



- Internal Audit Report for October 2009

Summary

Four reports were issued during the month:

- **Consulting Agreement with Fluidiqs, Incorporated Audit Report**
- **Inland Feeder Project - Salvaged Equipment Program Audit Report**
- **Remote Site Activities – Desert and Western Regions Audit Report**
- **Remote Site Activities – Eastern Region Audit Report**

Discussion Section

This report highlights the significant activities of the Internal Audit Department during October 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 Agreement with Fluidiqs, Incorporated Audit Report

Background

Water Systems Operations installed the Automatic Meter Reading (AMR)/Remote Terminal Unit (RTU) system in the mid-1990s. The AMR/RTU system consists of communication equipment, computer hardware and software installed at approximately 480 water meter locations throughout Metropolitan's distribution system. Of these locations, 370 measure and record water delivered to Member Agencies, whereas the remaining devices are used for water distribution system control. However, the AMR/RTU system has reached the end of its service life, as parts are no longer manufactured and vendor services are being phased out. Accordingly, in February 2005, the Corporate Resources Group recommended an upgrade of the AMR/RTU system. This upgrade was designed to replace all meter devices with updated and reliable commercial off-the-shelf units. This system was expected to transmit meter readings in near real-time, while simplifying system maintenance and improving the reliability and security of Metropolitan's water billing system.

Consequently, on February 2006, Metropolitan entered into a three-year \$4.2-million contract with Fluidiqs, Incorporated (Fluidiqs) to provide design services for the system upgrade, develop and deploy the system's hardware and software, and provide one-year operating support for the project. The Fluidiqs agreement was amended twice to modify the scope of work, increase the maximum amount payable by \$464,000, and to extend the agreement to December 2009. This project was planned for two phases where Fluidiqs completed the upgrade of 30 devices between February 2006 and April 2007 during Phase I of the project. During Phase II, which was initiated in May 2007, the remaining 450 meters were scheduled to be replaced. As of July 2009, Phase II is 99 percent completed and Metropolitan has paid a total of \$4.2 million to Fluidiqs.

Opinion

In our opinion, the accounting and administrative procedures over consulting contract with Fluidiqs, 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 February 2006 through March 2009.

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.

We could not locate the surety certificate for a payment bond of \$208,000 by the consultant in favor of Metropolitan. This bond would cover potential claims for the subconsultant's installation work performed during Phase II.

This is in contrast to the Bonds Required Section (Specific Conditions) of the agreement that requires the consultant to provide payment bond coverage for 100 percent of the price bid for installation work under Phase II.

We recommend that Management remind the Agreement Administrator of the need to comply with the terms and conditions of the agreement. We also recommend that the Agreement Administrator establish procedures to ensure compliance to the terms of the agreement and conduct periodic reviews to ensure compliance.

Inland Feeder Project - Salvaged Equipment Program Audit Report

Background

On September 29, 2009, water deliveries from State Water Project flowed through the 44 miles of pipelines and tunnels that comprise Metropolitan's Inland Feeder Project (IFP). This event signified the completion of IFP and its remaining final segment, the 8.1-mile Arrowhead east and west tunnels. However, since completion of the tunneling operations in 2008, Metropolitan has been disposing of salvaged equipment, materials, and scraps from these projects. The majority of these items have been sold by Ritchie Brothers Auctioneers through public auctions; however, several items have been sold directly to contractors or disposed of for scrap value. As of August 2009, proceeds from sale of salvaged equipment, materials, and scraps totaled \$2.1 million. This amount has been deducted from the IFP's total project costs (\$1.1 billion as of August 2009), as required by Operating Policy F-01 (Operating, Expensed and Capital Equipment).

Administrative Code Section 8270 and Operating Policy F-02 establish policies and procedures for the disposal of Metropolitan's surplus personal property, and these standards were applied to the IFP's surplus equipment and materials. In addition, Operating Policy F-01 establishes accounting policies for recording revenues from these sales. The responsibility for the disposal of IFP's surplus property has been assigned to IFP Management. Accordingly, the Investment Recovery Coordinator directs the sale to direct buyers and scrap dealers, whereas, the Inventory Management and Contracting Services Unit Managers are responsible for approving these sales.

Opinion

In our opinion, the accounting and administrative procedures over the Inland Feeder Project - Salvaged Equipment Program 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 2008 through August 2009.

Comments and Recommendations

PERIODIC REVIEW AND RECONCILIATION - AUCTION, DIRECT AND SCRAP SALES

Accounting control is achieved, in part, by performing periodic reviews and reconciliations of the accounting records. These procedures provide assurance as to the propriety of the transactions affecting the accounts, they identify potential erroneous entries, and they describe follow-up procedures for exceptions.

We reviewed 35 selected transactions totaling \$1 million from salvaged equipment sales activity (auction sales - \$577,000; direct sales - \$117,000; and scrap sales - \$353,000) and noted:

1. Reconciliation procedures for salvaged equipment and materials sold through auctions were not formalized. Further review revealed that Project Management has been recording and monitoring articles shipped to the auction house since the first auction. The majority of these shipped articles, however, could not be reconciled to the auction sales detailed report, as the auctioneer inconsistently included Metropolitan tag number information or Metropolitan's description of shipped articles in the auctioneer's database. Instead, Project Management had manually reconciled auction sales details to the potentially salvageable equipment inventory that it has maintained since 2006. We understand that Project Management has completed 67 percent of the first auction sales reconciliations.
2. Although Project Management staff maintains a log for all salvaged equipment, material, and scrap sold, documentation that evidenced periodic review and reconciliation of the log's reported sales to the general ledger could not be located. As a result, a direct sale of a cement silo and vent line for \$27,063 which includes sales tax of \$2,061, was incorrectly recorded to a general ledger expense account instead of a revenue account and a corresponding sales tax liability account. This was corrected by Accounting Operations in August 2009.
3. Salvaged equipment, material, and scrap sold to direct buyers, scrap dealers and through auction were not invoiced by the Accounts Receivable section. As a result, these sales were not recorded to the general ledger until the remittances were received and deposited to the bank by the Treasurer's Office. Further review revealed that although the sales contracts were executed with direct buyers, their remittances were received more than a week or sometimes more than a month after the sales contract date or bill of lading date. Scrap dealer remittances, on the other hand, were received from one to three months after the scrap was removed from Metropolitan sites, and the auction sales proceeds were received within 21 days of auction date.
4. Sales taxes for direct sale of salvaged equipment and materials were not always billed to the buyers. Specifically, we noted that \$90,000 of \$117,000 in direct sales was billed without sales taxes (sales tax totaled \$7,425).

We recommend that the Program Management formalize procedures for reconciling salvaged equipment sold through auction. Further, we recommend that the Program Management perform periodic review

and reconciliation of scrap, direct and auction sales and resolve the sales tax issues. Lastly, we recommend that the Controller's Office consider developing invoice procedures for Inland Feeder Project's sale of surplus, as well as Metropolitan's sale of other surplus personal property.

Remote Site Activities – Desert and Western Regions Audit Report

Background

Remote site activities are performed throughout Metropolitan's conveyance and distribution system and include maintenance, landscaping, general administration, and the guest services provided at the Gene Pumping Plant facility. The conveyance and distribution system extends over 5,200 square miles and serves approximately 19 million people. The system includes over 775 miles of pipelines and canals, 16 hydroelectric plants, 17 reservoirs, and hundreds of facilities and structures. Metropolitan's facilities are divided into three regions: Eastern, Western and Desert. The Eastern region includes Orange County, Riverside, Robert A. Skinner Water Treatment Plant and the Diamond Valley Lake Teams. The Western region includes Los Angeles, La Verne, and the Valley Teams. Finally, the Desert region includes Gene Pumping Plant and Whitsett Intake Pumping Plant, Iron Mountain Pumping Plant, Eagle Mountain Pumping Plant, and the Julian Hinds Pumping Plant. This audit encompassed a review of remote site activities for the Western and Desert Regions.

Remote site activities within the Desert and Western Regions include contracts with Mariposa Horticultural Enterprises, Incorporated (Mariposa) and with Tropical Creations, Incorporated (Tropical) to provide landscaping services. The Mariposa agreement is a three-year contract beginning January 2007 with a maximum payable of \$459,798. The Tropical agreement is a three-year contract effective December 2006 with a maximum payable of \$549,355. As of March 2009, \$849,658 has been paid under these agreements.

Remote site activities for the Desert Region include Guest Services at the Gene Pumping Plant facility, which provides meals and lodging for directors, employees, contractors, and inspection trip participants. In calendar year 2008, Guest Services provided 3,343 breakfasts, 7,594 lunches, 3,648 dinners, and 3,859 beds for overnight stay.

Opinion

In our opinion, the accounting and administrative procedures over Remote Site Activities - Desert and Western Regions 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 December 2006 through March 2009.

Comments and Recommendations

COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENT

Our review of 19 invoices totaling \$218,057 (6 Mariposa Horticultural Enterprises invoices -\$76,633 and 13 Tropical Creations invoices - \$141,424) revealed:

1. Discounts of \$1,104 were not taken for five Tropical invoices. These discounts (2 percent of the invoice total) would have been granted if payment was made within 20 days of the invoice date.

2. Invoice payment for a Tropical invoice for \$11,299 was made 38 days after the invoice due date. This is in contrast to Section 6-b of the agreement that requires payment within 30 days after receipt of the invoice.
3. Required purchase order information was missing on two Mariposa invoices. This is contrast to Section 6-a of the agreement that requires purchase order information be included in each invoice.

We recommend that the Agreement Administrators establish procedures to ensure compliance with the terms of the agreements and available discounts are utilized. We also recommend that the Agreement Administrators conduct periodic reviews to ensure compliance.

Remote Site Activities – Eastern Region Audit Report

Background

Remote site activities are performed throughout Metropolitan's conveyance and distribution system and include maintenance, landscaping, general administration, and the guest services provided at the Gene Pumping Plant facility. The conveyance and distribution system extends over 5,200 square miles and serves approximately 19 million people. The system includes over 775 miles of pipelines and canals, 16 hydroelectric plants, 17 reservoirs, and hundreds of facilities and structures. Metropolitan's facilities are divided into three regions: Eastern, Western, and Desert. The Eastern Region includes Orange County, Riverside, Robert A Skinner Water Treatment Plant, and the Diamond Valley Lake Teams. The Western Region includes Los Angeles, La Verne, and the Valley Teams. Finally, the Desert Region includes the Gene Pumping Plant and Whitsett Intake Pumping Plant, Iron Mountain Pumping Plant, Eagle Mountain Pumping Plant, and the Julian Hinds Pumping Plant. This audit encompassed a review of remote site activities for the Eastern Region.

Remote site activities for the Eastern Region include a contract with the California Department of Forestry and Fire Protection to provide fire protection services over and above those normally provided. This agreement was effective from August 2006 to June 2009 and has a maximum payable of \$2 million. In addition, an agreement with Mariposa Horticultural Enterprises, Incorporated to provide landscaping services from July 2008 to June 2009 was made with a maximum payable of \$ 236,534. As of March 2009, Metropolitan has paid \$1.5 million under these agreements.

Opinion

In our opinion, the accounting and administrative procedures over Remote Site Activities - Eastern Region 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 December 2006 through March 2009.

Comments and Recommendations

COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENT

Our review of ten invoices totaling \$860,127 (five California Department of Forestry and Fire Protection invoices - \$766,044; and five Mariposa Horticultural Enterprises, Incorporated invoices - \$94,083) revealed:

1. Documentation in support of labor charges (timesheets and payroll reports) for the California Department of Forestry and Fire Protection (CDF) invoices could not be located. In addition, documentation identifying the breakdown between labor and additive components for two of these CDF invoices totaling \$303,017 could not be located. However, it should be noted that these invoices were dated from 2007; whereas, tests of invoices from 2008 and 2009 revealed compliance to documentation standards.
2. Three Mariposa invoices totaling \$58,794 were paid between 4 and 11 days after the invoice due date. This is in contrast to Section 6-b of the agreement that requires payment within 30 days, after receipt of the invoice.

We recommend that the Agreement Administrator obtain itemized documentation for all invoices. In addition, we recommend that the Agreement Administrator establish procedures to ensure compliance with the terms of the agreements and conduct periodic reviews to ensure compliance.