



MWD

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Report

March 31, 2008

Office of the General Auditor

- **Internal Audit Report for March 2008**

Summary

Four reports were issued during the month:

- **MWH Americas and Richard Brady & Associates Audit Report**
 - **CAL-FED Category III Audit Report**
 - **Fuel Supply Follow-up Audit Report**
 - **Official Statement for the Water Revenue Bonds, 2008 Authorization, Series A1/A2**
-

Discussion Section

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

MWH Americas and Richard Brady & Associates Audit Report

Background

The Colorado River Aqueduct (CRA) is a 242-mile-long conveyance system which transports water from Lake Havasu to Lake Matthews. Although the CRA continues to perform reliably to-date, portions of the system are exhibiting signs of normal wear and tear, as may be expected with over 60 years of operation. As a result, Metropolitan has undertaken CRA rehabilitation projects since 2001. These projects are expected to be completed by 2009. Metropolitan has also undertaken a major assessment of the repair and rehabilitation needs of the distribution system. The distribution system consists of approximately 780 miles of pipelines and related structure that deliver potable water from Metropolitan's five water treatment plants to its' Member Agencies' service connections. Major portions of this system were initially constructed in the 1940s and have been in continuous service since. Resulting from this assessment, several capital projects in the distribution system were identified for rehabilitation, and Metropolitan has undertaken rehabilitation of these projects since 2005.

To assist Metropolitan staff with peak-load projects, portions of engineering work for the rehabilitation projects are performed by consultants. In May 2006, Metropolitan entered into a three-year professional services agreement with MWH Americas (MWH) in an amount not to exceed \$6 million. MWH was retained to provide engineering support services, on an as needed basis, to the CRA Rehabilitation projects and the Second Lower Cross Feeder Project. In August 2005, Metropolitan entered into a five-year professional services agreement with Richard Brady & Associates (RBA) in an amount not to exceed \$2 million per year. RBA was retained to provide design support services, on an as-needed basis, to the distribution system rehabilitation projects. There has been one amendment to the MWH agreement to include subconsultant work and fee schedules and no amendments to the RBA agreement. Payments to the consultants under their respective agreements totaled \$576,000 (MWH) and \$2 million (RBA) as of December 2007.

Opinion

In our opinion, the accounting and administrative procedures over the agreements 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 August 2005 through December 2007.

Comments and Recommendations

COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENT

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 MWH compliance with contractual billing and payment requirements revealed that Small Business Enterprise (SBE) Utilization reports were not submitted with the consultant's monthly invoices. This was in contrast to the billings and payments section of the agreement that required consultant's invoices be accompanied by a SBE Utilization Report. We noted, however, that MWH has been maintaining records of SBE utilization to monitor its compliance with the contractual SBE participation requirements.

We recommend Corporate Resources Management remind 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.

CAL-FED Category III Audit Report

Background

The Bay-Delta Accord (Accord) was signed in December 1994 by thirteen federal, state, urban, agricultural, and environmental agencies, including California Urban Water Agencies (CUWA) to implement a protection plan for the Bay-Delta estuary. Among the principles of this Accord was a commitment to fund a comprehensive program to address Category III non-outflow related factors that contributed to the decline in the Bay-Delta ecological system. These non-flow factors included unscreened water diversions, fish passage around dams, pollution from municipal, industrial and agricultural discharges, over-fishing and illegal fishing, and degradation of habitat due to levees and channelization.

The Ten-Member CUWA consortium, which includes Metropolitan, agreed to provide \$32.2 million in funding to the Category III Program. Metropolitan's share of this commitment was \$30 million and the Category III Memorandum of Understanding designates Metropolitan as the contracting party, contract administrator, and treasurer for the program. Since signing the Accord, 44 Bay-Delta Restoration Projects were funded by the program. Of these projects, one is

ongoing, thirty-five have been completed, and eight are inactive or have been terminated. Funded projects are selected by CALFED, which is a consortium of state and federal agencies assigned with the management and regulatory responsibility within the Bay-Delta estuary. Through October 2007, the program expenditures totaled \$24.7 million, with the remaining fund balance of \$7.5 million available for current and future projects.

The following table summarizes the four CUWA Category III Program agreements reviewed. It includes the contractor's name/agreement number, agreement inception and termination dates, and agreement amount. Furthermore, it lists the amounts paid to the contractors and a brief description of the contracted services.

Contractor/ Agreement	Agreement Inception – Termination Dates	Agreement Amount	Payments to Contractors (Thru 10/07)	Contracted Services
Battle Creek No. 54888	July 2003 – August 2008	\$369,000	\$167,000	Outreach and technical services for Battle Creek Salmon and Steelhead Restoration Projects
Turlock No. 20186	July 2000 – September 2004	\$2.8 million	\$2.8 million	Restoration of instream and shaded riverine aquatic habitat at the lower Tuolumne River (river mile 25.9)
Turlock No. 17894	February 2001 – March 2003	\$2.3 million	\$2.3 million	Restoration of instream and shaded riverine aquatic habitat at the lower Tuolumne River (river mile 34.2 to 40.2)
DWR No. 18411	June 1998 – June 2002	\$395,000	\$369,000	Engineering investigation services for Upper Battle Creek Project

Opinion

In our opinion, the accounting and administrative procedures over the agreements with Conservancy, Turlock and DWR 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 July 1, 2003 through October 31, 2007.

Comments and Recommendations

COMPLIANCE TO 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 agreement. Compliance with the contractual terms and conditions also ensures that parties fully discharge their duties and obligations and exercise their legal rights associated with the agreement. Our review of fourteen selected invoices totaling \$1.1 million and reimbursement claims for contract administration services revealed:

1. Department of Water and Resources (DWR) and Turlock Irrigation District (Turlock) were slow in providing adequate supporting documentation or project deliverables, as required by their agreements. As a result, Metropolitan (the Agreement Administrator) withheld payments of \$863,456 until the required deliverables and supporting documentation were submitted. The payment details for these contractors were as follows:

Contractor	Agreement Number	Invoice Number	Invoice Date	Date Paid	Invoice Amount
DWR	18411	1800007982	05/15/2003	07/21/2003	\$ 89,825
DWR	18411	1800007985	05/15/2003	01/26/2004	37,965
Turlock	20186	9357	09/06/2003	01/02/2004	273,284
Turlock	20186	10236	04/30/2004	06/17/2004	224,690
Turlock	20186	11801	08/12/2004	10/14/2004	5,400
Turlock	17894	10192	04/28/2003	12/18/2003	9,510
Turlock	17894	10364	06/16/2003	03/18/2004	222,782
Total					\$863,456

It should be noted that the DWR payments were withheld from one-to-seven months after payment due date due to non-submission of adequate supporting documentation; and the Turlock payments, from one-to-nine months due to non-submission of contract deliverables and incorrect invoice formatting.

2. Battle Creek Watershed Conservancy was billed twice for airfare costs (\$359) incurred by its subcontractor Terraqua. This amount was billed in Invoice No. 21 dated September 1, 2006, and Invoice No. 22 dated November 15, 2006, which Metropolitan paid on September 15, 2006 and December 22, 2006 respectively.
3. Reimbursement claims for contract administration services rendered by Metropolitan staff were submitted to CUWA on an irregular basis. We noted that the cost of services totaling \$14,000 rendered from October 2004 through June 2006 were billed only in November 2007, seventeen to thirty-seven months after the services were rendered. In addition, the cost of services (approximately \$9,000) rendered from July 2006 through October 2007 (fourteen months) remained unbilled, as of February 2008.
4. Interest earnings of approximately \$6,800 remained unpaid on the outstanding contributions by Santa Clara Valley Water District to the CUWA Category III Program fund. This interest is for the period July 2002 through October 2007.

We recommend that the Agreement Administrator resolve the noted discrepancies. We also recommend that the Agreement Administrator remind the contractors of the need to comply with the terms and conditions of the agreements and conduct periodic reviews to ensure compliance. Further, we recommend that the Agreement Administrator submit billings for contract administration services to CUWA and to facilitate payment of interests to CUWA members on a periodic basis (at least annually).

Fuel Supply Follow-up Audit Report

Background

The Audit Department has completed a follow-up review of audit recommendations contained in the Fuel Supply audit report issued on February 27, 2007. The prior audit was rated as “Less Than Satisfactory” and included recommendations in the areas of Perpetual Fuel Inventory (PFI) reconciliations, verification of fuel charges, and compliance with policies and procedures.

Our follow-up procedures consisted of verifying that Management’s corrective action plans were implemented, and functioning effectively. Accordingly, we evaluated revised procedures and retested selected controls. Revised procedures were deemed adequate and appropriate, however, current period testing revealed inconsistencies in the preparation of the monthly PFI reports, non-compliance with current practices for recording fuel deliveries, and inadequate supporting documentation for reviewing Oil Price Information Service reports. Management concurs with these findings and will conduct reviews to ensure compliance with established policies and procedures.

Official Statement for the Water Revenue Bonds, 2008 Authorization Series A1/A2

The Audit Department has completed a review of the Official Statement for the Water Revenue Bonds, 2008 Authorization, Series A1 and A2. This review was undertaken to provide the underwriters of the Water Revenue Bonds (Bonds) “comfort” that the Official Statement for the Bonds is complete, consistent with supporting financial records, and accurate in all material respects. The review was completed and no exceptions were noted. We issued letters describing the agreed upon procedures, and the results obtained, to the underwriters of the Bonds.

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.