MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

• Internal Audit Report for June 2005

Summary

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- **Agreement with Keith Companies, Inc. Audit Report**
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- **Contract with Banshee Construction Company, Inc. Audit Report**

Detailed Report

This report highlights significant activities of the Internal Audit Department during June 2005. In addition to presenting the opinions expressed in the audit reports, background information and discussions of findings noted during the reviews are presented.

The Center for Water Education Audit Report

Opinion
In our opinion, the accounting and administrative procedures over The Center for Water Education (The Center) 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 October 1, 2003 through March 31, 2005.

Background
In 2001, Metropolitan formed an independent entity known as The Center. In order to begin design of the facilities, Metropolitan awarded The Center a $2 million grant. In May 2003, Metropolitan approved an additional $14 million grant to The Center. The Center leases their museum location from Metropolitan, and Metropolitan also provides administrative and financial services support to The Center for a monthly fee.

The Center is being constructed adjacent to Diamond Valley Lake as part of the East Recreation Area being developed by Metropolitan. The Center and the Western Center for Archaeology and Paleontology (The Western Center) are located on the same campus and share some common areas. The Center, although an independent entity, will work cooperatively with Metropolitan's water education program that currently reaches 1,000 classrooms and 30,000 students annually. The Center plans to highlight the rich history of water, the environment, and the cultural heritage of Western North America, with a focus on the role that water plays in cultural, biological, climatic, environmental, social and economic continuity, and change.

Comments and Recommendations
Comments were noted in the areas of lease agreements; shared improvement costs; non-compliance with insurance provisions; and inaccurate interest calculations. Specifically, we noted that The Center had not received $1.3 million from The Western Center, as of March 31, 2005, for shared improvement costs paid on their behalf. Of this amount, $1.15 million was past due and no interest had been accrued. It should be noted that a payment of $1.1 million was received from The Western Center on May 6, 2005. We also

noted that required insurance coverage on three agreements examined did not comply with contractual provisions and that an error in calculating interest earned resulted in an overstatement of interest income of $52,000. It should be noted that this overstatement was adjusted in April 2005.

We recommended that the Agreement Administrators consistently monitor the agreements to ensure compliance with the terms and conditions of the agreements and to ensure adequate control over billings and payments. We also recommended that the Agreement Administrators consistently monitor The Center's vendors to ensure compliance with the terms and conditions of the agreements and to ensure adequate control over vendor payments. Finally, we recommended that Metropolitan and The Center's management continue to review the financial statements of The Center.

Agreement with Keith Companies, Inc. Audit Report

Opinion

In our opinion, the accounting and administrative procedures over the Keith Companies agreement 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 January 20, 2003 through March 31, 2005.

Background

The Diamond Valley Lake (DVL) East Recreation Area is immediately adjacent to the DVL East Dam. As the site developer, Metropolitan is responsible for the installation of infrastructure to support planned recreation amenities. Such amenities planned for the site include: (1) the Center for Water Education; (2) the Western Center for Archeology and Paleontology; (3) the Valley-Wide Recreation Park and Aquatic Facility; (4) a recreation lake with day-use picnic area; and (5) a youth camp. Infrastructure required to support these planned facilities includes roadway, utilities, drainage facilities, and miscellaneous grading. Through March 2005, $34.7 million has been spent on the DVL Recreation program.

As part of the development of the DVL East Recreation Area, Metropolitan awarded an agreement to Keith Companies, effective from January 2003 through January 2005, to prepare infrastructure construction drawings and specifications suitable for future construction at the DVL East Recreation site. Specifically, this agreement requires Keith Companies to design infrastructure for utility lines, drainage facilities, roadways, pathways, and parking lots in addition to construction bid documents for these areas. In December 2004, this agreement was amended to provide rough grading design and technical support during construction at the Valley-Wide Recreation Park through December 2006. The Keith Companies agreement is a time and material type contract with a total amount payable limitation of $1.195 million (as amended). As of March 31, 2005, approximately $628,000 on sixteen billings has been paid to Keith Companies.

Comments and Recommendations

Comments were noted in the areas of timely submission of billings; missing timesheets; and mark-ups on billings for temporary employees. Specifically, although the contract calls for monthly billings, we noted five invoices that included labor charges totaling approximately $349,000 for work performed over an extended period ranging from two to nine months. In addition, the consultant did not include timesheets substantiating employees' labor charges on any of the invoices reviewed and overpayments from the incorrect billings reviewed totaled approximately $18,000. Finally, we were unable to locate the evaluation worksheet used in the consultant selection process. It should be noted that management initiated remedial actions during our review in response to these issues; we commend them for their quick response.

We recommended that DVL management request that Keith Companies refund the $18,000 in excess payments. We further recommended that the Agreement Administrator and other DVL staff continue to work with Keith Companies to ensure compliance with terms and conditions of the agreement. In addition, we recommended that the Agreement Administrator conduct periodic reviews of Keith Companies' activities to ensure compliance with the terms and conditions of the agreement. Finally, we recommended that the Contract Administration Section retain all documents pertinent to the consultant selection process.

Risk Management Process Audit Report

Opinion
In our opinion, the accounting and administrative procedures over the Risk Management 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 January 1, 2004 through March 31, 2005.

Background
Oversight of Metropolitan's risk management related activities is shared between the Chief Financial Officer's Risk Management Unit (Risk Management) and the Water System Operation's Workplace Health and Safety Unit (WHS). Risk Management is responsible for managing Metropolitan's property/liability claims program and for directing the Health, Safety, and Environmental (HSE) Audit program. This review did not include a review of the HSE Audit program, as that review was completed in 2004. Risk Management is also responsible for assessing risk related to contracts, leases and permits; purchasing insurance policies; and administering risk management related contracts excluding the workers compensation claims administration contract. WHS is responsible for managing the workers compensation claims program and administering the third party claims administrator contract.

Metropolitan self-insures third party liability for $25 million, 100% for property damage, and the first $2 million per occurrence for workers compensation claims. In addition, Metropolitan annually purchases excess commercial liability insurance coverage and obtains specialty insurance. Metropolitan contracted with Carl Warren & Co. to administer the property/liability claims program, with a maximum annual contract amount of $130,000, and with JT2 Integrated Resources to administer the workers compensation claims program, with a maximum annual contract amount of $175,000.

For the fifteen-month period ending March 31, 2005, Metropolitan resolved 180 non-litigated third party liability claims, which included 33 settled claims totaling $ 120,000; 119 unrecoverable claims totaling $340,000; and 28 recovered-payments totaling $150,000. Additionally, Metropolitan also settled 35 workers compensation claims totaling $859,000. As of March 31, 2005, Metropolitan has 553 outstanding claims, including 380 property/liability claims and 173 workers compensation claims.

Comments and Recommendations
Comments were noted in the areas of inconsistent reporting of claims costs; lack of updated or non-existent policies and procedures; inaccurate reporting of claims; and non-compliance with established contract tracking procedures. For example, we noted that the claims handling procedures manuals have not been updated since 1996 and that guidelines for writing-off uncollectible judgments do not exist, resulting in

instances in which claim settlements, cost collections, and uncollectible judgments were reported incorrectly.

We recommended that management establish target dates for the completion of the Property/Liability Incident and Claims Handling Procedures Manual. Additionally, we recommended that management provide training to employees to ensure that they understand how to perform the tasks indicated in the manual and periodically test to ensure compliance with these procedures. Finally, we recommend that an uncollectible amount totaling $122,000 be written off.

With respect to inaccurate reporting of claims to management, we recommended that Risk Management remind the third party claim administrator of the importance of providing timely updated information. We also recommended that Risk Management establish procedures to ensure that management reports provide accurate, complete, and timely information. Additionally, we recommended that management perform periodic reconciliations of reported claims to ensure accuracy and completeness of its records and to ensure that adequate follow-up procedures exist. Finally, we recommended that management establish procedures to ensure compliance with the District's policies and procedures and conduct periodic reviews to ensure compliance.

Power Operations and Administration Audit Report

Opinion
In our opinion, the accounting and administrative procedures over Metropolitan's power operations 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, 2004 through December 31, 2004.

Background
Over 2,400 gigawatt hours (GWH) of electricity are required in years that Metropolitan pumps 1.25 million acre-feet of water on the Colorado River Aqueduct (CRA). This energy is obtained through federal power contracts at the Hoover and Parker Dam Power Plants, a contract with Southern California Edison (SCE) for benefit and exchange energy, and supplemental energy purchases. Metropolitan's federal power contracts are cost-based and, together with benefit and exchange energy from SCE, provide about 70 percent of the total annual CRA energy requirement. The remaining 30 percent is purchased in the wholesale power market to serve off-peak needs and is commonly referred to as supplemental energy. Metropolitan relies on both forward purchase contracts of not more than one year in duration and day-ahead purchases to secure this supplemental energy. The Operations Planning Unit of the Water System Operations Group manages Metropolitan's power resources, contracts, and pre-scheduling functions.

For the calendar year 2004, Metropolitan used approximately 1,508 GWH to move water along the CRA at a net cost of $4.6 million. In addition, power revenues from Metropolitan's sixteen hydroelectric power plants totaled $23 million. It is important to note that these figures do not include the energy costs billed to Metropolitan as part of the State Water Project. It should be noted that our audit scope did not evaluate the calibration nor determine the reliability of the flow meters.

Comments and Recommendations
Minor and isolated comments were noted in the area of inspecting meters at Hoover Dam. Specifically, we were unable to locate the results of the meter inspection for 2004. Furthermore, the latest test available was performed in 2001 and one of the meters did not pass the test. It should be noted that Western Area

Power Administration is working on new protocols for online meter testing and plans to implement the program by July 2005. We understand that mitigating controls exist that would detect inaccurate or erroneous meter readings.

Contract with Banshee Construction Company, Inc. Audit Report

Opinion

In our opinion, the accounting and administrative procedures over the Banshee Construction contract 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, 2004 through April 30, 2005.

Background

The Colorado River Aqueduct (CRA) is a 242-mile-long conveyance system designed to transport water from Lake Havasu to Lake Matthews. The CRA, which has been in operation for more than 60 years, consists of five pumping plants, 124 miles of tunnel, 63 miles of concrete-lined canal, 55 miles of cut-and-cover conduit, inverted siphons, reservoirs, and pumping plant piping. The CRA provides the only means for Metropolitan to convey water from the Colorado River to Southern California. Any disruption to CRA water conveyance would significantly limit the water supply to Metropolitan service areas.

An extensive program to rehabilitate the CRA was initiated in 2001 with four distinct programs being identified within Metropolitan's Capital Investment Plan (CIP). One program is the CRA Conveyance Reliability Program that focuses on the rehabilitation of water conveyance infrastructures including canals, siphons, and tunnels. This program consisted of two phases. Phase I, rehabilitation of reservoirs, trash racks, and portions of deteriorated canal liner, was completed during the fiscal year 2002/03 shutdowns. Phase II, which included the Banshee Construction contract, in the amount of $10.8 million, was designed to replace the existing concrete canal liner with new liner; rehabilitate three sand traps at Hinds, Eagle Mountain, and Iron Mountain Pumping Plants; rehabilitate existing siphons; install tunnel monitoring instrumentation for the Iron Mountain Tunnel; dewater five siphons for Metropolitan's investigation; and furnish sealer gates and blocker gates. This contract commenced in September 2004 and scheduled to be completed by September 2005. As of April 30, 2005, approximately $9 million has been paid to Banshee Construction.

Comments and Recommendations

There were no material findings to report.