



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Internal Audit Report for October 2011

Summary

Four reports were issued during the month:

- **Physical Security Management – Colorado River Aqueduct and Pumping Plants Audit Report**
- **Sukut Construction, Incorporated Agreement 1688 Audit Report**
- **Audit Quality Assurance - Audit Plan Update**
- **Official Statement for the Water Revenue Refunding Bonds, 2009 Authorization, Series A1**

Discussion Section

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

Physical Security Management – Colorado River Aqueduct and Pumping Plants Audit Report

Background

The Security Management Unit of the Water System Operations (WSO) Group oversees the physical security function at Metropolitan facilities, including the Colorado River Aqueduct (CRA) and its five pumping plants. Specific duties include controlling physical access to the facilities, identifying and addressing access irregularities, investigating security incidents, and performing periodic physical security inspections. These responsibilities also include managing the contract with Securitas, an independent security services firm that provides guard, patrolling, monitoring, and investigatory support to Metropolitan. The Security Management Unit also coordinates physical security efforts with the Desert Region Conveyance and Distribution Unit such that Metropolitan employees perform air and ground patrols along the CRA on weekdays, while Securitas performs ground patrols during the weekends.

In December 2005, Metropolitan entered into a five-year agreement with Securitas to provide security guard services at Metropolitan facilities throughout Los Angeles, Orange, San Bernardino, and Riverside Counties. These services included ground patrolling of Metropolitan's properties; controlling physical security access to facilities; providing emergency response assistance; coordinating activities with public safety and emergency service organizations; and providing general security to staff and visitors. This agreement was amended twice to revise the fee schedule, adjust the annual cost of living and performance incentives, and to extend the contract term to December 31, 2010. The agreement constituted a time-and-material contract capped at \$6 million per year and payments to Securitas since contract inception through termination totaled \$30 million.

In January 2011, Metropolitan entered into a one-year-rollover agreement with Securitas that was capped at \$6.5 million for the initial year. This agreement is renewable up to four times for a not-to-exceed total of \$35 million for the five-year term. The terms, conditions, and scope of services of this agreement were similar to that of the prior agreement. Payments to Securitas since inception through June 30, 2011 totaled \$2.6 million.

Opinion

In our opinion, the accounting and administrative procedures over Physical Security Management – Colorado River Aqueduct and Pumping Plants 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 from July 2009 through June 2011.

Comments and Recommendations

CONTROLLING PHYSICAL ACCESS AND MONITORING SECURITY

Physical security over Metropolitan facilities is essential to providing a safe and reliable water supply to the public, and to ensure a secure environment for staff and visitors. Monitoring points-of-entry (i.e., entrance gates) is a primary control to prevent theft, destruction of equipment, and disruption of operations. Metropolitan's Access Control Guidelines require that security officers obtain proper identification from Metropolitan employees, vendors, and visitors prior to entry. We observed access controls, security monitoring, and patrol procedures at the CRA and pumping plants and noted:

1. We could not locate written procedures detailing air and ground patrol responsibilities required for the CRA, nor could we locate evidence that ground patrols were performed by WSO Group staff. It is important to note that current practices include weekly air patrols and semiweekly ground patrols of the CRA by staff on weekdays. These efforts are augmented by weekend ground patrols by Securitas personnel. While we noted that the weekly air patrols are recorded in the WSO Group pilot's notebook, there is no formal recordation of these activities. In addition, we noted that the weekend ground patrols are documented in the "Security Inspection Patrol Route Checklist" by Securitas.
2. Responsibilities and procedures for authorizing gate-entry access have not been formalized. Currently, any plant staff can provide access to non-plant personnel, contractors, service providers, residents or guests during normal business hours. In addition, for after business hours, the on-call staff is assigned to assist in this process. We were informed by plant management and staff that a significant number of man-hours are required for these duties.

We recommend that WSO Group management establish CRA's air, ground patrol, and gate entry procedures. We also recommend that WSO Group management establish procedures to ensure that air and ground patrols are completed and documented appropriately. We also recommend that WSO Group management conduct periodic reviews to ensure compliance. Lastly, we recommend that WSO Group management perform a cost-efficiency analysis between staff time used to provide gate-entry access versus security officers placed at the pumping plant gates.

INCIDENT REPORTING

Operating Policy E-03, "Incident Reporting", requires that all incidents be reported to the General Counsel via the Incident Reporting System in a prompt, confidential, and accurate manner. These incidents include injuries at work, vehicle accidents, hazardous material spills, and damage to Metropolitan property. Managers are responsible for ensuring that staff understand and comply with the reporting procedures. The Risk Management Unit, within the Human Resources Group, is responsible for maintaining data received from the Incident Reports, taking actions, and adopting procedures authorized by the General Counsel.

We reviewed three incidents reported to the Security Watch Center at Eagle Rock by Securitas for the months of April 2011, May 2011, and June 2011 and noted that two incidents were not reported to Risk Management. Further review revealed that these incidents related to third party damage to a card-reader-mounting stanchion at the Gene Pumping Plant main gate, and a shell casing found between the pumping plant and reservoir at Julian Hinds Pumping Plant. We understand that the shell casing incident did not warrant reporting to Risk Management.

We recommend that WSO Group management remind Security Management and Pumping Plant staff to comply with Metropolitan's established procedures for incident reporting, and conduct periodic reviews to ensure compliance.

COMPLIANCE TO 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 agreement. Compliance with contractual terms and conditions also ensures that parties fully discharge their duties and obligations, and exercise their legal rights associated with the agreement. We reviewed 30 Securitas invoices (16 invoices under prior Agreement 73995 and 14 invoices under current Agreement 118063) totaling \$216,300 and noted:

1. All 30 invoices tested were submitted directly to the WSO Group Security Management Unit rather than to Accounts Payable. This is in contrast to the current procedures of submitting vendor invoices directly to Accounts Payable. We also noted that these invoices were not signed by the contractor and the required "affirmation statement" and agreement number were not indicated on these invoices.
2. Although all 16 invoices tested under Agreement 73995 were paid timely (15 days after receipt of the invoice), we noted that they were submitted to Accounts Payable from 12 to 54 days of the invoice date.
3. Nine of 14 invoices tested under current Agreement 118063 were paid late, from 9 to 57 days, after the invoice due date. Security Management indicated that the main reason was due to Securitas' late submission of invoices to Security Management. It is important to note that Security Management had completed its review of these invoices and has forwarded to Accounts Payable for payment processing within five days after receipt of Securitas invoices.

4. Supporting documentation for vehicle, medical, and cell phone charges of \$107,000 was not attached to the invoice. However, we were able to obtain proper supporting documents for this reimbursement prior to the issuance of this report.
5. We could not locate the high school diploma or equivalent for all six Securitas officers tested and proof of one year security experience for two of these officers. This is in contrast to the Selection Requirements Section of the agreement that requires Securitas personnel to meet specific minimum certification and experience.

We recommend that WSO Group management remind Security Management and Securitas to comply with Metropolitan's established procedures for the submission of contractor invoices and adhere to the terms and conditions of the service agreements. We also recommend that Security Management consider amending the payment term for Agreement 118063 to allow payment of invoices within 30 days of invoice receipt.

Sukut Construction, Incorporated Agreement 1688 Audit Report

Background

The Robert B. Diemer Water Treatment Plant (Plant) is located in the city of Yorba Linda and was placed into service in 1963. At that time, the Plant had a single "improved road" entrance located within a residential neighborhood. This design proved effective and efficient as the residential area was being developed and built. Moreover, a second "unimproved" Plant entrance was created utilizing Carbon Canyon Road that provided limited access to the facility via an easement through the Chino Hills State Park (CHSP). This easement, commonly known as Telegraph Canyon Trail (Trail), provides access to the Plant's northern most facilities especially the north solids lagoons.

However, in 2005 the California Department of Parks and Recreation (State Parks) approached Metropolitan regarding construction of a new CHSP visitor center that would be located along Carbon Canyon Road near the entrance to CHSP. As this route was shared by Metropolitan and the State Parks (as a joint-use trail and roadway easement), both parties acknowledged the opportunity and benefit of removing Plant traffic from the Trail; thereby, separating motor traffic from park hikers, cyclists, and equestrian trail users. Accordingly, a property exchange and roadway improvement agreement was negotiated to construct a secondary access road (called the North Access Road) to the Plant. In December 2005, the Board authorized preliminary design and approved Phase I of the three-phase Diemer North Access Road Project (Project).

For Phase II and III of the Project, the Board appropriated \$12.1 million and awarded a \$9.1-million contract with Sukut Construction, Incorporated for the construction of the new North Access Road. The Project consists of relocating the Plant's access route on State Parks' property to separate traffic from the park's users as a safety measure, as well as construction of a road from the Plant solids lagoons to the main plant for operational and emergency response needs. The Project is scheduled to be completed in November 2011 and \$7,028,119.41 has been paid to Sukut Construction, Incorporated through August 31, 2011.

Opinion

In our opinion, the accounting and administrative procedures over Major Construction Project - Sukut Construction, Incorporated 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 between October 2009 and August 2011.

Comments and Recommendations

There were no material findings to report.

Audit Quality Assurance - Audit Plan Update

In June 2011, the Audit and Ethics Committee and Board of Directors reviewed and approved the Audit Plan (Plan), which allocates resources to the areas of greatest perceived risk for Metropolitan. We recently evaluated the Audit Department's performance versus the Plan for the first quarter, and noted that eight audits and special reviews have been completed. Additionally, total resources for the quarter (4,970 hours) were below Plan levels by 490 hours primarily due to one open position. However, further analysis of Audit Department time charging for the quarter indicated a higher charge-out rate to projects of 56 percent, as compared with 52 percent in the Plan. Accordingly, we believe that the Plan is on schedule and therefore modification to the Plan is not required. Further, we believe that the Audit Department will fulfill its responsibilities to complete the Plan as presented to the Audit and Ethics Committee and the Board in June of this year. Moreover, the recruitment for the open audit position (after the first of the year) will ensure that the Audit Department has sufficient resources to complete the balance of the Plan in an efficient and effective manner.

In keeping with industry standards, we evaluated the Plan to identify significant changes in risk profiles or resource levels which could result in a recommendation to adjust the Plan. We do not believe such adjustment is necessary at this time and we will continue to monitor risk and resources and provide formal updates on at least a quarterly basis.

**Official Statement for the Water Revenue Refunding Bonds,
2009 Authorization, Series A1**

The Audit Department has completed a review of the Official Statement for the Water Revenue Refunding Bonds, 2009 Authorization, Series A1. 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.