



**District of Columbia
Board of Directors
Audit Committee**

**Thursday, October 28, 2004
8:30 a.m.**

Meeting Minutes

COMMITTEE MEMBER(S) PRESENT

Michael Hodge, Chairman
Anthony Griffin
Paul Folkers
Larry Coffman

WASA STAFF PRESENT

Jerry Johnson, General Manager
Michael Hunter, Director, Internal Audit
Olu Adebo, Controller
Avis M. Russell, General Counsel
Linda R. Manley, Board Secretary

Call to Order

Mr. Hodge called the meeting to order at 8:40a.m. Michael Hunter began with a review of the Internal Audit Office's activities for the 3rd and 4th quarters and a discussion of the FY2005 audit plan. (Power Point Presentation)

Review of Internal Audit Office Activities

Mr. Hunter noted that the Internal Audit Office (IAO) performed two audits this summer that resulted in the certification of the Authority's Biosolids Management Program. The Construction Inspection Process review was completed last month. He noted that there are very strong controls in the area of the inspection process both onsite and offsite. The Contract Hauling Review was requested by the Audit Committee and was performed in FY2004. This engagement is scheduled for completion in mid-November. Mr. Hunter noted that there were no major issues to disclose in this engagement.

The IAO performed a review of the Emergency Priority Lead Service Line Replacement at the request of Engineering and Technical Services (DE&TS). The Authority agreed to perform an emergency replacement of 500 lead service lines based on three distinct categories (not to be confused with the entire lead service line replacement program). The initial phase of the Comprehensive Recommendation Follow-up Review began this summer and is almost complete. This process includes collecting all of the audit reports that have been prepared within the WASA as well as outside of WASA from various sources. A tentative schedule has been established to review the findings with the respective departments. For the first time, the IAO completed the Software Licensing Review and found WASA to be on the same level with some larger organizations in the area of software compliance. There were no major issues determined.

Contractor Billing Review was completed this summer at the request of the DE&TS. During this review, the IAO looked at the independence of one of the Authority's contractors dealing with the SW Federal Center station. There were questions surrounding whether one of our

contractors were performing work for another company on WASA's time. There was no support for this assertion.

The IAO worked with the Procurement Department on the Contract Close-out Review of the contracts for the lab testing services associated with the lead testing program. This review is expected to be completed within the next couple of weeks. The Biosolids Cost Review is approximately 90% complete. The IAO had to work with WSSC to get access to the Oracle package and the WSSC financial system to review detailed cost allocation methods. The IAO plans to issue a white paper on the Sarbanes-Oxley Act. Mr. Hodge asked the General Manager if the Authority was any closer to resolving the matter of the Biosolids Cost Review. Mr. Johnson noted that due to changes in administration along with other issues, it has been extremely difficult to find a decision maker in WSSC; consequently, the Authority is no closer to coming to a resolution of this issue. He noted that he had met with the Interim General Manager and they plan to have some discussion to identify the issues and determine if they can bring the issues to closure. Mr. Hodge asked if any Executives remained at WSSC with any institutional memory of the issue like General Counsel or the CFO. Mr. Johnson noted that there are some people in the financial operation with some knowledge and memory of the issues being discussed. One of the larger issues has spilled over into the participating jurisdictions in the McGaughan settlement. The Authority met with the staff and members of Council for Prince Georges County and there were additional efforts that they wanted the staff to undertake and provide feedback on before bringing the matter to closure. There is some movement, but it is at a slow pace at this point.

FY2004 3rd and 4th Quarter Internal Audit Office Accomplishments

The Audit Recommendation Program has finally been instituted with the assistance of Internal Audit contractor, Mr. William Walsh. Mr. Hunter stated that as a result of the two reviews of the Biosolids Management Program, WASA is one of five organizations in the country to obtain this certification and one of two organizations to secure certification on the first go around. WASA is part of the first set of demonstrating agencies and will serve as a model for other facilities seeking certification. Mr. Hodge noted that WASA should make public note of this achievement. Mr. Johnson noted that the Authority has sent out press releases and contacted the media, but had only noted interested from the New York Times. WASA has been working with the local papers to get publicity for this certification, but will probably get more coverage in the industry journals where the issue is of more significance. He noted the accomplishment is extremely significant among members of the NBP around the country. He also noted that although the Authority had been ridiculed for its management of biosolids in the past, the Authority is leading the pack in terms of research and the management program.

Staffing and Recruitment

Mr. Hunter noted that the IAO has recruited Mr. Gregory Spencer as a Senior Internal Auditor. Mr. Spencer is a Certified Information Systems Auditor and a CPA candidate. Mr. Spencer comes from the Office of the Inspector General (OIG) and possesses strong credentials and good work experience.

The IAO has secured contracting services from Account Assets, Inc. through Mr. William Walsh. Mr. Walsh has been working with the IAO since June 2004 to complete the audit plan. Mr. Walsh has extensive experience in internal controls and financial reporting. Since his start, he's worked on 4 or 5 engagements and provided assistance on the Sarbanes-Oxley study. The IAO is currently fully staffed.

Proposed FY2005 Internal Audit Plan

Mr. Hunter noted that the FY2005 Internal Audit Plan is being presented via a pie chart. The office will begin by focusing on a lot of business process reviews designed to assist the office in learning more about the operations and make good recommendations to assist the Authority in meeting its goals. The Plan will also include some compliance and follow-up reviews. Depending on the direction the Authority plans to take regarding additional certifications, the IAO has also allotted time in its Plan for Environmental Management Systems reviews. Because the Authority does a significant amount of contracting, the Overhead Cost Reviews noted in the plan will assist the Authority in ensuring that consultants are being paid properly for their services. Technology Projects will account for 13% of the overall Audit Plan and Procurement and Contracting will account for 15%. Local Small Business Development reviews will account for 15% of the Plan and will focus on the detailed contracts, which exists in WASA.

Mr. Hodge inquired about the make up of follow-up reviews. Mr. Hunter explained that follow-up reviews are previously issued engagements with recommendations that need to be re-visited. Mr. Griffin noted that follow-up reviews are an important function and in his organization it is understood that Internal Audit issues reviews with recommendations that should be implemented by Management. However, when the recommendations were re-visited, often it was found that the recommendations have not been addressed. Therefore, there must be a method to enforce the commitment to ensure that recommendations are implemented. Mr. Griffin inquired about the number of hours available for the IAO to perform audits. He noted that at a glance, there appears to be 2 staff years allocated to the plan, but it appears there are more than 2 auditors. Mr. Hunter noted that the IAO includes 2 Senior Auditors, a contractor and himself. Mr. Griffin noted the hours appear to only add up to 2 staff people. Mr. Hunter noted the hours should add up to 4100 hours. Mr. Hunter noted that he determined that in the course of a year, 1800 hours are available for a full-time person, assuming they did nothing but audits. Most organizations use 75% of the available hours (1800) as the amount of audit hours. Mr. Griffin noted he agreed with the process used to determine audit hours, however he believes that the suggested number of audit hours does not equate to the amount of staffing in the audit and that these figures should be re-visited. Mr. Hodge asked if 1800 hours would be considered high. Mr. Griffin noted that the figure is reasonable because you have to allow for training, vacation and sick leave; therefore, the actual number of hours for each person would be less than the actual 2080 work hours for a year.

Audit Committee Training

Mr. Hunter noted that the Committee should also select some possible dates for the training. Mr. Hodge asked if the Board members had been surveyed to determine their continued interest in the training. Mr. Hunter noted that correspondence noting that training was open to the full Board and Senior Management was sent earlier in the year. The training was originally scheduled for September 21, 2004. However, this date had to be changed. Mr. Hunter noted that the Internal Audit Office never got the Board's commitment to the training date. Mr. Johnson noted that with the pending Board appointments and likely restructuring of some of the Committees, this is probably one of the items that will be held off until these changes occur. Mr. Johnson also noted that trying to identify possible dates at this time would be difficult because of the manner in which new Board members are being selected.

Review of Sarbanes-Oxley Act – Staff Presentation

Mr. Hunter noted that a decision on a method of communication for future discussions on the Sarbanes-Oxley Act is needed. The IAO feels like this is a significant piece of legislation that will be looking for non-profit organizations in the future. The Committee might be well served by having representation at some of the National Leaders on Sarbanes-Oxley discussions to

determine how the Act can impact non-profit organizations. The Committee agreed to hold discussions regarding the Sarbanes-Oxley Act via e-mail. Mr. Griffin suggested that information on the topic be provided in bulleted format summarizing the key points in lieu of a white paper. Mr. Griffin also noted that he believes that the public sector has been doing far more than the private sector was required to do. He noted that he's been signing the county's financial reports and doing full disclosures for quite some time, as had his predecessors. He noted that it is new for the Corporate Officers of the private sector to be required to sign their own financial reports. Mr. Griffin agreed that the Board should be paying attention to the Act and how it may start to affect non-profit organizations. He noted that the Board has a responsibility to the public to ensure that it is performing as much of a disclosure as possible.

FY2004 Independent Financial Audit

Mr. Olu Adebo, Controller, announced that the FY2004 financial audit is on track. He reviewed the audit closing schedule, which started in July 2004. Mr. Adebo noted that there is approximately \$8M of consumable inventory that is test counted and reviewed by the external auditors. The preliminary work started on August 2, 2004 with substantive testing of internal controls and EDP reviews. On October 20, 2004, the audit crew commencement meeting was held with the managing partners, the Senior Management for the audit, the CFO, Controller, and a few staff members. The audit plan was reviewed and the schedule and timeframes were determined. The auditors will return in November to start the final phase of the audit. By then, the draft financials will be generally complete and the numbers will be ready for testing. The first draft of the financial statements should be completed by December 1, 2004. The final draft of the will be available for the auditors by December 20, 2004. The final signed opinion is expected to be available by December 31, 2004. The comprehensive annual financial reports will be issued by December 31, 2004. The A-133 audit will be performed simultaneously with the financial audit; however, the A-133 report will not be issued until February 2005. Management letter comments are expected in late February 2005. The Internal Auditor will meet with the Audit Committee and the external auditors before the management letter comments are finalized. This is the final year of the audit contract and in early February, development of the new audit contract will begin. This year, instead of a full RFP process, we will go through the GSA vendor pool and target RFP recipients. Between March and April, the responses will be reviewed and an award will possibly be presented for recommendation to the Board in May or June. Mr. Adebo clarified that the RFP process will actually be a distribution of the scope of work requesting a bid for a new auditor to the GSA vendor pool that already provides audit services. Mr. Griffin noted the significance of tracking the physical inventory. Most of the \$8M of inventory is mostly spare parts (physical inventory includes such things as valves and pipes, while the fixed asset inventory includes such things as computers and supplies). It was noted that Congress has adopted the District's budget.

Process Improvement Presentation

In an attempt to ensure the Internal Audit Office's assistance in making WASA a world-class organization, the Internal Audit Office will be making some changes to its approach. Mr. Hunter gave a presentation entitled, "Internal Audit – Unlocking the Path to Excellence." Mr. Hunter noted that the Internal Audit Office intends to improve education on the internal audit function for the Audit Committee, WASA Management, and WASA staff. The Internal Audit Office will begin participating in the New Employee Orientation in order to educate new employees on the function. The office also has process improvement initiatives in place for the Internal Audit staff.

The IAO seeks to eliminate the perception that the function exists only to point out faults and to educate the staff on its true purpose – process improvement and objective assessment. The Internal Audit Office believes it holds a unique perspective on the business process that could

result in the reduction of cost. Also, in light of Chairman Gerstell's interest in the area of corporate governance, the Internal Audit Office will be closely focusing on compliance.

The Internal Audit Office has begun to issue Client Satisfaction surveys to assess its work based on the views of its clients. This is one way the IAO can improve the perception of the function, increase the confidence in the function and foster a team atmosphere. Mr. Hunter noted that the Internal Audit Office will need to have open lines of communication, involvement, and support from the Board and Executive Management. He noted that the Office is also seeking a formal evaluation of its function.

Mr. Griffin noted that audit is a resource and an asset to an organization, but there is a negative perception of the function and that the primary focus is finding ways to improve, which should be the overall objective of the organization. He noted that the type of relationship the Internal Audit Office is attempting to build with the Authority's departments does not happen overnight, but is the right direction toward which to head. Mr. Griffin also noted that the IAO has his support in the initiative. Mr. Folkers asked if a formal evaluation of the internal audit function had ever taken place and in what format this evaluation might be performed. Mr. Hunter noted that such an evaluation has not been performed in the past, but such evaluations usually address core competencies.

Mr. Griffin noted that in Virginia, auditors have a formal organization where world professionals review audit shops. He noted that his shop recently went through one of these peer reviews. Mr. Hunter noted that WASA just joined the National Association of Local Governmental Auditors (NALGA) and intends to go through a peer review through their process now that the office is fully staffed.

Mr. Hodge noted that if there were no other questions or pending business and adjourned the meeting.

Action Items

1. Review the audit hours proposed in the FY2005 Audit Plan and report back to the Audit Committee on their accuracy based on available staff.
2. Provide a bulleted summary of the Sarbanes-Oxley Act to the Audit Committee for review and discussion via e-mail.
3. Provide information denoting the areas by which the Internal Audit Office should be evaluated.
4. Ensure that the regulatory agencies in Virginia and Maryland get copies of the press release on the Biosolids Management Program.