Report
August 31, 2008
Office of the General Auditor

- **Internal Audit Report for August 2008**

Summary

One report was issued during the month:
- **Parsons Water & Infrastructure, Incorporated , Kennard Development Group, and E2 Environmental, Incorporated Audit Report**

Discussion Section
This report highlights the significant activities of the Internal Audit Department during August 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.

Parsons Water & Infrastructure, Kennard Development Group, and E2 Environmental Audit Report

Background
Metropolitan implemented the Oxidation Retrofit Program (ORP) to provide Treatment Plants an alternative disinfectant process (i.e., ozone) that would remove water blend restrictions and substantially lower disinfection by-product levels for compliance with the United States Environmental Protection Agency's Disinfectant/Disinfection By-Products Rule. Accordingly, Metropolitan contracted with Parsons Water & Infrastructure, Incorporated (PWI) effective July 2005 through September 2009, in an amount not to exceed $14.9 million to provide construction management and inspection services to ORP, specifically the Skinner ORP project. The PWI agreement was amended twice to increase the scope of work and to revise fee schedule. Furthermore, Metropolitan contracted with Kennard Development Group (KDG) effective October 2005 through October 2011, in an amount not to exceed $1.7 million to provide project management support services to the Skinner, Weymouth and Diemer ORP projects.

Metropolitan also contracted with England Geosystem, Incorporated (EGI) (Agreement 70950), effective September 2005 through August 2008, in an amount not to exceed $240,000 per contract year to provide as needed environmental consulting services to various Metropolitan projects, including ORP projects. EGI, however, ceased operations in November 2005 due to a legal dispute between former and current equity holders. In a court approved sale, EGI assets were acquired by E2 Environmental, Incorporated (E2). Thereafter, EGI agreement with Metropolitan was assigned to E2 effective December 2005. All these agreements were critical to the implementation of the Skinner, Weymouth and Diemer ORP projects.

As of June 2008, Metropolitan paid $10 million to PWI, $1 million to KDG and $98,000 to E2 under their respective agreements.

Opinion
In our opinion, the accounting and administrative procedures over Oxidation Retrofit Program Agreements with Parsons Water & Infrastructure, Incorporated, Kennard Development Group, and E2 Environmental, 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 July 2005 through June 2008 (three years).

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 agreements. 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 agreements.

Our review of 20 selected invoices totaling $3.1 million (eight Parsons Water & Infrastructure, Incorporated (PWI) invoices-$2.8 million; eight Kennard Development Group (KDG) invoices-$280,000; and four E2 Environmental, Incorporated (E2) invoices-$49,000) revealed:

1. Invoices from E2 were not submitted on a monthly basis, the billed labor rates for 5 of 6 E2 employees tested did not agree to the fee schedule (although billed rates were lower), and the billed labor classifications for 3 of 6 employees tested were not specified in the fee schedule. It should be noted that the E2 agreement expires in August 2008.

2. Consultant invoices for 6 of 8 PWI invoices and 3 of 4 E2 invoices were paid 2 to 32 days, after their due dates. This is in contrast to the Billings and Payments Section of the PWI and E2 agreements that requires payment within 30 days after receipt of the invoice. Agreement Administrators indicated that the late payment was due to subconsultants' failure to submit appropriate documentation promptly and a lengthy payment process following invoice approval.

3. Payment requirements for the KDG agreement were unique compared to PWI, E2 and other consulting agreements. Specifically, we noted the KDG agreement does not require payment within 30 days after receipt of invoice. In addition, we noted that the 8 KDG invoices tested were approved for payment by Engineering within 32 days after receipt of invoice. This resulted in KDG invoices being paid on a variable basis.

We recommend the E2 Agreement Administrator resolve the noted differences and remind the consultant of the need to comply with terms and conditions of the agreement. Further, we recommend the E2 and KDG Agreement Administrators assess the need to amend the billing or payment requirements of their respective agreements. Finally, we recommend that the Agreement Administrators establish procedures to ensure compliance to the terms of the agreements 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; 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 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. 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 and discuss this at the September Audit and Ethics Committee meeting.