



Internal Audit Report for July 2015

Summary

Two reports were issued during the month:

- **Water Management Fund Audit Report**
- **Yorba Linda Power Plant Modifications 15446 Program Audit Report**

Discussion Section

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

Water Management Fund Audit Report

Background

The Audit Department has completed a review of the accounting and administrative controls over the Water Management (WM) Fund, as of May 31, 2015. Our review consisted of evaluating the internal controls over administration of the WM Fund. We evaluated processes related to project selection and approval, fund allocation and authorization, and tracking and reporting. We also verified payment validity and propriety of payments to contractors for compliance with contractual terms and conditions, and for assurance that amounts billed were properly calculated and adequately supported.

On April 8, 2014, the Metropolitan Water District (Metropolitan) Board authorized the transfer of unrestricted funds estimated to exceed the target reserve level of \$350 million on June 30, 2014, from the Water Rate Stabilization (WRS) Fund to the Replacement and Refurbishment (R&R) Fund, Other Post-Employment Benefits (OPEB) Trust, and the WM Fund. The deposits were to be made as follows: \$100 million to R&R Fund for Pay-As-You-Go Funding of the Capital Investment Plan; \$100 million to OPEB Trust to pay down the unfunded liability; and the remaining estimated amount over target of \$150 million to the WM Fund to cover costs associated with replenishing storage, purchasing transfers, and funding drought response and conservation programs.

On October 23, 2014, the Controller's Office determined the actual remaining reserve amount over target was \$232 million and deposited this amount into the WM Fund. In addition to these approvals, the Board authorized the General Manager to enter into agreements with other water agencies and entities to pursue additional water transfers, increase water storage and pump-back capacity, fund conservation incentives, and other water management programs.

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The actual costs incurred for various programs funded under the WM Fund were \$58.3 million through May 31, 2015. Specific details for the WM Fund allocation, projected costs, and actual costs are:

ITEM	PROGRAM	FUND ALLOCATION	APPROVAL DATE	TOTAL PROJECTED COSTS FY 2014/15 & FY 2015/16	ACTUAL COSTS THRU 05/31/15
1	Conservation	\$ 40,000,000	December 2014	\$ 40,000,000	\$ 31,677,057*
2	SWC Buyers Group Transfer	\$ 71,000,000	March 2015	\$ 14,500,000	\$ 11,475,100*
3	Yuba Transfer	\$ 29,975,000	Oct 2014/May 2015	\$ 18,805,500	\$ 8,830,050*
4	Semitropic Program	\$ 5,800,000	September 2014	\$ 5,800,000	\$ 5,800,000*
5	SWC Buyers Group Initial Deposit	\$ 500,000	January 2015	\$ 500,000	\$ 500,000*
6	Multiyear Program	\$ 46,000,000	February 2015	\$ 1,500,000	\$ 0
7	On-site Retrofit Program	\$ 7,500,000	May 2015	\$ 7,500,000	\$ 0
8	Arvin-Edison Program	\$ 3,000,000	March 2015	\$ 3,000,000	\$ 0
9	Kern Delta Program	\$ 2,500,000	March 2015	\$ 2,500,000	\$ 0
10	External Affairs	\$ 2,500,000	March 2015	\$ 2,500,000	\$ 0
11	San Bernardino Program	\$ 1,000,000	October 2014	\$ 1,000,000	\$ 0
	Total	\$209,775,000		\$ 97,605,500	\$ 58,282,207
	Fund Authorization	\$232,000,000		\$232,000,000	\$232,000,000
	Remaining Fund To May 31, 2015	\$ 22,225,000		\$134,394,500	\$173,717,793

*Indicates an active project

CONSERVATION PROGRAM - ACTUAL COSTS \$31.7 MILLION

On December 9, 2014, the Board increased the conservation budget by \$40 million, which was transferred from the WM Fund and resulted in a total conservation funding of \$100 million. Prior to this date, the Board approved the conservation budget of \$40 million for fiscal years 2014/15 and 2015/16 and approved an additional funding of \$20 million in February 2014. The actual costs of \$31.7 million were related to Metropolitan-based incentives paid to customers under the regional Residential and Commercial Water-Efficient Device Rebate Programs, Turf Removal Program, Metropolitan-Funded/Member Agency Administered (MAA) Program, and other conservation programs. It is important to note that in May 2015 the Board increased the Water Conservation Incentive Programs by \$350 million, for a total funding of \$450 million for fiscal years 2014/15 and 2015/16. These changes were not included in this audit.

STATE WATER CONTRACTORS INCORPORATED BUYERS GROUP TRANSFER AND INITIAL DEPOSIT OF STATE WATER CONTRACTORS INCORPORATED ADMINISTRATIVE COSTS - ACTUAL COSTS \$12 MILLION

In January 2015, Metropolitan entered into an agreement with the State Water Contractors Incorporated (SWC) to pay up to \$500,000 in administrative costs, \$5 per acre-feet (AF) up to 100,000 AF to pursue 2015 Sacramento Valley water supplies. This agreement also required Metropolitan to deposit \$500,000 from the WM Fund. In March 2015, Metropolitan in partnership with other state water contractors through the SWC's agreement entered into a one-year water transfer agreement with eight Sacramento Valley water districts (Sellers).

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The Sellers included Butte Water District, Cordua Irrigation District, South Sutter Water District, Sutter Extension Water District, Garden Highway Mutual Water District, Plumas Mutual Water Company, Richvale Irrigation District, and Western Canal Water District. The water-transfer base price was set at \$700 per AF, with maximum payment of \$71 million from the WM Fund. As of May 31, 2015, payment to SWC totaled \$12 million and included the initial deposit for SWC administrative costs of \$500,000 and \$11.5 million for water transfer costs scheduled to occur beginning June 2015.

YUBA TRANSFERS - ACTUAL COSTS \$8.8 MILLION

On December 4, 2007, the California Department of Water Resources (DWR) entered into an agreement with the Yuba County Water Agency (Yuba) to purchase its surface water. On December 21, 2007, Metropolitan entered into an agreement with DWR to purchase water supplies under the DWR-Yuba agreement. The DWR-Yuba agreement which expires on December 31, 2025, was amended four times between 2009 and 2012. These amendments addressed a technical Reservoir-Fill Accounting Provision, allowed groundwater substitution to DWR, and provided for annual pricing negotiations. Based on these amendments, DWR and Metropolitan executed conforming amendments to their Metropolitan-DWR agreement. In December 2014, the DWR-Yuba agreement was amended to establish prices for water made available after September 30, 2015. On December 5, 2014, DWR and Metropolitan executed another conforming amendment; whereby, Metropolitan would prepay up to \$20 million to lock in water prices for five years. As of May 31, 2015, \$8.8 million was paid to DWR and this amount represents a 50 percent deposit for Yuba transfer supplies that are scheduled to start on September 30, 2015.

SEMITROPIC PROGRAM - ACTUAL COSTS \$5.8 MILLION

On December 12, 1994, Metropolitan entered into a Water Banking and Exchange Agreement with Semitropic Water Storage District (Semitropic) to store up to 350,000 AF of Metropolitan State Water Project entitlement water in the Semitropic Groundwater Basin. The stored water is to be returned later at Metropolitan's discretion. This Semitropic agreement expires in 2035, and was amended twice in 2003 and 2012. A third amendment was executed on December 5, 2014, to temporarily increase Semitropic's pump-back capacity of Metropolitan's water supplies by 13,200 AF per year beginning September 1, 2015. The amendment also allowed Semitropic to purchase for its own use, sell, or commit to sell all or a portion of the 13,200 AF pump-back capacity to a third party after January 31, 2016, provided that Semitropic supplies Metropolitan with the same amount of pump-back capacity production. For each AF of pump-back capacity that Semitropic purchases for its own use or for sale to a third party, Semitropic would reimburse Metropolitan \$440 per AF. As of May 31, 2015, Metropolitan's payment to Semitropic totaled \$5.8 million under this agreement. This payment was for purchase and installation of permanent pumps and motors at Semitropic's existing facilities to increase its pump-back capacity of Metropolitan water supplies stored in its basin.

Opinion

In our opinion, the accounting and administrative procedures over the WM Fund 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 controls from July 1, 2014 through May 31, 2015.

Comments and Recommendations

REVIEW AND APPROVAL

Review and approval controls are designed to verify the accuracy of billings for goods and services, provide assurance as to the propriety of transactions, confirm compliance with contractual terms and conditions, and ensure that follow-up procedures exist for exception processing. For the WM Fund, procedures require that the Water Resource Management (WRM) Group track projected and actual costs charged to the WM Fund and provide cost reports to the Board and management on a quarterly basis or as needed. Procedures also require agreement administrators to monitor compliance with contractual terms and conditions. Our review of 13 invoices totaled \$59.1 million, and cost reports submitted to the Board and management revealed:

1. Allocated funds, projected costs, and projected payments of \$199.8 million, \$97.6 million, and \$90.1 million through March 31, 2015 were reported to the Board and management by the WRM Group Supply Acquisition Team. However, we noted that actual costs of \$55.8 million incurred through March 31, 2015 for all projects funded under the WM Fund, were not included in that board presentation.
2. Conservation incentive payments of \$2 million for the MAA Program were charged to MAA Program Project 600993 instead of to MAA Program WM Fund Project 601104. Project 600993 was established in August 2009 to account for funding provided to member agencies for their water-use efficiency programs implemented in fiscal year 2009/10. Project 601104 was established in February 2015 to account for Metropolitan funding of conservation incentive payments made through the MAA Program. The WRM Group Water Efficiency Team has corrected this discrepancy.
3. Two Electric & Gas Industries Association invoices totaling \$36,417 for conservation incentives were paid four to seven days late.

Incomplete reporting of program costs and failure to record costs to appropriate projects could result in incorrect information being provided to the Board and management.

We recommend the WRM Group Water Supply Acquisition Team management include the actual costs incurred for all projects funded under the WM Fund in its board and management reports. We also recommend the WRM Group Water Supply Acquisition Team management remind agreement administrators to comply with contract payment terms and conditions.

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Lastly, we recommend the WRM Group Water Supply Acquisition Team management continue to conduct tests of invoices to ensure compliance.

Yorba Linda Power Plant Modifications 15446 Program Audit Report

Background

The Audit Department has completed a review of the accounting and administrative controls over the Yorba Linda Power Plant Appropriation 15446 (Yorba Power Plant), as of April 30, 2015. Our review consisted of evaluating the administration and reporting practices, and reviewing the project authorization process. We also evaluated the validity and accuracy of invoice payments for assurance that amounts billed were properly calculated, and adequately supported. Finally, we reviewed the Actual versus Budgeted costs and compared these totals to appropriated amounts and management reports.

The Yorba Linda Feeder (Feeder) conveys a blend of untreated water from the State Water Project and Colorado River Aqueduct to the Robert B. Diemer Treatment (Diemer) Plant. Due to its high-delivery pressure, flows from the Feeder are regulated by the Yorba Linda Pressure Control Structure and Yorba Power Plant. The Yorba Power Plant has an electrical generation capacity of five megawatts, and revenue from energy sales is \$2.5 million per year depending on operational conditions.

Prior to the Oxidation Retrofit Program, the Yorba Power Plant's Impulse-Water Turbine (Pelton Wheel) was positioned above the operating water surface of the Diemer plant. The Pelton Wheel functioned as a horizontal impulse waterwheel that generated power, as it dissipated excess energy within the Feeder.

However, the addition of ozone contactors under the Oxidation Retrofit Program changed the hydraulic profile such that water levels entering Diemer plant is eight feet higher than before construction. This would have effectively submerged the Pelton Wheel, rendering it inoperable. Dissipation of excess hydraulic energy would occur in the Pressure Control Structure, with no energy recovery and no revenue to Metropolitan. Replacement of the Pelton Wheel with a Francis Impulse-Reaction Turbine (Francis Turbine) capable of operating under a submerged-discharge condition permits the Yorba Power Plant to return to service.

In May 2008, Metropolitan's Board authorized the final design to replace the existing Pelton Wheel with a Francis Turbine. In March 2012, the Board awarded James Leffel & Company a procurement contract for a Francis Turbine based on planned operating conditions, physical constraints of the existing Yorba Power Plant structure, and hydraulic and control requirements. Manufacture of the equipment was completed and the Francis Turbine was delivered on August 2014, at a total cost of \$3.6 million.

In November 2013, the Board awarded J.F. Shea Construction, Incorporated (Shea) a \$4.9-million construction contract to modify the existing structure to accommodate the dimensions of the new turbine generator, install a temporary anchoring system to support the draft tube and spiral case during construction, replace the outdated motor control center and its electrical control panels, install the new turbine generator with its associated instrumentation and controls, and remove the existing equipment. As of April 30, 2015, Metropolitan has paid \$4.4 million to Shea and the project is 88 percent completed.

Opinion

In our opinion, the accounting and administrative procedures over the Yorba Power Plant include those practices usually necessary to provide for a satisfactory internal control structure. The degree of compliance with such policies and procedures provided effective controls from April 1, 2012 through April 30, 2015.

Comments and Recommendations

COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENTS

Compliance with contractual requirements is necessary to ensure accurate accounting records, proper supporting details, and adequate controls over administration of agreements. Compliance with the contractual terms and conditions also ensures that parties fully discharge their duties and obligations, and exercise their legal rights associated with the agreements.

During our review of 10 construction progress payments and 15 various consultants' invoices totaling \$4.9 million, we could not locate itemized receipts for business meal expenses totaling \$846 billed on one of 15 consultant invoices tested. It should be noted that credit card receipts were provided rather than itemized receipts.
