



- **Internal Audit Report for April 2011**

## Summary

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Three reports were issued during the month:

- **Butier Construction Managers 78559 and Tetra Design 96980 Audit Report**
- **Layfield Environmental Systems Corporation Contract 1681 Audit Report**
- **Employee Benefits Audit Report**

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## Discussion Section

This report highlights the significant activities of the Internal Audit Department during April 2011. 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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## **Butier Construction Managers 78559/Tetra Design 96980 Audit Report**

### **Background**

In March 2005, Metropolitan initiated the Perris Valley Pipeline Project (Project) to meet projected water demands in Riverside County; maximize capacity of the Henry J. Mills (Mills) Water Treatment Plant; offset peak demands on the Robert A. Skinner Water Treatment Plant; strengthen water delivery system reliability; and increase operational flexibility. When completed, the 96-inch-diameter pipeline will be 6.5 miles long, have five service connections, and have a capacity of 375 cubic feet per second. The Project is being executed in two construction elements.

The first construction element involved the design and construction of the Mills Water Treatment Plant/Perris Valley Pipeline Tie-In. For this segment, Metropolitan contracted with Western Municipal Water District of Riverside County (Western), wherein Western was responsible for the tie-in work with Metropolitan reimbursing Western for a portion of project costs.

The second construction element includes building the Perris Valley Pipeline. This effort was divided into two contracts in October 2006, when the Board authorized the North and South Reach Projects. Metropolitan awarded the North Reach construction contract to W.A. Rasic Construction in July 2007. The North Reach contract was completed in December 2009, and the facilities are now in service. Metropolitan awarded the South Reach construction contract to Oscar Renda Contracting in June 2008 and construction is 90 percent complete as of December 2010.

As part of this effort, Metropolitan is responsible for construction management and inspection of the project. Metropolitan entered into a \$5.5-million agreement (78559) with Butier Construction Managers (Butier) for construction management and inspection support services. This project includes contract administration; field inspection of the pipeline, appurtenances, and

surface restoration; fabrication and welding inspection; and other specialty work. The Butier agreement was initially effective from June 2006 through May 2008. This agreement was amended twice to extend the contract duration to August 2011 to cover ongoing South Reach construction, and to include new fee schedules. As of December 31, 2010, Metropolitan has paid Butier \$4.6 million under this agreement.

The F.E. Weymouth (Weymouth) Water Treatment Plant in La Verne was placed into service in 1941 to treat water received from the Colorado River. The Fabrication Shop, Machine Shop, and East and West Coatings Shops (La Verne Shops) have been located at the Weymouth Plant since that time. These specialized La Verne Shops are involved in all major refurbishment and emergency response projects that occur within Metropolitan's conveyance and distribution system, and within its treatment plants. The La Verne Shops were expanded in the 1960s, when larger facilities were built. They were expanded again in the 1980s to support a major rehabilitation of the Colorado River Aqueduct pumps.

In July 2002, Metropolitan initiated the La Verne Shops Upgrade Program which involved constructing shop building additions, and refurbishing and replacing shop equipment. The preliminary design for expansion of the La Verne Shops was completed in early 2007. In March 2008, the Board authorized final design for expansion of these shops.

Metropolitan entered into a not-to-exceed \$1.32-million agreement (96980) with Tetra Design (Tetra) in April 2008 to provide final design for the La Verne Shops expansion. This project also included architectural, structural, mechanical, electrical, plumbing, civil engineering, and cost estimating services for the final design and preparation of construction documents. The Tetra agreement was amended in November 2009 to modify the scope of services and to increase the maximum amount payable by \$230,000 to \$1.55 million. As of December 2010, the final design for the expansion project was 95 percent completed and Metropolitan paid Tetra \$1.4 million under this agreement.

### **Opinion**

In our opinion, the accounting and administrative procedures over the consulting agreements 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 May 2006 through December 2010.

### **Comments and Recommendations**

#### **COMPLIANCE TO BILLING AND PAYMENT REQUIREMENTS**

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 associated with the agreement. Our review of 12 invoices totaling \$1.6 million (8 Butier totaling \$802,000 and 4 Tetra totaling \$760,000) revealed:

1. Subconsultant Degenkolb Engineers labor charges for \$1,281 were billed twice by Tetra and subsequently paid twice.

2. Labor charges (\$96,840) for a subconsultant to Tetra (F. W. Kohl Industrial Group, Incorporated (Kohl)) were billed under the labor category as “Consultant”, which was not included in the fee schedule. This is in contrast to the Compensation Section of the agreement that requires the consultant to pay for services performed and costs incurred in accordance with the fee schedule.
3. We could not locate Kohl’s expense report for travel expenses totaling \$1,773 per receipts incurred in May 2008. This is in contrast to the Allowable Travel Expenses Section of the Tetra agreement that requires the submission of an expense report with the invoice.
4. Travel expenses totaling \$390 for Kohl were incurred outside the expense reporting period of August 17, 2008 through August 28, 2008.
5. We could not locate prior approval documentation for Kohl’s airline travel expenses totaling \$2,660 billed on all four Tetra invoices tested. This is in contrast with Exhibit D (Allowable Travel Expenses) of Tetra agreement that requires prior approval for airline travel expenses.
6. Small Business Enterprise (SBE) Utilization Reports were not submitted for 2 of 4 (50 percent) Tetra invoices tested. This is in contrast to the Billings and Payments Section of Tetra agreement that requires consultant’s invoices to be accompanied by a SBE Utilization Report.
7. Work commenced on Tetra’s Task Order No. 1 totaling \$612,492 prior to its approval by Metropolitan on May 12, 2008. This is in contrast to Exhibit A (Scope of Work) of the Tetra agreement that requires approval of tasks by Metropolitan prior to commencing any work.
8. Billing periods for all 4 (100 percent) of Tetra’s invoices and 1 of 8 (13 percent) Butier invoices, including subconsultant invoices, ranged from two to eleven months. This is in contrast to the Billings and Payments Sections of Butier and Tetra agreements that require monthly invoicing.
9. Invoices were paid between 14 to 51 days after the due date on 3 of 4 (75 percent) Tetra invoices and 2 of 8 (25 percent) Butier invoices tested. This is in contrast to the Billings and Payment Sections of Tetra and Butier agreements that require payment within 30 days of receipt of the invoice.

We recommend that the agreement administrator collect the \$1,281 double payment to Tetra related to subconsultant Degenkolb Engineers. We also recommend that the agreement administrator resolve subconsultant Kohl ineligible travel expenses and inconsistent billings. Additionally, we recommend that the agreement administrator consider reviewing the subconsultant’s invoices to ensure accuracy. Finally, we recommend that the agreement administrator establish procedures to ensure compliance to the terms of the agreement and conduct periodic reviews.

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## **Layfield Environmental Systems Corporation Contract 1681 Audit Report**

### **Background**

The Robert A. Skinner Water Treatment Plant (Plant) was placed into service in 1976 to treat water received from the Colorado River. The Plant currently treats a blend of Colorado River and State project water and delivers it to the Eastern Municipal Water District, Western Municipal Water District of Riverside County, and the San Diego County Water Authority. The Plant includes the 326 acre-feet Skinner Finished Water Reservoir (Skinner Reservoir) that was completed in 1991. The Skinner Reservoir, along with all finished water reservoirs, is covered to prevent cross-connections of potable with untreated water, in accordance with California Department of Public Health Standards. This floating cover measures approximately 700,000 square-feet and is made of hypalon.

Although the existing cover has performed well, it has reached the end of its useful life which was initially estimated as between 15 to 20 years. In June 2006, numerous tears were discovered during routine inspection and maintenance tasks. In September 2006, the Board authorized the final design for a replacement cover. The final design was completed in 2009, and the Board authorized construction of a replacement cover to coincide with the shutdown of the Skinner Reservoir from December 2009 to March 2010.

In July 2009, Metropolitan entered into a \$3.44-million contract with Layfield Environmental Systems Corporation Contract 1681 to construct a replacement cover for the Skinner Reservoir. The project includes removing and replacing the existing floating cover, adding rain water collection pumps, modifying the existing electrical system, and installing drain pipes.

Construction was completed in

April 2010, and Metropolitan paid \$3.46 million (including \$29,000 in extra works) under this contract through December 2010.

### **Opinion**

In our opinion, the accounting and administrative procedures over Layfield Environmental Systems Corporation Contract 1681 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 2009 through December 2010.

### **Comments and Recommendations**

#### **COMPLIANCE WITH CONTRACTUAL TERMS**

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 obligations and exercise their rights.

Our review revealed that 2 of 5 (40 percent) contractor invoices tested (totaling \$1.5 million) were paid late up to 7 days. This is in contrast to General Conditions of the contract that requires payment within 30 days of receipt of payment request from the contractor. Further

review revealed that the late payment was due to the contractor's failure to submit signed vouchers in time.

We recommend that Project Management remind the contract administrator of the need to comply with the terms and conditions of the contract and conduct periodic reviews to ensure compliance.

## Employee Benefits Audit Report

### Background

Metropolitan established a 401(k) Savings Plan in 1985 and a 457 Deferred Compensation Plan in 1977. The 401(k) Savings Plan is a defined contribution retirement plan that allows Metropolitan employees and Metropolitan temporary employees (Employees) to invest pretax earnings, which are matched by Metropolitan on a dollar-to-dollar basis up to 4.5 percent of an Employee's annual salary. The 457 Deferred Compensation Plan is available to Employees of state and local governmental entities and tax-exempt entities only, and enables them to defer a portion of their gross earnings (which is not matched by Metropolitan).

Through these plans, Employees authorize Metropolitan to deduct a specified amount from their payroll and instruct the third-party service provider to allocate that money among various investment options offered by the plans. Plan contributions and related investment earnings are not subject to taxes until they are withdrawn from the plans.

In October 2003, Metropolitan contracted with Great-West Life & Annuity Insurance Company (GW) for recordkeeping and plan management services through March 2010, as amended. In April 2010, Metropolitan entered into a new contract with GW for a five-year period. Below are financial highlights of these plans for the period under review:

	<b>Year Ending 12/31/2007</b>		<b>Year Ending 12/31/2008</b>		<b>Year Ending 12/31/2009</b>	
	<b>401(k)</b>	<b>457</b>	<b>401(k)</b>	<b>457</b>	<b>401(k)</b>	<b>457</b>
Contributions	\$23.5M	\$7.6M	\$23.6M	\$7.5M	\$24.2M	\$7.0M
Assets	\$180.4M	\$60.0M	\$163.0M	\$58.8M	\$203.0M	\$68.4M
Distributions	\$10.6M	\$4.4M	\$10.3M	\$4.2M	\$14.0M	\$4.2M
Participants	2,074	1,447	2,142	1,483	2,183	1,490

### Opinion

In our opinion, the accounting and administrative procedures over Employee Benefits 401(k) Savings Plan and 457 Deferred Compensation Plan 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 January 2007 to January 2011.

### Comments and Recommendations

There were no material findings to report.