

- **Internal Audit Report for May 2006**

Summary

One comfort letter and five audit reports were issued during the month:

- **Official Statement for the Water Revenue Refunding Bonds, 2006 Series A-1 and A-2 Review**
 - **Brutoco Engineering & Construction, Incorporated Audit Report – Satisfactory**
 - **Camp, Dresser & McKee Engineers Audit Report – Satisfactory**
 - **Employee & Director Expense Audit Report – Satisfactory**
 - **Proposition 13 Conjunctive Use Programs Audit Report – Satisfactory**
 - **Tuition Reimbursement Program Audit Report – Generally Satisfactory**
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Discussion Section

This report highlights the significant activities of the Internal Audit Department during May 2006. In addition to presenting background information and the opinion expressed in the audit report, a discussion of findings noted during the examination is presented.

Official Statement for the Water Revenue Refunding Bonds, 2006 Series A-1 and A-2 Review

The Audit Department has completed a review of the Official Statement for the Water Revenue Refunding Bonds, 2005 Series A, Series B-1, and Series B-2. This review was undertaken to provide the underwriters of the Water Revenue Refunding Bonds (Bonds) “comfort” that the Official Statement for the Bonds is complete, consistent with supporting financial records, and accurate in all material respects. The review was completed and no exceptions were noted. We issued letters describing the agreed upon review procedures performed, and the results obtained, to the underwriters of the Bonds.

Brutoco Engineering & Construction, Incorporated Audit Report

Background

On September 14, 2004, Metropolitan’s Board awarded Brutoco Engineering & Construction, Incorporated (Brutoco) a construction contract for \$14.09 million for the Weymouth Solids Handling Facility. These services consist of upgrading an existing sludge pump station, constructing two gravity thickeners, a new solids dewatering facility building to house three new filter belt presses, a truck loading facility, and four solids storage hoppers. As of March 31, 2006, this project is 99% completed and approximately \$14.06 million has been paid to Brutoco.

The coagulant chemical feed systems at Metropolitan's treatment plants were originally designed for turbidity and particle removal, which resulted in low to moderate chemical usage. However, to comply with Stage 1 of the Disinfectants By-Products Rule, the coagulant dosages have been significantly increased to improve disinfection by-product precursor removal. The higher coagulant dosage is specifically required while treating the higher percentages of State project water that are used at the F.E. Weymouth Filtration Plant. The resulting increased solids production is currently being mechanically processed with leased equipment. A permanent solids handling facilities will allow Metropolitan to reliably treat higher percentages of State project water while complying with water quality regulations and existing permit conditions.

Opinion

In our opinion, the accounting and administrative procedures over the Brutoco 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 October 20, 2004 through March 31, 2006.

Comments and Recommendations

There were no material findings to report.

Camp, Dresser & McKee Engineers Audit Report

Background

Metropolitan's Oxidation Retrofit Program (ORP) consists of retrofitting its five water treatment plants with an ozonation process to replace chlorine as the primary disinfectant to meet U.S. Environmental Protection Agency disinfectant by-product standards. Total estimated program cost for the ORP Program is \$829.4 million, and the program's construction completion date is scheduled for late 2010 and start-up activities in early 2011. The Mills and Jensen treatment plants were the first two facilities within Metropolitan's system to be retrofitted and were placed into service in October 2003 and July 2005, respectively.

As part of the development of ORP, Metropolitan awarded an agreement to Camp, Dresser & McKee (CDM) Engineers, effective November 13, 2002 through November 12, 2007, to provide process engineering services for the Skinner, Diemer, and Weymouth Oxidation Retrofit Programs in an amount not to exceed \$500,000. On July 8, 2003, the agreement was amended to include final design for the Skinner ORP and Skinner Expansion No. 4, which will add additional capacity to the Skinner plant and the maximum amount payable to CDM Engineers was increased by \$13,951,000.

On June 30, 2004, the agreement was amended to include preparation and revision work for ozone equipment specifications for remaining ORP treatment plants, with a maximum amount payable increase of \$300,000. On November 11, 2004, the agreement was again amended to include a \$600,000 increase for technical assistance with preliminary, final design, and construction support of ORP projects. On July 18, 2005, the agreement was further amended to include a \$5,500,000

increase, bringing the maximum payable amount to \$20,851,000 for construction engineering support services for the Skinner ORP and Washwater Reclamation Plant No. 3 (Washwater Reclamation Plant is a component of the Skinner Expansion No. 4). As of February 2006, approximately \$14.9 million has been paid to CDM Engineers.

Opinion

In our opinion, the accounting and administrative procedures over the CDM Engineers agreement 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 November 1, 2002 through February 28, 2006.

Comments and Recommendations

During our review, we noted some minor non-compliance with the terms and conditions of the agreement. Specifically, we noted task orders being completed late and charges incorrectly applied resulting in a net underpayment of \$3,842.

We recommend that the Agreement Administrator work with CDM Engineers to ensure compliance with terms and conditions of the agreement. In addition, we recommend that the Agreement Administrator conduct periodic reviews of CDM Engineer's activities to ensure compliance with the terms and conditions of the agreement.

Employee & Director Expense Audit Report

Background

Metropolitan's Administrative Code and Travel Guide specify travel policies; expense reporting procedures; and guidelines for preparing and submitting expense reports. Expense reports are processed through the Travel Expense Reporter (TER) system for directors and employees who have incurred travel and operating expenses on behalf of Metropolitan. The Payroll and Accounts Payable Team from the Controller Section, in the Office of the Chief Financial Officer, administer and record expense reports and issue payments.

For the twelve months ended March 31, 2006, expenses totaling approximately \$2.2 million were processed through TER. This total was made up of 1,053 employees who submitted 5,483 expense reports amounting to \$2 million, and 31 directors who submitted 149 reports totaling \$226,674. Airfare, lodging, per diem for employees, and business mileage accounted for \$1.5 million or 67% of total expenses incurred for the review period.

Opinion

In our opinion, the accounting and administrative procedures over employee and director expense reports 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 April 1, 2005 through March 31, 2006.

Comments and Recommendations

During our review, we noted comments relating to compliance with established policies and procedures, which are presented in detail.

COMPLIANCE WITH ESTABLISHED POLICIES AND PROCEDURES

During our review of employee and director expense reports between April 1, 2005 and March 31, 2006, we noted:

- Section 6331(b)(2) of the Administrative Code states “Directors’ expense claims shall be submitted to the Executive Secretary’s office no later than the end of the month following the month in which the director incurred the expenses or participated in an activity for which District funds were utilized on the director’s behalf.” In addition, Section 6331 (b)(3) states “Employees’ expense claims, approved in accordance with the provisions of this section, shall be submitted to the Office of the Chief Financial Officer no later than the end of the month following the month in which the employee incurred the expenses or participated in an activity for which District funds were utilized on the employee’s behalf.” We noted 561 approved expense reports totaled \$551,199 included expenses for periods ranging from 61 days to 700 days after the expenses were incurred. The expense reports submitted by employees and directors beyond the 60-day guideline are:
 - 1) Employee expense reports: 482 expense reports were submitted beyond the 60-day guideline. It should be noted that the number of expense reports submitted beyond the 60-day guideline remained the same as prior report at 9%.
 - 2) Director expense reports: 81 expense reports were submitted beyond the 60-day guideline. It should be noted that the number of expense reports submitted beyond the 60-day guideline increased slightly from 48% during prior audit to 54% during review period.
- A Director, who incurred prepaid expenses totaling \$10,074 from July 2003 to December 2005, has yet to file the expense reports.
- Chapter 5 Section C of the Travel Guide states, “Expenses of \$25 or more must be accompanied by supporting documentation. Supporting documentation may include (1) original receipts, (2) itemized bills, (3) charge tickets for expenses charged on Metropolitan credit cards, (4) photocopies of charge tickets for items charged on personal credit cards, (5) charge slips for business meals, (6) airfare receipts, even if Metropolitan paid for the airfare, including a notation of any unused airline tickets returned to the BRC Travel Desk.” We noted four instances (2 directors and 2 employees) where expenses greater than \$25 were not accompanied by supporting documentation.

We recommend that Group Managers continue to emphasize the importance of compliance with established procedures and conduct periodic tests to ensure compliance.

Proposition 13 Conjunctive Use Programs Audit Report

Background

On March 7, 2000, California voters approved Proposition 13 allowing the state to sell \$1.97 billion of general obligation bonds to improve the safety, quality, reliability of water supplies, and to improve flood protection.

In May 2000, the Governor released the State Annual Budget, which appropriated funds to the Department of Water Resources (DWR) to carry out a number of programs that provide loans and grants to local agencies for various water-related purposes. Under this Safe Drinking Water, Clean Water, Watershed Protection and Flood Protection Act, DWR allocated \$45 million in grants to Metropolitan to help finance its groundwater conjunctive use programs. These programs are part of Metropolitan's Integrated Resources Plan (IRP), adopted by its Board of Directors in January 1996 to provide additional dry-year supply. The 1996 IRP identified the need for 200,000 acre-feet (AF) per year of dry-year yield from Southern California region groundwater storage by 2000; 275,000 AF per year by 2010; and 300,000 AF per year by 2020.

In November 2000, Metropolitan issued an initial Request for Proposals to its member agencies to prospect participation in its groundwater storage programs. As of December 31, 2005, Metropolitan has eight active agreements with seven member agencies and allocated \$40 million of Proposition 13 grants to fund their water reliability improvement projects. The seven member agencies include Long Beach, Central Basin Municipal Water District, Inland Empire Utilities Agency, Municipal Water District of Orange County, Foothill Municipal Water District, Three Valleys Municipal Water District, and City of Compton.

Opinion

In our opinion, the accounting and administrative procedures over the programs 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, 2005.

Comments and Recommendations

There were no material findings to report.

Tuition Reimbursement Program Audit Report

Background

Metropolitan encourages the personal growth of employees by offering a Tuition Reimbursement Program (Program). Administrative Code and Operating Policy J-01 specifies this Program's policies and eligibility criteria. Under the Program, employees may be approved for reimbursement of tuition and eligible fees up to a maximum of \$8,000 per year. These reimbursements are limited to expenses associated with voluntary, off-duty education programs,

or courses benefiting both the employee and Metropolitan. For the eighteen-month period ended December 31, 2005, tuition reimbursements requested by 107 employees totaling \$413,315 were processed through the Travel Expense Reporter System.

Opinion

In our opinion, the accounting and administrative procedures over the Tuition Reimbursement Program include those practices usually necessary to provide for a generally satisfactory internal control structure. The degree of compliance with such policies and procedures provided effective control for the period July 1, 2004 through December 31, 2005.

Comments and Recommendations

During our review, we noted issues with reconciliations of tuition reimbursements, compliance with established procedures, and review and approval controls. We conducted detailed discussion with management and have received an acceptable and thorough response that adequately addresses the noted concerns.