



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

- Internal Audit Report for June 2010

Summary

Two reports were issued during the month:

- **Skinner Plant Solar Power Generation Facility Audit Report**
- **Budget and Financial Reporting Audit Report**
- **Special Variable Rate for Water Revenue Refunding Bonds, 2010 Authorization, Series A**

Discussion Section

This report highlights the significant activities of the Internal Audit Department during June 2010. 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.

Skinner Plant Solar Power Generation Facility Audit Report

Background

Metropolitan initiated the Energy Management Program in the fall of 2006 partly in response to the California Global Warming Solutions Act of 2006 (Assembly Bill 32), which requires California to reduce greenhouse gas emissions to 1990 levels by 2020. The Energy Management Program's four primary goals are to implement additional renewable energy production, reduce energy consumption, identify Metropolitan's greenhouse gas inventory, and develop and implement comprehensive strategies to manage power resources in a cost-effective manner.

By accomplishing these goals, Metropolitan hopes to operate its facilities in a sustainable manner and reduce its carbon footprint to help California comply with the requirements of Assembly Bill 32. In conjunction with the Energy Management Program, Metropolitan conducted a study in 2006 that concluded that a solar power generation facility at the Robert A. Skinner Filtration Plant was viable and would help offset power consumption from Southern California Edison.

Accordingly, in July 2008 Metropolitan entered into a \$10-million contract (1668) with SunPower Corporation (SunPower) to construct the Skinner Plant Solar Power Generation Facility. The project consisted of providing all equipment, and constructing a one-megawatt photovoltaic, solar power generation facility that complies with all the rebate requirements of the State's administered California Solar Initiative (CSI) Program. Under the CSI Rebate Program, Metropolitan will be rebated \$0.46 per kilowatt-hour of production, which would provide financial incentives of up to \$5 million over the first five years of operation.

The SunPower contract consisted of installing solar panels on single or dual-axis tracking platforms, equipment pads, canopies, inverters, weather station, monitoring systems, chain-link fences, and gates. Further, the work involved testing and commissioning of the solar power generation facility by the contractor. The facility is designed to generate over 2 million kilowatt-hours of power annually and will meet up to one-sixth of the average energy demand of the Oxidation Retrofit Program at the Robert A.

Skinner Filtration Plant. In addition, this project will reduce Metropolitan's greenhouse gas emissions by over 2 million pounds annually.

The solar generation power facility was completed in October 2009. As of December 2009, project costs totaled \$14.9 million, including contract payments of \$10.1 million to SunPower. Payments to SunPower include approved extra work orders totaling \$82,000. Financial incentives received under the CSI Rebate Program through March 2010 totaled \$543,811.

Responsibilities for the Energy Management Program are split between the Corporate Resources Group and the Water System Operations Group. That is, the areas of design, facilities, equipment, carbon footprint, and information technology are managed by the Corporate Resources Group. The Water System Operations Group is responsible for demand management, energy efficiency, power resources, treatment process assessments, and impacts to operations.

Opinion

In our opinion, the accounting and administrative procedures over Skinner Plant Solar Power Generation Facility 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 2008 through December 2009.

Comments and Recommendations

ECONOMIC ANALYSIS, REBATE PROCEDURES, AND PROJECT PLAN

Written procedures should be established to provide a framework for achieving Metropolitan's goals and objectives. Procedures assist management in training new employees, provide guidance for consistent performance of daily responsibilities, and are a source of reference for experienced personnel. For the Skinner Plant Solar Power Generation Facility, formal procedures should establish processes for preparing benefit and cost analysis and calculating the payback period. Formal procedures should also establish processes for claiming solar rebates, managing, monitoring project, and defining staff roles and responsibilities for these processes. Our review revealed:

1. Procedures for performing economic analysis of the project were not formalized. That is, documentation evidencing a benefit and cost analysis, evaluating potential savings, and calculating the payback period was inconsistent.
2. Solar rebate claims submitted to California Solar Initiative (CSI) were not processed through the Accounts Receivable invoicing system. These claims were submitted directly to CSI by a third-party contractor, Trimark, on behalf of Metropolitan. As a result, CSI rebate transactions were recorded to the general ledger only when remittances were received, and deposited to the bank account by the Treasury Section. It is estimated that over \$5 million in rebate claims will be submitted to CSI within the five-year limit. Further, we noted that the solar rebates received were recorded as deductions to O&M project's electricity charges. Lastly, we noted that Metropolitan's procedures for verifying the accuracy of rebate claims submitted to CSI by Trimark were not formalized.
3. Corporate Resources Group Solar Project Management received the first five CSI rebate checks (total \$612,000); however, three of these checks were held from nine to thirty-five days before forwarding

to the Treasury Section for deposit. We also noted that the Corporate Resources Group Solar Project management was not an authorized agent to receive remittances for Metropolitan, as specified in the Operating Policy C-09 "Remittances Handling/Processing." This process presents undue secure custody risk to the Corporate Resources Group.

4. The Project Management Plan was not prepared for the Solar-Power Generation Project. This is in contrast to the Engineering's Project Management Procedures/Manuals and Civil Design Manual that require project managers to prepare this plan for each of the four construction phases: preliminary design, final design, construction, and inspection. Program management indicated that the Project Management Plan was not prepared due to aggressive schedule to meet the rebate application deadline for the CSI Rebate Program.
5. Lastly, we noted that two of four (50 percent) contractor invoices tested (total \$550,000) were paid 18 to 21 days after the due date. This is in contrast to the General Conditions of the contract that requires payment within 30 days, after receipt of payment request from the contractor. The contract administrator indicated that the late payments were due to the contractor's failure to submit signed voucher in due time.

We recommend that the Corporate Resources Group Solar Project Management and/or the Water System Operations Group Manager's Office formalizes procedures for preparing benefit and cost analysis, calculating payback period for capital projects, and verifying and submitting solar rebate claims to CSI. Further, we recommend that the Corporate Resources Group Solar Project Management and/or the Water System Operations Group Manager's Office coordinate all CSI rebate requests to the Revenue and Receivables Unit for invoicing and recording purposes; obtain guidance from the Accounting Operations Unit for proper accounting of solar rebates; and to inform CSI to remit payments directly to the Treasurer. In addition, we recommend that management remind project managers and contract administrators of the need to comply with the Project Management Procedures Manual/Civil Design Manual and the invoice payment requirements. Lastly, we recommend that management conduct periodic reviews to ensure compliance.

Budget and Financial Reporting Audit Report

Background

The Metropolitan Water District Administrative Code requires the preparation of the annual budget under the direction of the General Manager. The Administrative Code also requires the adoption of the annual budget by the Board no later than the regular Board meeting in June, immediately preceding the fiscal year to which the budget applies. The purpose of the annual budget is to identify adequate financial resources to support Metropolitan's mission and to provide a basis for accountability in fiscal management. The Budget and Financial Planning Section (BFPS) of the Office of the Chief Financial Officer, the Group Managers, and their budget coordinators utilize the Integrated Budget Management System to prepare, coordinate, and monitor the annual budget.

The budget is comprised of three primary areas: expenditures, Capital Investment Plan (CIP), and revenues. The O&M budget, which is part of overall expenditures and includes the operating equipment

budget, identifies the planned expenditures for the operation and maintenance of Metropolitan functions, and is developed by BFPS in conjunction with operating management.

The CIP budget is comprised of estimates for all existing capital projects approved by the Board during the fiscal year along with new projects recommended by the CIP Steering Committee. The Project Coordination Office of the Corporate Resources Group manages the development and reporting of the CIP budget. The revenue and revenue requirements component facilitates the setting of water rates charged to member agencies for the budget year and future fiscal years. The preparation of the revenue requirements is also managed by BFPS. The O&M budgets (including operating equipment) for FY 2010-11 and FY 2009-10 were \$336.7 million and \$340.9 million, respectively. The CIP budgets were \$259.9 million and \$412.1 million for the same fiscal years.

Opinion

In our opinion, the accounting and administrative procedures over Metropolitan's budget process 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 2007 through February 2010.

Comments and Recommendations

COMPLIANCE WITH ESTABLISHED PROCEDURES

Compliance with established procedures is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the planning and monitoring of Metropolitan expenditures. The Financial Systems Manual (FSM) established procedures for the preparation, monitoring and reporting of budget trends and analysis (variances). We understand that this manual was withdrawn with the implementation of the Integrated Budget Management System (IBMS) in 2008. Our review of fiscal year 2009/10 O&M Budget vs. Costs Analysis as of February 28, 2010 revealed:

1. Inconsistent reporting of monthly budget variances. We noted (a) Four groups did not provide an explanation to any account or account category variance; and (b) Seven groups did not provide an explanation to one or more account or account category variances.
2. Budget variance reporting procedures as defined in the IBMS manuals "User Guide for Monitoring Budgets" and the "User Guide for Reporting" do not meet the standards set forth in the outdated Financial System Manual. We noted that FSM procedures required respective groups to provide explanations, preferably on a monthly basis, for any account or account category whose year-to-date actual costs were over or under budget by 5 percent, over budget by \$100,000, or under budget by \$250,000 regardless of budget variance percentages. The IBMS manuals do not include these requirements.
3. IBMS monthly reports do not include analytical reports necessary for monitoring budget variances. IBMS does not produce a report that identifies whether a group has input budget variance explanations.

4. We could not locate electronic or manual approvals on all twenty operating equipment budget requests tested. This is in contrast to IBMS's User Guide for Applications that requires approval of budget requests by management before any operating equipment can be purchased.

We recommend that the Budget and Financial Planning Section (BFPS) establish a schedule for updating the IBMS manuals. These updates should include the guidelines for required variance explanations. Further, we recommend that BFPS work together with the Information Technology Section to develop statistical reports for use in budget variance monitoring. In addition, we recommend that BFPS remind group management to complete the electronic approval process for budget requests prior to purchase of operating equipment. Lastly, we recommend that BFPS establish procedures to conduct periodic reviews to ensure compliance.

ACCESS RIGHTS REPORT

Access controls should be established to protect against the unauthorized destruction and/or modification of computer data. This control is achieved in part by limiting access to the system, based upon an analysis of staff duties and responsibilities and includes periodic reviews of user access capabilities for propriety. BFPS, the Group Managers, and their budget coordinators utilize the IBMS to prepare, coordinate, and monitor the annual budget.

Our review revealed that the access rights reports were not available from IBMS, and periodic reviews of employees' access rights were not completed.

We recommend that BFPS and the Information Technology Section meet to discuss the requirements for a user access rights report. Further, we recommend BFPS establish procedures to perform a periodic review of user access rights.

Special Variable Rate for Water Revenue Refunding Bonds, 2010 Authorization, Series A

The Audit Department has completed a review of the Special Variable Rate for Water Revenue Refunding Bonds, 2010 Authorization, Series A. 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.
