



- **Internal Audit Report for February 2008**

Summary

Three reports were issued during the month:

- **Deferred Water Rights Audit Report – Satisfactory**
 - **Inland Feeder Project Audit Report – Generally Satisfactory**
 - **KPMG Single Audit Report for Year Ended June 30, 2007**
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Discussion Section

This report highlights the significant activities of the Internal Audit Department during February 2008. 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.

Deferred Water Rights Audit Report

Background

Metropolitan has entered into several water exchange and storage agreements with its members and with other outside agencies. These agreements provide Metropolitan with water supplies that supplement deliveries of Colorado River and State Water Project water. In addition, Metropolitan is pursuing other agreements; both within and outside its service area to further augment water supplies. These exchange and storage agreements generally provide for advance delivery of water during periods when water is available.

The expenditures associated with these agreements are recorded as Deferred Water Rights and are charged either to the Cost of Water as the rights are exercised or are transferred to Participation Rights when construction or implementation of a Storage Program project is completed. The Deferred Water Rights accounting consists of an Intangible Water Rights account and several Prepaid/Deferred Charges accounts. The expenditures recorded to the Intangible Water Rights account represent storage or withdrawal fees incurred to store or retrieve water to/from other agencies' groundwater basins. Whereas, the expenditures recorded to Prepaid/Deferred Charges represent costs incurred for the purchased water and Storage Program projects under construction or implementation. At June 30, 2007 and 2006, Deferred Water Rights balances were \$103.8 million and \$111.3 million, based on volumes of 1,413,000 acre-feet and 1,521,000 acre-feet.

Opinion

In our opinion, the accounting and administrative procedures over Deferred Water Rights 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 July 2005 through June 2007.

Comments and Recommendations

There were no material findings to report.

Inland Feeder Project Audit Report

Background

Metropolitan's Inland Feeder Project consists of 44 miles of tunnels and pipelines that will enable Metropolitan to convey up to 1,000 cubic feet per second of State Water Project water from California Aqueduct's Devil Canyon Afterbay to Diamond Valley Lake. Through October 2007, 36 miles or 82% of Inland Feeder Project's length have been completed. The remaining work includes completion of the Arrowhead East and West Tunnels, which are presently under construction and are expected to complete in the latter part of 2008.

The following table summarizes the five Inland Feeder Project agreements reviewed. It includes the consultant's name, agreement number, along with the agreement inception and termination dates. Furthermore, it shows the initial not-to-exceed amounts, discloses the amended contract totals, and lists the amount paid to the consultant through October 2007 (our audit date). Finally, the table provides a brief description of the contracted services.

Consultant Name/ Agreement No.	Agreement Dates (As of October 2007)	Initial Agreement Amount (Not to Exceed)	Amended Amount as of October 2007	Payment to Consultant (Through October 2007)	Contracted Services
PW&I #4705	September 1994 - 2010	\$2.9 million	\$13.95 million	\$11 million	Program management services
PCI #12788	December 1996 - 2008	\$80,000	\$2.8 million	\$2.3 million	Project labor agreements administration
Jacobs #44968	April 2002 – December 2007	\$10 million	\$10 million	\$9.2 million	Engineering support services for Arrowhead Tunnels
HMM #46862	May 2002 – July 2008	\$12 million	\$20.9 million	\$15 million	Cost management services for Arrowhead Tunnels
Psomas #57409	November 2003 - 2010	\$3 million	\$5.2 million	\$2.5 million	Environmental monitoring services

Opinion

In our opinion, the accounting and administrative procedures over the agreements with Parsons Water & Infrastructure, Incorporated (PW&I); Parsons Constructors, Incorporated (PCI); Jacobs & Associates (Jacobs), Hatch Mott MacDonald (HMM); and Psomas, Incorporated 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 November 2004 through October 2007.

Comments and Recommendations

COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENTS

During review of contract insurance requirements, we noted that the certificates of insurance for current and prior fiscal years’ coverage could not be located for PWI, PCI, Jacobs and HMM. This was in contrast to the insurance section of the agreements that required the consultants to maintain insurance coverage for the duration of the agreements. The details of the missing insurance certificates were as follows:

Consultant	Insurance Covered Period	Missing Insurance Certificates
PW&I	FY 2006-07	General Liability, Auto, and Workers Comp *
PW&I	FY 2005-06	General Liability, Auto, and Workers Comp
PW&I	FY 2004-05	General Liability, Auto, and Workers Comp *
PCI	FY 2006-07	General Liability, Auto, and Workers Comp *
PCI	FY 2004-05	General Liability, Auto, and Workers Comp
Jacobs	FY 2007-08	General Liability, Auto, and Workers Comp * Professional Liability
Jacobs	FY 2006-07	General Liability, Auto, Workers Comp, and Professional Liability *
Jacobs	FY 2004-05	General Liability, Auto, and Workers Comp *
HMM	FY 2006-07 and FY 2007-08	General Liability *
HMM	FY 2005-06	Professional Liability
HMM	FY 2004-05	Auto and Workers Comp

* IFP Project Controls Team subsequently coordinated with the consultants to obtain copies of missing insurance certificates.

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.

KPMG Single Audit Report for Year Ended June 30, 2007

The Federal Single Audit Act of 1984, as amended by the Single Audit Act Amendments of 1996, requires state or local government units that expend \$500,000 or more of federal financial assistance in any one-year to have an audit conducted for that year. The firm of KPMG, in accordance with generally accepted auditing standards promulgated by the American Institute of Certified Public Accounts (AICPA), audits Metropolitan’s accrual basis financial statements. In the event that a so-called “Single Audit” is required to be conducted for a particular year, the cost of such an audit is included as part of the required audit services provided by that firm under its agreement with Metropolitan.

Due to the magnitude of federal sources, moneys expended during the fiscal year ended June 30, 2007; Metropolitan was required to have a Single Audit performed. Staff from KPMG performed the necessary additional auditing procedures and the firm issued the required audit reports.

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.

Internal Controls over Financial Reporting Controls

We have continued our assistance to the Controller's Section in the completion of an assessment of the internal controls over financial reporting. This assessment is based on the COSO internal control framework and includes identification of general ledger accounts and business processes to be included in the project, documentation and testing of the business processes/control activities, evaluation of operating effectiveness, and communication of any internal control deficiencies.