



THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA

• **Internal Audit Report for May 2011**

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## Summary

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Five reports were issued during the month:

- **J.R. Filanc Construction Company, Incorporated Contract 1682 Audit Report**
- **Palo Verde Irrigation District Forbearance and Fallowing Program Audit Report**
- **Take Supply Chain Contract 89052 and Ciber, Incorporated Contract 85972 Audit Report and Management Response**
- **Official Statement for the Water Revenue Refunding Bonds, 2011 Authorization, Series A1, A2, A3, and A4**
- **Employee Separations Review**

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## Discussion Section

This report highlights the significant activities of the Internal Audit Department during May 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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## **J.R. Filanc Construction Company, Incorporated Contract 1682 Audit Report**

### **Background**

The F.E. Weymouth Water Treatment Plant (Plant) was placed into service in 1941 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 Central Pool portion of the distribution system. Originally sized at a capacity of 100 million gallons per day (mgd), the Plant was expanded to its current capacity of 520 mgd in order to meet the increased demands from member agencies. In addition to these expansions, the Plant has had facility upgrades and improvements throughout the years.

As part of these upgrades, the Board authorized the construction of three related projects at the Plant: (1) the Inlet Conduit Relocation and Rapid Mix Systems upgrades; (2) the Fire and Domestic Water Systems upgrades; and (3) the Electrical Upgrades. In order to maximize efficiency and minimize contractor interferences and the Plant's shutdowns, the construction of the first two projects and a portion of the Electrical Upgrades Project were merged in a single construction contract.

The relocation of the Inlet Conduit will reduce seismic vulnerability, and will enable the future addition of ozone contractors at the Plant. The upgrades of the associated Rapid Mix Systems are necessary to comply with the United States Environmental Protection Agency's filter backwash recycling rule. Finally, upgrades of the Fire and Domestic Water Systems will provide adequate pressure throughout the Plant, and meet fire flow requirements for existing and planned facilities.

In August 2009, Metropolitan entered into a \$30.1-million contract (1682) with J.R. Filanc Construction Company, Incorporated to relocate the existing Plant's inlet conduit and construct the rapid mix facilities, fire and domestic water systems, and elements of the electrical systems. This project included construction of a concrete box conduit connection from the Upper Feeder to the existing basins and the new rapid mix facilities; relocation of return wash water piping and sulfuric acid feeds; and modification of the existing chlorine injection facilities. The project also included the installation of additional domestic and fire water pumps, fire and water system piping and fire hydrants; construction of electrical duct banks; and grading and fencing of a switchyard.

In January 2011, the California Department of Public Health approved \$20 million in state's Proposition 50 "The Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002" grants to Metropolitan to be used for the Plant's Oxidation Retrofit Program. Of this amount, \$8.9 million was allocated for the relocation of the Plant's inlet conduit. Metropolitan is currently in the process of submitting claims for the inlet conduit relocation costs incurred under this contract.

As of March 2011, the contractor has completed 93 percent of the project work, and Metropolitan has paid \$26 million, including \$498,000 in approved extra work orders under this contract.

### **Opinion**

In our opinion, the accounting and administrative procedures over J.R. Filanc Construction Company, Incorporated Contract 1682 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 2009 to March 2011.

### **Comments and Recommendations**

There were no material findings to report.

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## **Palo Verde Irrigation District Forbearance and Fallowing Program Audit Report**

### **Background**

In August 2004, Metropolitan entered into a 35-year Forbearance and Fallowing Program (Program) agreement with the Palo Verde Irrigation District (PVID) to develop a flexible water supply of up to 125,000 acre-feet per year through non-irrigation of qualified farmlands in the Palo Verde Valley area. From 2005 to 2006, Metropolitan entered into long-term agreements with PVID and 99 landowners to fallow the qualified farmlands through July 2040.

Under the terms of the Program, participants would not irrigate their lands and the saved Colorado River water was made available to Metropolitan. Metropolitan was then required to make payments to these landowners for fallowing their lands, and to compensate PVID for related administration costs. Annual payments to landowners under this Program were \$648, \$664, and \$681 per fallowed acre for Program fiscal years 2008/09, 2009/10, and 2010/11 respectively. Payments totaled \$45.6 million for the three Program years under review. An annual advance payment was also made to PVID to cover administrative costs for each Program year. These annual advances totaled \$557,000 for the last three Program years.

In March 2009, the Board authorized the PVID Emergency Short-Term Fallowing Program due to cutbacks in State project water supplies and the statewide emergency drought conditions. From April through August 2009, Metropolitan entered into short-term emergency fallowing agreements with PVID landowners to fallow up to 13,350 acres, in addition to the nearly 26,000 acres being fallowed under the long-term program. The short-term program, which ended in July 2010, provided Metropolitan with approximately 56,400 acre-feet. Under this program, Metropolitan paid landowners \$1,665 per fallowed acre for a total of \$21.2 million.

The annual payments under the long-term and short-term programs, and the annual advances to PVID for program administration were initially capitalized to short-term asset account PVID Deferred Operating Costs. These costs were adjusted at the end of each fiscal year in proportion to the remaining Program water stored at Lake Mead at the end of the prior calendar year (i.e., if 50 percent was remaining then 50 percent deferred costs were written off). The deferred operating costs totaled \$28.6 million as of March 31, 2011.

### **Opinion**

In our opinion, the accounting and administrative procedures over the Palo Verde Irrigation District Forbearance and Fallowing 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 August 2008 through March 2011.

### **Comments and Recommendations**

#### **MANAGEMENT REPORTING – EFFICIENCY THROUGH AUTOMATION**

Operating efficiency occurs as a result of automating manual tasks because it provides for an increased processing capability by reallocating available resources to other tasks. In addition, automation provides for greater assurance that detailed, repetitive tasks are completed correctly, and it may free-up personnel to perform more analytical work. These efficiency and assurance based controls are critical to management reporting to ensure that performance targets are met and associated Water Resource Management (WRM) Group strategies are realized.

During our review, we noted that PVID maintains a database of Excel spreadsheets that includes the contract, water account, program field, and parcel number. It also has canal and gate information and the assessor parcel number. Finally, it identifies qualified acreage and the number of acres fallowed.

Our review also revealed that a Structured Query Language (SQL) database system was developed by the WRM Group to track similar data elements. This system is utilized by both WRM Group program management and PVID for spontaneous queries, verification of fallowed acreage, and for management reporting purposes. Although this SQL database system has been in use since 2005, it has not been integrated or linked to the hundreds of Excel spreadsheets maintained by PVID. As a result, when updating the SQL database system, WRM Group staff manually inputs information derived from the Excel spreadsheets into the database system. Manual input of data into the SQL database results in operating inefficiencies and could result in incorrect and/or inaccurate data elements.

We recommend that the WRM Group program management develop procedures to link PVID's Excel spreadsheets to the WRM Group SQL database system. These processes should ensure that the PVID data input is used as a single point data entry to process, track and monitor landowner's participation in the Program.

#### PERIODIC REVIEW AND RECONCILIATION

Accounting control is achieved by performing periodic reviews and reconciliations of program and accounting records. These procedures provide assurance as to the propriety of the transactions affecting the accounts, they identify potential erroneous entries, and they describe follow-up procedures for exceptions. For the Forbearance and Fallowing Program (Program), WRM Group program management and the Controller Section should perform periodic reviews of water savings, stored water, billings and reconciliations of participation rights, and its amortizations to ensure propriety and accurate recording of Program costs. We reviewed the deferred operating costs, participation rights accounts and selected landowner and PVID invoices and noted:

1. Although updates to the Program water savings and stored water information were provided periodically to the Controller Section by the WRM Group, we noted that these updates were not reflected in the general ledger during the current fiscal year 2010/11. As a result, the PVID deferred operating costs were overstated by \$8.5 million through March 2011. Further review revealed that this overstatement is the result of a dispute between Imperial Irrigation District, Bureau of Reclamation and Metropolitan on certain contested water deliveries during CY 2010 and is the subject of ongoing discussions.
2. General Ledger Account "Accumulated Amortization - PVID Participation Rights" (1217515) was overstated by \$171,181, as of March 2011 due to error in recording September 2010 Amortization for Kern County Participation Rights to this account.
3. PVID staff overtime hours (41 percent of regular labor hours tested) billed to the Program were not supported with written approval from PVID's chief engineer. It should be noted that PVID's current procedures require written approval of staff overtime by immediate supervisor.
4. Payment due dates for all 18 landowner invoices tested were inconsistent with the required payment date of September 1 of each applicable contract year per the agreements. We noted that these payment due dates were up to more than two months prior to September 1. All these invoices appeared to have been paid late by Metropolitan by up to 75 days, as the checks were issued to landowners a week or two prior to September 1 of each applicable year.

We recommend that the WRM Group management provide periodic updates of the Program water savings and stored water information to the Controller's Section on a consistent basis, and that they utilize these reports for semi-annual adjustment of PVID deferred operating costs. Further, we recommend that the Controller Section conduct periodic reconciliations of Accumulated Amortization - PVID Participation Rights account to ensure proper recording of transactions. In addition, we recommend that WRM Group program management establish procedures that require written approval by PVID management for PVID staff overtime hours billed to the Program.

Lastly, we recommend that WRM Group program management resolve the landowner invoices' payment due date issue.

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## **Take Supply Chain Contract 89052 and Ciber, Incorporated Contract 85972 Audit Report**

### **Background**

In 2005, an internal warehouse operations assessment identified potential computer automation improvements at Metropolitan's eight warehouses in La Verne, Lake Mathews, Gene Camp, Jensen, Lake Skinner, Diemer, Mills and Soto Street. In January 2006, the Corporate Resources Group initiated the Warehouse Improvement Program (WIP), which included the implementation of a bar coding system for inventory tracking. Metropolitan entered into a \$642,113 fixed-price agreement with Take Supply Chain to implement an inventory bar coding system using their proprietary system.

This agreement was effective from October 2007 through September 2009. The Take Supply Chain agreement was amended several times to increase the maximum amount payable up to \$701,598, change the fee schedule, extend the contract duration to December 2010, and change the consultant's name from "Clearorbit, Incorporated" to "Take Supply Chain." This project was completed in September 2010, and Metropolitan has paid Take Supply Chain \$676,000 through December 31, 2010.

In 2006, Human Resources (HR) established the HR Improvement Project (Project) to improve its business processes and operating efficiencies. This Project consisted of two phases. Phase I delivered web-based, self-service capabilities to employees that allowed them to update personal information, to enter their annual benefit enrollment elections, and to access their paycheck compensation history. This phase also automated benefits administration and was completed in early 2007. Phase II consisted of two elements: (1) An upgrade of the PeopleSoft Human Resource Management System (HRMS) from version 8.3 to 8.9, and (2) The elimination of separate HR related parallel systems that were maintained outside the PeopleSoft HRMS.

Metropolitan entered into a three-year \$1.2-million fixed price agreement (85972) with Ciber, Incorporated to provide project management, technical, and functional services for the upgrade of PeopleSoft HRMS to version 8.9. This agreement was effective from May 2007 to September 2009. The Ciber, Incorporated agreement was amended three times to change the agreement administrator, add project tasks, modify the payment schedule, extend the duration to December 2010, and to increase the contract amount to \$1.44 million. Phase II was completed in January 2011 and Metropolitan has paid Ciber, Incorporated \$1.44 million under this agreement through December 31, 2010.

### **Opinion**

In our opinion, the accounting and administrative procedures over consulting agreements with Take Supply Chain and Ciber, Incorporated include those practices usually necessary to provide for a less than satisfactory internal control structure. This opinion is the result of failure to withhold retention amounts of \$12,600 and the failure to record retention payables of \$92,600. It should be noted that management has initiated remedial actions in response to our concerns. We will continue to assist management in the evaluation of solutions addressing this internal control structure concern while meeting operational needs.

## **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 associated with the agreements.

We reviewed twelve consultant invoices totaling \$1.1 million (six Ciber, Incorporated invoices totaling \$740,000 and six Take Supply Chain invoices totaling \$402,000) and noted:

#### A. Ciber, Incorporated:

1. The Contract retention of \$12,079 was not withheld from the payments of two consultant invoices totaling \$120,790. This is in contrast to the Compensation section of the agreement that requires the withholding of 10 percent retention from each invoice until the successful completion and final acceptance of the contract deliverables by Metropolitan.
2. The contract retention of \$54,090 for three consultant invoices tested was not recorded as a liability to the consultant. Further review revealed that Metropolitan recorded the consultant charges for these invoices based on the net invoice amounts of \$486,810 (net of \$54,090 contract retention) rather than the gross amounts of \$540,900.
3. All six consultant invoices tested were not signed and certified by the consultant and did not include information as required in the agreement, such as beginning and ending billing dates, the maximum amount payable, and total amount previously invoiced. In addition, these invoices were submitted directly to the agreement administrators rather than to the Accounts Payable Unit, in contrast to the Billings and Payment section of the agreement.
4. One of six consultant invoices tested was paid 30 days late. This is contrast to the Billings and Payments section of the agreement that requires payment of consultant invoice within 30 days of invoice receipt.
5. We could not locate the written task order request issued by Metropolitan for additional consultant services totaling \$6,600. This is in contrast to Scope of Work section of the agreement that requires issuance of a written task order request for any out-of-scope work requested by Metropolitan.
6. We could not locate the SBE utilization reports (for three of six) and the task acceptance certificates that accompanied the five of six consultant invoices tested. The utilization reports were required by Business Program Outreach section of the agreement. The certificates served as evidence of approval by the agreement administrator for incremental payments of consultant services.

7. We could not locate the consultant and subconsultant's biweekly time reports, as required by the Time Reports section of the agreement. These reports identify the completed work for each contract deliverable at a summary level and percent of completion, and are used for project management reporting purposes.

B. Take Supply Chain:

8. The Contract retention of \$534 was not withheld from payment of one consultant invoice (\$5,338). This is in contrast to the Compensation section of the agreement that requires withholding of retention amount from each invoice until successful completion and final acceptance of contract deliverable by Metropolitan.
9. Contract retention of \$38,467 on four consultant invoices tested was not recorded as a liability to the consultant. Further review revealed that Metropolitan recorded the consultant charges for these invoices based on the net invoice amounts of \$346,211 (net of \$38,467 contract retention) rather than the gross amounts of \$384,678.
10. The consultant invoices tested were not signed and certified by the consultant and did not include information as required by the agreement, such as the beginning and ending billing dates, the maximum amount payable and total amount previously invoiced. In addition, these invoices were submitted directly to the agreement administrator rather than to the Accounts Payable unit, in contrast to the Billings and Payments section of the agreement.

We recommend that the agreement administrator resolve the non-withholding of contract retentions from consultant payments. Further, we recommend that the agreement administrator coordinate set up of contract retention liabilities with the Accounts Payable unit. Lastly, we recommend that the agreement administrator remind the consultants of the need to comply with terms and conditions of the agreement and conduct periodic reviews to ensure compliance.

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## **Official Statement for the Water Revenue Refunding Bonds, 2011 Authorization, Series A1, A2, A3, and A4**

The Audit Department has completed a review of the Official Statement for the Water Revenue Refunding Bonds, 2011 Authorization, Series A1, A2, A3, and A4. We performed this review to provide the issuer of the Bonds "comfort" that the Official Statement for the Bonds is complete, consistent with supporting financial records, and accurate in all material respects. We completed our review in accordance with agreed upon procedures specified by the underwriter. We issued letters to the underwriter describing the agreed upon review procedures performed, and the results obtained.

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## **Employee Separations Review**

We have completed a review of the impact on controls following an increased number of employee separations (both retirements and terminations) during calendar year (CY) 2010. Specifically, we noted 106 separations occurred during CY 2010, compared with 56 separations during the prior year. Our review consisted of assessing management actions in response to these separations and to gain reasonable assurance that controls have been effectively maintained. Our scope was limited, and therefore, we do not express an opinion on the system of internal controls.

We conducted interviews with managers of 20 employees who had separated during CY 2010, and disclosed no obvious control gaps as a result of these separations. We noted that managers conscientiously responded to employee turnover and directed significant effort to ensure no control issues resulted. Additionally, we developed several common themes from our interviews, which we offered for management's consideration to help maintain controls during periods of change. These themes included accelerating identification of opportunities to streamline and redesign processes; evaluating organizational structure; monitoring costs related to turnover; and documenting detailed position procedures.

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**MWD**

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

**Date:** June 6, 2011

**To:** Gerald C. Riss, General Auditor

**From:** David C. Edwards, Section Manager, Information Technology  
Diane Pitman, Section Manager, Human Resources

**Subject:** Response to "Review of the Accounting and Administrative Controls Over Information Technology (IT) Consulting Agreements with Take Supply Chain and Ciber, Inc. as of December 31, 2010"

Transmitted for your information and review is our response to the Audit Department's recommendations in regards to the "Review of the Accounting and Administrative Controls Over Information Technology (IT) Consulting Agreements with Take Supply Chain and Ciber, Inc. as of December 31, 2010." We would like to express our appreciation for the work completed by Neena Mehta on this review.

As we discussed during the audit exit conference, the issues related to retention primarily centered upon different interpretations of contract amendment language. The agreement administrators did not intend to have retention held for tasks identified in the audited contract amendments and worked with Contracts to word the amendments accordingly. Audit felt that the amendment wording was not clear and could have been interpreted to require retention. To avoid such differences of interpretation in the future, staff has initiated follow-up discussions with Contracts, Legal and Audit with the goal of improving the clarity of standard amendment language from this point forward.

The other findings and recommendations mainly related to issues with invoices that were addressed in December 2009 in conjunction with another audit. As this audit primarily involved invoices processed prior to that date, similar findings were identified. We are confident that the revised procedures put in place in December 2009 will help avoid such findings in the future.

The specifics of actions taken are included in the attachment.

Please feel free to contact us if there are any questions.

Handwritten signature of David C. Edwards in black ink.

David C. Edwards

Handwritten signature of Diane Pitman in black ink.

Diane Pitman

Attachments

cc: J. Kightlinger  
M. I. Scully  
D. Elliot  
G. F. Ivey  
D. C. Man  
R. Patterson  
T. Debacker  
S. Bennion  
D. N. Upadhyay  
R. T. Hicks  
R. L. Wolfe  
J. Green  
F. M. Mares  
D. Pitman  
A. Azmi  
M. Tracey  
N. Mehta  
A. Kokuga

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**RESPONSE TO REPORT ON IT CONSULTING AGREEMENTS WITH CIBER AND TAKE SUPPLY CHAIN**

<b>REVIEW AREA</b>	<b>Recommendations</b>	<b>Response to Recommendations</b>	<b>Responsible Area</b>	<b>Target Completion Date</b>
Resolve the non-withholding of contract retentions from consulting payments	Recommend coordinating with Accounts Payable to setup retention liability account on invoice payments, when applicable.	Management concurs with the recommendation. These contracts are completed and closed. A retention process was established between Finance and the Information Technology Section and is in place.	Project Management Unit	COMPLETED
Compliance with contractual requirements to ensure accurate accounting records and adequate control over the administration of the agreement.	Recommend that the Agreement Administrator resolve the noted issues and remind the consultants of the importance of complying with terms and conditions of the agreements.	Management concurs with the recommendation. Staff has developed a new invoice template that addresses consultant certification, retention, SBE reporting, maximum amount payable, spent to date and expense receipts.	Project Management Unit	COMPLETED
		Guidelines have been established for IT Program Manager's to conduct quarterly reviews with agreement administrator's to ensure compliance with the terms of the agreements/contracts.	Project Management Unit	COMPLETED