MWD
METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Report
September 28, 2007
Office of the General Auditor

- **Internal Audit Report for September 2007**

Summary

Three reports were issued during the month:
- **Griffith Company Contract Audit Report – Satisfactory**
- **J.U. Enterprise Contract Audit Report – Less Than Satisfactory**
- **J.R. Filanc Construction Contract Audit Report – Generally Satisfactory**

Discussion Section
This report highlights the significant activities of the Internal Audit Department during September 2007. In addition to presenting background information and the opinions expressed in the audit reports, a discussion of findings noted during the examination are also provided.

Griffith Company Contract Audit Report

Background
In February 2006, Metropolitan entered into a $6.2 million contract with the Griffith Company to construct the Searl Parkway Improvements Phase II Project (Phase II Project) in the Diamond Valley Lake Recreation (DVLR) area. Searl Parkway is the primary access roadway and utility corridor into the East Recreation area and the land-leasing tenants. This project is part of the DVLR Programs being undertaken by Metropolitan to construct and/or improve the East Recreation area and East Marina. The project consists of grading and constructing a new roadway and sewer, water and storm drain pipes; signing, striping, and street lighting; installing electrical distribution, telephone and cable TV conduits; and trenching for and backfilling of Gas Company-installed gas main. The Phase II Project was completed in January 2007 at a cost of $6.1 million.

Opinion
In our opinion, the accounting and administrative procedures over Major Construction Projects-Griffith Company 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 from March 2006 (contract inception) through June 2007.

Comments and Recommendations
There were no material findings to report.

J.U. Enterprise Contract Audit Report

Background
In September 2005, Metropolitan entered into a renewable one-year contract for up to $1.5 million annually with J.U. Enterprise to provide regional advertising services and media buys, promoting water conservation through the California Friendly Program initiated by Metropolitan and the Family of Southern California Water Agencies. Of this amount, 80% was used to purchase advertising space and airtime, with the remainder to creative development, production costs, and

agency commissions. This contract was amended on August 25, 2006, to extend the terms to September 2007, and to increase the maximum amount payable to $2.9 million. A third amendment effective June 15, 2007 extended the terms to September 2008, and increased the maximum amount payable to $8.35 million. Metropolitan has paid J.U. Enterprise $2.6 million as of April 30, 2007.

Opinion

In our opinion, the accounting and administrative procedures over the J.U. Enterprise contract provide for a less than satisfactory internal control structure. This opinion is the result of incorrect billings on agency commission, and fees on creative development/account management and partnership coordination activities. It should be noted that Management immediately initiated remedial actions in response to these concerns.

Comments and Recommendations

REVIEW AND APPROVAL

Review and approval controls are established to designate specific points in a process for formal reconsideration and authorization. Review compels a specified person to reconsider a transaction, at a specified point in a process with a view toward change/revision. Approval operates as a triggering mechanism requiring authorization by Management approved personnel, before the next phase of the process. Review and approval controls serve to protect against unauthorized, inaccurate, or duplicate transactions/requests. For the J.U. Enterprise's contract, a compensation schedule is included that identifies program fees and expenditures that are eligible for payment or reimbursement. Program Management should agree to charges listed on each invoice to this compensation schedule before payment. Our review of sixteen (16) invoices totaling $1.2 million revealed:

1. Invoice No. 116A for $40,000 for the Fall Campaign's creative Development/Account Management Fee (Management Fee) did not agree with the terms and conditions of the contract. Specifically, we noted that the contract stipulates a Management Fee of $36,000, and formal documentation could not be located that reconciles this discrepancy. We understand that Media Services staff authorized and approved the Fall Campaign Management Fee in advance.

2. Invoice No. MWD125 for $20,000 for retail partnership coordination activities did not agree with the terms and conditions of the contract. Specifically, we noted that the contract stipulates that consultant fees cannot exceed $8,000 per year, and formal documentation could not be located to reconcile this discrepancy. We understand that Media Services staff authorized and approved the additional funds of $12,000.

3. Agency commissions paid to J.U. Enterprise for television, radio, and print media purchases on Invoice No. 102N and No. 110 was 11% rather than the 10% stipulated under the terms of the contract. Further review revealed that J.U. Enterprise calculated the invoice amount billed to Metropolitan by dividing the total media purchases by ninety percent (9/10). The resultant calculation was then invoiced to Metropolitan, and J.U. Enterprise's commission

was the difference between this invoiced amount and the actual television, radio, or print media cost. This resulted in the following overcharges:

A	B	C	D	E	F	G	H
Invoice No.	**Date**	**Description**	**Media Purchase Total**	**Total Invoiced to Metropolitan (D div by .9)**	**Commission to JU Enterprise (E minus D)**	**Commission at 10% (D times 10%)**	**Overcharge (F minus G)**
102	02/08/06	Spring TV Media Campaign April–June 2006	$120,309	$133,676.67	$13,367.67	$12,030.90	$1,336.77
110	04/27/06	Spring Campaign Incremental Media Purchases	$15,938	$17,708.89	$1,770.89	$1,593.80	$177.09
						Total	**$1,513.86**

It should be noted that Customer and Community Services Management has reviewed all similar invoices and found additional overpayments of $22,559.06 on billings through August 2007. Accordingly, we understand that Management has made adjustments against September billings for $24,072.92 (22,559.06 + 1,513.86) to resolve these differences. We also noted that Customer and Community Services Management have conducted staff meetings to remind personnel of the importance of compliance with the terms and conditions of the contract.

We recommend that Customer and Community Services Management establish procedures to ensure compliance with the terms and conditions of the contract. Furthermore, we recommend Customer and Community Services Management conduct periodic tests to ensure compliance.

J.R. Filanc Construction Contract Audit Report

Background

The Henry J. Mills Water Treatment Plant (Mills Plant) was placed into service in 1978, with an initial capacity of 75 million gallons per day. The Mills Plant exclusively treats State Project water and delivers treated water to Eastern Municipal Water District and Western Municipal Water District of Riverside County. On March 14, 2006, the Board of Directors appropriated $25.7 million and awarded a $19.9 million construction contract to J.R. Filanc Construction for the Mills Chemical System upgrades, including construction of a chlorine containment facility and fluoridation facilities. As of August 2007, construction was 70 percent complete with payments to the contractor totaling $14 million.

Opinion

In our opinion, the accounting and administrative procedures over J.R Filanc Construction includes 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 from May 2006 (contract inception) through August 2007.

Comments and Recommendations

COMPLIANCE WITH POLICIES, PROCEDURES, AND REGULATIONS

Compliance with policies, procedures, and regulations is necessary to ensure adequate control over the administration of the construction project. Compliance with contractual terms ensures that parties fully discharge their obligations and exercise their rights. During our documentation review, we noted:

1. Internal Revenue Service (IRS) Form W-9 (Request for Taxpayer Identification Number and Certification) for J. R. Filanc Construction could not be located. Section 6109 of the IRS Code requires that any entity that is required to file an information return with the IRS must obtain a Tax Identification Number (TIN), using the W-9 Form prior to commencing work and disbursing funds.

2. Certified payroll filings for the period from April through August 2007 could not be located. The construction contract stipulates in Article 65 of the General Conditions that monthly payroll records, showing the name, address, social security number, work classification, straight time, and overtime hours worked each day and week, and the actual per diem wages paid to each journeyman, apprentice, worker, or other employee employed in connection with the public work be on file.

We recommend that the Agreement Administrator resolve the noted discrepancies. In addition, we recommend that Management remind personnel of the importance of compliance with policies and regulatory requirements, and conduct periodic reviews to ensure compliance.

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; and discussing open issues/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 Board monthly.

Center for Water Education

Assisted Management on the review and assessment of proposed payments of the Center for Water Education’s construction debts.