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RONALD O. NICHOLS
General Manager

September 22, 2011

The Honorable City Council
c/o Office of the City Clerk
Room 395, City Hall
Mail Stop 160

Honorable Members:

Subject: Audit of the Loan Program for the Calendar Year Ended
December 31, 2010

Los Angeles Administrative Code (LAAC) Section 23.141 requires that audits be conducted to validate the number of the loan agreements that the Los Angeles Department of Water and Power (LADWP) entered into, to analyze and summarize delinquency and default rates by borrowers, to determine administrative costs and expenses, and to verify whether the requirements stipulated in LAAC Section 23.141 have been met. Section 23.141 also requires that the General Manager report the audit findings to the City Council on at least an annual basis.

Enclosed, please find the report on the Audit of Compliance with the Loan Program Requirements under LAAC Section 23.141 for the Calendar Year Ended December 31, 2010, completed by the Internal Audit Division of the LADWP.

There were 67 loans totaling \$38.3 million awarded from 2002 to 2010, of which 24 loans totaling \$19.4 million were outstanding as of December 31, 2010. Thirteen of the outstanding loans totaling \$18 million were made to the various City of Los Angeles departments. The remaining 11 loans totaling \$1.4 million were made to other qualified LADWP customers.

The audit concludes that the Loan Program is in compliance with the requirements stipulated in LAAC Section 23.141 and no loan default occurred in 2010.

Water and Power Conservation ... a way of life

111 North Hope Street, Los Angeles, California 90012-2607 Mailing address: Box 51111, Los Angeles 90051-5700
Telephone: (213) 367-4211 Cable address: DEWAPOLA



The Honorable City Council
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If you have any questions, please call me at (213) 367-1338, or have a member of your staff contact Mr. James Tan, Director of Internal Audit, at (213) 367-4436.

Sincerely,

A handwritten signature in blue ink, appearing to read "Ronald O. Nichols".

Ronald O. Nichols
General Manager

JT:jt

Enclosure

c/enc: The Honorable Councilmembers
Miguel A. Santana, City Administrative Officer
Mr. Gerry F. Miller, Chief Legislative Analyst
Ms. Winifred J. Yancy

Date: July 29, 2011

**DEPARTMENT OF WATER AND POWER
CITY OF LOS ANGELES
INTERNAL AUDIT DIVISION**

Internal Audit Report of:

AUDIT OF COMPLIANCE WITH LOAN PROGRAM REQUIREMENTS

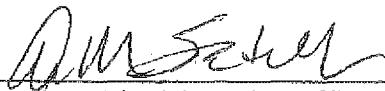
UNDER LOS ANGELES ADMINISTRATIVE CODE SECTION 23.141

FOR THE CALENDAR YEAR ENDED DECEMBER 31, 2010

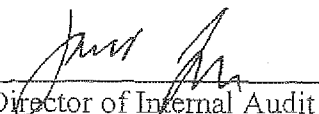
Distribution	Copies	FOR	
		Securing Action	Information
Ronald O. Nichols, General Manager	1		X
Aram H. Benyamin	1		X
James B. McDaniel	1		X
Gary E. Wong	1		X
Lorraine A. Paskett	2		X
Thomas L. Gackstetter			
Kelli Bernard	1		X
Ann M. Santilli	4		X
Mario Ignacio			
Peter Huynh			
Edsel Arceo			
Board of Water and Power Commissioners			
KPMG LLP			
Internal Audit Division File			

An X following your name in the column "For Securing Action" means that you are responsible for securing the corrective actions stated in your response. Internal Audit Division may conduct a follow-up review to ensure that the corrective actions have been taken.

Released by:



Interim Chief Financial Officer



Director of Internal Audit

**FINANCIAL SERVICES ORGANIZATION
INTERNAL AUDIT DIVISION**

July 29, 2011

**AUDIT OF COMPLIANCE
WITH THE LOAN PROGRAM REQUIREMENTS
UNDER LOS ANGELES ADMINISTRATIVE CODE SECTION 23.141
FOR THE CALENDAR YEAR ENDED DECEMBER 31, 2010**

BACKGROUND

We have completed an audit of compliance with the Loan Program (Loan Program) Requirements under Los Angeles Administrative Code (LAAC) Section 23.141 as required by LAAC Section 23.141 (i).

The Loan Program was originally authorized by Ordinance Number 172606 and DWP Board Resolution 002-170. It was later amended by Ordinance Number 179147. The ordinances are codified under LAAC Section 23.141.

LAAC Section 23.141 allows the Los Angeles Department of Water and Power (LADWP) to enter into loan agreements with LADWP customers for solar energy, utility infrastructure, water conservation, and energy efficiency projects.

LAAC Section 23.141 requires that audits be conducted to validate the number of loan agreements entered into, to analyze and summarize delinquency and default rates by customers and to determine the amount of administrative costs and expenses, and to verify whether the conditions described in LAAC Section 23.141 have been satisfied. The General Manager and Chief Financial Officer shall report the audit findings to the Board of Water and Power Commissioners and to the City Council on at least an annual basis.

The prior audit of the loan program was published on April 28, 2010.

The Energy Efficiency Section of the Sustainability Programs and External Affairs Division administers the energy efficiency loans to various Los Angeles City Departments (City Departments).

The Economic Development Division administers the water conservation loans, utility infrastructure and solar power loans. They also administer the energy efficiency loans to commercial customers.

PURPOSE

Our objectives were to validate the number of loans awarded, to analyze and summarize delinquency and default rates by customers, to determine the amount of administrative costs and expenses, and to verify whether the requirements described in the LAAC Section 23.141 (b) through (h), relating to the qualification of borrowers, interest rates charged, loan amount limits, credit checking, and other requirements, have been met.

SCOPE

The audit covered 24 outstanding loans with a total balance of \$19,370,522 as of December 2010. We reviewed the requirements under LAAC Section 23.141, analyzed the population of outstanding loans for compliance with general requirements, judgmentally selected a sample of 6 loans and tested them for compliance with specific requirements. The 6 loans were comprised of three energy efficiency loans issued to City Departments, and three utility infrastructure loans granted to other qualified LADWP commercial customers.

Of the 24 outstanding loans, 11 of them were reviewed in the prior audits. From the remaining 13 loans, 6 loans were tested during the current audit. The 6 loans amounted to \$10.1 million, representing 52 percent of the total outstanding loan amount, or 25 percent of the total outstanding loans.

CONCLUSION

Under the Loan Program, 67 loans totaling \$38.3 million were awarded from 2002 to 2010. As of December 31, 2010, 24 loans totaling \$19.4 million were outstanding. Thirteen of the outstanding loans, totaling \$18 million were made to various City Departments. The remaining 11 loans, totaling \$1.4 million, were made to other qualified LADWP customers.

The outstanding loans made to the LADWP customers other than the City of Los Angeles did not exceed the \$15 million limit, set under LAAC Section 23.141 (g).

All loans were awarded with a recovery period which did not exceed the 10-year limit set by LAAC Section 23.141 (e).

Credit checks were performed on all loans, except for the loans made to other City Departments, as required under LAAC Section 23.141 (h).

The prior audit report issued on March 25, 2008 noted two loans in default with a combined outstanding balance of \$190,725. These loans went into litigation, and a settlement was reached on July 16, 2008. The borrower agreed to pay \$160,000 plus interest at an annual rate of 5.4 percent in three installments. As of March 23, 2010, LADWP had received \$113,333. The borrower has failed to

make the payment for the balance of the loan amount. The case is with the City Attorney's Office.

The current audit did not note any additional borrower's default.

Administrative costs for the Loan Program include costs for loan application, loan processing and loan servicing. The loan application and processing costs increased by 34 percent from calendar year 2009 due to increased hours spent on application reviews, more credit checks performed and inclusion of managers' loan approval time. The total LADWP administrative costs for the last three calendar years are as follows:

	<u>CY 2008</u>	<u>CY 2009</u>	<u>CY 2010</u>	<u>Average</u>
Loan Application & Processing Costs:	\$46,202	\$79,462	\$106,491	\$77,385
Loans Processed:	4	6	6	5
Processing Cost per loan:	<u>\$11,551</u>	<u>\$13,244</u>	<u>\$17,749</u>	<u>\$14,510</u>

For a detailed analysis of administrative cost, please see Attachment 1.

We concluded that the Loan Program was in compliance with the requirements stipulated in LAAC Section 23.141.



Mohammed Del Hossain, CPA
Internal Auditor



Lucy Chou, CPA
Senior Internal Auditor



Dan C. Cuejilo
Senior Internal Auditor

Administrative Cost Analysis

Administrative costs for the Loan Program include costs for loan application, loan processing and loan servicing. The total administrative costs for the last three calendar years are as follows:

	<u>CY 2008</u>	<u>CY 2009</u>	<u>CY 2010</u>	<u>Average</u>
Loan Application & Processing Costs:	\$46,202	\$79,462	\$106,491	\$77,385
Loan Service Costs:	\$12,742	\$13,753	\$15,080	\$13,858
Total Administrative Cost:	<u>\$58,944</u>	<u>\$93,215</u>	<u>\$121,571</u>	<u>\$91,243</u>

Loan application and processing costs include labor costs for review of technical specifications, credit evaluation, financial analysis, and the preparation, review and approval of the loan package. The application and processing costs per loan application for the last three calendar years are as follows:

	<u>CY 2008</u>	<u>CY 2009</u>	<u>CY 2010</u>	<u>Average</u>
Loan Application & Processing Costs:	\$46,202	\$79,462	\$106,491	\$77,385
Loans Processed:	4	6	6	5
Processing Cost per loan:	<u>\$11,551</u>	<u>\$13,244</u>	<u>\$17,749</u>	<u>\$14,510</u>

Loan servicing costs include the preparation and approval of invoices sent to loan recipients, and other administrative tasks. The service costs per outstanding loan for the last three calendar years are as follows:

	<u>CY 2008</u>	<u>CY 2009</u>	<u>CY 2010</u>	<u>Average</u>
Loan Service Costs:	\$12,742	\$13,753	\$15,080	\$13,858
Loans Outstanding:	29	30	24	28
Annual Invoicing Cost per loan:	<u>\$439</u>	<u>\$458</u>	<u>\$628</u>	<u>\$501</u>