



Internal Audit Report for March 2013

Summary

Four reports were issued during the month:

- **Lower Colorado River Drop 2 Storage Reservoir Audit Report**
- **W. M. Lyles Company Contract 1730 Audit Report**
- **Remarketing Statement for the Water Revenue Refunding Bonds, 2009 Authorization, Series A-2**
- **KPMG LLP Single Audit Report For Year Ended June 30, 2012**

Discussion Section

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

Lower Colorado River Drop 2 Storage Reservoir Audit Report

Background

In December 2007, the Bureau of Reclamation (Reclamation) established new guidelines that allow agencies to create and store new water supplies, known as intentionally created surplus (ICS) water. One of the methods by which ICS can be created is through developing and funding system efficiency projects - projects that conserve or more efficiently manage existing Colorado River supplies. The Lower Colorado River Drop 2 Storage Reservoir Project is one such system-efficiency-type project. The other ICS methods include extraordinary conservation, importation and tributary conservation.

In April 2008, Metropolitan's Board authorized participating in the funding agreement for construction of the Drop 2 Reservoir Project located adjacent to the All-American Canal in Imperial County, California. The funding agreement commenced in December 2007 and will remain in effect until delivery of all ICS or December 31, 2036, whichever is earlier.

The parties to this agreement were the Bureau of Reclamation, Southern Nevada Water Authority (SNWA), Central Arizona Water Conservation District (CAWCD), and Metropolitan. Reclamation constructed the Drop 2 Reservoir Project with capital funds provided by SNWA, CAWCD, and Metropolitan totaling \$172 million. In return for these contributions, Reclamation made available a total of 600,000 acre-feet (AF) of ICS water to the Drop 2 Reservoir Project funding partners. For Metropolitan's contribution of \$28.7 million, Metropolitan received 100,000 AF of ICS water credits.

Construction of the Drop 2 Reservoir Project is substantially complete, ahead of schedule, and under budget. The Drop 2 Reservoir Project has undergone first filling, first draining, and a one-year testing and commissioning period. Reclamation anticipates completing the Drop 2 Reservoir Project in mid-2013 for a total cost of \$149.5 million. Metropolitan's ICS water stored in Lake Mead, Nevada totaled 66,000 AF, with an equivalent cost of \$15.7 million.

Opinion

In our opinion, the accounting and administrative procedures over the Drop 2 Reservoir Project 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 December 2007 through November 2012. Although this opinion is an acceptable rating, we do express concern over lack of adequate documentation of contribution refunds (about \$3.3 million) remitted to Metropolitan in 2010 and 2011, as they were based on anticipated rather than actual capital costs. While we understand that a final accounting from Reclamation is not expected until August 2013, we encourage management to follow up to ensure that the final accounting is received and verified as to its accuracy and propriety.

Comments and Recommendations

There were no material findings to report.

W. M. Lyles Company Contract 1730 Audit Report

Background

The 242-mile-long Colorado River Aqueduct (CRA) conveyance system transports water from the Colorado River to Lake Mathews. Major portions of the system, which were constructed in the late 1930s, have shown signs of wear and tear from extended usage over the past 70 years. Metropolitan commenced the CRA Transition and Manhole Structure Covers Replacement (Covers Replacement) Program in September 2007 to replace the covers which provide access to the aqueduct for maintenance and repair activities, while restricting unauthorized entry. Phase I of the CRA Covers Replacement Program replaced the 37 most severely deteriorated covers. In November 2011, Phase II of the CRA Covers Replacement Program was approved to replace the remaining transition and manhole structure covers.

In November 2011, Metropolitan entered into a \$3.3-million contract (1730) with W.M. Lyles Company for the replacement of 56 steel transition covers, 77 concrete manhole covers, and the repair of 66 manhole structures. The work was completed in December 2012 and Metropolitan has paid \$3.2 million under Contract 1730.

Opinion

In our opinion, the accounting and administrative procedures over the W.M. Lyles Company Contract 1730 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 November 2011 through December 2012.

Comments and Recommendations

There were no material findings to report.

Remarketing Statement for the Water Revenue Refunding Bonds, 2009 Authorization, Series A-2

The Audit Department has completed a review of the Remarketing Statement for the Water Revenue Refunding Bonds (Bonds), 2009 Authorization, Series A-2. 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.

KPMG LLP Single Audit Report for Year Ended June 30, 2012

The Federal Single Audit Act of 1984, as amended by the Single Audit Act Amendments of 1996, requires state or local government units that expend \$500,000 or more of federal financial assistance in any one year to have an audit conducted for that year. In the event that a so-called “Single Audit” report is required of Metropolitan for the year, the cost of such an audit is included as part of the required audit services provided by KPMG LLP (KPMG) under its agreement with Metropolitan.

Due to the magnitude of federal sources and money expended during the fiscal year ended June 30, 2012, Metropolitan was required to have a Single Audit performed. KPMG performed the necessary auditing procedures to be able to issue the required audit reports:

1. Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*.
2. Report on Compliance with Requirements Applicable to the Major Program and on Internal Control over Compliance with OMB Circular A-133.

We completed our assistance to KPMG in the performance of auditing procedures and have submitted to them all work performed. KPMG will provide their opinions and issue these reports by March 31, 2013.
