau review how and when the department transfers money from its water fund and power fund to the city as well as the department's policies and procedures regarding expenditures, contracting, and personnel practices.

Finding #1: The department followed the requirements of the city charter when it transferred money to the city's reserve fund.

The Los Angeles City Charter (city charter) authorizes the department to transfer surplus money from the Water Revenue Fund (water fund) and the Power Revenue Fund (power fund) to the city of Los Angeles' (city) reserve fund. Although the Board of Water and Power Commissioners' (board) resolutions currently identify the targeted annual transfers as 5 percent of the gross revenue from the water fund and 7 percent of the gross revenue from the power fund, these transfers are potentially limited by provisions in the department's bonds. Under the bonds' provisions, transfers may not exceed the prior year's net income and remaining equity must meet specified equity-to-debt ratios. Our review found that the department followed the requirements of the city charter and the terms and conditions of its bond debt when it transferred a total of \$82.4 million from the water fund and \$574.7 million from the power fund to the city's reserve fund since fiscal year 2001–02.

The department is not unique in transferring money from its water fund and power fund to the city each year. According to a June 2003 presentation of financial information for 38 electric power utilities compiled by Fitch Ratings, a financial research and debt rating company,

- ☑ *In a November 2004 report, the department's internal auditor reported that the department's administration of a series of contracts and purchase orders for the implementation of an automated supply chain management project, valued at more than \$9.7 million, was materially flawed.*
 - ☑ *The department did not ensure that only authorized employees approved invoices for payment.*
 - ☑ *The department did not use available information to consistently assess compliance with, or ensure uniform enforcement of, policies regarding the city's purchasing card program—a program that uses credit cards issued by a commercial bank to provide a cost-efficient procurement process.*
 - ☑ *The lack of central control over the department's personnel files has reduced its ability to ensure that it adequately maintains personnel files that contain the records necessary to support and explain hiring and promotion decisions.*
 - ☑ *The individuals who occupy seven of the exempt positions we reviewed carry job titles and perform duties that are different from those approved by the mayor and city council.*
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32 (84 percent) of the utilities studied transfer an average of 5.82 percent of their annual revenues to city general funds. The department's annual transfers are close to this average.

We made no recommendation to the department regarding this finding.

Finding #2: The department's Corporate Purchasing Services (CPS) did not always follow its own and the city's policies for competitively bidding contracts for goods and services.

The department's CPS is responsible for processing contracts and purchase orders in compliance with city and department rules. However, CPS did not award contracts in compliance with city and department competitive bidding requirements for two of the 12 contracts we reviewed. The larger of the two contracts was the third of three consecutive contracts awarded to the same vendor for graphic art and design services, valued at \$149,500 each. CPS sought competitive bids for the first of the three contracts but issued the other two contracts to the vendor without seeking competition. The combined total of the three contracts is \$448,500. The department's contract manual states that most expert services usually can be performed by more than one vendor and should be awarded via competitive bid. In addition, the city's administrative code requires the department to seek competitive bids when practicable. However, the city's administrative code also exempts certain personal services contracts that are less than \$2 million from that requirement. Nonetheless, the department's policy still urges competitive bidding. Because CPS did not adequately explain why obtaining competitive bids for the contract was not in the city's interests, we believe CPS should have followed its policy and sought bids for the latest contract and the one preceding it.

In addition, the CPS staff member who executed the contract was not authorized to do so. The contract we reviewed was valued at \$149,500. However, the CPS staff member who signed the contract had authority at that time to sign contracts only up to \$50,000 in value.

We recommended that to ensure the department receives high-quality services and materials at the best available prices, CPS should comply with department and city competitive bidding policies when awarding contracts for goods or services. In addition, CPS should ensure that its staff members sign contracts that obligate the department only when they are authorized to do so.

Department's Action: Corrective action taken.

The department states that it continues to comply with the city charter, city administrative code, department, and city competitive bidding policies when awarding contracts for goods and services. In addition, the board stated it has developed new policies and mandates to increase competitive bidding. The department further states that CPS' signature authorities are reviewed annually and the general manager has rescinded signature authorities for contracts over \$100,000.

Finding #3: CPS awarded contracts for goods and services without obtaining required approvals.

CPS does not always obtain approvals for the contracts it awards. For the graphic art and design services contract valued at \$149,500 previously discussed and five other contracts valued at \$150,000 each, CPS violated board policy because these contracts extended the value of the original contracts beyond the threshold set by board resolution without receiving its approval. By not seeking board approval for contracts when required, CPS cannot ensure that it adheres to the board's control over the department's contracts.

We recommended that CPS recognize when the contracts it awards are extensions of existing contracts and seek board approval when the amended amount exceeds the threshold contained in the department's policy for obtaining such approval.

Department's Action: Partial corrective action taken.

The department states that at the direction of the general manager, the department is currently reviewing a supply management system that includes the ability to track contracts. Pending the system's implementation, the department stated that it is taking the following actions: (1) disseminated a general manager bulletin for department-wide release addressing contracts and (2) the Purchasing, Affirmative Action Outreach Committee oversees approval of all contracts and acts as gatekeeper for all formal contract requests. The department stated that it is also working with other city departments regarding their existing systems.

Finding #4: The department's internal auditor identified several issues related to its administration of a series of contracts.

A November 2004 report prepared by the department's internal auditor contained a finding that the department's administration of a series of contracts and purchase orders for the implementation of an automated supply chain management project, valued at more than \$9.7 million, was materially flawed. Before the system was completed, the vendor abandoned the project and turned off the system. Some of the internal auditor's findings included the following:

- The department had not sought competitive bids for any of the purchase orders or contracts it awarded to the vendor.
- The department's payments on one of the contracts and an amendment exceeded their combined value by almost \$150,000.

- The department had yet to recover the unused portion of the \$275,000 it prepaid for maintenance fees.
- The department had yet to recover two servers from the vendor's premises, costing more than \$13,000, which it purchased to support the system.

To improve its controls over the contracts awarded for goods and services, we recommended CPS promptly implement the recommendations presented in the department's internal auditor's November 2004 report.

Department's Action: Partial corrective action taken.

The department states that CPS is in the process of implementing eight of the 11 internal auditor's recommendations listed in the November 2004 report. With regard to the remaining three recommendations, the department stated that due to current litigation, it is working with the City Attorney's Office as to the appropriate manner of implementation.

Finding #5: The Accounts Payables Unit (accounts payable) does not ensure that expenditures are authorized properly.

The department's accounts payable is responsible for overseeing payments to suppliers. However, although made for appropriate purposes, for 16 of the 45 payments we reviewed (36 percent), accounts payable audit clerks did not ensure that only authorized employees approved invoices for payment.

In order to ensure that the department processes payments correctly and to ensure that payments are made only for authorized purposes, we recommended accounts payable strengthen its internal control procedures to include a process for verifying that contract administrators at the business unit level review and authorize invoices before approving them for payment.

Department's Action: Corrective action taken.

The department states that accounts payable implemented a new payment process incorporating signatory review as of March 1, 2005.

Finding #6: CPS does not oversee the purchasing card program adequately.

The city initiated the purchasing card (P-card) program—a program that uses credit cards issued by a commercial bank—to provide a cost-efficient procurement process for city employees. CPS is responsible for administering the department's participation in the city's P-card program. However, CPS has not implemented procedures to use available information on violations of P-card program policies, such as the results of CPS audits of cardholders' purchases and business unit staff reports of P-card policy violations. Such procedures would enable CPS to consistently assess compliance with, or ensure uniform enforcement of, P-card program policies. These policies restrict the uses for the P-cards, including prohibiting the purchase of certain types of items. They also set daily and monthly dollar limits on purchases and require business unit staff to review purchases to ensure they are authorized and approved. In addition, CPS has not provided clear guidance to the department's business unit

managers for determining the appropriate corrective action business units should take against P-cards in response to P-card policy violations and clear criteria for determining when it would be appropriate to restrict, suspend, cancel, or deactivate P-cards.

We recommended that to strengthen the oversight over the P-card program and to obtain the information needed to evaluate the costs and benefits of the program and minimize abuses, CPS should:

- Collect and use the information that results from CPS audits of cardholders' purchases and business unit staff reports of P-card policy violations to track violations on an ongoing basis, including repeat violations of P-card policy.
- Track and follow up business unit managers' responses to reports of suspected P-card policy violations that result from CPS audits of cardholders' purchases to ensure that the corrective actions business unit managers take against P-cards are effective and that policies are enforced consistently.
- Provide clear guidance for determining the appropriate corrective action business units should take against P-cards in response to violations and clear criteria for determining when it would be appropriate to restrict, suspend, cancel, or deactivate a P-card. Further, CPS should ensure the uniform enforcement of such policies through its improved monitoring efforts.
- Develop criteria or a process to deactivate long inactive P-cards to reduce the risk of inappropriate use and to ensure that access to P-cards is secure.
- Use the information and data available, such as transaction data, compliance data, and activity data, to establish goals for minimizing the rates of policy violations for the P-card program on an ongoing basis.

Department's Action: Partial corrective action taken.

The department states that CPS continues to work with the financial institution that issues the P-cards to have automated reports that will facilitate tracking violations, however, the financial institution's upgrade of the software has been delayed until November 2006. In addition, requests for resources for fiscal year 2005–06 were not approved due to departmental budget constraints.

The department stated it reviewed its policies and processes for possible improvements and implementation, and CPS will continue to track P-card violations on a limited basis and inform business unit managers of these violations. CPS will continue to ensure that employees who are assigned P-cards sign and adhere to the Purchasing Card Employee Acknowledgement of Responsibilities. CPS continues to provide training to new P-card holders regarding the appropriate use of the P-card.

The department stated that CPS reviewed its policy and is developing criteria necessary to review and deactivate long inactive P-cards with input from business units and the controller's office. CPS will submit its policy to deactivate P-cards to executive management for approval.

The department also stated that CPS is using information and data available to establish goals for minimizing the rates of policy violations for the P-card program on an ongoing basis. An additional exception report was added by CPS staff to use in the review of cardholders' transactions to partially comply with the recommendation.

Finding #7: Decentralized responsibility for maintenance personnel files reduces comprehensive personnel record keeping and oversight of positions.

The department's lack of central control over personnel files has reduced its ability to ensure that it adequately maintains personnel files that contain the records required by department policy. For example, department policy requires that documents that support and explain civil service hiring and promotion decisions be kept in these files. These documents are an important element of resolving discrimination complaints that may arise against the department over its hiring or promotion practices. Each business unit, which may be located away from the department's headquarters, maintains personnel files for its employees. However, the business units do not always ensure that these files are complete. As a result, the department could not produce the documents necessary to support and explain its hiring and promotion decisions for four of the 12 civil service appointments we reviewed. In addition, the department's personnel files did not contain evidence that the employees who occupied nine of the department's exempt positions possess the qualifications the department used to justify exempting these positions from civil service regulations. Further, according to research conducted by the department's human resources director for seven of the exempt positions we reviewed, the individuals who occupy them carry job titles and perform duties that are different from the job titles and duties approved by the mayor and the city council for these positions. By not using these positions as approved, the department reduces the city's control over the department's exempt positions and reduces the transparency to the public of its hiring decisions for exempt employees.

To ensure that it adheres to its policies for a single comprehensive record for employees' work history and uniform filing and file retention of employee personnel records, we recommended the department consider changing the decentralized nature of its personnel record keeping and establish a centralized system, administered and maintained under the supervision of the department's director of human resources. In addition, the department should seek approval from the mayor and city council when it uses its exempt positions for duties other than those previously approved by the city.

Department's Action: Partial corrective action taken.

The department states it is in the process of centralizing all employee folders. Exempt folders were compiled in February 2005, and the department anticipates centralizing all employee folders by June 2006.

The department will seek approval of exempt positions not currently approved by the city council once it completes an evaluation of its organizational structure. The general manager has undertaken such an evaluation and anticipates completing it by March 2006.