THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Report

Office of the General Auditor
November 30, 2010

- **Internal Audit Report for November 2010**

Summary

Three reports were issued during the month:

- **Brutoco Engineering Construction, Incorporated Contracts 1673 and 1677 Audit Report**
- **Employee and Director Expense Reports Audit Report**
- **Calleguas Groundwater Storage Conjunctive Use Program Audit Report**

Discussion Section

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

Brutoco Engineering Construction, Incorporated Contracts 1673 and 1677 Audit Report

Background

The Joseph P. Jensen Water Treatment Plant (Plant) was placed into service in 1972 to supply treated State project water to Metropolitan's Central Pool portion of the distribution system, and to the service areas on the west side of the system. The Plant had an initial capacity of 350-million gallons per day (mgd) and was expanded to its current capacity of 750 mgd in 1990. Residual solids produced from treating State project water are thickened on-site, and then air-dried at the Los Angeles Department of Water and Power solids lagoons, as part of an agreement with Metropolitan that expires in 2014. Metropolitan's long-term plan calls for the Plant to thicken and dewater all residual solids on-site. These plans are being executed in two phases. Phase I involves expanding the Plant's existing solids thickening capacity. Phase II includes the addition of new belt presses and the construction of on-site lagoons. The Brutoco contracts under review are part of Phase I of these plans.

Accordingly, Metropolitan entered into a $5.5-million contract (1673) with Brutoco in September 2008 to construct two additional thickeners (Jensen Solids Thickeners No. 5 and No. 6). This project also included the repair of joints and removal of polychlorinated biphenyl (PCB) containing joint sealant material in Basin No. 3. When completed, the project will add solids processing capacity, provide more efficient thickening, increase decant wash-water recovery, ensure water quality compliance, and improve Plant operational flexibility and reliability. This project was completed in May 2010 and Metropolitan paid approximately $6 million, including extra work orders of $500,000 to Brutoco under this contract.

In addition, Metropolitan entered into a $1.5-million contract (1677) with Brutoco in April 2009 to seismically strengthen the Plant's Administration Building, which was built in 1970. This project included the fabrication and installation of structural steels and concrete beams, cross-bracing, and electrical devices. The project also included the removal and disposal of PCB laden sealant at the upper roof edge of the clerestory. This project was completed in June 2010 and Metropolitan paid approximately $1.8 million, including extra work orders of $300,000 to Brutoco under this contract.

During construction/upgrades of these projects, additional PCB containing materials were discovered on the segments of the reinforced concretes in Basin No. 3 and in the Plant's Administration Building Lobby. The remediation efforts for these additional jobs were performed by Brutoco on separate extra work orders totaling $400,000, under the respective contracts.

Opinion

In our opinion, the accounting and administrative procedures over the Brutoco Engineering Construction, Incorporated Contracts 1673 and 1677 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 October 2008 through August 2010.

Comments and Recommendations

There were no material findings to report.

Employee and Director Expense Reports Audit Report

Background

Metropolitan's Administrative Code and Travel Guide specify travel policies, expense reporting procedures, and guidelines for preparing and submitting expense reports. Expense reports are processed through the Travel Expense Reporter (TER) system for directors and employees, who have incurred travel expenses and operating expenses on behalf of Metropolitan. The Payroll and Accounts Payable Team from the Controller Section, in the office of the Chief Financial Officer, administers and records expense reports, and issues payments. For the twelve months ended March 31, 2010, expenses totaling $2.5 million were processed through the TER system for employees and directors. This represents an 8.7 percent increase over the prior year. These transactions were made up of 4,835 employee expense reports totaling $2.3 million, and 145 director expense reports totaling $178,869.

Opinion

In our opinion, the accounting and administrative procedures over Employee and Director Expense Reports 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 April 1, 2009 through March 31, 2010.

Comments and Recommendations

LATE SUBMISSION OF TRAVEL EXPENSE CLAIMS, UNFILED TRAVEL EXPENSE REPORTS AND RECONCILIATION OF PREPAID EXPENSES

Administrative Code Sections 6331(b)(2) and 6331(b)(3) require that the employees' and directors' expense claims shall be submitted to the Office of the Chief Financial Officer and the Office of the Board Executive Secretary no later than 60 days, following the day employee or director incurred the expenses, or participated in an activity for which Metropolitan funds were utilized on the employee's or director's behalf.

We reviewed 28,620 expense-line items claimed on 4,980 employee and director travel expense reports (TERs) submitted between April 1, 2009 and March 31, 2010, for timely submission. Of this number, 4,856 TERs were approved and processed (4,711 for employees and 145 for directors) and 124 TERs were submitted, but not processed.

1. Employee Expense Reports: 1,778 expense-line items claimed on 182 TERs were submitted late (beyond the 60-day standard). This is a decrease of 26 percent from prior year.

No. of Days Expense was Incurred	No. of Expense Items	No. of Expense Reports (TERs)	Expenses Claimed
61 to 90 days	1,253	147	$94,535
91 to 180 days	515	31	$49,598
181 to 365 days	10	4	$878
Total	1,778	182	$145,011
Total for period	26,429	4,835	$2,331,992*

2. Director Expense Reports: 608 expense line items claimed on 79 TERs were submitted late (beyond the 60-day standard). This is a decrease of 17 percent from prior year.

No. of Days Expense was Incurred	No. of Expense Items	No. of Expense Reports (TERs)	Expenses Claimed
61 to 90 days	364	52	$39,066
91 to 180 days	218	22	$19,684
181 to 365 days	26	5	$2,825
Total	608	79	$61,575
Total for period	2,191	145	$178,869**

* Represents submitted, approved and processed TERs ($2.3 million) as well as submitted but not approved/processed TERs ($50,590).
** Represents submitted, approved and processed TERs ($178,869).

We also reviewed 634 expense line items for expenses prepaid by Metropolitan and incurred by employees and directors between April 1, 2009 and March 31, 2010, but TERs had not been filed. These items were prepaid through check payments or agency-issued credit cards. Our analysis revealed:

3. Outstanding Prepaid Expenses: 51 employees and 25 directors have yet to file expense reports for $111,099 ($95,602 for employees and $15,497 for directors), prepaid by Metropolitan (through check payment and agency issued credit cards) within the 60-day standard.

Employees:

No. of Days Expense was Incurred	No. of Expense Items	Expenses Claimed for Employees
61 to 90 days	70	$5,919
91 to 180 days	207	$59,551
181 to 365 days	167	$30,132
Total	444	$95,602

Directors:

No. of Days Expense was Incurred	No. of Expense Items	Expenses Claimed for Directors
61 to 90 days	23	$127
91 to 180 days	87	$5,020
181 to 365 days	80	$10,350
Total	190	$15,497

4. Reconciliation of Prepaid Expenses: 162 expense items totaling $18,480 that were prepaid through company-issued credit cards, and submitted on TERs have not been reconciled to the monthly credit card statements by the Payroll and Accounts Payable Team. These expenses were incurred between April 2009 and January 2010.

We recommend that management emphasize the importance of submitting TERs within the 60-day guideline, and conduct periodic tests to ensure compliance. We also recommend that the Payroll and Accounts Payable Team, through coordination with Group Managers, continue to follow up on outstanding prepaid expenses to employees and directors.

MILEAGE REIMBURSEMENT

Administrative Code Section 6326(d) requires that the type of transportation employed shall be selected on the basis of the lowest overall cost to Metropolitan, after all costs are considered including travel time and salary of the employee. This section also requires that trips, which require travel in excess of 200 miles one-way, shall be made by commercial airline. The reimbursements for transportation costs, for trips over 200 miles one-way by any form of transportation, shall generally not exceed the standard round-trip airline coach airfare in effect at the time. These cost estimates are established by the Contracting Services Manager, and include personal auto mileage and airport parking that would have been incurred and reimbursable, if airline transportation had been used.

We reviewed 40 travel expense claims (360 total claims), with reported mileage over 200 miles one-way, and noted that eight did not have adequate information or explanation (i.e., cost consideration) for using personal car in lieu of air transportation. This is in contrast to Administrative Code Section 6326(d) which requires consideration for transportation's lowest overall cost to Metropolitan.

We recommend that the Management emphasize the importance of providing adequate information or explanation for business mileage claimed on the expense reports.

Calleguas Groundwater Storage Conjunctive Use Program Audit Report

Background

Metropolitan's Integrated Water Resources Plan (Plan) provides a road map for maintaining regional water supply reliability over the next 25 years. The Plan calls for Metropolitan to develop groundwater storage programs and provide multiple water delivery routes to all parts of Metropolitan's service area. In June 1995, Metropolitan entered into a 40-year contract (1104) with Calleguas Municipal Water District (Calleguas) to develop a groundwater storage conjunctive use program (Program) in the North

Las Posas Groundwater Basin (Basin). This Program has two components: (1) system reliability development (Phase I and Phase II), which provides a second point of delivery of treated State project water to Calleguas; and (2) the groundwater storage program, which provides water for regional benefit.

Phase I started in 1996 and was completed in 2001. It consists of four Aquifer Storage and Recovery (ASR) wells and associated pipelines. Phase II started in 2002 and was completed in 2006. It consists of 14 ASR wells and associated pipelines. The groundwater storage component of the Program consists of using the ASR facilities to store Metropolitan water in the Basin and to retrieve an equivalent quantity of water later at Metropolitan request. The groundwater storage component also includes the construction of 10 additional ASR wells in the future.

This review was for Contract 1104, which was made in June 1995 and amended in March 2000 to increase the capacity of water that can be stored in the Basin from 100,000 acre-feet to 210,000 acre-feet. The contract was again amended in March 2008 to set power and O&M costs responsibilities for both Metropolitan and Calleguas, and to initiate studies for the final phase of the groundwater storage component of the Program. As of June 30, 2010, Metropolitan has paid a total of $33.2 million ($28.3 million in construction costs and $4.9 million in operation and maintenance costs) to Calleguas under this Program. Metropolitan stored a total of 61,171 acre-feet of treated State project water in the Basin, recovered 22,906 acre-feet, with remaining stored water totaling 38,265 acre-feet through June 2010.

<u>Opinion</u>
In our opinion, the accounting and administrative procedures over the Calleguas Groundwater Storage Conjunctive Use 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 January 2007 through June 2010.

<u>Comments and Recommendations</u>

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 the contractual terms and conditions also ensures that parties fully discharge their duties and obligations and exercise their legal rights associated with the agreement. Our review of six selected invoices totaling $2.5 million revealed:

1. Monetary penalties of approximately $13.5 million were not imposed to Calleguas despite underperformance of required water production, in concert with the terms and conditions of the agreement. We noted that Calleguas produced only 10,258 of the 20,000 acre-feet (51 percent) of the water requested by Metropolitan in January 2009, due to several production constraints. The Groundwater Storage and Extraction Section 1.II.J.2 of the agreement require the imposition of a penalty for nonperformance. This penalty is to be calculated at two-times the Tier 2 full-service treated water rate applied to the quantity of acre-feet of nonperformance. The agreement also provides that such penalty could be waived by the Operating Committee (this committee consists of Calleguas and Metropolitan staff), if nonperformance was due to unanticipated production or water quality issues.

By a letter dated February 10, 2010, Metropolitan informed Calleguas management that the Operating Committee had recognized that the nonperformance resulted from unanticipated operational difficulties, and that the nonperformance penalty should not be assessed pending mutual concurrence on a corrective plan. In this letter, Metropolitan requested that Calleguas prepare a mutually agreeable course of action and schedule to correct the deficiencies, including detailed information related to the full build-out of the Moorpark Pump Station and any required pipelines, and completion of groundwater treatment facilities.

Based on information shared in the Operating Committee meetings, we understand that Calleguas is developing plans for construction of a groundwater treatment plant and construction of the Moorpark Pump Station. Calleguas has also retained a well-drilling contractor to address sanding issues in certain wells. However, Calleguas has yet to provide Metropolitan with a comprehensive corrective plan that contains detailed information and schedules, as requested by Metropolitan in the February 10, 2010 letter. As a result, Metropolitan has not yet agreed to the completeness of this corrective plan, and has requested Calleguas provide further detailed information and schedules.

2. We could not locate the supporting timesheets for consultant labor charges totaling $2,752. These charges were billed under Calleguas Invoice 091508 dated September 3, 2008.

3. Power and other shared costs were billed on an irregular basis. We noted that contractor charges totaling $526,769 incurred during 2007 were not billed to Metropolitan by Calleguas until September 2008 (9 to 21 months later). Further review revealed that, although the agreement was amended in March 2008 to accept the submission of invoices on a quarterly basis, Calleguas remained late in its submission of invoices in subsequent periods, submitting invoices an average of four months after the completion of the quarterly billing period of the invoice.

4. Calleguas invoices were submitted directly to the agreement administrator instead of the Accounts Payable Unit. This is in contrast to the current procedures of submitting vendor invoices directly to Accounts Payable.

5. We could not locate the annual reconciliation for Metropolitan water stored and extracted from the North Las Posas Groundwater Basin. This is in conflict with Section 1.1.D of the agreement, which requires the Operating Committee to prepare an annual reconciliation to determine the accuracy of water stored and extracted from the facilities. Subsequent discussions with Water Resource Management and Water System Operations Group management revealed that Metropolitan and Calleguas staff have been meeting to reconcile production and extraction values back to the inception of the Program, and have identified two instances of number discrepancies. The Operating Committee will formalize these findings.

We recommend that the Operating Committee follow up with Calleguas on the implementation of corrective action plan that would fix the production and water quality issues. We also recommend that program management seek reimbursement for unsupported consultant charges of $2,752. Further, we recommend that program management establish procedures to ensure compliance to the terms and conditions and reconciliation requirements of the contract and conduct periodic reviews to ensure compliance.