



• Internal Audit Report for December 2009

Summary

Six reports were issued during the month:

- **Sacramento Valley Water Transfer Program Audit Report**
- **Workers' Compensation Program Audit Report**
- **External Affairs – California Friendly Landscape Training Program Audit Report**
- **IT Consulting Agreements with CHB and TRM Audit Report and Management Response**
- **Official Statement for the Water Revenue Refunding Bonds, 2009 Authorization, Series E**
- **Official Statement for the Waterworks General Obligation Refunding Bonds, 2009 Authorization, Series A**

Discussion Section

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

Sacramento Valley Water Transfer Program Audit Report

Background

In November 2007, Metropolitan and seven state water contractors entered into an agreement with the State Water Project Contractors Authority (SWPCA) to create the Sacramento Valley Water Transfer Program. Under the terms of this agreement, the SWPCA pursued water transfer option agreements with Sacramento Valley water districts and the SWPCA accepted responsibility for payment processing on behalf of the buyers. These option agreements were modified to allow buyers to directly purchase up to 200,000 acre-feet of water.

The SWPCA efforts resulted in joint one-year water transfer purchase agreements with Richvale Irrigation District (Richvale), Western Canal Water District (Western), South Feather Water and Power Agency (South Feather), and South Sutter Water District (South Sutter). The Richvale and Western agreements were effective from April through December 2008, required the buyer to pay \$200 per acre-foot of water, and provided 14,326 acre-feet. Next, the South Feather agreement was effective from June through December 2008, required the buyer to pay \$165 per acre-foot, and provided 10,000 acre-feet. Lastly, the South Sutter agreement was effective from June 2008 through December 2008, required the buyer to pay \$200 per acre-foot, and provided about 10,000 acre-feet of water.

Under these four water transfer purchase agreements, Metropolitan received 20,658 acre-feet of water (net of 22 percent conveyance water loss) and paid a total of \$5.1 million.

Opinion

In our opinion, the accounting and administrative procedures over the Sacramento Valley Water Transfer Program include those practices usually necessary to provide for a generally satisfactory internal control structure. The degree of compliance with such procedures provided effective control for the period July 1, 2006 through June 30, 2009.

Comments and Recommendations

DELTA CARRIAGE AND CONVEYANCE WATER LOSS RATE

Water losses that occur during conveyance could result from regulatory requirements, evaporation, inefficient conveyance systems, high seepage rates, improper calibration of measurement devices leading to errant volume calculation, and canal construction in soils with high infiltration rates. The 2008 water transfer agreements stipulate that water purchased from the participating Sacramento Valley water districts to be subject to normal carriage water losses.

During our review, we were informed by Program Management that the majority of the Delta Carriage and Conveyance water losses are incurred to comply with Delta Salinity Standards under the State Water Resources Control Board's Water Right Decision 1641. In addition, we were informed that the 22 percent Delta Carriage and Conveyance water loss rate, applied to the 2008 water purchase agreements, was within the range of the historical rate used.

However, we could not locate evidence that the Delta Carriage and Conveyance water loss rate under State Water Resources Control Board's Water Right Decision 1641 has been evaluated by Metropolitan, other State Water Contractors, or participating Sacramento Valley water districts. Further, formal documentation establishing that Metropolitan concurs with such a rate could not be located.

We encourage Program Management to evaluate the delta carriage and conveyance water loss rate under State Water Resources Control Board's Water Right Decision 1641. In addition, we recommend that Management consider documenting the results of such evaluations for future water transfer programs.

MANAGEMENT REPORTING

Management reports are designed to combine information into a meaningful form, so that Management can assess a program's performance and develop strategic plans to achieve program goals and objectives. Management reports allow for analysis and tracking to take place without daily involvement from Management, and provide timely feedback on program activities. These reports can be informative (amount of water deliveries) or analytical (regulatory, option payment, and administrative costs).

During our review, we noted that water transfer program status and activities were reported to Management and the Board monthly through the "Water Surplus and Drought Management Plan on Water Supply and Demand" Report. However, we noted that certain program details (e.g., expenditures and quantities of water delivered) were excluded from the "Transfers and Exchanges" section of the report.

We recommend that Water Resources Management include program expenditures and water delivered information in the monthly reports to Management and the Board.

Workers' Compensation Program Audit Report

Background

Workers' compensation is a form of insurance that provides for medical care and compensation for employees who are injured in the course of employment, in exchange for the mandatory relinquishment of the employee's right to sue his or her employer for the tort of negligence. California State workers' compensation laws establish the standards for these benefits to ensure that employees receive medical care for work related injuries or illnesses and monetary payments for temporary or permanent disabilities. These laws also require that employers subscribe to workers' compensation insurance to pay for these benefits. However, in 1979 the California Department of Industrial Relations granted Metropolitan the authority to self-insure its workers' compensation liabilities. Accordingly, the District self-insures the first \$5 million per claim and supplements this with excess insurance coverage of \$25 million.

Under the Metropolitan Workers' Compensation Program, employees are entitled to receive medical treatment for on-the-job injuries or illnesses and are eligible to receive up to 104 weeks of temporary disability benefits. Payments for temporary disability benefits begin after an employee is hospitalized overnight or unable to return to work within three days of an incident. Payments for permanent disability begin within 14 days after the final temporary disability payment, and continue until the maximum amount allowed by law is met or when a settlement has been made.

Management of the Workers' Compensation Program is shared by the Human Resources Group and a third-party Claims Administrator, JT² Integrated Resources. Under this agreement, the Administrator reviews and investigates all claims and estimates the workers' compensation liability. The Human Resources Group is responsible for reviewing the injury report, facilitating the claim submission to the Claims Administrator, and coordinating the initial medical treatment for employees. They also review the claims handling, payments made and assess the liability reserve made by JT² Integrated Resources.

As of June 2009, Metropolitan had 123 open workers' compensation claims and a liability reserve of \$10.3 million. Workers' compensation benefit payments totaled \$6.2 million from July 2006 through June 2009 (three fiscal years).

Opinion

In our opinion, the accounting and administrative procedures over Metropolitan Workers' Compensation 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 1, 2006 through June 30, 2009.

Comments and Recommendations

SUCCESSION PLANNING

Succession planning establishes a process that recruits employees, develops their skills and abilities, and prepares them for advancement or future roles within an organization. Succession planning also includes identifying critical positions throughout the organization, determining workforce trends and developmental needs, and formulates a strategy to ensure that goals and objectives can be realized.

During our review, we noted that the Human Resources Group has one full-time staff assigned to manage the Workers' Compensation Program and oversee its third-party Claims Administrator. However, we noted that this staff position was not supported by backup or cross-training to ensure that the workers' compensation process will not be disrupted due to staff absence, transfer, or termination.

We recommend that the Human Resources Group Management identify core competencies for the above position and develop a plan for effective succession management.

PROCEDURES MANUAL

Written procedures should be established and documented to provide a framework for achieving compliance with applicable regulatory requirements, Metropolitan's policies, goals, and objectives. Procedures assist Human Resources Management in the training of new employees, provide guidance for consistent performance of daily responsibilities, and provide a source of reference for experience personnel.

During our review, we noted that program procedures and practices specific to Metropolitan's workers' compensation management have not been formalized in writing. They include: initiation/completion of claims, assessment of the work-related injuries, coordination of initial medical treatments, review of claims handling, and benefit payments by a third-party Administrator.

We recommend that Human Resources establish a target date to complete the procedures manual for the Workers' Compensation Program. This procedure manual should include, among others, its purpose and function, key controls, staff responsibilities including oversight of the third-party Administrator, and cross-training of staff. We also recommend that Human Resources Management perform random testing to ensure compliance.

External Affairs – California Friendly Landscape Training Program Audit Report

Background

The California Friendly Landscape Training (CFLT) Program was established in 1993 to provide training on water-efficient landscape management practices. Originally known as the "Protector de Agua" Program, courses were developed for both home gardeners and landscape professionals. Residential customers (home gardeners) are trained in the basics of irrigation systems, watering and fertilizing, basic landscape design, and plant identification. Landscape professionals are provided coursework in landscape water management practices, such as landscape design, soil preparation, native plant selection, efficient irrigation systems, and water controller technologies.

The CFLT Program was initially developed and managed by the Water Resource Management Group; however, in July 2008, it was transferred to the External Affairs Group to better align the community centered goals for the CFLT Program with the section's primary function. These CFLT Programs are integral to Metropolitan's outreach efforts to educate the public on efficient outdoor water use.

CFLT Program costs are shared by Metropolitan and Member Agencies, whereby Metropolitan provides for the instructors and educational materials, and Member Agencies provide for classroom facilities and refreshments. During fiscal year 2008/09, the CFLT Program conducted 311 classes (residential and professional courses combined) with a total of 8,953 attendees. Disbursements for these programs totaled \$305,000.

Opinion

In our opinion, the accounting and administrative procedures over the California Friendly Landscape Training 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 of July 1, 2008 through June 30, 2009.

Comments and Recommendations

EVALUATION OF PROGRAM CURRICULUM AND EDUCATION MATERIALS

The California Friendly Landscape Training (CFLT) Program provides classroom instruction to home gardeners and landscape professionals to promote efficient outdoor water use. To preserve CFLT Program quality, CFLT Program Management should conduct periodic evaluations of the CFLT Program curriculum, course descriptions, and education materials to ensure that the CFLT Program satisfies stated goals, meets expectations, and presents up-to-date water efficiency practices. During our review, we noted that the Professional, Plant and Residential courses and related education material have not been evaluated since their inception in 1993.

We recommend that CFLT Program Management, in collaboration with Member Agencies, conduct periodic evaluations of the CFLT Program's curriculum to ensure program quality, compliance with best practices, and consideration of emerging technologies and water efficiency practices. We also recommend that CFLT Program Management enhance course evaluation policy and procedures.

PROGRAM GUIDELINES

Policies and procedures should be enhanced and centralized to provide a framework for achieving CFLT Program goals and to satisfy Metropolitan's water conservation objectives. Procedures assist Management in the training of new employees and cross-training of back-up staff, provide guidance for consistent performance of daily operations, and provide a source of reference for Metropolitan personnel.

During our review, we noted that CFLT Program Management has not centralized formal policies and procedures for the administration of the CFLT Program. Specifically, we noted the lack of procedures for requesting and approving class requests from Member Agencies, monitoring and reporting CFLT Program activities, processing vendor payments, and cross-training of back-up staff.

We recommend that CFLT Program Management develop procedures for processing class requests, scheduling classes, monitoring instructor performance, and cross-training of staff. We also recommend that CFLT Program Management perform random testing to ensure compliance.

IT Consulting Agreements with CHB and TRM Audit Report

Background

Metropolitan utilizes distinct information technology solutions to address the unique needs of the end user. These solutions often necessitate the development of separate software applications that respond to the singular operational needs of the unit. This report consists of a review of two such applications that involve financial budgeting (CBH) and fleet maintenance management (TRM). The CBH application is discussed first, followed by the TRM management application.

Since 1999, Metropolitan has utilized five custom-developed financial budgeting software applications to develop, analyze, and report on the Operation & Maintenance and Capital Investment Plan budgets. However, these applications were not integrated with the Oracle Financial or PeopleSoft Human Resources/Payroll systems and were nearing the end of their useful life.

Accordingly, in October 2006, the Corporate Resources Group recommended the implementation of an integrated budget management system that would ensure consistent budget development, analysis, and reporting. In January 2007, Metropolitan entered into a two-year contract with CBH for a not-to-exceed total of \$1.8 million to provide consulting services for the implementation of an Integrated Budget Management system. As of September 2009, Metropolitan has paid \$1.5 million to CBH under the agreement.

For fleet maintenance management Metropolitan utilizes the MAXIMO system to schedule and track preventive and corrective maintenance for its vehicle fleet. However, while this system supports general fleet maintenance operations, it does not track information such as asset identification, vehicle specifications, and warranty dates. This information is maintained in other systems, databases, spreadsheets, and in manual records.

Consequently, in June 2007 the Corporate Resources Group recommended the implementation of the Transportation Manager module in MAXIMO to ensure that fleet management needs are met. This module provides for improved asset information collection capabilities, it creates maintenance alerts based on vehicle specific metrics, it generates life cycle cost reporting and it establishes key performance indicators.

In September 2007, Metropolitan entered into a two-year fixed-fee agreement with TRM for \$945,000 to provide specialized consulting services to implement this new Transportation Manager module. As of September 2009, Metropolitan has paid TRM \$783,000 under this agreement.

Opinion

In our opinion, the accounting and administrative procedures over IT Consulting Agreements with CBH and TRM provide for a less than satisfactory internal control structure. This opinion is the result of the failure to withhold retention amounts of \$159,700 from CBH and TRM payments, in accordance with the contract terms. In addition, this opinion results from the lack of supporting documentation for CBH consultant charges totaling \$96,300. It should be noted that Management was aware of the retention issue before the audit began, and was in the process of developing corrective action plans. In addition, Management has subsequently initiated remedial actions in response to our other concerns. We will continue to assist in the evaluation of solutions that address these internal control structure concerns.

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 agreement. Compliance with contractual terms also ensures that parties fully discharge their obligation and exercise their rights. Our review of thirteen invoices totaling \$1,007,000 (seven CBH invoices - \$380,000 and six TRM invoices - \$627,000) revealed:

1. Contract retention of \$150,000 was not withheld from payments to CBH invoices totaling \$1.5 million. Moreover, we also noted that the five percent retention of \$9,700 was not withheld from payment of four TRM invoices. This is in contrast to the Compensation Section of the agreements that requires withholding of retention amounts from each invoice, until successful completion and final acceptance of contract by Metropolitan. In addition, the retention withheld from the payment of the two additional TRM invoices was incorrectly recorded as a deduction to TRM payments, rather than to a retention liability account. It should be noted that Management was aware of these deficiencies and was in the process of developing corrective action plans.
2. CBH consultant billings for selected labor charges totaling \$34,251 were not supported with time sheets and payroll reports such as payroll registers or certified payroll reports. These labor charges were all billed under invoice #s 13758 and 13958.
3. We could not locate the supporting documentation for consultant charges totaling \$56,754 billed on selected CBH invoices (#15620 and Hamilton).
4. We could not locate supporting documentation for the prior approval of airline travel totaling \$4,743 billed on CBH invoice #13127. This is in contrast with Exhibit G (Allowable Travel Expenses and Travel Guidelines) of the agreement that requires prior approval for airline travel expenses.
5. All selected CBH invoices were not signed and certified by the consultant and did not include information as required in the agreements, such as the project name, beginning and ending billing dates, the maximum amount payable, and total amount previously invoiced.

We recommend that the Agreement Administrator resolve the noted issues and remind the consultants of the importance to comply with terms and conditions of the agreements. We also recommend that the IT Program Managers establish procedures to ensure compliance to the terms of the agreements and conduct periodic reviews to ensure compliance.

Official Statement for the Water Revenue Refunding Bonds, 2009 Authorization, Series E

The Audit Department has completed a review of the Official Statement for the Water Revenue Refunding Bonds, 2009 Authorization, Series E. This review was undertaken to provide the underwriters of the Water Revenue Refunding 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.

Official Statement for the Waterworks General Obligation Refunding Bonds, 2009 Authorization, Series A

The Audit Department has completed a review of the Official Statement for the Waterworks General Obligation Refunding Bonds, 2009 Authorization, Series A. This review was undertaken to provide the underwriters of the 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 review procedures performed, and the results obtained, to the underwriters of the Bonds.



MWD

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Date: December 21, 2009
To: Gerald C. Riss, General Auditor
From: David C. Edwards, Manager, Information Technology
Subject: Response to "Report on IT Consulting Agreements with CBH and TRM"

Transmitted for your information and review is our response to the Audit Department's "Report on IT Consulting Agreements with CBH and TRM."

We appreciate the time and effort expended by your staff, in particular Faviola Sanchez, in making this assessment.

Please feel free to contact me at extension 75750 if there are any questions.

A handwritten signature in black ink that reads "David C. Edwards".

David C. Edwards

Attachments

cc: R. L. Wolfe
G. Johnson
A. Azmi
M. Tracey
J. Wedseltoft
R. Murdock
L. Gagliano
F. O. Sanchez

RESPONSE TO REPORT ON IT CONSULTING AGREEMENTS WITH CBH AND TRM

REVIEW AREA	Recommendations	Response to Recommendations	Responsible Area	Target Completion Date
<p>Compliance with contractual requirements to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of the agreement.</p>	<p>Recommend that the Agreement Administrator resolve the noted issues and remind the consultants of the importance of complying with terms and conditions of the agreements.</p>	<p>An internal review procedure within IT had identified the retention issue prior to the start of the audit. Appropriate measures were taken to help ensure this does not recur in the future.</p> <p>Consultant (CBH) employee timesheets had not been required as backup for labor charges on invoices to avoid any potential common law employment issues, given that the consultants were performing work on-site at Metropolitan. Subsequent to the audit review, timesheets were requested and obtained from the consulting firm. Staff verified that the timesheets matched the labor hours included on the invoices. In addition, IT management worked with Legal and Audit to document specific guidelines (attached) to be used in the future on time and material agreements to ensure that there is sufficient supporting documentation to substantiate and review consultant labor charges without creating issues from a common law employee standpoint.</p>	<p>PMU (Mike Tracey)</p>	<p>COMPLETED</p>

RESPONSE TO REPORT ON IT CONSULTING AGREEMENTS WITH CBH AND TRM

REVIEW AREA	Recommendations	Response to Recommendations	Responsible Area	Target Completion Date
	<p>Establish procedures to ensure compliance with the terms of the agreements and conduct periodic reviews to ensure compliance.</p>	<p>Consistent with the recommendation, staff has developed a new invoice template that addresses consultant certification, retention, SBE reporting, expense receipts and timesheets. This included the revised procedure for time and material consulting agreements. In addition, guidelines have been established for IT Program Managers to conduct quarterly reviews with agreement administrators to help ensure compliance with the terms of their contracts.</p>	<p>PMU (Ashraf Azmi)</p>	<p>COMPLETED</p>

Attachment

Invoice Processing Procedure for IT Time and Material Consulting Agreements

The follow guidelines are to be followed for IT time and material consulting agreements:

- 1) Invoices need to provide sufficient detail regarding the hours worked to facilitate review and approval by the Metropolitan agreement administrator. At a minimum the level of detail should be consulting hours broken down by resource, by day, by task/deliverable. Require timesheets to be kept on file by the firm and to be made available to Metropolitan upon request to perform reviews and spot checks as appropriate to ensure the consultant timesheet hours match the amount of hours Metropolitan was invoiced for.
- 2) Include the clause below on the face of the invoice and require that an authorized representative of the firm sign the invoice before it is submitted for Metropolitan's approval:

“By signing this invoice, I, as an authorized representative of [consulting firm], certify that the billing hours and work described herein are an accurate and correct record of time spent performing consulting services for Metropolitan as per the agreement terms and that these hours have not been billed under any other client invoices.” [Best]

“By signing this invoice, I certify that the information on this invoice is, to the best of my knowledge, true and accurate.” [Minimum]