

- **Internal Audit Report for October 2005**

Summary

An Audit Report and a Limited Review Report were issued during the month of October 2005:

- **United States Forest Service Review** – Issued without an opinion
 - **Moffatt & Nichol Engineers Audit Report** – Issued with a Generally Satisfactory opinion
-

Discussion Section

This report highlights the significant activities of the Internal Audit Department during October 2005. In addition to presenting background information and the opinion expressed in the audit report, a discussion of findings noted during the examinations is presented.

United States Forest Service Review

Project Description

Based upon the request of Inland Feeder Management, a limited review of payments made to the Forest Service from May 1999 to June 2005 was completed. This limited review tested the accuracy of payments made to the Forest Service and evaluated the completeness of supporting documentation for such payments. The objective of this limited review then, was to evaluate compliance with the terms and conditions of the contractual agreement with the Forest Service. Accordingly, this review included an evaluation of Forest Service documentation in support of the voluntary payments; a recomputation of total expenditures incurred by the Forest Service for each corresponding period; and a comparison of these totals to the advance payments made by Metropolitan.

It is important to note that Inland Feeder Management made several requests to the Forest Service for them to supply supporting documentation per the terms and conditions of the contract. We understand that the Forest Service largely ignored these requests and, as a result, Inland Feeder Management enlisted the Audit Department to assist in obtaining and evaluating these records.

Background

In 1993, the Forest Service granted Metropolitan a Special Use Permit for the construction, operation, and maintenance of a tunnel/pipeline on National Forest System land within the San Bernardino National Forest. In 1997, Metropolitan entered into a Collection Agreement to reimburse the Forest Service for staff costs incurred in reviewing, analyzing, and monitoring groundwater and mitigation activities associated with the construction of the Arrowhead Tunnels for the Inland Feeder Project (IFP). This work was initially estimated to cost \$35,000 annually for

the duration of the IFP. In return, Metropolitan agreed to make voluntary advance payments, upon request by the Forest Service, to cover the cost of mutually agreed upon work. Furthermore, the agreement required the Forest Service to provide an itemized statement of actual expenditures for completed work when requesting additional advance payments.

Metropolitan then suspended tunneling operations in April 1999 due to concerns from the Forest Service and the San Manuel Band of Mission Indians (Mission) regarding the amount of groundwater inflows into the tunnel. Working closely with the Forest Service, the Mission's representatives, and other technical experts to improve design and construction techniques to minimize short-term impacts on the local groundwater table, Metropolitan resumed construction of the IFP tunnel in mid-2001. In addition, the Forest Service amended Metropolitan's special use permit in July 2001 to extend the expiration date from the original construction completion date of December 31, 2002 to the current completion date of December 31, 2008.

In December 2004, the Collection Agreement was amended, for the sixth time, to increase the maximum reimbursable fee to \$5 million to compensate the Forest Service for all required work anticipated through completion of the IFP in December 2008. Total fees paid since inception of the agreement in 1997 through June 2005 were approximately \$3,170,000.

Review Engagement

This review was conducted in accordance with the Institute of Internal Auditor's International Standards for the Professional Practice of Internal Auditing applicable to **review engagements**. The scope of a **review engagement** is limited in nature and thus provides less assurance than an audit conducted in accordance with Generally Accepted Auditing Standards. As such, review procedures performed would not necessarily disclose all material weaknesses in the internal control structure over the agreement with the Forest Service. Accordingly, we do not express an audit opinion on the internal control structure over the agreement with the Forest Service.

Comments and Recommendations

The comments and recommendations section of this report describes opportunities to improve operations.

VOLUNTARY ADVANCE PAYMENTS

Metropolitan's collection agreement with the Forest Service requires Metropolitan to make voluntary advance payments to cover the cost of mutually agreed upon work to be performed by the Forest Service. The agreement also requires the Forest Service to deposit these advance payments into their "cooperative work fund" upon receipt and to either refund funds in excess of project expenditures or apply such excess toward subsequent agreements, at Metropolitan's request.

During our review of the Forest Service's accounting records, Forest Service staff prepared a reconciliation of Metropolitan's voluntary advance payments and project expenditures for fiscal years 1999 through June 2005. The reconciliation revealed that Metropolitan has contributed

approximately \$634,000 in excess of expenditures made by the Forest Service since inception of the project through June 30, 2005, as shown in the following table:

Fiscal Year	Project Expenditures	Overhead	Total Expenditures	MWD Advance Payments	Advance Payments over (under) Expenditures
1999	\$85,156	\$21,289	\$106,445	\$135,000	\$28,555
2000	342,506	68,501	411,007	305,000	(106,007)
2001	530,806	102,333	633,139	525,000	(108,139)
2002	323,245	64,649	387,894	490,000	102,106
2003	365,870	73,026	438,896	735,000	296,104
2004	240,797	47,911	288,708	490,000	201,292
2005	210,693	59,564	270,257	490,000	219,743
	\$2,099,073	\$437,273	\$2,536,346	\$3,170,000	\$633,654

It should be noted that we compared advance payments in Metropolitan's accounting records to the Forest Service's reconciliation and noted that all advance payments had been recorded in the Forest Service's accounting records. We also determined that adjustments in the reconciliation for cost transfers between years resulting from the Forest Service's accounting and administrative problems were reasonable. Finally, we were able to agree total expenditures on the reconciliation for FY 2004 and 2005 to transaction registers tested and concluded that the reconciliation had been properly prepared.

We recommended that IFP management request that the Forest Service apply the \$633,654 in excess payments noted above to future work to be performed on behalf of Metropolitan. We further recommend that the IFP management and staff work with the Forest Service to ensure compliance with terms and conditions of the agreement. Finally, we recommended that IFP management or staff conduct periodic reviews of the Forest Services activities to ensure compliance with the terms and conditions of the agreement. IFP management concurs with these recommendations.

COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENT

The terms and conditions of the Forest Service agreement identify documentation required to properly administer the agreement. This requires the Forest Service to include an itemized statement of actual expenditures for completed work with each subsequent request for additional advance payments.

Our review revealed that the Forest Service requested 16 advance payments totaling \$3.1 million during the period from May 1999 through June 2005 without providing itemized statements of actual expenditures for work previously completed. It should be noted that Metropolitan's IFP management requested such documentation on several occasions and it was not until they requested assistance from the Audit Department that any documents were provided. It should also

be noted that Forest Service personnel has indicated that they experienced accounting, administrative, and management problems that contributed to the lack of response to our requests.

We recommended that the Forest Service estimate advance payments required from Metropolitan and submit such requests on a quarterly basis. We also recommended that the Forest Service attach a summary level "Transaction Registers: Actual Expenditure Reports" to these future requests for advance payments. Finally, we recommended that IFP management use these summary level reports as the basis for requesting additional detailed documentation, as deemed necessary, to ensure compliance with the terms and conditions of the agreement. IFP management and the Forest Service concur with these recommendations.

MONITORING PROJECT EXPENDITURES

Our review then focused on an evaluation of documentation received from the Forest Service. We reviewed supporting documentation for transactions totaling approximately \$1.4 million (or 61%) of the \$2.3 million spent on the Project during the period from May 1999 to September 2004. Our review included cost transfers between fiscal years; disbursements to other governmental agencies (i.e. United States Department of the Interior, Bureau of Reclamation and the United States Department of the Interior, Geological Survey); overhead applied; employee payroll charges; and disbursements to consultants.

Our review revealed a lack of documentation supporting services provided by other governmental agencies for the period May 1999 through September 2002. Specifically, we could not locate documentation supporting \$365,865 of the \$604,715 disbursements tested and made to other governmental agencies. It should be noted that we were able to review adequate documentation for selected disbursements to these agencies for fiscal year 2004.

We recommended that IFP management and staff work with Forest Service staff to ensure that documentation is provided to Metropolitan to support billings from other governmental agencies for the current and future fiscal years to ensure compliance with the terms and conditions of the agreements.

Moffatt & Nichol Engineers Audit Report

Background

In October 2002, the Diamond Valley Recreation Special Committee and Metropolitan's Board appropriated funds and authorized preliminary design of Phase I of the East Marina at Diamond Valley Lake (DVL). This request was in response to a desire to open DVL for boating by summer 2003. Phase I design was tailored to develop limited and necessary facilities sufficient to meet the scheduled opening date. The facilities constructed under Phase I were: (1) completion of the East Marina Road, (2) installation of a temporary parking area, (3) temporary restroom facilities, (4) installation of a boat launch ramp, (5) dock facilities, and (6) wave attenuator.

As part of the development of the DVL East Marina, Metropolitan awarded an agreement to Moffatt & Nichol, effective from October 2002 through October 2004, to provide design services for Phase I of the East Marina in an amount not to exceed \$750,000. On April 8, 2003 the agreement was amended to include preliminary design for Phase II of the East Marina and the maximum amount payable was increased by \$299,000 to \$1.049 million. On December 9, 2003, the agreement was amended to include design for the boat ramp extension project and the maximum amount payable was increased by \$164,600 to \$1.214 million and extended the term of the agreement until October 23, 2005. As of June 30, 2005, approximately \$1.17 million on forty-eight billings has been paid to Moffatt & Nichol.

Opinion

In our opinion, the accounting and administrative procedures over the Moffatt & Nichol 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 October 24, 2002 through June 30, 2005.

Comments and Recommendations

Comments were noted in the areas of improper mark-ups and charges on contractor billings and other minor contract administrative findings.

Specifically, we noted that seven of the eighteen invoices tested included mark-ups on labor and reimbursable costs for Moffatt & Nichol and their sub-consultants. Further, we noted that such mark-ups, ranging from 2% to 6% on labor charges and 15% on reimbursable costs, resulted in overpayments of \$5,874. We recommended that DVL management seek repayment of these charges. DVL management concurs with this recommendation.