

- **Internal Audit Report for July 2006**

Summary

Two audit reports were issued during the month:

- **Human Resources Section Audit Report – Unsatisfactory**
 - **Butier Construction Managers Audit Report – Generally Satisfactory**
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Discussion Section

This report highlights the significant activities of the Internal Audit Department during July 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.

Human Resources Section Audit Report

Background

Human Resources Organization is guided by an internal control structure established and maintained by Metropolitan Management. The objective of internal controls are to provide reasonable, but not absolute, assurance as to the reliability and integrity of information; compliance with policies, plans, procedures, laws and regulations; the safeguarding of assets; the economical and efficient use of resources; and the accomplishment of established goals and objectives. Management is required to assess the expected benefits and related costs of control practices and procedures, and to determine if they will achieve Metropolitan's financial and operational objectives.

Opinion

In our opinion, the Human Resources Section is operating at an unsatisfactory level. Our examination revealed poorly designed business practices and significant operating inefficiencies that have resulted in lost productivity and excessive labor costs. These problems were noted throughout the Human Resources Section, although they were particularly significant in the recruiting function, the classification and compensation services unit, the labor relations environment, and in managing equal employment issues. Significant improvements are necessary to meet present and increasing expectations of Management and employees. Consequently, we recommend a restructuring of the Human Resources organization to include a Chief Human Resources Executive, and four Managers to lead the Human Resources Services, Employee Relations Services, Employee Development Services, and Employee Safety. (The appendix of the attached report discussed this and other recommendations designed to improve the business practices and improve operating efficiencies.)

Comments and Recommendations

Based on Management's request, Internal Audit has completed a review of the business practices and operational policies of the Human Resources Section as of August 31, 2005. Human Resources consultant Stanley McKnight, McKnight & Associates, Incorporated, in partnership

with Internal Audit personnel, completed this review. In addition, assistance from Ms. Lynndy Kennedy, Interim Human Resources Manager, was instrumental in forming recommendations that were sound, careful, and practical. Finally, this review could not have been completed without the cooperation and backing of the Human Resources staff.

Our review consisted of an evaluation of services and functions that include Recruiting Services, Classification and Compensation Services, the Labor Relations Environment, Equal Employment Opportunity, and Training and Development. (The following report provides an overview of our investigation and findings, along with recommendations for Management consideration.)

Management response to the audit and its action plan were sent to the Board of Directors by Chief Administrative Officer Gilbert Ivey on July 19, 2006. In addition, the Special Committee on Human Resources on July 25, 2006 received presentations from Mr. Ivey, General Auditor Gerald Riss, and Human Resources Unit Manager Diane Pitman regarding the audit findings and management's action plans. The Internal Audit Department will continue to work with Management to review actions plans and assess results.

Butier Construction Managers Audit Report

Background

In October 2002, Metropolitan's Board authorized staff to proceed with design and right-of-way acquisition for the San Diego Pipeline No. 6 North Reach and Service Connection EM-21 projects. This effort was completed in June 2004 with the advertisement of the San Diego Pipeline No. 6 North Reach construction contract, under Specifications No. 1479. The North Reach construction contract consists of a 10-foot-diameter steel pipeline approximately seven miles in length, appurtenant facilities, connection to the Lake Skinner Outlet Conduit, road and right-of-way restoration, and the EM-21 service connection.

In December 2003, Request for Qualifications (RFQ) No. 550 was advertised for construction management and support services for multiple programs. This RFQ included construction management, inspection, field survey, pipe fabrication inspection, and materials testing services. Based upon a competitive evaluation, an agreement was recommended with Butier in an amount not to exceed \$5 million for construction management and support services. As of March 31, 2006, Butier has billed Metropolitan approximately \$1.78 million under this agreement.

Opinion

In our opinion, the accounting and administrative procedures over the Butier Agreement 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 February 14, 2005 (inception of the agreement) through March 31, 2006.

Comments and Recommendations

During our review, we noted comments relating to compliance with terms and conditions of the agreement, which are presented in detail.

COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENT

During our review period, we examined eight of the thirteen invoices processed totaling \$1.05 million of the \$1.78 million paid to Butier and noted the following issues:

- Section 12(b) of the Master Agreement requires that “Consultant’s invoices shall be certified to be true and correct to the best of Consultant’s knowledge and shall include the following information: the maximum amount payable, a summary of costs for the current invoice, amount due for this invoice, and total amount previously invoiced.” We noted that all eight invoices tested were not certified to be true and correct, and did not include the maximum amount payable or the total amount previously invoiced.
- Section 12(e) of the Master Agreement states that “Subject to the approval of the Agreement Administrator, Metropolitan shall make payment to Consultant within 30 days after receipt of the invoice.” We noted that five of the eight invoices tested were paid from one week to one month past the 30 days. However, it should be noted that payments after the review period were made within 30 days. In addition, we noted discrepancies between the detailed timesheets and total time billed. It should be noted that these minor discrepancies resulted in a net overpayment of \$314.

We recommend that the Agreement Administrator work with Butier to recapture any overpayments made. In addition, we recommend that the Agreement Administrator continue to work with Butier to ensure compliance with terms and conditions of the agreement.