



## **Audit Department Report for February 2015**

### **Summary**

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Three reports were issued during the month:

- **External Affairs – Specialized Marketing Services, Jan Fambro, and Harvey Mudd College Contracts Audit Report**
- **Business Outreach Program Audit Report**
- **La Verne New Machine and Fabrication Shop Building Stage 4 and Diemer Electrical Improvements Stage 2 Construction Projects Audit Report**

### **Discussion Section**

This report highlights the significant activities of the Audit Department during February 2015. In addition to presenting background information and opinions expressed in the audit reports, a discussion of findings noted during the examinations is also provided.

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## **External Affairs – Specialized Marketing Services, Jan Fambro, and Harvey Mudd College Contracts Audit Report**

### **Background**

The Audit Department has completed a review of the accounting and administrative controls over three consulting agreements managed by the External Affairs Group as of October 31, 2014. These include the Specialized Marketing Services, Jan Fambro, and Harvey Mudd College contracts. Our review consisted of evaluating the internal controls over the consultant selection process, reviewing agreement administration and reporting practices, and testing compliance with the terms and conditions of the agreements. In addition, we evaluated the validity and propriety of invoice payments for assurance that the amounts billed were properly calculated and adequately supported.

The External Affairs Group is responsible for working with state and federal legislators to enhance and protect the operational interests of Metropolitan and its member agencies. They also promote board-adopted policies for consideration within the scope of the legislative process. These goals are achieved by providing clear and direct communication of Metropolitan's operations, policies, and programs to the public and other stakeholders. These efforts provide important information to member agencies; local, state, and federal officials; the media; business groups; environmental and community organizations; and the general public. External Affairs also develops and implements educational programs related to responsible water stewardship concepts.

These communication goals are achieved by the distribution of publications, brochures and videos, through the focused content of Metropolitan's websites and with the help of a wide ranging K-12 water resource education program. Outside assistance with these broad programs range from strategic planning and content development to obtaining technical assistance and leadership guidance on individual program elements. This audit examined consulting contracts from each of these areas.

In August 2009, Metropolitan issued a Request for Proposal (RFP 920) to pre-qualify firms for direct mailing services for the distribution of education and conservation literature. These services included inventory management, fulfillment, tracking, and reporting. Proposals were received from four firms and Specialized Marketing Services received the highest scores. Accordingly, Metropolitan entered into a three-year rollover service agreement that was effective from January 23, 2010 through January 22, 2013, with a maximum of \$100,000 per year. However, on January 17, 2013, the agreement was amended to revise the fee schedule and to extend the agreement term to January 22, 2016. As of October 2014, Metropolitan has paid \$180,211 under this agreement.

In August 2011, Metropolitan entered into a one-year sole-source agreement with Jan Fambro to provide internal and external communication services. The initial scope of work included strategic planning, event planning, and training of Metropolitan staff on crisis communication and was capped at \$75,000. This agreement was amended four times to extend the agreement term to June 2015; to change the scope of work to include project management, copy writing, and editing services related to Metropolitan's mwdh2o.com website; and to increase the maximum amount payable to \$225,000. Payments from contract inception through October 2014 totaled \$103,701.

Lastly, Metropolitan and its member agencies have sponsored the Solar Cup Program since 2002. This event is a seven-month program that begins each fall, in which high school students design and build solar-powered boats and then participate in a boating competition at Lake Skinner in the spring. In order to provide technical support services to the participating teams of the Solar Cup Program, Metropolitan entered into a three-year rollover agreement with Harvey Mudd College in a fixed annual fee of \$50,000. This agreement was effective from August 2011 through July 2014. As of October 2014, Metropolitan paid \$150,000 under this agreement.

### **Opinion**

In our opinion, the accounting and administrative procedures over the consulting agreements with Specialized Marketing Services, Jan Fambro, and Harvey Mudd College 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 January 2010 to October 2014.

### **Comments and Recommendations**

#### **NONCOMPLIANCE TO TERMS AND CONDITIONS**

Compliance with contractual requirements is necessary to ensure accurate accounting records, proper supporting detail, and adequate control over the administration of the agreements. Further, compliance with the agreements' terms and conditions ensures that parties fully discharge their duties and obligations and exercise their rights associated with the agreements. We reviewed 27 consultant invoices totaling \$160,746 between March 25, 2010 to August 28, 2014 (17 Specialized Marketing Services invoices \$51,278; seven Jan Fambro invoices \$39,468; and three Harvey Mudd College invoices \$70,000) and noted:

1. The Jan Fambro agreement excluded the "General Liability" and "Professional Liability" insurance coverage clauses that are generally required on consulting agreements. Further investigation revealed that External Affairs group management had waived these requirements for this agreement.

2. One Jan Fambro invoice totaling \$7,033 included charges for the mwdh2o.com website redesign project. These charges were erroneously recorded under the general activity category (“External Relations” 53035) instead of the Website Redesign Project (PA002080).
3. None of the selected Jan Fambro and Harvey Mudd College invoices included the certification that “the invoice to be true and correct to the best of his/her knowledge,” as required by Section 8b of the agreements.
4. Two Specialized Marketing Services invoices totaling \$2,651 and three Jan Fambro invoices totaling \$16,079 did not indicate the billing period. This is in contrast to section 8a of the agreement which requires that “consultant invoice shall include the beginning and ending billing dates.”
5. Two Jan Fambro invoices totaling \$13,703 included charges for more than one month. This is in contrast to Section 8 of the agreement, which requires the consultant to submit monthly invoices to Metropolitan.
6. Three Harvey Mudd College invoices included charges for multiple milestones instead of one milestone per invoice, as required by Section 8a of the agreement. It should be noted there were no billing discrepancies.

We recommend that External Affairs management evaluate the need to require consultants to provide adequate insurance coverage that is established by Metropolitan’s Risk Management Unit. We also recommend that management establish procedures to ensure that costs are recorded in the proper account and project. Finally, we recommend that the agreement administrators remind the consultants to comply with the terms and conditions of the agreements.

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## **Business Outreach Program Audit Report**

### **Background**

The Audit Department has completed a review of the operating and administrative controls over the Business Outreach Program as of September 30, 2014. Our review consisted of evaluating the Business Outreach Program’s policies and procedures designed to ensure certification of Small Business Enterprises (SBE). In addition, we performed tests of the accuracy and completeness of data entered into the Business Outreach database used to track SBE participation by vendors. Finally, we reviewed Business Outreach monitoring and management reporting processes.

Metropolitan encourages participation by individuals and businesses operating as small business enterprises in the solicitation for contracts with Metropolitan. These contracts include the procurement of equipment, materials and supplies, professional service agreements and for construction projects. These efforts are designed to advance participation by business enterprises that may be small, locally owned, or economically disadvantaged.

Accordingly, in August, 2001, board directives established the Business Outreach Program to create an environment which affords all individuals open access to the business opportunities available within the regional service area in a manner that reflects the diversity of our service area. These policies were codified in Administrative Code Sections 8300 and 8301.

The program is designed to ensure that small businesses have an equitable opportunity to compete for business opportunities, and that they share in the resulting contract awards. Metropolitan's SBE participation goal was initially set at 18 percent. However, in July 2014, the Metropolitan increased the goal for small business participation to 25 percent. Metropolitan currently averages 31 percent small business participation through the program.

### **Opinion**

In our opinion, the operating and administrative procedures over the Business Outreach Program 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 July 1, 2012 through September 30, 2014.

### **Comments and Recommendations**

#### **REVIEW AND APPROVAL**

Management reports are designed to combine information into a meaningful form in order to assess operations and develop effective strategic plans. These reports can be informative (e.g., measurement of volume) or analytical (e.g., percent of budget/goal). Peer review is the evaluation of work by one or more people of similar competence to the producers of the work. These review methods are employed to maintain standards of quality, improve performance, and provide credibility to management reports. For Business Outreach Management reports, peer review of SBE participation percentages and agreement with source documentation should be performed to verify the correctness of board-reported totals. Our review revealed that annual SBE Participation Reports are prepared and presented without the benefit of a peer review.

Failure to review Business Outreach Management reports could result in misrepresenting SBE participation activity to Metropolitan's Board and management due to duplicate, invalid or erroneous entries.

We recommend that Business Outreach management establish a review and approval (peer review) process to ensure the completeness and accuracy of board reporting.

#### **BUSINESS OUTREACH PROGRAM MANUAL**

Written procedures should be established and documented to provide a framework for achieving the Business Outreach Program's goals and objectives. Procedures assist management in the training of new employees, provide guidance for consistent performance of daily responsibilities, and provide a source of reference for staff. Our review of the Business Outreach Program manual revealed that the procedures contained in the manual had not been updated since 2007. However, we noted that significant changes have been made to Business Outreach operational practices and we understand that material changes have been made to the Planetbids software program.

We recommend that Business Outreach management update the Manual to reflect current procedures. We also recommend that management establish a schedule for updating the Business Outreach Program Policy & Procedure manual on a periodic basis.

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## **La Verne New Machine and Fabrication Shops Stage 4 and Robert B. Diemer Treatment Plant Audit Report**

### **Background**

The Audit Department has completed a review of the accounting and administrative controls over the La Verne New Machine and Fabrication Shops Stage 4 and Robert B. Diemer Treatment Plant (Diemer) Electrical Improvements Stage 2 construction projects as of December 30, 2014. Our review consisted of evaluating the internal controls over contractor selection, administration, reporting, and compliance with the significant terms and conditions of the contracts. We also reviewed project authorizations, and actual versus budgeted costs. Lastly, we evaluated the reasonableness and validity of progress payments and the accuracy and completeness of source documents and financial records.

In order to ensure reliable high quality water supplies, Metropolitan performs ongoing studies and inspections of its conveyance and distribution system, treatment plants and other operational facilities. These studies can affect repair and maintenance schedules and often result in the initiation of capital improvement projects. This review consisted of an examination of two such projects: the La Verne New Machine and Fabrication Shops Building Stage 4 and the Diemer Electrical Improvements Stage 2.

The La Verne Shops, located at the F.E. Weymouth Treatment Plant, were built in 1941, when the plant was originally placed into service. They consist of four buildings: fabrication, machine and two coatings shops. These shops provide support for Metropolitan's maintenance activities, rehabilitation work, and capital projects. These capabilities are also utilized to provide equipment rehabilitation services for the California Department of Water Resources (DWR) and for routine and emergency fabrication support to member agencies. Metropolitan has maintained an agreement with DWR since the 1980s to provide shop services which support maintenance activities along the State Water Project. Metropolitan performs these services on a fee-for-service basis, which is based on machine rates, raw material costs, and fully burdened labor rates, including additives and overhead. Member agency support services are also provided and include agency-requested service connections, which involve fabrication, coating, and the lining of pipe.

The La Verne shops provide approximately \$10 million in manufacturing services for over 120 projects on an annual basis. However, the La Verne shops were in need of updating to improve the quality, efficiency, and safety of the shops as well as to comply with modern building codes. Moreover, enhancements were needed to improve the shops emergency response capabilities.

Accordingly, in May 2012, the Board awarded Stronghold Engineering, Inc. (Stronghold) \$16.3 million to expand the existing machine and fabrication shops by 22,000 square feet. In addition, the agreement updated the fire protection system and relocated equipment within the existing buildings to increase efficiency, improve productivity, and enhance safety. As of January 31, 2015, Metropolitan has paid \$17 million to Stronghold. These totals include \$650,643 of extra work orders which are allowed by Administrative Code Section 8123(b) as long as they are within 5 percent of the initial amount of the contract. This contract was completed as of January 2015.

The second capital improvement project involved the Robert B. Diemer treatment plant. This facility was placed into service in 1963 with an initial capacity of 200 million gallons per day (mgd), and was expanded in 1969 to its current capacity of 520 mgd. When portions of the plant were upgraded or additional facilities were constructed, the electrical system was expanded or adapted to accommodate the increased electrical loads.

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However, the architecture of the electrical system and its principal components were not updated. Accordingly, in August 2013, the Board awarded Southern Contracting \$11.1 million for work on the Diemer electrical system, including installation of new electrical conduits, additional duct banks, new unit power and motor control centers to increase system reliability.

The scope of work also includes redistribution of the power feed to treatment plant equipment with additional circuits to improve reliability; upgrading of the grounding system to reduce the potential for unplanned outages caused by ground faults; and replacement of obsolete liquid-propane-powered 480V standby generators with diesel-powered units. As of December 30, 2014, Metropolitan has paid \$4.4 million to Southern Contracting. This project is scheduled to be completed by March 2016.

### **Opinion**

In our opinion, the accounting and administrative procedures over the La Verne New Machine and Fabrication Shops Stage 4 project and the Diemer Electrical Improvements Stage 2 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 June 2012 through December 2014.

### **Comments and Recommendations**

#### **RECORDING OF RETENTION INVOICE**

Construction payment retention is a common business practice of withholding an amount from a contractor's progress payments to ensure the job is satisfactorily completed before the final payment is made. Metropolitan requires retention withheld on construction contract payments of 5 percent to 10 percent of the invoice amount, which are recorded in the asset account "Construction in Progress" under the subaccount "Other", when paid to the escrow agent.

During our review of 18 constructions progress payments, we noted three retention invoices, totaling \$61,584, were recorded twice. Specifically, they were recorded in subaccounts "Construction Contracts" and "Other". As a result, subaccount "Construction Contracts" and the "Liability" were overstated by \$61,584. It should be noted that during the course of our audit, Accounts Payable has reversed these entries to correct the issue.

Failure to accurately record retention invoice could result in inaccurate financial records.

We recommend Accounts Payable management remind personnel of the importance of accurately recording the retention invoice.

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