

- **Audit Department Report for January 2004**

Summary

- **P&D Consultants, Inc.—Billings and Overhead Costs Special Report**
- **Purchasing Process and Controls Report**
- **Emergency Management Process Risk Assessment Report**
- **Suspense Account Process and Controls Report**

Detailed Report

This report highlights significant activities of the Audit Department during January 2004. In addition to identifying the opinions expressed in the Audit Reports or the risk exposure in the Risk Assessment Report, background information and a discussion of findings noted during the reviews are presented.

P&D Consultants, Inc.—Billings and Overhead Costs Special Report

A limited review of overhead costs and selected billings from P&D Consultants, Inc. was undertaken, at the request of the Inland Feeder Project Manager, to evaluate the propriety of labor, overhead and other direct costs billed to Metropolitan; to determine whether amounts billed had been properly calculated and adequately documented; and to ascertain contractual compliance with Federal Acquisition Regulation Guidelines.

Background

In April 1994, Metropolitan contracted with P&D for environmental mitigation monitoring services related to the Inland Feeder Project (IFP). This agreement was initially a time and material contract capped at \$4.5 million. However, in August 1999, the agreement was amended and converted to a cost reimbursable plus fixed fee contract with the maximum amount payable set at \$11 million. The terms of this contract provided for the reimbursement to P&D of sub-consultants' fees, allowable costs incurred (direct & indirect labor and other direct costs) and a pre-negotiated fixed-fee of 10% of the direct labor and other direct cost expenditures. The indirect labor component was contractually set at a "provisional billing rate" of 170% of the direct labor costs and included a cap of 175% of these costs. The amended contract also required that P&D provide evidence of their actual indirect cost rates within 90 days of fiscal year-end to Metropolitan's Agreement Administrator for possible adjustment of the "provisional billing rate" for the succeeding year. Cumulative through June 30, 2003, P&D has been paid approximately \$8.1 million.

Executive Summary

Overall, costs billed to Metropolitan were properly calculated, adequately documented and conformed to agreement terms. We did note, however, incorrect overhead rate calculations that resulted in overpayments of approximately \$163,000 to P&D for the four fiscal years ended September 2002. Management is making adjustments to future billings to resolve these discrepancies. In addition, we noted instances where Contracting Services Unit management and the P&D Agreement Administrator should strengthen contract development and negotiation procedures to explicitly define all significant contract terms and conditions. Finally, we also identified operating practices in which administrative procedures should be expanded to improve the monitoring of consultants' services and billings. Management concurs with our observations and recommendations and has initiated appropriate steps to improve these processes.

Purchasing Process and Controls Report

Opinion

In our opinion, the accounting and administrative procedures for the Purchasing process include those practices usually necessary to provide for a generally satisfactory internal control structure. The degree of compliance with such procedures provided effective control for the past twelve months.

Background

The Purchasing Unit of the Corporate Resources Group is responsible for purchasing Metropolitan's materials, supplies, and nonprofessional services. Purchasing responsibilities involve creating the appropriate purchase requisition, obtaining required approvals, conducting the bid process and creating and administering the purchase contract. These activities are governed by Metropolitan's Administrative Code; Metropolitan's Operating Policies, General Instructions and Purchasing Manual; and the Uniform Commercial Code. The scope of this review excluded certain types of contracts including major construction contracts, professional consulting agreements, joint participation agreements and real estate contracts.

As of February 28, 2003, Purchasing was responsible for 488 materials, supplies and nonprofessional services contracts open or expired within the last twelve months with a requisition value totaling approximately \$255 million. Purchasing activities are processed through an Oracle purchasing application, which was upgraded during the fourth quarter of 2002.

Comments and Recommendations

Comments were noted in the areas of separation of duties within the purchasing process; system access to Metropolitan's purchasing application; data input into the Oracle Purchasing Module; and VISA card program administrative procedures. Specifically, recommendations were made to adjust the existing purchasing process and Oracle application rules to ensure adequate segregation of duties; limit access to Metropolitan's purchasing application; and modify the Oracle Purchasing Module to preclude execution of incomplete contracts. We also made recommendations related to establishing VISA card procedures to govern the use and acceptance of VISA cards. Management concurs and has initiated changes to departmental procedures.

Emergency Management (EM) Process Risk Assessment Report

Current Exposure: Medium

Current exposure was assessed to be medium, as we identified issues and concerns that continue to require management's concerted and dedicated attention. Since the first audit report issued in August 2003, MWD has made important progress in addressing issues raised. Specifically, management hired a Business Continuity (BC) Manager and created two oversight committees, one consisting of top-level executives and the other consisting of representatives from Information Technology, Operations and Finance, to guide and provide leadership to the Emergency Management (EM) effort. Currently, the BC Manager estimates that about 46% of the various initiatives are complete. We encourage management to take the necessary steps to meet the targets established by the committee. We will continue to provide quarterly risk assessments of these efforts.

Background

The catastrophic attacks on the World Trade Center Building in New York City and the Pentagon in Washington, D.C., along with the attack on the Alfred P. Murrah Federal Building in Oklahoma City, shocked the nation into the reality that there are no domestic safe havens from acts of terrorism. These

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unrelated events punctuate our nation's vulnerability, and highlight California's risk of similar attack against its public officials, private and multi-national corporations, and public infrastructure and government facilities. Additionally, California's history of earthquakes and other natural disasters underscores the need to have a well-developed emergency management process that details the procedures and resources necessary to respond to any emergency.

In response to these threats, Metropolitan has established an EM strategy, which includes maintaining an Emergency Operations Center and Business Incident Command Center at the Eagle Rock, Water Quality and Field Incident Command Centers and in implementing an Information Technology disaster recovery process. This process is aligned with industry best practice to focus on the organization's critical operational and business processes that need to be recovered in the event of a disaster.

Suspense Account Process and Controls Report

Opinion

In our opinion, the accounting and administrative procedures over the suspense account process include those practices usually necessary to provide for a generally satisfactory internal control structure. The degree of compliance with such procedures provided effective control for the period July 1, 2002 through September 30, 2003.

Background

A "suspense" account is opened to record expenditures or income that cannot be properly allocated to a specific budget related expenditure or income account. By definition, entries in suspense accounts are transitional and they should not remain in the suspense account over a period of time. For this reason, individual entries in suspense accounts should be properly documented and should be reviewed regularly to confirm that their retention in suspense is justified.

Metropolitan's suspense account is a general ledger sub-account used primarily to record cash receipts and bank deposits or credits temporarily, which are not identifiable due to lack of supporting documentation at time of receipt. As of September 30, 2003, the outstanding balance in the suspense account totaled \$1,218,568.

Comments and Recommendations

Comments were noted in the area of unidentified cash receipts and bank deposits or credits. Specifically, recommendations were made to investigate outstanding undistributed receipts promptly.