



- Internal Audit Report for March 2009

Summary

Four reports were issued during the month:

- **Consulting Agreements with Pressure Pipe Inspection Company (60464) and Kleinfelder West, Incorporated (79236) Audit Report**
- **Major Construction Contracts with Brutoco Engineering & Construction, Incorporated (1633 and 1649)**
- **Consulting Agreement with Power-Tech Engineers, Incorporated (83209) Audit Report**
- **KPMG Single Audit Report for Year Ended June 30, 2008**

Discussion Section

This report highlights the significant activities of the Internal Audit Department during March 2009. In addition to presenting background information and the opinion expressed in the audit reports, a discussion of findings noted during the examination is also provided.

Consulting Agreements with Pressure Pipe Inspection Company (60464) and Kleinfelder West, Incorporated (79236) Audit Report

Background

Metropolitan owns and operates 163 miles of Pre-stressed Concrete Cylinder Pipe (PCCP), which was installed between 1965 and 1985 throughout the conveyance and distribution system. In 1996, the Board authorized the Corporate Resources Group to conduct the PCCP Assessment Program in response to ongoing pipeline failures. The purpose of this program was threefold. First, the Engineering Services Section (ESS) of the Corporate Resources Group performed an overall review of the condition of the PCCP lines. Next, the ESS evaluated state of the art pipeline inspection techniques and selected Remote Field Transformer Coupling (electromagnetic inspection) as the preferred testing technology. Finally, ESS developed an inspection plan to conduct thorough assessments of PCCP pipelines during distribution system shutdowns.

In December 2000, the Board authorized a PCCP inspection plan utilizing the electromagnetic inspection method that would be completed over a three-year period. By September 2004, all but 20 miles of the PCCP had been inspected by Metropolitan personnel. Subsequently, the Board appropriated \$1.87 million and authorized staff to enter into an agreement (60464) amount not to exceed \$1.3 million with the Pressure Pipe Inspection Company to perform electromagnetic inspections of the remaining 20 miles, and to perform follow-up inspections of 75 miles of previously identified distressed pipe sections. The three-year professional agreement with Pressure Pipe Inspection Company was amended in October 2007 to extend the contract period to June 2008. As of October 2008, Metropolitan has paid \$1.3 million to the Pressure Pipe Inspection Company.

The Central Pool Augmentation (CPA) Program is a major water conveyance and treatment system that is planned to augment water deliveries to the Central Pool and Western Riverside County. The Environmental Impact Report (EIR) for the CPA Program was certified in 1995. However, construction

of the CPA Program was postponed due to successful implementation of conservation programs and development of local resources within the Central Pool.

In July 2004, Metropolitan's Board authorized staff to reassess the technical feasibility of the tunnel alignment identified in the EIR, and to evaluate the feasibility of an alternative pipeline alignment due to concerns over high groundwater levels. The completed evaluation and reassessment identified the need for detailed geotechnical investigations for the proposed tunnel alignment.

Metropolitan entered into a \$2.9-million, three-year agreement (79263) with Kleinfelder West, Incorporated (Kleinfelder West) effective from October 2006 through October 2009. Under the terms of this agreement, Kleinfelder West was required to provide supplemental geotechnical field exploration and testing services in support of tunnel evaluation studies. Kleinfelder West's scope of work includes hard rock core drilling, core logging, in-situ testing, installation of transducer and observation wells, field and laboratory testing, and geologic analysis. The Kleinfelder West agreement was amended in April 2007 to make additions to the scope of work and to revise the fee schedule. As of October 2008, Metropolitan has paid \$2.9 million to Kleinfelder West under this agreement.

Opinion

In our opinion, the accounting and administrative procedures over the consulting agreements with Pressure Pipe Inspection Company and Kleinfelder West, Incorporated 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 November 2004 through October 2008.

Comments and Recommendations

There were no material findings to report.

Major Construction Contracts with Brutoco Engineering & Construction, Incorporated (1633 and 1649) Audit Report

Background

The Joseph Jensen Water Treatment Plant was placed into service in 1972 to treat water exclusively from the State Water Project, and deliver it to Metropolitan's Central Pool service area of the distribution system. Due to increased demands from Member Agencies, the plant was expanded in the early 1990s from its initial capacity of 350 million gallons per day (mgd) to its current capacity of 750 mgd. The Board has consistently authorized upgrades of the chlorine systems to provide chlorine containment and neutralization facilities at each of Metropolitan's five water treatment plants.

As part of this chlorine systems upgrade at the Joseph Jensen Water Treatment Plant, Metropolitan entered into a \$19.9-million contract (1633) in July 2006 with Brutoco Engineering & Construction, Incorporated to construct the chlorine containment and corresponding neutralization facility, fluoridation facility, and the tank farm roof for the fluoridation facility. The chlorine containment facility was constructed to comply with the California fire code regulations. The fluoridation facility was constructed to implement the Board's policy regarding the use of fluoride at each of Metropolitan's five water treatment plants. The tank farm roof was constructed to reduce handling and disposal costs for

contaminated liquid. As of January 2009, these three projects were 100 percent complete. Metropolitan has paid \$20.9 million to Brutoco Engineering & Construction, Incorporated under this contract including approximately \$945,000 in approved extra work orders.

The F.E. Weymouth Water Treatment Plant was placed into service in 1941 to treat blended waters from the Colorado River Aqueduct and the State Water Project, and deliver them to Metropolitan's Central Pool service area. Due to increased demands from Member Agencies, the F.E. Weymouth Water Treatment Plant was expanded twice from its initial capacity of 100 mgd to its current capacity of 520 mgd. Metropolitan's Conveyance and Distribution System relies on several maintenance support functions located at the F.E. Weymouth Water Treatment Plant to ensure reliable and efficient operation of the water treatment process. To address plant needs and to provide more efficient and effective maintenance services, Metropolitan staff recommended combining the mechanical, electrical, and control systems shops which were located throughout the plant, into a single facility. In 2005, the Board authorized the construction of a new centralized maintenance center at the F.E. Weymouth Water Treatment Plant.

Metropolitan entered into a \$9-million contract (1649) in June 2007 with Brutoco Engineering & Construction, Incorporated to construct the Weymouth Operations and Maintenance Building. This consisted of welding/fabrication shop, parts cleaning facilities, a tool crib, test stations, workstation space, and storage areas for the mechanical, electrical, and control systems support functions. As of January 2009, the Operations and Maintenance Building is complete. Metropolitan has paid \$9.1 million to Brutoco Engineering & Construction, Incorporated under this contract, including approximately \$82,000 in approved extra work orders.

Opinion

In our opinion, the accounting and administrative procedures over the contracts 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 2006 through January 2009.

Comments and Recommendations

There were no material findings to report.

Consulting Agreement with Power-Tech Engineers, Incorporated (83209) Audit Report

Background

The State of California Code of Regulations requires that all treated water supply systems be protected from potential cross connection contamination through blow offs, air vacuum relief valves, and other piping configurations. To comply with the State of California Code of Regulations, Metropolitan surveyed its treated water distribution system for vulnerable locations and initiated a Cross Connection Prevention (CCP) Program in 1994. The survey initially identified 1,280 potential cross connection sites along Metropolitan's distribution system. The CCP Program was designed to address these concerns and consists of three phases.

Under Phase I (completed between 1994 and 2001), Metropolitan modified or relocated 160 of the most vulnerable or high risk sites. During Phase II (completed from 2002 through mid-2004), Metropolitan identified 150 additional cross connection vulnerabilities and prioritized 300 of the sites as high risk requiring near-term modification or relocation, and listed the remaining 970 sites as low risk that did not require immediate action. The California Department of Health Services (CDHS) concurred with Metropolitan's findings and conclusions.

In September 2004, and as part of Phase III, the Metropolitan Board authorized the appropriation of \$6.1 million to provide funding for the final design, permit acquisition, and preparation of bid documents for the 300 high risk sites. Modifications for these sites were planned to be completed under 12 construction contracts. In November 2006, the Metropolitan Board appropriated \$8.6 million and awarded three construction contracts totaling \$5.7 million to modify 74 of 300 high risk sites and to purchase vacuum/air release valves and surge check valves required for modifications of all 300 sites. Construction at these 74 sites started in December 2006.

Metropolitan entered into Agreement 83209 with Power-Tech Engineers, Incorporated (Power-Tech) from December 2006 to August 2008, to provide inspection services for the work performed at the 74 high risk sites. Power-Tech's scope of work included the following: field inspection of the pipelines and structures; fabrication and welding inspection; and specialized support (surveying and materials testing). As of December 2008, Metropolitan has paid \$820,000 to Power-Tech.

Opinion

In our opinion, the accounting and administrative procedures over the agreement with Power-Tech 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 December 2006 through October 2008.

Comments and Recommendations

There were no material findings to report.

KPMG Single Audit Report for Year Ended June 30, 2008

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 and moneys expended during the fiscal year ended June 30, 2008, 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. These meetings included extensive discussions on the progress of obtaining pipe hauling permits from the city of San Bernardino and the impact that these efforts have on project costs. 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 the General Counsel's office to evaluate the magnitude of potential loss to Metropolitan. It should be noted that the IFP Manager reports on contractors' claims currently in litigation and other potential claim issues to the Board monthly.