

- **Internal Audit Report for March 2007**

Summary

Three reports were issued during the month:

- **Black & Veatch Corporation Audit Report – Generally Satisfactory**
 - **GeoPentech, Incorporated Audit Report – Generally Satisfactory**
 - **Ozonia North America Audit Report – Satisfactory**
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Discussion Section

This report highlights the significant activities of the Internal Audit Department during March 2007. In addition to presenting background information and the opinion expressed in the audit report, a discussion of findings noted during the examination is also provided.

Black & Veatch Corporation Audit Report

Background

On November 2001, Metropolitan's Board authorized staff to perform studies of on-site solids handling facilities to address the increased solids production in the water treatment process. On May 13, 2003, Metropolitan awarded an On-Call Process Engineering Services agreement, up to \$3 million, to Black & Veatch Corporation Agreement 55207 (Black & Veatch), effective June 1, 2003 through May 31, 2006. On November 1, 2004, Agreement 55207 was amended to include additional engineering support during construction of the Weymouth Solids Handling Facilities, and the maximum amount payable was increased to \$3.8 million. On May 11, 2005, Agreement 55207 was again amended to include engineering support during construction of the Diemer Solids Handling Facilities. The maximum amount payable was increased to \$4.75 million, and the agreement was extended to September 30, 2007. As of December 31, 2006, Metropolitan has paid Black & Veatch approximately \$3.95 million under Agreement 55207.

Opinion

In our opinion, the accounting and administrative procedures over the Black & Veatch Agreement 55207 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 June 1, 2003 (inception of the Agreement) through December 31, 2006.

Comments and Recommendations

REVIEW AND APPROVAL OF CONSULTANT INVOICES

Consulting contracts should be monitored to ensure compliance with the terms and conditions of the contract. These efforts serve to evaluate the timeliness and quality of deliverables, test the propriety of consultant billings, verify the adequacy of supporting documentation, and ensure

control over payments. Metropolitan's Agreement Administrator and Project Management supporting staff are responsible for verifying the accuracy and validity of the consultant invoices, testing the propriety of supporting documentation to such billings, and monitoring and evaluating contract deliverables.

We selected ten invoices processed during the review period and compared the billings rates against those shown in the approved Fee Schedule. These invoices totaled \$2.54 million or 64% of the \$3.95 million paid to Black & Veatch. We noted discrepancies totaling \$13,054 on six invoices tested. Specifically, we noted:

- Incorrect billing rates were used for invoices billed before June 2004 resulting in an overpayment of \$577.
- Reimbursements of \$437 to a consultant for the purchase of software and a hydrology manual were noted that were not specified in the approved Fee Schedule.
- Incorrect labor classifications on invoices billed before June 2004, resulting in a discrepancy of \$12,040. Black & Veatch indicated that the billing rates for these consultants were correct although they used incorrect labor classifications on these invoices. Management is assessing this claim.

Additionally, at our request, Management reviewed the remaining four invoices processed during the same period and discovered other discrepancies totaling \$5,530. Specifically, Management noted an overpayment of \$186 due to incorrect billing rates and a discrepancy of \$5,344 due to incorrect labor classifications.

We recommend that the Agreement Administrator work with Black & Veatch to recapture any overpayments made. We also recommend that the Agreement Administrator continue to follow-up with Black & Veatch to substantiate consultant rates/classifications for the \$17,384 discrepancy (\$12,040 and \$5,344). In addition, we recommend that Management perform random testing of consultant invoices to ensure compliance with the terms and conditions of agreement.

COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENT

We also noted the following minor instances of non-compliance with contractual terms and conditions of the Black & Veatch agreement.

- Section 8(a) of Agreement 55207 states that "Consultant shall submit a monthly invoice to Metropolitan...each invoice shall indicate Consultant's name and mailing address, Metropolitan's name and agreement number, and beginning and ending billing dates." We noted that the consultant submitted one invoice (#183584) for the billing period September 2004 through July 2005. Furthermore, all ten invoices tested did not include the beginning billing dates.
- Section 8(e) of Agreement 55207 states that "Invoice shall include Task Order number where applicable and the beginning and ending billing dates." We noted all ten invoices tested did

not include the beginning and ending billing dates for each task order. However, we were able to compute the beginning and ending dates based on our review of Black & Veatch's time sheets that were submitted with each invoice.

- Section 8(j) of Agreement 55207 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 eight of ten invoices tested were paid 2 to 42 days late.

We recommend that the Agreement Administrator work with Black & Veatch to ensure compliance with terms and conditions of the agreement. We also recommend that the Agreement Administrator conduct periodic reviews of Black & Veatch's activities to ensure compliance.

GeoPentech, Incorporated Audit Report

Background

On June 1998, Metropolitan's Board appropriated funds for Phase 1, technical studies in the Upper Chuckwalla Basin, and development of the Upper Chuckwalla Groundwater Storage Program. This Multi-Phase Program would allow Metropolitan to deliver water from the Colorado River, store it in the Upper Chuckwalla Groundwater Basin, recover, and pump it back into the Colorado River Aqueduct in dry years. On March 2001, Metropolitan's Board authorized staff to enter into a contract up to \$1.85 million with GeoPentech, Incorporated (GeoPentech) Contract 38963, for Phases II and III, feasibility investigations of the Chuckwalla Groundwater Basin. Under Contract 38963, GeoPentech also agreed to conduct impact assessment, pilot test, and facility planning. On November 2004, Metropolitan's Board approved staff recommendation, to defer completion of the Chuckwalla Groundwater Storage Program due to the Colorado River drought. As of September 30, 2006, GeoPentech has billed Metropolitan approximately \$1.29 million.

Opinion

In our opinion, the accounting and administrative procedures over the GeoPentech Contract 38963 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 May 01, 2001 (inception of the contract) through September 30, 2006.

Comments and Recommendations

SUBCONSULTANT CHARGES

Section 4 of the GeoPentech Contract 38963 states, "For the services performed and the costs incurred by Consultant under this Agreement, and with approval of Agreement Administrator, Metropolitan will make payment to Consultant in accordance with the Fee Schedule. Metropolitan will only pay Consultant and sub-consultant's expenses, when these expenses are identified in this Fee Schedule. This Fee Schedule shall remain in effect for the duration of this agreement. No payment will be made for charges not included in this schedule, including sub-consultants fees and expenses."

During our review, we noted differences between the sub-consultant billing rates and the Fee Schedule included in the contract for invoice numbers 217A, 229A, and 245C. Further review revealed that the Agreement Administrator had approved these changes, as they resulted from additional work performed by the sub-consultant during phase III of the program (Subtask 3.5 Pilot Test and Monitoring). However, we could not locate documentation in support of these revised charges.

We recommend that the Agreement Administrator establish procedures to ensure that supporting documentation is maintained on all changes made to approved fee schedules, and conduct tests to ensure compliance.

Ozonia North America Audit Report

Background

On July 2003, Metropolitan's Board authorized final design of the Skinner Oxidation Retrofit Program (Program) to replace chlorine with ozone, as the primary disinfectant to meet United States Environmental Protection Agency Disinfectant/Disinfection By-Product Standards. As part of this Program, Metropolitan appropriated \$11 million and awarded Contract No. 1582 to Ozonia North America (Ozonia) for \$8,409,000, for the fabrication and delivery of liquid oxygen storage and feed equipment, ozone generators, a control system, ozone off gas system, and support equipment. The estimated completion date for this contract is December 2008. As of December 31, 2006, approximately \$5.6 million had been paid to Ozonia, net of \$618,508 contract retention.

Opinion

In our opinion, the accounting and administrative procedures over Ozonia Contract 1582 include those practices usually necessary to provide for a satisfactory control structure. The degree of compliance with such procedures provided effective control during the period from contract inception of May 2004 through December 31, 2006.

Comments and Recommendations

No reportable concerns noted.

Continuous Audit Activities (monthly reviews)

Inland Feeder Project

Our review included agreeing actual costs reported to the Board to source documentation, including the general ledger, the Inland Feeder Project (IFP) Monthly Report, and selected contract payments; reviewing estimated costs at completion; analyzing changes in various cost components; and attending on-site meetings held to review actual costs and discuss current problems. Our review did not reveal any material differences between reported amounts and supporting documentation.

In addition, our ongoing review procedures for potential claims, liability exposures, and other pending issues have been designed to track such items in accordance with applicable reporting requirements under Financial Accounting Standards #5 (Accounting for Contingencies). Accordingly, for all pending legal claims, we consult with the Chief Financial Officer, IFP Management, or General Counsel's Office to evaluate the magnitude of potential losses to Metropolitan. It should be noted that the IFP Project Manager reports on contractors' claims currently in litigation and other potential claim issues to the Executive & Operations Committee monthly.

We also met with IFP Management to discuss the procedures utilized to review the Shea/Kenney invoices under the terms of the new agreement. Specifically, we discussed the review procedures for detailed transaction analysis of non-labor charges and Construction Contract Administration (Metropolitan staff) review responsibilities.

Center for Water Education

Reviewed the monthly financial statements and attended the March Board of Directors Meeting. In addition, participated in discussions with the General Manager's Office on transition processes.