



Internal Audit Report for December 2011

Summary

Four reports were issued during the month:

- **Drought Water Bank Program Audit Report**
- **Colorado River Water Users Association Financial Review**
- **Quarterly Consulting Contracts Report Review**
- **Inspection Trips Review**

Discussion Section

This report highlights the significant activities of the Internal Audit Department during December 2011. In addition to presenting background information and the opinion expressed in the audit reports, a discussion of findings noted during the examinations is also provided.

Drought Water Bank Program Audit Report

Background

On June 4, 2008, then-Governor Arnold Schwarzenegger issued Executive Order S-06-08, which proclaimed a condition of statewide drought and he ordered the Department of Water Resources (DWR) to take immediate action to develop the Drought Water Bank (Water Bank) Program. Under the Water Bank Program, DWR was tasked to facilitate water transfers between buyers and sellers, and prepare to operate a dry-year water purchasing program in 2009. As DWR initiated the Water Bank Program, 25 buyers and 30 sellers expressed interest in participation, with the intention of exchanging up to 600,000 acre-feet (AF) of water. However, actual Water Bank Program activity consisted of 9 buyers and 21 sellers for a total of 74,051 AF.

On February 10, 2009, Metropolitan's Board concluded that the Water Bank Program was consistent with the goals and objectives of the Integrated Resources Plan, and approved participation of up to 300,000 AF. Accordingly, on April 10, 2009, Metropolitan executed an agreement with DWR to purchase up to 100,000 AF of water and ultimately received nearly 50 percent of the available water in the Water Bank Program or 36,900 AF. Metropolitan paid \$10.2 million (or \$275 per AF), including 23 percent conveyance losses under this agreement.

Metropolitan staff from the Water System Operations (WSO) Group is responsible for metering deliveries from State Water Project turnouts, including supplies received from the Water Bank Program. Staffs from the Water Resource Management (WRM) Group and the Chief Financial Officer (CFO) Office share responsibility for administering transactions under the Water Bank agreement. Specifically, WRM is responsible for water receipt reconciliations for deliveries metered and reported by the WSO Group, and the CFO Office is responsible for water inventory accounting and invoice payment.

Opinion

In our opinion, the accounting and administrative procedures over the Drought Water Bank Program 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 from inception of the agreement on April 10, 2009 thru September 30, 2011.

Comments and Recommendations

There were no material findings to report.

Colorado River Water Users Association Financial Review

We have performed a limited review of the Colorado River Water Users Association (CRWUA) Financial Report for the period April 1, 2011 through October 31, 2011. The purpose of this review is to gain reasonable assurance that information included on the CRWUA Financial Report is accurate and supported by appropriate documentation. Since our review was limited in scope, we did not express an opinion on the internal control structure over CRWUA.

Background

The CRWUA was incorporated in the State of Nevada on December 6, 1968. The CRWUA Administrative Guidelines (Guidelines) were approved by the Board of Trustees on May 2, 2008. The Guidelines document the purpose and mission of CRWUA; delineate the duties and responsibilities of the trustees, officers, resident agent, and standing committee chairs; and includes the Articles of Incorporation and bylaws. From April 1, 2011 through October 31, 2011, CRWUA reported total receipts of \$112,500 and total disbursements of \$74,000. As of October 31, 2011, CRWUA's total fund available was \$487,900.

TESTING PROCEDURES PERFORMED

- a. We agreed the CRWUA Financial Report to the transactions schedule.
- b. We agreed financial information from the transaction schedule to source documents including bank statements, check registers, receipts, and other third party provided documents.
- c. We performed analysis and computations, when necessary, and validated 100 percent of the financial information contained in the transaction schedule.
- d. We reviewed monthly bank reconciliations and assessed reasonableness of reconciling items and accuracy of balances.

TESTING RESULTS

Our review did not reveal any material differences between the reported amounts and the supporting documentation. We did note an instance where a check was endorsed by only one

authorizing signature rather than two, as stipulated in the May 20, 2011 Bank Authorization Resolution. It should be noted that this resolution revised prior practices that required one authorizing signature. We recommend that CRWUA management comply with the Bank Authorization Resolution.

Quarterly Consulting Contracts Report Review

We have reviewed a quarterly report, issued by the Professional Services Contracting Team, concerning consulting and professional service agreement activity during the first quarter of fiscal year 2011/12. The purpose of this review is to gain reasonable assurance that information included on the quarterly report is accurate, complete and timely, and in compliance with the Administrative Code.

Background

The Administrative Code Section 2720(a) requires that the General Manager report to the Engineering and Operations Committee on the employment of any professional and technical consultant, the extension of any professional and technical consulting agreement, and on the exercise of authority under Section 8121(c) and 8122(h) during the preceding calendar quarter. The report covering the last calendar quarter of the year may be combined with, and included in the annual report. Each report shall indicate when a consultant is a former employee of Metropolitan.

During the first quarter of fiscal year 2011/12, the amount paid for consulting and professional services totaled \$11.5 million. This amount includes \$10.3 million paid on agreements administered by the Office of the General Manager, and \$1.2 million paid on agreements administered by the Legal Department. The General Manager reported 321 active agreements with 40 terminations and the Legal Department reported 36 active agreements with no terminations.

TESTING PROCEDURES PERFORMED

Our procedures included validation of the actual costs, as reported to the Board, to the Oracle financial system reports for the first quarter of fiscal year 2011/12. We also reviewed the entries in the quarterly report for significant items. In addition, we performed a cursory review of vendors with multiple active agreements to determine whether agreements were split into smaller agreements to circumvent the established approval authority limits.

TESTING RESULTS

Our review did not reveal any material differences between the reported amounts and supporting documentation. In addition, our review did not reveal any agreements which appeared to have been split into smaller agreements.

Inspection Trips Review

Based on management's request, we have completed a review of the Inspection Trips program to evaluate the efficiency and effectiveness of current processes while maintaining program objectives. Our review consisted of comprehensive discussions and observations with inspection trip management and staff in order to understand trip operations; evaluate related processes; and collaboratively develop enhancements. This study was limited, and therefore, we did not express an opinion on the system of internal controls.

Background

Administrative Code Section 2610 grants authority to directors to sponsor field inspection trips of Metropolitan and related facilities to provide interested citizens with firsthand knowledge of operations. These trips, primarily of the Colorado River Aqueduct System or State Water Project facilities, are funded by Metropolitan with a 2010/11 travel budget of about \$650,000. Personnel from the Office of the General Manager support the directors and coordinate with member agencies in planning and conducting these trips.

Observations

We noted the significant effort by Inspection Trip management and staff to provide directors and guests with great service and a meaningful educational experience. Further, we recognized that staff has implemented a number of operational changes designed to streamline processes such as registering guests; accumulating and reporting trip costs; and arranging hotel accommodations.

In this spirit, we worked with staff to continue these enhancement efforts. Our recommendations included streamlining the airline travel booking, payment and expense reporting processes; considering purchase of nonrefundable tickets to reduce airline costs; eliminating permanent cash advances; and completing the in-process Procedures Manual. It is important to note that several of these recommendations have already been implemented by management. We will continue to work with management to refine these recommendations to improve controls and operating efficiency.
