



THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA

# Report

Office of the General Auditor

December 29, 2010

## • Internal Audit Report for December 2010

### Summary

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Three reports were issued during the month:

- **Surplus Personal Property Audit Report**
- **Chino Basin Groundwater Conjunctive Use Project Audit Report**
- **Official Statement for the Water Revenue Refunding Bonds, 2010 Authorization, Series A**

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### Discussion Section

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

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## Surplus Personal Property Audit Report

### Background

Administrative Code Section 8271, Operating Policy F-02, and the Disposal of Surplus Personal Property Manual establish policies and procedures for the identification and disposal of Metropolitan's surplus personal property. These items include equipment, scrap, stock, refuse, or stockpiled raw materials (including excavated materials) for which Metropolitan has no further use. The equipment category includes office, operating and heavy machinery, furniture, automobiles, and trucks. Operating policies authorize the disposal of this property through Web-based and live auctions, trade-ins with suppliers, recycling of equipment or material, and donations to outside entities.

The responsibility for the identification and disposal of Metropolitan's surplus property has been assigned to the Business Services Section of the Corporate Resources Group. The Contracting Services Unit and the Inventory Management Team are responsible for authorizing the disposal of surplus items. The Investment Recovery Coordinator directs the sale of these items to auctioneers, direct buyers, and scrap dealers.

From January 2009 through October 2010, Metropolitan retired \$3.7 million (cost-basis) worth of surplus personal property. We noted that 1,477 surplus personal property items were sold or auctioned by Metropolitan for the same period, resulting in cash proceeds of \$541,450. Of this amount, \$440,219 (81 percent) relates to the sale of vehicles and heavy equipment.

### Opinion

In our opinion, the accounting and administrative procedures over Surplus Personal Property 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 January 2009 to October 2010.

## **Comments and Recommendations**

### **COMPLIANCE WITH ESTABLISHED POLICIES & PROCEDURES**

Compliance with established procedures is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the retirement and disposal of surplus personal property. Metropolitan's Administrative Code Section 8271, Operating Policy F-02, and the Disposal of Surplus Personal Property Manual establish policies and procedures for the identification and disposal of surplus personal property. In addition, Administrative Code Section 8140 establishes the policies for competitive procurements valued at \$25,000 or more.

Our review of disposal activities for surplus personal property revealed that the professional auction services contract entered in May 2005 was not competitively bid. Further review revealed that for the period under review (January 2009 - October 2010) cash proceeds from auction sales totaled \$541,450 and commissions paid to the auctioneer totaled \$13,207. We estimate that the commissions paid to this firm since 2005 (inception) exceeded \$33,000, and thus may be subject to Administrative Code Section 8140 stipulations. We recommend that Business Services management consider utilizing a competitive bidding process for future professional auctioneering service contracts.

### **PROPER CLASSIFICATION OF DISPOSED ITEMS**

Upon disposal of personal property items, the Controller Section of the Chief Financial Officer removes the recorded items from the General Ledger, along with the associated costs and depreciation. In addition, the Controller's Section should indicate in the Oracle Assets Tracking System (OATS) the classification for the disposed items based on the documentation provided. Our review revealed that 78 of 80 disposed items tested were classified as "Stolen" instead of "Cycle Count" in the OATS system. The incident reports indicated that these items could not be found as part of the cycle-count process, and were identified as lost or stolen in the system. It is important to note that there was no evidence that the items were actually stolen or that a police report was filed.

We recommend that management establish procedures for the thorough investigation and resolution of cycle-count discrepancies. In addition, we recommend management prepare definitive conclusions as to those items that are identified as stolen, and consider filing appropriate documentation with law enforcement authorities. Finally, we recommend management establish accountability standards for team, unit, and section managers for the proper safeguard over personal property assets.

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## **Chino Basin Groundwater Conjunctive Use Project Audit Report**

### **Background**

In March 2000, California voters approved Proposition 13 (Safe-Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act) to allow the state to sell \$1.97 billion of general obligation bonds for water-related projects. In May 2000, the Governor released the State Annual Budget, which appropriated funds to the Department of Water Resources (DWR) to carry out a number of programs that provide loans and grants to local agencies for various water-related purposes. Under Proposition 13, DWR allocated \$45 million in grants to Metropolitan to help finance its Groundwater Conjunctive Use Programs.

In March 2003, Metropolitan entered into a 25-year agreement with the Inland Empire Utilities Agency (IEUA), Three Valleys Municipal Water District, and the Chino Basin Watermaster to provide funding for the Chino Basin Groundwater Conjunctive Use Project (Project). The funding consisted of a \$9.4-million grant under Proposition 13, and \$18.5 million financial assistance from Metropolitan.

The Project involves the construction of groundwater production facilities in the Chino Basin area, such as new wells and ion exchange treatment facilities. When completed, the Project will enable Metropolitan to store up to 100,000 acre-feet (AF) of surplus “wet” water in Chino Basin and produce 33,000 AF of water per year during dry, drought, or emergency periods. This agreement was amended several times to extend the deadline for plan submission, change the water extraction terms, extend the construction completion date, reallocate other Proposition 13 grants to the Project, and provide for the reimbursement of member agency costs.

As of June 30, 2010, Proposition 13 grant funds of \$9.4 million and Metropolitan’s financial assistance of \$18.5 million were fully utilized. In addition, Metropolitan paid a total of \$837,000 to the Chino Basin Watermaster for administering the Metropolitan water storage account in the Chino Basin. Through June 2010, Metropolitan stored 88,434 AF of State project water and Colorado River water in the Basin. Of this total, 74,213 AF was extracted, losses of 5,678 AF were incurred, and 8,543 AF remained in storage.

### **Opinion**

In our opinion, the accounting and administrative procedures over the Chino Basin Groundwater Conjunctive Use Project 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.

### **Comments and Recommendations**

#### **REVIEW AND APPROVAL PROCESS**

Review and approval controls are designed to verify the accuracy of billings for goods and services, provide assurance as to the propriety of transactions, and they ensure that follow-up procedures exist for exception processing. The reviewer and/or approver should review expenditures listed on the invoices for propriety and match them to source documentation to ensure accuracy and completeness of transactions. Our review of DWR Proposition 13 billings and Inland Empire Utilities Agency (IEUA) invoices revealed:

1. Reimbursable costs were billed to the Department of Water Resources on an irregular basis. Specifically, we noted that grant eligible costs totaling \$986,000 were billed to DWR between 91 to 95 days after Metropolitan paid these costs via invoices to IEUA.
2. Subagency charges included in IEUA invoices were billed on an irregular basis. Specifically, we noted that construction and consulting charges totaling \$1.5 million, incurred by subagency Jurupa Community Services District from May 2004 through October 2006, were not billed to Metropolitan until April 2007 (5 to 34 months past).

We recommend that Project management ensure that billings to the Department of Water Resources are processed on a timely basis. In addition, we recommend that Project management remind Chino Basin Program management of proper procedures that ensure timely billing of project costs to Metropolitan.

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## **Official Statement for the Water Revenue Refunding Bonds, 2010 Authorization, Series A**

The Audit Department has completed a review of the Official Statement for the 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.

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