Report

Office of the General Auditor
August 31, 2010

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

- **Internal Audit Report for August 2010**

Summary

Three reports were issued during the month:

- **Property Leases Audit Report**
- **Skinner East Bypass Screening Structure Rehabilitation Audit Report**
- **Yuba Accord Dry Year Water Purchase Program Audit Report**

Discussion Section

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

Property Leases Audit Report

Background

The Real Property Development and Management (RPDM) Group and the Controller's Section of the Chief Financial Officer's Group share responsibility for the administration, billing, collection, and accounting for property leases. The RPDM Group leasing responsibilities are divided between the Revenue Optimization and the Right-of-Way Units. Each of these units negotiates leases, sets up and records the contract terms and conditions in the Asset Information Management System (AIMS), and reconciles payments and collections. Once the lease is set up in AIMS, and upon execution of lease agreements, the Accounts Receivable Team within the Controller's Section establishes a lessee account in the Oracle Accounts Receivable (Oracle AR) module for billing, collection, and monitoring. As of March 31, 2010, the AIMS database revealed 304 leases, licenses, and entry permits with an annual lease income of $4.5 million.

Opinion

In our opinion, the accounting and administrative procedures over Property Leases 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 from July 1, 2006 through March 31, 2010.

Comments and Recommendations

COMPLIANCE WITH POLICIES & PROCEDURES FOR *STANDARD LEASES*

Compliance with established procedures is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of property leases. The RPDM Policy and Procedures Manual establish duties and responsibilities for the initiation, administration, or termination of standard lease agreements.

Our review of the March 31, 2010 Oracle Revenue Lease Aging Report revealed:

1. Eleven of 202 leases totaling $18,000 (5 percent of total lease receivables) were past due between 31 to 181days. We noted that management is actively working in the collection efforts of past due accounts.

2. Late charge penalty clauses were not included on all Property Lease agreements reviewed. It is important to note that RPDM's Policies and Procedures Manual requires management to assess a 10 percent late fee for rent payments not received within 20 days of the contractual due date. The estimated late fees income lost for past due accounts was $66,000 for the period January 2009 through March 2010.

We recommend that the RPDM Group and the Controller Section collect all lease receivables and late payment charges on past due accounts. Further, we recommend that the RPDM Group and the Controller Section establish procedures to ensure compliance with terms and conditions of lease agreements. Lastly, we recommend that management conduct periodic tests to ensure compliance.

COMPLIANCE WITH POLICIES AND PROCEDURES FOR *NONSTANDARD LEASES*

Compliance with established procedures is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of leases. Prospective leases that do not meet the minimum requirements set for standard leases can be approved as nonstandard leases. These leases may be to not-for-profit entities, government agencies, or other civic based organizations whose mission is consistent with that of Metropolitan.

The criteria considered, and requirements needed for these nonstandard leases, are specified in the Property Use Request Form. This form is used to document the justification used to approve the lease, it is used in the calculation of net annual benefit to Metropolitan, and it documents the evaluation of rents or fees by a qualified or professional appraiser.

The Property Use Request Form is also used to prompt reporting to the Board. Our review of ten nonstandard leases, with contract amounts from $0 to $50 revealed:

1. Terms and conditions for two of the ten lease agreements reviewed were not reported to the Board. Additionally, three of the ten leases made were not reported in the subsequent quarter.

2. Property Use Request Forms were incomplete for seven of the ten lease agreements reviewed. This primarily consisted of missing information which included the rents, fees, or benefit analysis.

3. Completed Property Use Request Forms were missing for one of the ten lease agreements reviewed.

4. RPDM's Policies and Procedures Manual did not include policies and procedures for the initiation, administration, and termination of nonstandard lease agreements. However, we noted that a policy has been drafted and will be presented to the Board at a future meeting.

We recommend that the RPDM Group resolve the noted differences. We also recommend that the RPDM Group formalize procedures for nonstandard lease agreements, provide training to staff, and conduct periodic tests to ensure compliance.

RECONCILIATION AIMS AND ORACLE SYSTEMS

The RPDM Group utilizes AIMS to record and track lease activities; whereas, the Accounts Receivable Unit uses the Oracle AR module to track lease billings and collections. Reconciliations between these systems should be made to ensure the accuracy and completeness of input data, and to aid in the timely follow-up of lease receivables and collections.

Our comparison of the AIMS database, with billing transactions on the Oracle AR system for the period July 1, 2006 through March 31, 2010 revealed:

1. Oracle AR billing amounts for seven leases did not agree with the “to be invoiced amounts,” as noted in AIMS. Six invoices were billed incorrectly when compared to related billing terms, resulting in total net underpayment of $1,800.

2. Six lease agreements were not billed on a timely basis.

3. Billing transactions for six leases were processed correctly in the Oracle AR system; however, their status in AIMS is incorrectly shown as “working status” which denotes that the contract has not been completed.

4. Four lease agreements in AIMS did not have corresponding billing transactions in Oracle AR.

5. Policies and procedures for the reconciliation of lease information in AIMS, to the Oracle AR, were not formalized.

We recommend that the RPDM Group resolve the noted discrepancies. We also recommend that the RPDM Group formalize procedures for reconciling AIMS data against the Oracle AR system, provide training to staff, and conduct periodic tests to ensure compliance.

ACCESS CONTROLS

AIMS is utilized by the RPDM Group to set up and record the terms and conditions of Property Lease agreements. Access controls to the system should be established to prevent the unauthorized destruction, disclosure, or modification of data. These controls are achieved by limiting access to the database, based on an analysis of staff duties and responsibilities. Periodic reviews of user access authorities should be conducted to verify the propriety of the data security rule sets. Our review of AIMS access controls revealed:

1. We could not locate documentation that supported the access granted to each user. We noted that the user identity and history of password changes were not recorded or retained in the system.

2. All users have full access with the same read and write capability to the AIMS Access database. This is in contrast to the policy that access levels should be commensurate to the user’s operational needs.

3. Periodic reviews of the list of users to AIMS were not performed by the RPDM Group.

We recommend that the RPDM Group meet with the Information Technology Section for assistance on implementing information technology standards to safeguard access to AIMS and prevent unauthorized data changes. Further, we recommend that the RPDM Group establish procedures for maintaining a record of history of changes to AIMS data. Lastly, we recommend that the RPDM Group conduct periodic reviews of AIMS access rule sets.

Skinner East Bypass Screening Structure Rehabilitation Audit Report

Background

The Lake Skinner East Bypass Screening Structure (LSEBSS) was constructed in 1969 to prevent algae mats, and other floating debris, from entering the treatment plant or the San Diego and Riverside Counties water systems via the bypass pipelines. The LSEBSS is located at the terminus of the San Diego Canal, which is the starting point for water that bypasses Lake Skinner to downstream users. As the LSEBSS screening equipment reached its useful life, the rotating components became inoperable so they functioned as stationary screens. Debris collected on these screens and they needed to be manually cleaned. When the screens clog, water deliveries to member agencies are reduced. In September 2007, the Board authorized construction efforts to rehabilitate the screening system. Rehabilitation of this system was designed to increase the available screening capacity from 30 percent to 80 percent of the total bypass capacity.

In August 2008, Metropolitan entered into a $4.6-million contract with Gantry Constructors, Incorporated (Gantry) to rehabilitate the LSEBSS. The project consisted of removing the old screens and emergency generator, installing rotating screens and a bypass slide gate, installing emergency generators and fuel tank, and constructing a fuel unloading pad. The work also included refurbishing the algae removal facilities and upgrading all electrical systems.

The project was completed in April 2010, after a six-month delay. This delay was due to the replacement of the originally specified emergency generators with low emission-rate generators, in order to comply with new South Coast Air Quality Management District regulations. As of April 2010, project costs totaled $7.1 million, including payments of $4.6 million to Gantry Constructors, Incorporated under the contract.

Opinion

In our opinion, the accounting and administrative procedures over Major Construction Projects - Lake Skinner East Bypass Screening Structure Rehabilitation 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 August 2008 through April 2010.

Comments and Recommendations

There were no material findings to report.

Yuba Accord Dry Year Water Purchase Program Audit Report

Background

On December 4, 2007, the Department of Water Resources (DWR) entered into a long-term water purchase agreement with the Yuba County Water Agency (YCWA) for implementing the Yuba River Accord. Under this agreement, DWR would make water purchases from YCWA available to the State Water Project and Central Valley Project contractors. The Yuba River Accord is an initiative by the YCWA and its member units, and supported by DWR to resolve issues associated with the operation of the Yuba River Development Project (Project). The Project is owned and operated by YCWA to protect lower Yuba River fisheries and local water supply reliability.

On December 21, 2007, Metropolitan entered into an agreement with DWR to purchase water supplies acquired by DWR from YCWA. This agreement provides Metropolitan with an assured purchase of between 13,750 and 35,000 acre-feet per year of water supplies in dry years until 2025. This agreement has been amended three times. Two amendments to the agreement were made in April 2009 to (i) revise the “Reservoir Refill Accounting Provisions” of Exhibit A to the DWR-YCWA Agreement; and (ii) increase the purchase price of Component 4 Water during 2009 to $250 per acre-foot (from a specified price of $100 per acre-foot). The agreement was also amended in April 2010 to increase the purchase price of Component 4 Water during 2010 to $200 per acre-foot (from a specified price of $75 per acre-foot).

As of March 31, 2010, Metropolitan received 53,812 acre-feet of water (20,510 acre-feet in 2008 and 33,302 acre-feet in 2009) net of 20 percent Delta carriage and 3 percent California Aqueduct conveyance losses and paid a total of $12.8 million to DWR.

Opinion

In our opinion, the accounting and administrative procedures over the Yuba Accord Dry Year Water Purchase 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 December 1, 2007 through March 31, 2010.

Comments and Recommendations

GENERAL LEDGER PROJECT ACCOUNTING AND RECONCILIATION

Project accounting controls are designed to assist management in tracking program costs and evaluating operating performance. They facilitate planning and budgeting, ensure cost control, and assist in problem resolution. Timely and accurate reconciliation of accounting activity is essential to ensure proper matching of invoices against contractual payments, or original requests for goods and services. These efforts provide reasonable assurance as to the safeguarding of Metropolitan assets against loss from unauthorized use or disposition. For purchases of water acquired by DWR from YCWA, the agreement administrator tracks payments on an Excel spreadsheet and reconciles them periodically to the Oracle General Ledger system.

Although program management staff maintains a log of payments to DWR for purchases of YCWA water supplies, documentation that evidenced periodic review and reconciliation of the log's reported payments to the general ledger could not be located. As a result, initial water purchases of approximately $1.6 million were incorrectly recorded to Project 901314 (Water Resource Management Group Transfer, Develop and Manage) instead of Project 600962 (Yuba Accord Dry Year Water Purchase Program).

We recommend that program management resolve the noted difference of approximately $1.6 million. We also recommend that program management formalize procedures for reconciling purchases of YCWA water supplies. Lastly, we recommend that program management perform periodic review and reconciliation of these water purchases.