



- **Internal Audit Report for July 2008**

## Summary

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Four reports and one Comfort Letter were issued during the month:

- **Water Savings Performance and Artificial Turf Replacement Audit Report**
  - **Treasury Investment System Audit Report**
  - **Perris Valley Pipeline Consulting Agreement with Kennedy/Jenks Consultants and Black & Veatch Corporation Audit Report**
  - **Health, Safety, and Environmental Follow-up Audit Report**
  - **Official Statement for the Water Revenue Refunding Bonds, 2008 Authorization, Series C**
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## Discussion Section

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

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# Water Savings Performance and Artificial Turf Replacement Audit Report

## Background

The Artificial Turf Replacement (ATR) Program was established to promote projects that conserve water through reduced irrigation and to gather information on the installation and operation of synthetic grass. In June 2005, Metropolitan established a pilot project to provide financial incentives to six Member Agencies and other public agencies (competitively bid) to install artificial turf on municipal and public lands within Metropolitan's service area. This two-year pilot program was partially funded by a \$220,000 grant from the United States Bureau of Reclamation (USBR), and financial incentives were based on the square footage installed at \$1.00 per square foot (\$0.25 from Metropolitan and \$0.75 from USBR).

The pilot program was expanded to include participation by four other public agencies (previously not selected during the competitive bid process), with funding provided solely by Metropolitan at a total cost of \$30,000 (\$7,500 each). These participants were required to collect and analyze program data, identify water savings, and report on operations and maintenance requirements related to artificial turf conversions. In July 2007, the Board approved an enhancement to the ATR Program that promoted the installation of artificial turf at both the commercial and residential levels at a rate of \$0.30 per square foot. As of December 2007, Metropolitan has paid \$241,000 (including USBR's share of \$174,000) to project participants and incurred \$101,000 for in-kind service costs for agreement administration.

The Water Savings Performance (WSP) Program is a major component of the Commercial, Industrial and Institutional Conservation Program established in 1997. The WSP Program has evolved through the years, and now consists of the Large Landscape Measured Water Savings

(Landscape) and the Industrial Process Improvement (Process) Programs. Under the Landscape Program, participants upgrade existing irrigation system equipment with more efficient hardware that results in reduced water demand. For the Process Program, participants install equipment that captures, treats, and reuses water that would otherwise be discharged to the sewer. In addition, participants may replace equipment with more efficient models that reduce water demand. Since June 2000, Metropolitan entered into 14 WSP Programs (Landscape and Process agreements) with Member Agencies and private entities within Metropolitan's service area. These agreements provide up to \$1.8 million in incentives. As of December 2007, three projects were completed, one is active, and ten have not yet started. Metropolitan has paid \$309,000 to program participants.

### **Opinion**

In our opinion, the accounting and administrative procedures over the programs 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 January 2004 through December 2007.

### **Comments and Recommendations**

#### COMPLIANCE TO TERMS AND CONDITIONS OF THE AGREEMENTS AND PROGRAM GUIDELINES

Compliance with contractual terms and program guidelines is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of the agreements and the Artificial Turf Replacement (ATR) and Water Savings Performance (WSP) programs. Compliance with agreement terms also ensures that parties fully discharge their obligations and exercise their rights. Our review of twelve selected payments (\$170,000) to five funding recipients (ATR 3 recipients and WSP 2 recipients) revealed:

1. The ATR Program agreement does not provide for invoicing requirements, such as billing intervals (monthly, quarterly or annually) nor specific documentation supporting the invoice. In addition, ATR agreements also do not provide for installation verification requirements, such as method and party to conduct installation verification, and audit rights, such as review of invoices and supporting documentation within three years following completion of the project.
2. Closeout procedures utilized by Water Resources Management's Conservation Team do not provide for timelines or due dates to closeout ATR and WSP Program agreements. As a result, ATR Program agreements with Upper San Gabriel Valley Municipal Water District, City of Santa Ana and Hemet Unified School District, which all terminated in May 2007, were not closed as of December 2007. Furthermore, agreements with the City of Anaheim/Alstyle Apparel and Active Wear that terminated in February 2006 were also not closed as of December 2007.

We recommend the Conservation Team develop contract requirements for invoicing, installation verification and audit rights, and include them as separate provisions to all future ATR Program

agreements. We also recommend the Conservation Team develop procedures to ensure timely close-out of ATR and WSP Program agreements. Further, we recommend Conservation Team remind recipients of the need to comply with terms and conditions of the agreements and conduct periodic reviews to ensure compliance.

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## **Treasury Investment System Audit Report**

### **Background**

The Treasury Section has been using the Sympro software system to record and report daily investment transactions since 1995. Sympro, a standalone application, is installed on Treasury staff's workstations and a shared copy is also available on Metropolitan's wide area network for the Controller's Office staff to generate various Sympro reports. The Treasury staff uses the Sympro application to prepare journal entries and produce Management reports. The Controller's Office staff utilizes the Sympro reports to perform research and review investment transactions. The Sympro application processes about \$10 billion of investment activity annually, with the average portfolio balance of \$1 billion.

### **Opinion**

In our opinion, the accounting and administrative procedures over the Treasury Investment System 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 as of April 30, 2008.

### **Comments and Recommendations**

#### **ACCESS RESTRICTIONS TO SYMPRO DATA FILES**

Access to financial data files should be restricted to prevent the unauthorized disclosure or modification of data. The Sympro application is utilized by the Treasury Section as the repository of Metropolitan's investment activity. A network-based copy of this data is stored on a shared folder in the wide area network to allow the Treasury Section and the Controller's Office staff to generate investment and Management reports. Access rights to this shared folder should be limited to authorized persons and periodically reviews should be conducted to ensure that proper access rights are assigned.

During our review of access records, we found that 65 employees had been granted "write" and "delete" capabilities for the shared folder data. These access rights allow users to modify data files and create unique Management reports. Further review revealed that the Treasury Section does not periodically review users' access to the shared folder data, thus these access profiles have not been purged of old and/or outdated records. However, we also understand that these reports are used solely for research by the Treasury Section, Controller's Office and the Budget & Financial planning staff. The reports are not distributed to the Board or Senior Management. Thus, the propriety and integrity of Board and Management reports is not compromised.

We recommend that the Treasury Section periodically review the access rights to the Sympro shared files and restrict “write” and “delete” access rights to the appropriate staff.

#### DATA ERROR HANDLING PROCEDURES

Data error handling procedures should be established, documented, and implemented. Data errors and processing problems should be identified, corrected, and documented before being posted to the General Ledger. During our review, we noted that the Treasurer did not have written procedures for handling data errors in Sympro. We randomly selected 17 investments to test Sympro processing accuracy for interest earned and for the current balance. We noted that a manual change had been applied to the interest earned but no record was maintained to show the manual correction. Data errors in Sympro may not be effectively identified and corrected if written procedures on how to identify, correct, and document an error are not documented and enforced.

We recommend that the Treasury Section prepare data error handling procedures for the Sympro application.

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## **Perris Valley Pipeline Consulting Agreement with Kennedy/Jenks Consultants and Black & Veatch Corporation Audit Report**

### **Background**

In March 2005, Metropolitan initiated the Perris Valley Pipeline (PVP) Program to meet the projected water demands in Riverside County, maximize capacity of the Mills plant, offset peak demands on the Skinner plant, strengthen water delivery system reliability, and increase operational flexibility.

The PVP Program was intended to be constructed using a single design-build project delivery method managed by Eastern Municipal Water District. In October 2006, Metropolitan's Board authorized discontinuing the design-build effort and proceeding under a revised project plan of a traditional design-bid-build project delivery method, with separate construction contracts for the North and South Reaches. Black & Veatch continued the North Reach design work under the existing on-call \$3 million per year, three-year maximum agreement. The remainder of the work went out to bid. In May 2007, the Board authorized a \$1.5 million agreement with Kennedy/Jenks Consultants for South Reach final design work. As of March 2008, payment to Kennedy/Jenks and Black & Veatch for the PVP Program totaled \$585,000 and \$1 million, respectively.

### **Opinion**

In our opinion, the accounting and administrative procedures over the agreements with Kennedy/Jenks and Black & Veatch 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 January 2006 through March 2008.

## **Comments and Recommendations**

### COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENTS

Our review of the consultants' compliance with contractual billing requirements noted that the Small Business Enterprise (SBE) Utilization Reports were not submitted with three of four (75%) Kennedy/Jenks' and three of six (50%) Black & Veatch's monthly invoices reviewed. Although the consultants may meet their contractual SBE goals, they did not comply with the billings and payments section of the agreement that require consultant's invoices to be accompanied by an SBE Utilization Report.

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.

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## **Health, Safety, and Environmental Follow-up Audit Report**

### **Background**

We performed a follow-up review of audit recommendations contained in the Health, Safety, and Environmental (HSE) Follow-up Audit Report. This audit was rated as "Less Than Satisfactory" and included recommendations in the areas of HSE compliance and audit program, compliance with policies and procedures, Management reporting, and renewal and maintenance of HSE permits and fees.

Our follow-up procedures consisted of verifying that Management's corrective action plans were implemented and functioning effectively. We evaluated revised procedures and selected controls. Our testing revealed that Management addressed all concerns noted in the audit report. In most instances, Management implemented corrective actions that embodied the recommendations contained in the audit report. In other instances, Management implemented other measures to mitigate risk. Revised procedures were deemed adequate and appropriate; however, we did note that updates are needed to reflect the 2006 reorganization structure and changes. Management concurs with our finding and recommendations and will revise the applicable procedures. In addition, we informed Management that we intend to periodically follow-up on the status of the new plan under the reorganized HSE Section.

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## **Official Statement for the Water Revenue Refunding Bonds, 2008 Authorization, Series C**

The Audit Department has completed a review of the Official Statement for the Water Revenue Bonds, 2008 Authorization, Series C. 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.

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## **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. We also reviewed the procedures designed to dispose of salvaged equipment to ensure the safeguarding of assets and the propriety of the processes. 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

We 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 Committee of Sponsoring Organizations 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. For fiscal year 2007/08, these efforts involved over 2,000 hours of internal staff time and are nearing completion. Accordingly, I will present an opinion on the internal controls over financial reporting at the conclusion of the external audit in August 2008.