



Internal Audit Report for January 2013

Summary

Four reports were issued during the month:

- **Morillo Construction, Incorporated Contract 1718 Audit Report**
- **Pure Technologies U.S. Incorporated Contract 122337, Black & Veatch Corporation Contract 115665, and Public Resources Advisory Group Contract 119116 Audit Report**
- **Remarketing Statement for the Water Revenue Refunding Bonds, 2011 Authorization, Series A-1 and A3**
- **Audit Quality Assurance – Audit Plan Update**

Discussion Section

This report highlights the significant activities of the Internal Audit Department during January 2013. 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.

Morillo Construction, Incorporated Contract 1718 Audit Report

Background

The La Verne Shops (Shops) located on-site at the F. E. Weymouth Treatment Plant were placed into service in 1941. The Shops include a Machine Shop, Fabrication Shop, and two Coating Shops which provide emergency response service, support routine maintenance, and perform fee-for-service work for member agencies and the California Department of Water Resources.

In March 2011, Metropolitan entered into a \$6.7-million contract (1718) with Morillo Construction, Incorporated (Morillo) for the expansion and renovation of the Coat Shops and expansion of the Fabrication Shop. The work included constructing a new larger-capacity Coating Shop with sandblast, paint, and drying booths; renovating the existing Coating Shops; constructing additional work and storage space in the Fabrication Shop; performing site paving and demolition work; and installing underground conduits, cables, and utilities. As of September 30, 2012, Morillo has completed approximately 88 percent of the work and Metropolitan has paid \$5.7 million, including \$185,867 in extra work orders under Contract 1718.

Opinion

In our opinion, the accounting and administrative procedures over the Morillo Contract 1718 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 March 2011 through September 2012.

Comments and Recommendations

There were no material findings to report

Pure Technologies U.S. Incorporated Contract 122337, Black & Veatch Corporation Contract 115665, and Public Resources Advisory Group Contract 119116 Audit Report

Background

First, in an effort to provide for a reliable supply of high-quality water, Metropolitan performs inspections, enhancements, and studies throughout its infrastructure, facilities, and service areas. Metropolitan's water distribution system includes 163 miles of prestressed concrete cylinder pipe (PCCP) that was installed between 1965 and 1985. The reinforcing wires in these PCCP lines are vulnerable to corrosion or deterioration, which can ultimately lead to pipeline failure. Currently, electromagnetic inspections are used to identify distressed pipe sections and to assist in prioritizing repairs.

In September 2011, the Board authorized Contract 122337 with Pure Technologies U.S. Incorporated (Pure Technologies) in an amount not to exceed \$4.18 million to electromagnetically inspect up to 163 miles of PCCP lines, and to install and monitor acoustic fiber optic monitoring systems on selected PCCP lines. Payments to Pure Technologies from agreement inception through September 2012 totaled \$652,660.

Second, in August 2010, Metropolitan's Board authorized an on-call engineering services contract with Black & Veatch Corporation (Black & Veatch) in an amount not to exceed \$2 million per year. In October 2010, Metropolitan entered into Contract 115665 with Black & Veatch to provide supplemental and specialized engineering services on board-authorized capital projects. This on-call contract is utilized to execute project task orders related to smaller value and shorter duration projects, and specific assignments are issued via written task orders. Contract 115665 was amended twice to add a subconsultant and to revise the fee schedule. Payments to Black & Veatch during the period of July 2011 to September 2012 totaled \$287,779.

Third, the office of the Chief Financial Officer issued Request for Qualification 964 (RFQ 964) in September 2010 for financial advisory services related to the timing, method, structure, and pricing of debt transactions. The Public Resources Advisory Group (PRAG) was selected under RFQ 964 and Metropolitan entered into a three-year contract (119116) with PRAG in February 2011, with a maximum amount payable not to exceed \$240,000 per year. The scope of services primarily involved assisting and advising Metropolitan in evaluating opportunities to refinance and restructure outstanding debt, and to provide perspective relating to economic and capital market conditions.

Contract 119116 was subsequently amended to increase the maximum rollover amount payable to \$315,000 for the first contract year (fiscal year 2011/12) and to \$290,000 for the second contract year (fiscal year 2012/13), in accordance with Metropolitan's board authorization in December 2011. Payments to PRAG during the period of July 2011 to September 2012 totaled \$300,312.

Opinion

In our opinion, the accounting and administrative procedures related to Pure Technologies Contract 122337, Black & Veatch Contract 115665, and PRAG Contract 119116 consulting contracts provide for a generally satisfactory internal control structure. The degree of compliance with such policies and procedures provided effective control for the period between July 2011 and September 2012.

Comments and Recommendations

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 contracts.

Compliance with the contractual terms and conditions also ensures that parties fully discharge their duties and obligations, and exercise their rights associated with the contracts.

Our review of 22 invoices totaling \$1,169,840 revealed that 10 of 22 invoices were paid 4 to 71 days after their due dates. The invoices involved Pure Technologies, Black & Veatch, and PRAG. This is in contrast to the Billing and Payment Section of the contracts that require payment within 30 days after receipt of the invoice.

We recommend that management remind agreement administrators of the need to comply with the terms and conditions of the agreements.

Remarketing Statement for the Water Revenue Refunding Bonds, 2011 Authorization, Series A-1 and A-3

The Audit Department has completed a review of the Remarketing Statement for the Water Revenue Refunding Bonds (Bonds), 2011 Authorization, Series A-1 and A-3. This review was undertaken to provide the remarketers of the Bonds "comfort" that the Remarketing Statement for the Bonds is complete, consistent with supporting financial records, and accurate in all material respects. The review was completed and no exceptions were noted. We issued letters describing the agreed upon review procedures performed, and the results obtained to the remarketers of the Bonds.

Audit Quality Assurance - Audit Plan Update

In June 2012, the Audit and Ethics Committee and Board of Directors reviewed and approved the fiscal year 2012/13 Audit Plan (Plan), which allocates audit resources to the areas of greatest perceived risk. In keeping with professional standards, we perform quarterly reviews of the Plan and our progress against the Plan to identify significant changes in audit resource levels, risks, or Plan directives. Such changes could result in a recommendation to the Audit and Ethics Committee and the Board to adjust the Plan in order to direct resources appropriately.

Our review of the Audit Department's performance for the first half of the fiscal year revealed that 21 audits, special reviews, and "comfort letters" have been completed. Moreover, our analysis of resource levels for the first half of the fiscal year indicated that audit hours were below Plan levels primarily due to an auditor's long-term disability leave. In January 2013, we engaged an audit consultant to supplement available audit resources. In addition, our analysis revealed a higher than anticipated charge-out rate that was offset by audit project budget overages.

We then considered audit work planned for the remainder of the year for significant changes to risk profiles. We believe our progress to the Plan is tracking to schedule and, therefore, adjustment to the Plan is not recommended. Further, we believe that the Audit Department will fulfill its responsibilities to complete the fiscal year 2012/13 Plan. We will continue to monitor risks and resources and provide formal status updates on at least a quarterly basis through the end of the fiscal year.
