



- **Internal Audit Report for December 2007**

Summary

Two reports were issued during the month:

- **Water Rate Stabilization and Revenue Remainder Funds Audit Report – Satisfactory**
 - **Richard Brady & Associates and RBF Consulting Audit Report – Generally Satisfactory**
-

Discussion Section

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

Water Rate Stabilization and Revenue Remainder Funds Audit Report

Background

The Revenue Remainder (RR) Fund was established in 1975 to maintain working capital in the event that water sales revenues are insufficient to pay the operating costs of Metropolitan. Deposits to the RR Fund result from monies remaining in the Water Revenue Fund at month-end, after meeting the priority expenditures set forth in Metropolitan's bond resolutions. These conditions are set forth in Administrative Code §5202(a), which requires that the balance of the RR Fund at June 30 be equal to the fixed costs estimated to be recovered by water sales revenues for the subsequent 18 months. The Revenue Remainder Fund balances were \$159 million and \$167 million as of June 2006 and 2007, respectively.

The Water Rate Stabilization (WRS) Fund was established in 1987 to maintain stable and predictable water rates and charges. Deposits to the WRS Fund result from the monies remaining in the RR Fund and the Replacement and Refurbishment Fund after meeting their fund requirements. These conditions are set forth in Administrative Code §5202(e), which requires that the balance of the WRS Fund be equal to the portion of the fixed costs of Metropolitan estimated to be recovered by water sales revenues during the two years immediately following the 18-month period referenced in Section 5202(a). The WRS Fund balances were \$98 million and \$124 million as of June 2006 and 2007, respectively.

Opinion

In our opinion, the accounting and administrative procedures over the funds include those practices usually necessary to provide for a satisfactory internal control structure. The degree of compliance with such policies and procedures provided effective control for the period from July 2005 through June 2007.

Comments and Recommendations

There were no material findings to report.

Richard Brady & Associates and RBF Consulting Audit Report

Background

In March 2004, Metropolitan entered into five-year engineering design support service agreement with RBA in an amount not to exceed \$1 million per year. In addition, in May 2004 Metropolitan entered into five-year engineering design support service agreement with RBF in an amount not to exceed \$1 million per year. These consultants were retained to conduct studies and investigations, prepare preliminary and final designs, and provide construction support for projects at water treatment and distribution facilities. Under the terms of the agreements, the consultants were to provide on-call engineering services as requested by Metropolitan. There have been no amendments to the agreements, and payments to the consultants under the agreements totaled \$4.3 million as of September 2007.

Opinion

In our opinion, the accounting and administrative procedures over the agreements with RBA and RBF 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 March 2004 through September 2007.

Comments and Recommendations

COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENTS

Compliance with contractual requirements is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of the agreements. Compliance with contractual terms also ensures that parties fully discharge their obligations and exercise their rights. The terms and conditions of the consulting agreements stipulate insurance, billing, and payment requirements and identify documentation required to properly administer the agreements. Our review of the consultants' compliance with contractual insurance, billing, and payment requirements revealed:

1. Workers compensation insurance coverage for the RBF agreement expired on July 1, 2007, and we were unable to locate current proof of insurance. This is in contrast to the insurance section of the agreement that requires the consultant to maintain insurance coverage for the duration of the contract.
2. Although the consultant was compliance with the 20% Small Business Enterprise (SBE) participation requirement, SBE Utilization reports were not submitted with RBF's monthly invoices. This is in contrast to the billings and payments section of the agreement that requires consultant's invoices be accompanied by a SBE Utilization Report.

We recommend Corporate Resources Management remind the Contracting team and the Agreement Administrator of the importance of ensuring that consultants comply with contractual terms and conditions. Further, we recommend that Corporate Resources management 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; 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 consulted with the Chief Financial Officer, IFP management, or General Counsel's office to evaluate the magnitude of potential loss 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.