



THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA

## **Internal Audit Report for June 2011**

### **Summary**

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Three reports were issued during the month:

- **Cash Disbursements – Accounts Payable Audit Report**
  - **Colorado River Aqueduct Pumping Plant Reliability Program Audit Report**
  - **Official Statement for the Water Revenue Refunding Bonds, 2011 Authorization, Series B**
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### **Discussion Section**

This report highlights the significant activities of the Internal Audit Department during June 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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## **Cash Disbursements – Accounts Payable Audit Report**

### **Background**

The Accounts Payable Team provides administrative and fiscal support to assure that the liabilities of Metropolitan are met and properly recorded on the financial records. In addition, they are responsible for processing payments for Metropolitan's financial obligations from approved invoices or purchase orders. They also ensure the timely payment of vendor invoices and director and employee expense vouchers; maintain accurate records and control reports; and review applicable accounting reports and accounts payable registers to ensure accuracy and propriety. The Controller's Section is also responsible for policies related to petty cash funds, which are used for purchases of services and supplies up to \$50.

For the period January 1, 2009 through March 31, 2011 (27 months), Accounts Payable processed 101,339 invoices totaling \$1.9 billion for water costs, payroll, goods, and services. It should be noted that these totals exclude payments made for the State Water Project totaling \$1.1 billion. Vendor payments made during the period decreased by \$79 million (\$887 million in 2009 versus \$808 million in 2010). This decrease was mainly due to completion of a number of major construction projects.

### **Opinion**

In our opinion, the accounting and administrative procedures over Cash Disbursements - Accounts Payable 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 2009 through March 2011.

### **Comments and Recommendations**

#### **ACCOUNTS PAYABLE AGING REPORT**

An Accounts Payable Aging Schedule is a list of accounts showing vendor/service provider, past due amounts, and the length of time they have been outstanding. Accounts Payable Aging Reports are used to

reveal patterns of delinquency and identify points where payment efforts should be concentrated. The accounts payable staff performs weekly reviews of the Accounts Payable Aging Report. Their procedures require that past due items be researched to resolve any payment "Hold" status and initiate timely payment. It should be noted that there are a variety of legitimate business reasons for delaying payment to vendors. We reviewed the Invoice Aging Report as of April 27, 2011 and noted:

1. Invoices were outstanding between 1 and 354 days in 607 of 2,293 (26%) instances tested. Past due invoices totaled \$2.7 million as of April 27, 2011 with the following breakdown:

Past Due	Invoices	Amount
1- 60 days	389 (17 %)	\$1,800,000
61- 90 days	133 ( 6 %)	691,000
91 - 354 days	85 ( 3 %)	189,300
Total	607	\$2,680,300

2. Credit balances totaling \$120,000 were noted for sixteen vendors. These credit memos received from vendors for goods returned or services not performed are to be applied against future orders. We noted ten credit memos (\$102,500) were more than ninety days old.

We recommend that the Accounts Payable Management Team work with the unit or section managers to resolve these past due items. With regard to credit memos, we recommend that the Accounts Payable management team either request a repayment check, or ensure that credit memos are applied against future invoices in a timely manner. Lastly, we recommend that Accounts Payable management remind employees of the importance in complying with prescribed payable procedures.

## POLICIES AND PROCEDURES

Operating policies and procedures should be established and documented to provide a framework for achieving Metropolitan goals properly and adequately. Whereas policies guide actions toward a desired outcome, procedures provide management with guidelines for consistent performance of daily operations. The Procurement Team has established supplier setup procedures to ensure proper maintenance of records in the vendor database system. Our review of the Oracle Procurement Vendor Database through April 2011 revealed:

1. Director records for 91 former Metropolitan Board members remained coded as active "directors". Petty cash custodian records for 5 of 12 former custodians remained coded as valid. It should be noted that these records were corrected as of June 2011.
2. Vendor records for Lehman Brothers, Robinson-May, and Circuit City remained coded as valid "vendors."

We recommend that the Procurement Team update procedures for maintaining Director, employee, and vendor records in the Oracle Procurement Vendor Database and conduct periodic reviews to ensure records are current.

## PETTY CASH AND PERMANENT CASH ADVANCES

Operating Policy C-08 (Petty Cash) and the Petty Cash Procedures - Custodian's Guide establish the policies and procedures to regulate petty cash funds and permanent cash advances to employees. The policies and procedures describe the limitations, guidelines, and responsibilities for these funds, as well as the type of expenses and the amount (up to \$50) that can be reimbursed from the funds; fund security; responsibility for loss or theft of funds; expense documentation; non-comingling of other funds; and reconciliation responsibilities. We reviewed selected transactions of the 19 petty cash funds (outstanding balance \$13,650) and conducted cash counts of four petty cash funds. We noted:

1. Five of 19 petty cash funds reviewed have had minimal or no transactions for the 27-month period under review. In addition, we noted that the checking accounts related to some of the petty cash funds incurred bank service charges of up to \$18 per month.
2. During the 27-month period under review, total petty cash transactions of \$28,300 were reimbursed from 14 of 19 petty cash funds (approximately \$75 per month per fund on average).
3. Two of four petty cash funds tested were not reconciled on a monthly basis and count sheets for one petty cash fund were submitted to Accounts Payable rather than to Accounting Operations. These are in contrast to the requirements of the Petty Cash Procedures Custodian Guide.
4. Four employees that were issued Metropolitan credit cards also have permanent cash advances totaling \$2,800 as of March 31, 2011. These permanent cash advances were made prior to credit card issuance as these employees regularly incur business related expenses.

We recommend that Controller Section management eliminate petty cash funds with low activity and reevaluate the need for the remaining petty cash funds. In addition, we recommend the elimination of permanent cash advances for employees who also have credit cards. We also recommend that the Controller Section remind personnel of the importance of compliance with Metropolitan's policies and procedures.

## EMERGENCY CASH FUND

Emergency cash funds totaling \$20,000 were established for use in procuring goods and services when regular purchasing processes have been disrupted due to a declared emergency. The Emergency Cash Fund Procedures Custodian Guide establishes the guidelines for administering and accounting for emergency cash funds. Currently, these funds are held by the Emergency Operation Center and 9 Incident Command Centers (\$2,000 per location). We reviewed transactions and reconciliations for 3 of 10 emergency cash funds and noted that one fund was not reconciled on an annual basis and a second fund was not reconciled at the end of fiscal year 2009/10.

We recommend that the Controller Section management remind emergency cash custodians to perform annual reconciliations of emergency cash funds.

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## Colorado River Aqueduct Pumping Plant Reliability Program Audit Report

### Background

The Colorado River Aqueduct (CRA) is a 242-mile-long conveyance system which transports water from Lake Havasu to Lake Mathews. Major portions of the system were initially constructed in the 1940s and have been in continuous service ever since. However, portions of the system exhibit signs of wear and tear.

In July 2000, Metropolitan initiated the Infrastructure Reliability and Protection Plan (Plan) to evaluate risks and vulnerabilities of Metropolitan facilities and to identify cost-effective options to address those risks through rehabilitation, repair, or replacement. Accordingly, Engineering Services Group staff identified several system components of the pumping plants located at Whitsett Intake, Gene, Eagle Mountain, Iron Mountain, and Julian Hinds that needed repairs, refurbishment, or replacement. In August 2001, Metropolitan established the CRA Pumping Plant Reliability Program to plan and implement multiple projects to rehabilitate and/or replace aging equipment at the five pumping plants. As of April 2011, the Program consisted of fifteen projects (three ongoing, ten completed, and two canceled projects), totaling \$17.7 million. The Program is expected to be completed in fiscal year 2014/15.

As part of the CRA Pumping Plant Reliability Program, Metropolitan entered into a \$4.8-million contract with PCL Construction in October 2009 to replace deteriorated access covers along the CRA and to improve access pathways for fifteen domestic water tanks at the pumping plants. These two projects were consolidated into a single construction contract for greater efficiency. The Access Covers Replacement Project consists of removal and disposal of existing steel plate access covers and metal support beams; replacement of covers with new steel and concrete covers; and repair of one manhole structure. The Access Pathways Improvement Project consists of new concrete pathways, stairways, platforms hatch covers, lighting, ladders, safety cages, guardrail, grading, and all other appurtenant work.

As of April 2011, the two projects were 98 percent complete, and Metropolitan has paid PCL Construction \$3.8 million including \$136,000 in approved extra work orders. Below is the list of ongoing, completed, and canceled projects under the CRA Pumping Plant Reliability Program with their corresponding cumulative costs as of April 2011.

ONGOING PROJECTS			
ITEM	PROJECT	DESCRIPTION	AMOUNT
1	103742	Desert Water Tank Access and Safety Improvement	\$ 5,828,907
2	103183	CRA Main Pump Suction and Disc Lines, Exp Joint Repairs	655,443
3	103740	CRA Main Pump Motor Exciters Rehabilitation	107,402
		Total	\$ 6,591,752

COMPLETED PROJECTS			
ITEM	PROJECT	DESCRIPTION	AMOUNT
1	103113*	Intake Pumping Plant Instrumentation Repl and Auto	\$ 5,321,815
2	103179*	CRA Main Pump Circulating Water System Rehabilitation	2,689,719
3	103608	Desert Airfields Improvement Project	754,565

4	104299*	Eagle Mountain Pumping Plant Del Pipe Exp Jnt Repairs	568,424
5	104244	Iron Mountain Pumping Plant Del Pipe Exp Jnt Repairs	382,817
6	103173	High Pressure Compressor Replacement	380,986
7	103139	CRA Main Pump Study	372,943
8	103967	Intake Pumping Plant Automation Programming	364,549
9	103465	CRA Gene Pumping Plant Heavy Equipment Service Pit	119,672
10	103741	CRA Pumping Plant Vulnerability Assessment	104,012
		Total	\$11,059,502

\* Construction activities for these projects were completed, with "As Built" drawings still in process such as update of the design drawing and loading to the Electronic Data Management System.

CANCELED PROJECTS			
Item	PROJECT	DESCRIPTION	AMOUNT
1	103322	Eagle Mountain Kitchen Code Upgrade	\$ 66,019
2	103321	Discharge Line Coupling Installation	19,937
		Total	\$ 85,956

### **Opinion**

In our opinion, the accounting and administrative procedures over the Colorado River Aqueduct Pumping Plant Reliability 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 July 2009 through April 2011.

### **Comments and Recommendations**

#### PROJECT STATUS AND CLOSE OUT

Project management entails planning, organizing, and managing resources to bring about the successful completion of specific project goals and objectives. It involves monitoring and controlling activities from project initiation to project closeout. Projects should be closed after all contractual requirements have been met, all invoices have been accrued and/or paid, and Metropolitan has discharged all obligations.

We reviewed the project costs and status for all fifteen projects established under the CRA Pumping Plant Reliability Program and noted:

1. One completed project (103608) was over-budget by \$15,565 as of April 2011. It is important to note that the overall program expenditures were less than the board-appropriated amount at all times.
2. We could not locate the supporting Notice for Project Completion for one completed project (103113). Further, we noted that two completed projects (103465 and 103741) remained open up to 347 days after their completion.

3. Two canceled or discontinued projects (103321 and 103322) were reported as completed projects in the FY 2009/10 Capital Investment Plan.
4. Completion dates for three ongoing projects (103183, 103740, and 104244) have not been updated in the Project Accounting and Grant Management (PAGM) System as of April 2011. These projects were estimated to complete in June 2006 and December 2010. Further, we noted that project 103183 (total costs of \$655,400) was over-budget by \$288,700, as shown in the PAGM System at April 2011.
5. Completion dates for two ongoing projects reviewed (103173 and 103465) were inconsistent between the PAGM system and the supporting Notice for Project Completion (Form 542).

We recommend that program management resolve the noted discrepancies. We also recommend that program management remind project managers to comply with the developed/modified project management procedures to ensure the timely updates, close-out of projects, and conduct periodic tests to ensure compliance.

#### POLICIES AND PROCEDURES

Operating policies and procedures should be established and documented to provide a framework for achieving Metropolitan goals properly and adequately. Whereas policies guide actions toward a desired outcome, procedures provide management with guidelines for consistent performance of daily operations. For Construction Contract Administration, the standard 10 percent "holdback" retained from monthly progress payments on all construction contracts should be deposited to the escrow company only after the actual payment of respective contractor invoices.

We reviewed the contract payments to PCL Construction and noted five contract retentions tested (total \$197,946) were deposited to the escrow company up to 11 days prior to actual payment of the respective contractor's monthly invoices. Deposit of retentions to the escrow bank prior to actual payment from contractors results in a negative cash flow position for Metropolitan.

We recommend that the Controller's Office management remind the Accounting Operations and Accounts Payable staff to coordinate efforts when remitting retentions to the escrow company.

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### **Official Statement for the Water Revenue Refunding Bonds, 2011 Authorization, Series B**

The Audit Department has completed a review of the Official Statement for the Water Revenue Refunding Bonds, 2011 Authorization, Series B. 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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