

- **Internal Audit Report for April 2004**

Summary

- **Hatch Mott MacDonald Report**
- **State Grants Report**

Detailed Report

This report highlights significant activities of the Audit Department during April 2004. In addition to identifying the opinions expressed in the Audit Reports, background information and a discussion of findings noted during the reviews are presented.

Hatch Mott MacDonald Report

Opinion

In our opinion, the accounting and administrative procedures over the Hatch Mott MacDonald (HMM) agreements include those practices usually necessary to provide for a satisfactory internal control structure. The degree of compliance with such procedures provided effective control for the period January 1, 2002 through December 31, 2003.

Background

Metropolitan's Inland Feeder Project (IFP) is a high-capacity gravity-fed water delivery system that consists of a 44.2 mile, 12-foot-diameter tunnel/pipeline. Budgeted at \$1.18 billion, the IFP is the District's largest active construction project. The IFP tunnel/pipeline will link together the State Water Project and Colorado River systems; will improve water quality by blending State Water Project and Colorado River waters; and will convey and store water in groundwater basins and surface reservoirs within Metropolitan's service area for use during drought conditions.

As part of the IFP, Metropolitan awarded two consulting agreements to HMM. The original agreement (No.18703), effective August 25, 1998, provides construction management services for the Arrowhead West Tunnels, payable in an amount not to exceed \$10 million. The second agreement (No. 46862), effective May 1, 2002, provides construction management services for the Arrowhead Tunnels and other reaches of the IFP, payable in an amount not to exceed \$12 million. Both agreements are cost-reimbursable plus fixed-percentage fee-type contracts. As of December 31, 2003, approximately \$10 million had been paid to HMM for both agreements.

Comments and Recommendations

Isolated and minor instances of non-compliance to the terms and conditions of the agreements were noted during the review. Recommendations were made that IFP management to remind staff of the importance of compliance with the terms and conditions of the agreements and to conduct periodic reviews of HMM's activities to ensure compliance.

State Grants Report

Opinion

In our opinion, the accounting and administrative procedures for State Grants include those practices usually necessary to provide for a generally satisfactory internal control structure over the administration of State grants. The degree of compliance with such procedures provided effective control for the period from July 2002 through September 2003. Although this report is issued with an acceptable opinion, we noted internal control concerns relating to the centralization of grant management and standardization of policies and procedures. We recommend that management address these concerns.

Background

As of September 30, 2003, Metropolitan was awarded thirteen state grants totaling \$111 million from the Department of Water Resources, the California Energy Commission, and from the CALFED Bay-Delta Authority. Water Resources Management (WRM) administers eight of these grants (totaling \$103 million) and Water Systems Operations (WSO) administers five grants (totaling \$8 million). Day-to-day grant administration is assigned to project managers within WRM and WSO, who are responsible for monitoring project activities, and for reviewing and approving grant reimbursement and sub-recipient payment requests. In addition, WRM and WSO have assigned a "Grant Administrator" within their group to coordinate grant accounting and administration related activities with their project managers.

As support for grant activities, the Project Coordination Office of the Corporate Resources Group is responsible for establishing and closing projects upon request from the individual project managers. Additionally, the Controller Section from the Office of the Chief Financial Officer is responsible for activating account numbers for new projects, processing state grant reimbursement and sub-recipient payment requests and for processing costs transfers.

The scope of our review consisted of evaluating the efficiency and effectiveness of the grant administration and accounting functions to ascertain compliance with Metropolitan's policies and procedures and with state grant contractual requirements.

Comments and Recommendations

Comments were noted in the areas of grant administration, completion of a policies and procedure manual, compliance to grant accounting practices, timely project status reporting, and in improving the timing of advance payments made to grant sub-recipients. Specifically, we recommended that management consider centralizing the grant administration function to promote operating efficiencies, align accountabilities and responsibilities, improve control over grant compliance and to consolidate the District's ability to leverage relationships with Grant providers.

We also made recommendations that management establish a completion date for the Policies and Procedures manual, establish procedures to ensure that grant accounting principals and reporting practices are complied with on a consistent basis, and thirdly that management assess the feasibility of aligning reimbursements made to sub-recipients of future grant contracts with that of the expenditure reimbursement terms in state grant agreements.