THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Report
Office of the General Auditor
June 30, 2013

Internal Audit Report for June 2013

Summary

Four reports were issued during the month:

- **Aquatic Consulting Services Incorporated 119273, SoCal Bio-Environmental Associates LLC 119281, and Wagner Biological Consulting 11982 Audit Report**
- **Director and Employee Expense Reports Audit Report**
- **Ken Delta Water Management Program Audit Report**
- **Official Statement for the Water Revenue Refunding Bonds, 2013 Authorization, Series E**

Discussion Section

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

Aquatic Consulting Services Incorporated 119273, SoCal Bio-Environmental Associates LLC 119281, and Wagner Biological Consulting 11982 Audit Report

Background

In August 2010, Metropolitan issued a Request for Qualifications (RFQ 956) to prequalify firms in five environmental service categories, with the intent to execute on-call service agreements. These categories were: biological, cultural resources management, regulatory permitting and guidance, general on-call environmental planning services, and environmental planning support for future projects. These on-call agreements allowed Metropolitan to request services, as needed in a specific environmental service category through the issuance of task orders on a project-by-project basis.

Accordingly, Metropolitan entered into three year on-call agreements with Aquatic Consulting Services, Inc. (Aquatic), SoCal Bio-Environmental Associates, LLC (SoCal), and Wagner Biological Consulting (Wagner) to provide biological resources management services pertaining to native species and habitats in Metropolitan’s service area within Southern California, project areas in Northern California, the Colorado River, and the Southern California desert. Under the terms of the agreements, consultants were required to conduct general biotic surveys, protocol surveys for state and federal listed species, impact evaluations, construction monitoring and reporting, and consult with Metropolitan’s project personnel.

The three agreements are effective from March 2011 through March 2014, with a maximum amount payable per contract year of $125,000, $175,000, and $200,000, respectively. It should be noted that Aquatic terminated its agreement with Metropolitan in June 2012, as the consultant went out of business. Payments to the consultants under these agreements totaled $744,044, as of April 2013.

Opinion

In our opinion, the accounting and administrative procedures over Aquatic, SoCal, and Wagner 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 March 2011 through April 2013.

Comments and Recommendations

COMPLIANCE TO TERMS AND CONDITIONS OF THE AGREEMENTS

Compliance with contractual requirements is necessary to ensure the accurate accounting records, proper supporting detail, and adequate control over the administration of the agreements. Furthermore, compliance with contract terms and conditions also ensures that parties fully discharge their duties and obligations, and exercise their legal rights associated with the agreements. We reviewed 14 invoices totaling $226,656 between March 2011 and April 2013: 4 Aquatic totaling $95,069; 5 SoCal totaling $68,475; and 5 Wagner totaling $63,112 and noted the following:

1. Aquatic Agreement:

   a. We could not locate the supporting documentation for subconsultant reimbursable expenses of $1,696.

   b. We could not locate amended Task Orders T001 and T002 that reflected additional budget and time duration for the associated work.

   c. Pre-shutdown work performed from February 1, 2012 through February 11, 2012 for $5,293 was incorrectly charged to Task Order T003, rather than Task Order T002. Further, we noted that Task Order T002 was not amended for the additional work and budget relative to this work.

   d. Consultant is a registered Small and/or Disabled Veteran Business Enterprise (SBE). However, the agreement was not amended to delete provisions that require the consultant to utilize SBE at the participation level of 18 percent and submit an SBE/DVBE Utilization Report.

   e. One of four invoices was not certified by the consultant as to its propriety, which is in contrast to the requirements of the Billings and Payments Section of the agreement.

2. SoCal Agreement:

   a. We could not locate amended Task Orders T001 and T002 that reflected additional budget and time duration for the work performed.

   b. SoCal invoices were not certified by the consultant as to their propriety, which is in contrast to requirements of the Billings and Payments Section of the agreement.

   c. Consultant is a registered SBE. However, the agreement was not amended to delete provisions that require the consultant to utilize SBEs at the participation level of 18 percent, and submit an SBE/DVBE Utilization Report. Further, we noted the consultant was not an SBE until March 18, 2013, which is two years past the agreement's effective date.

3. Wagner Agreement:

   a. Consultant billed for services rendered for Task Orders T001 and T002 prior to the date that these task orders were approved.

   b. All five invoice selections were not certified by the consultant as to their propriety, which is in contrast to the requirements of the Billings and Payment Section of the agreement.

We recommend that the agreement administrators remind the consultants to comply with the terms and conditions of the agreements and conduct periodic reviews to ensure compliance. Moreover, we recommend that the procedures for amending task orders be revised and formalized. Finally, we recommend that the agreement administrators amend the agreements to reflect changes in terms and conditions of the agreements.

Director and Employee Expense Reports Audit Report

Background

Metropolitan's Administrative Code, Operating Policies, and Travel Guide specify travel policies, expense reporting procedures, and guidelines for preparing and submitting expense reports. Expense reports are processed through the Travel Expense Reporter (TER) system for directors and employees who have incurred travel expenses and operating expenses, on behalf of Metropolitan.

The Accounts Payable team, under the Controller Section in the Office of the Chief Financial Officer, administers and records expense reports and issues payments. For the ten months ended February 28, 2013, Accounts Payable processed expenses totaling $2.1 million through the TER system for directors and employees. This represents an 11 percent decrease over the same period from the prior year. These transactions were made up of 144 director expense reports totaling $129,005 and 3,950 employee expense reports totaling $1.98 million.

Opinion

In our opinion, the accounting and administrative procedures over Director and Employee Expense Reports include those practices usually necessary to provide for a generally satisfactory internal control structure. The degree of compliance with such procedures provided effective control for the period May 1, 2012 through February 28, 2013.

Comments and Recommendations

TRAVEL REIMBURSEMENT POLICIES

Travel Reimbursement policies ensure that employees are reimbursed for business-related expenses in a timely and accurate manner. These policies should require that employees substantiate their expenses within a reasonable period of time, and should limit reimbursements to business expenses incurred by the employee in connection with the performance of the employee's duties. If compensatory overtime pay for travel time is included, it should satisfy established requirements under the Fair Labor Standards Act (FLSA) in order to be eligible for compensation.

It should be noted that Metropolitan's Memoranda of Understandings contain provisions for paid release time when employees are participating in the recruitment process (e.g., taking written examinations, participating in job interviews). This could include paid travel time and reimbursement depending on locations of employee and interview, and depending on whether the travel met the requirements under FLSA to be considered compensable. During our review we noted:

1. One Expense Report was processed that reimbursed an employee $582.50 to attend a job interview at the Union Station offices. Moreover, we also noted that this employee was granted 8.5 hours of compensatory overtime, under the auspices of travel time. Further review of the TER revealed:

	DAY 1**	DAY 2	TOTAL
Per Diem	$150.00	$75.00	$225.00
Mileage ***	$170.00	$170.00	$340.00
Metrolink Ticket		$17.50	$17.50
Total	$320.00	$262.50	$582.50
Compensatory Time	5.0	3.5	8.5

**Day one was a Metropoitan Holiday
***Mileage based on 301 miles from Gene Camp to Los Angles Union Station offices and back.
Note: Reduction of miles driven by employee's normal commute not detailed on TER documentation.

2. Metropolitan reimbursed an additional employee $825 of per diem for four overnight stays to attend various promotional job interviews at Los Angeles Union Station offices.

We recommend management clarify the Reimbursement Policy to ensure that travel reimbursements are granted in alignment with the intent of the policy. We also recommend that management communicate policies to all employees, and conduct periodic reviews to ensure compliance.

REVIEW AND APPROVAL

Review and approval controls serve to protect against ineligible, inaccurate, or duplicate transactions; identify items that require correction; and ensure that follow-up procedures exist for exceptions. For expense reports, authorized personnel review details for compliance to policies and procedures, check supporting documentation for accuracy and completeness, and examine the expenses for propriety. Our review revealed:

1. Two employees submitted TERs for meals totaling $197, without itemized receipts. These expenses were supported only by credit card slips and the hotel invoice. This is in contrast to Chapter 5 of the Travel Guide which states, "Travelers must submit an itemized receipt" for business meals.

2. Three employees submitted duplicate TERs resulting in over-reimbursements totaling $72. It should be noted that two employees have reimbursed Metropolitan a total of $16.

We recommend the Accounts Payable team request a refund for the remaining overpayment. We also recommend reviewers conduct a periodic review of expense reports to ensure the validity, accuracy, and completeness of reported claims. Lastly, we encourage Accounts Payable management to decline payment for reimbursements without itemized receipts.

COMPLIANCE TO POLICIES AND PROCEDURES

Compliance with established policies and procedures is necessary to safeguard company property and protect against abuse, theft, or waste. In addition, compliance with policies and procedures is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of travel expenditures. During our review, we noted:

1. An employee submitted a TER for $440 in mileage claims for 779 miles of travel to a conference, without demonstrating the cost savings of driving instead of flying. This is in contrast to Administrative Code §6326(d) which states trips in excess of 200 miles one-way shall be made by airline, unless it can be demonstrated that other forms of transportation are cheaper.

2. Six employees submitted Travel Authorization Requests (TARs) approved at the section manager, assistant section manager, or special project manager level for travel outside of California. In addition, one employee did not complete a TAR for out-of-state travel. These instances are in contrast to Chapter 3 of the Travel Guide which requires approval of a group manager, with a copy of the TAR to the Chief Operating Officer for all travel outside of California.

We recommend Accounts Payable management remind all employees to comply with the Travel Guide and Accounts Payable Handbook. In addition, we recommend Accounts Payable management conduct periodic reviews to ensure compliance.

LATE OR UNFILED TRAVEL EXPENSE REPORTS AND RECONCILIATION OF PREPAID EXPENSES

Internal Controls over prepaid expenses ensure management is monitoring transactions to prevent waste or misuse of assets. Reconciliation of expense reports to receipts on a timely basis helps to ensure management meets these objectives.

At Metropolitan, the Accounts Payable staff reconciles TERs to the prepaid expenses incurred by employees by matching the employee’s TERs with supporting documentation. We performed an aging on 1,193 unreconciled prepaid expense line items from the TER system. These expense items totaled $279,640, and represented expenses for 27 directors and 158 employees. We noted that as of April 2013, 46 percent of the items examined (totaling $277,603) were greater than 12 months old. This included 184 line items from directors and 360 line items from employees.

This is in contrast to Administrative Code §6331(b)(2) which states, “Director’s expense claims shall be submitted to the Board Executive Secretary’s office no later than the end of the month following the month in which the director incurred the expenses or participated in an activity for which Metropolitan funds were utilized on the director’s behalf.” Moreover, Administrative Code §6331(b)(3) states, “Employees’ expense claims…shall be submitted to the Office of the Chief Financial Officer no later than the end of the month, following the month in which the employee incurred the expenses or participated in an activity for which Metropolitan funds were utilized on the employee’s behalf.”

We recommend the Accounts Payable team remind employees and the Board Executive Secretary of the importance of preparing TERs timely. In addition, we recommend management prepare policies to address unreconciled expenditures that have been outstanding for an extensive period of time.

Kern Delta Water Management Program Audit Report

Background
In November 2002, Metropolitan's Board authorized a 25-year agreement with the Kern Delta Water District (Kern Delta) for a Water Management Program (Program). This Program consists of several components including a storage and delivery system, an exchange of supplies, and a water supply element. The agreement allows Metropolitan to store its available State project water in a storage account of 250,000 acre-feet (AF), within the groundwater basin underlying the Kern Delta. The stored water can be retuned during droughts and emergencies to supplement Metropolitan's water supply needs.

The location of the Program is important, as the basin is south of the Delta in the San Joaquin Valley so that the storage and return of water is not limited by court decisions that restrict the Banks Pumping Plant water flows. At Metropolitan's request, Kern Delta would return a minimum of 50,000 AF of water to Metropolitan in a given year. The water could be returned by exchange or direct pumpback to the California Aqueduct.

The payment terms for the Program were structured to reimburse capital project costs and incentivize efficient program operation. That is, to cover the capital cost of Program facilities, Metropolitan would pay $105 per AF to store the water and an additional $40 per AF to extract the supplies. After the initial 250,000 AF of water had been stored, Program costs were reduced to $90 per AF ($50 per AF for storage and $40 per AF for extraction). These costs were escalated according to the agreement. In addition, Metropolitan would also pay actual operation, maintenance, and power costs for Program facilities.

In 2006, Kern Delta informed Metropolitan that capital costs had increased more than originally estimated. These increases were related to facilities associated with the expansion of the Cross Valley Canal and were impacted by higher land costs associated with real property purchases for spreading facilities. Accordingly, detailed negotiations were conducted to control capital cost increases and manage Metropolitan's cash payment flows. These efforts were successful in limiting capital costs that Metropolitan would fund. Metropolitan reduced its funding of the Cross Valley Canal expansion from 100 percent to 50 percent, and Kern Delta did not charge Metropolitan for additional land purchased to develop the spreading basins.

In 2011, Metropolitan completed its obligation towards paying the original capital program costs. Controlling the capital costs has not decreased Metropolitan's ability to put water into the storage program. Metropolitan put approximately 80,000 AF in 2010; 60,000 AF in 2011; and 50,000 AF in 2012. As of March 31, 2013, Metropolitan has paid Kern Delta $50.4 million under this Program and currently has 178,013 AF in storage.

Opinion
In our opinion, the accounting and administrative procedures over the Kern Delta Water Management 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 for the period October 1, 2008 through March 31, 2013.

Comments and Recommendations
There were no material findings to report.

Official Statement for the Water Revenue Refunding Bonds, 2013 Authorization, Series E

The Audit Department has completed a review of the Official Statement for the Water Revenue Refunding Bonds, 2013 Authorization, Series E. 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.