

Report

Office of the General Auditor

October 31, 2010



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

• Internal Audit Report for October 2010

Summary

Two reports were issued during the month:

- **Fraser Communications Audit Report**
 - **Metropolitan Trust Funds Audit Report**
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Discussion Section

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

Fraser Communications Audit Report

Background

In June 2008, Metropolitan's Board adopted the Water Supply Alert Resolution to manage and reduce the risk of water shortages in Southern California. The Water Supply Alert Resolution was designed to increase awareness of the region's critical water supply condition, and called for extraordinary actions. Metropolitan took immediate action in supporting member agency efforts to achieve water savings, by accelerating the media and outreach campaigns to communicate the need for extraordinary conservation.

Metropolitan entered into a three-year agreement for up to \$5 million annually with Fraser Communications to provide regional advertising services and media buys promoting water conservation. This agreement, effective from September 2008 through 2011, stipulates that services are ordered through the issuance of a task order, with the services performed and the costs incurred by the consultant to be paid in accordance with an established fee schedule. Metropolitan has paid Fraser Communications approximately \$8.3 million as of June 30, 2010, with the advertising campaigns reaching approximately 646 million viewers, listeners, and internet users.

Opinion

In our opinion, the accounting and administrative procedures over Consulting Agreements Fraser Communications Agreement provide for a generally satisfactory internal control structure. The degree of compliance with such policies and procedures provided effective control for the period September 15, 2008 through June 30, 2010.

Concern is noted that subconsultant overcharges were not collected on a timely basis. The nature of these charges consisted of media time purchases and related commissions. Overages occurred, as a result of billings being made on an estimated rather than actual basis, in contrast to the contract that stipulates billings shall be on an actual cost basis. We understand that External Affairs management has initiated remedial actions in response to these concerns. We will continue to assist in the evaluation of solutions addressing these internal control structure concerns, while meeting operational needs.

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 ten invoices totaling \$4.4 million revealed:

1. Billings were based on cost estimates rather than on actual costs incurred in contrast to the terms and conditions of the contract. The Compensation Section of the contract requires that the payment of services performed, and of the costs incurred by the consultant to be in compliance with the associated Fee Schedule. The Fee Schedule specifies that the consultant fees, commissions, and additional costs such as media buys, production costs, and related expenses be billed at actual cost. Our review revealed that the divergence from these terms was necessitated by the need to advance funding to the consultant in order for them to make timely payments for advertising production costs and media time purchases. For example, the charges billed on Invoice 6637 (\$711,316) and Invoice 6638 (\$336,565), both dated April 15, 2009, were for cable and television spots that were broadcast in May 2009. The funding for these services were made based on estimated costs to allow the consultant to make timely payment to the third-party vendor.
2. Reimbursement of overpayments for media time purchases was delayed until the conclusion of each program campaign. These campaigns may last from three to six months. Overpayments totaling \$27,475 for May 2009 Invoice 6637 and Invoice 6638 were not reimbursed until September 2009. In addition, an overpayment of \$22,004 for Invoice 8528 dated May 28, 2010 has not been reimbursed to Metropolitan as of September 2010 (four month delay).
3. Reimbursement of overpayments was miscalculated for two of ten invoices tested (Invoice 6773 dated May 2009 and Invoice 7369 dated August 2009). The Customer and Community Services staff has corrected these items on the August 2010 invoice.

Invoices	Amount Paid	Actual Cost	Overpayment	Reimbursed	Amount Due Metropolitan
6773	\$ 365,234	\$356,643	\$ 8,591	\$6,228	\$2,363
7369	573,385	570,536	2,849	1,167	\$1,682
Total					\$4,045

We recommend that the Customer and Community Services Management seek reimbursement for the \$22,004 overpayment to the consultant, and remind personnel of the importance of compliance with the terms and conditions of the agreement. We also recommend that the Customer and Community Services Management establish procedures to ensure compliance to the terms of the agreements and conduct periodic reviews to ensure compliance.

Metropolitan Trust Funds Communications Audit Report

Background

Our review consisted of evaluating the internal controls over the accounting of cash receipts, disbursements, and the reconciliation of cash balances held by Metropolitan in trust relationships (Trust Funds). We performed these detailed tests of six Trust Funds selected from a total of 19 that had significant balances, as of April 30, 2010. Our review included the San Luis Rey Indian Water Authority Trust (\$7.8 million), Southwestern Riverside County Multi-Species Reserve Trust (\$7.8 million), Lake Mathews Multiple Species Reserve Trust (\$3.8 million), Six Agency Committee Cooperative Management Agreement (\$1.6 million), Lower Colorado River Habitat Maintenance Trust (\$1.5 million), and Colorado River Association Cooperative Management Agreement (\$298,000). We also evaluated compliance to contribution, payment, and financial reporting requirements of the cooperative management and associated agreements. Lastly, we evaluated the validity and accuracy of invoice payments for assurance that the amount billed to the Trust Funds were properly calculated and adequately documented.

In common law legal systems, a trust is a relationship whereby property (including real, tangible, and intangible) is managed by a person (or organization) for the benefit of another. A trust is created by a settlor, who entrusts some or all of their property to a trustee of their choice. The trustee holds legal title to the trust property, but they are obliged to hold the property for the benefit of one or more individuals or organizations (the beneficiary) usually specified by the settlor, who hold equitable title. The trustees owe a fiduciary duty to the beneficiaries, who are the "beneficial" owners of the trust property. Trusts are governed by the terms and conditions of the trust agreement and by local law. A "trust fund" is an account established for the deposit and disbursement of funds held by the trustee, as a fiscal agent for the outside organizations or other public agencies.

Metropolitan is trustee for 19 fiduciary relationships that range from Cooperative Agreements to Environmental Trusts. Cooperative Agreements vary from conservation projects, water transfer programs, protection of water rights, to other water related activities. Whereas, Environmental Trusts help enhance, protect, and manage environmental and natural resource issues. Third party involvement varies from state and federal agencies, other public entities, to nonprofit organizations. In some instances, such as the San Luis Rey Indian Water Authority Trust, Metropolitan is simply holding funds until such time as the conditions precedent to payment are fulfilled and there is a determination as to what amount, if any, is due to the beneficiary.

Water Resource Management administers the water transfer agreements and the Corporate Resources Group administers the environmental and conservation projects. Other agreements that provide protection of water rights and habitat maintenance are administered by the Controller Section and the Bay Delta Initiatives.

The Controller Section of the Office of the Chief Financial Officer is responsible for processing cash receipts and disbursements, and for processing fund transfers based upon requests from program managers. Trust Funds held for these agreements are recorded as liabilities in Metropolitan books. Deposits to the Trust Funds are from Metropolitan or outside party contributions, payments for supplemental water, interest earnings, and other miscellaneous receipts. Disbursements are either direct payments from the Trust Funds or deductions from the Trust Funds, as a reimbursement to another

Metropolitan fund where the expenses were incurred. As of April 30, 2010, there were nineteen Trust Funds held by Metropolitan with outstanding balances totaling \$28.7 million.

Opinion

In our opinion, the accounting and administrative procedures over Metropolitan Trust Funds 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 April 2010.

Comments and Recommendations

COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENTS

Compliance with contractual requirements is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of the agreements. Compliance with the contractual terms and conditions also ensures that parties fully discharge their duties and obligations, and exercise their legal rights with associated agreements. Our test work revealed disputes over water and power billing rates, scheduling of water deliveries, late payment of invoices, and noncompliance to the terms and conditions of the Cooperative Management Agreements. Details of these disputes and issues are described below:

San Luis Rey Indian Water Authority (SLRIWA) Trust Fund was created pursuant to an agreement among the SLRIWA, Metropolitan, and the United States relating to the conserved water created as a result of the lining of the All American and Coachella canals.

1. Our review of the San Luis Rey Indian Water Authority (SLRIWA) Trust Fund revealed that Metropolitan and SLRIWA have not resolved a dispute over the method for calculating the amount to be deposited in a fund for potential future payment to the SLRIWA for supplemental water delivered to Metropolitan. Specifically, our review of nine water invoices revealed that SLRIWA's Trust Fund billing rates were 180 percent to 285 percent higher than the amount calculated by Metropolitan (\$367 to \$614 vs. \$203.07 to \$215.34 per acre-foot of water).

Similarly, our review of seven energy invoices revealed that SLRIWA's Trust Fund billing rates were 132 percent higher than Metropolitan's calculation (\$32.52 vs. \$24.61 per megawatt hour of energy used). SLRIWA's Trust Fund higher rates resulted in overbillings totaling \$5.3 million for the 16 invoices tested. We noted that the actual amounts credited to the SLRIWA Trust Fund for these invoices were based on lower rates calculated by Metropolitan, rather than SLRIWA's Trust Fund higher rates. There have been no disbursements from the SWRIWA Trust Fund to date and any future disbursements would be adjusted to reflect the resolution of the pending dispute.

2. Our review also revealed that a dispute has arisen over the scheduling of supplemental water deliveries to Metropolitan. The SLRIWA Trust Fund has taken the position that Metropolitan must schedule the water deliveries on a uniform basis throughout the year. As such, the SLRIWA Trust Fund has invoiced Metropolitan for the months of June through November 2009 on the basis of a uniform daily-delivery schedule.

It is Metropolitan's position, however, that it is not constrained to take delivery of the water on a uniform basis. The agreement administrator and Legal Department staff have been working to resolve the water and power billing rates, and the scheduling disputes with SLRIWA Trust Fund for some time. The agreement administrator expects to obtain final resolution of these disputes early next year.

Lake Mathews Multiple Species Reserve (LMMSR) Trust Fund:

3. Two invoices (W2139876 dated January 23, 2009 for \$3,542 and W2351665 dated July 24, 2009 for \$3,542) billed to the LMMSR Trust Fund were paid from 42 to 52 days, after their due date.
4. Our review also revealed that the reserve manager's position has remained vacant since 2005. As a result, the proposed annual operating budget and work plan for the LMMSR Trust Fund were not prepared from 2005 through the current fiscal year. Section XII E. (Financial Reports) of the LMMSR Trust Fund Cooperative Management Agreement requires the reserve manager to prepare the budget and the work plan for review and approval by the Reserve Management Committee, and to circulate to members at least 30 days prior to the Annual Meeting. We understand that the Reserve Management Committee will proceed with the recruitment of a reserve manager once the comprehensive update to the management plan is completed in 2012.

Southwestern Riverside County Multi-Species Reserve (SRCMSR) Trust Fund:

5. Metropolitan paid late Oakridge Ranch Home Owner Association for dues (total \$9,250) covering the last two quarters of 2008. This resulted in the SRCMSR Trust Fund paying for additional fees such as late fees, finance charges, and demand fees totaling \$2,261.
6. We could not determine the accuracy and validity of the consultant charges billed on two of four invoices tested (MSR0708 for \$30,086 and MSR0409 for \$21,789), as the supporting revised fee schedules could not be located. The Compensation Section of the agreement with the Riverside County Park and Open-Space District (RCPOSD) requires the fee schedule to be the basis for payment of consultant services. We understand that the Legal Department provided an opinion recently that fee schedules are not required under the Compensation Section of the RCPOSD agreement, based on the 1999 amendment to the agreement. Lastly, our review revealed that Invoice MSR0708 was paid 26 days after the due date.

Noncompliance to contribution and payment requirements and other terms and conditions of the agreements could result in a loss to Metropolitan or the trust funds if water and power rates were incorrectly billed, if required contributions were not billed to the contracting entities, or if payments to vendors were late.

We recommend the agreement administrator continue to work with the Legal Department to resolve the payment and water delivery scheduling issues with SLRIWA. If the resolution results in one or more different Metropolitan rates, that the agreement administrators work with the Controller's Office to update the SLRIWA Trust Fund balance. We also recommend that the Metropolitan representative, to the LMMSR's Reserve Management Committee, conduct periodic reviews to ensure compliance to the terms and conditions of the agreement. Further, we recommend that the Metropolitan representative and

other members of the LMMSR’s Reserve Management Committee consider filling the reserve manager position.

Lastly, we recommend that the agreement administrator amend the RCPOSD Agreement reflective of the Legal Department’s opinion to delete the fee schedule provision and to conduct periodic reviews to ensure compliance to the terms and conditions of agreements.

INACTIVE TRUST FUND ACCOUNTS

Our review of the monthly transactions for all 19 trust funds revealed that 2 accounts were inactive prior to 2003, and another account was inactive since August 2008. Details of the inactive accounts are as follows:

	Trust Fund Account No.	Description	Last Transaction	Balance (As of 4/30/10)
1.	2113022	Parker Dam Electricity	Prior to 2003	8,061
2.	2113024	Employees’ Contrib. to Sec 125	Prior to 2003	1,744
3.	2113035	World Water Forum	August 2008	614
		Total		10,419
