



Internal Audit Report for November 2018

Summary

Three reports were issued during the month:

- 1. Rehabilitation of the Second Lower Feeder Pre-stressed Concrete Cylinder Pipe Reach 1 Audit Report**
- 2. Diemer Administration Building Seismic Upgrades Audit Report**
- 3. Review of Colorado River Water Users Association Financial Report**

Discussion Section

This report highlights the significant activities of the Internal Audit Department during November 2018. In addition to presenting background information and the opinion expressed in the audit report, a discussion of findings noted during the examination is also provided.

Rehabilitation of the Second Lower Feeder (SLF) Pre-stressed Concrete Cylinder Pipe (PCCP) Reach 1 Audit Report

The Audit Department has completed a review of the accounting and administrative controls over the Rehabilitation of the Second Lower Feeder (SLF) Pre-stressed Concrete Cylinder Pipe (PCCP) Reach 1 project as of July 31, 2018.

Scope

Our review consisted of evaluating the accounting and administrative controls over the Rehabilitation of the SLF PCCP Reach 1 project. Specifically, we reviewed the contractor selection process, tested compliance with the terms and conditions of the contracts, and evaluated the validity and propriety of contractor and consultant invoices for assurance that the amounts billed were properly calculated and adequately supported.

Background

In September 2011, Metropolitan's Board authorized development of a comprehensive, long-term plan for replacing or relining Metropolitan's at risk PCCP lines. The strategy consists of four coordinated elements: (1) continued assessment and monitoring; (2) monitoring stray currents and installation of cathodic protection; (3) near-term repair of distressed segments; and (4) long-term rehabilitation.

Five feeders were identified as priorities for rehabilitation: (1) Second Lower Feeder (SLF), (2) Sepulveda Feeder, (3) Rialto Pipeline, (4) Calabasas Feeder, and (5) the Allen-McColloch Pipeline. SLF has been in continuous service for over 50 years and has required several urgent PCCP repairs. For this reason, along with the presence of corrosive soils, third-party stray currents and high internal operating pressure, it was chosen as the initial pipeline for rehabilitation.

In January 2015, Metropolitan's Board authorized the design to rehabilitate approximately 28 miles of PCCP on the SLF. The work was divided into six reaches and staged over a period of eight to ten years, using multiple construction and procurement contracts. Reach 1 is located within the cities of Long Beach and Lakewood and consists of approximately 23,100 feet of PCCP.

On May 9, 2017, the Board appropriated \$10.2 million and awarded a \$9.1 million procurement contract to Northwest Pipe Company to provide steel liner pipe for the SLF. Subsequently, on August 15, 2017, the Board appropriated \$39.5 million and awarded a \$19.4 million contract to Kiewit Infrastructure West Co. (Kiewit) to rehabilitate SLF Reach 1. In addition to the construction contract, the Board's action also awarded a procurement contract for valves and authorized two professional services agreements and two lease agreements to support the work.

Rehabilitation of Reach 1 included pit excavations, removal of portions of existing PCCP for access portals, installation of coiled steel liner cylinders, expanding the coiled cylinders, welding the steel cylinders, annular space grouting, applying cement mortar lining, modifying three existing blow-off structures, disinfection, site restoration, traffic control, lead and asbestos abatement, salvage of existing 8 inch and 12 inch diameter plug valves, and installation of Metropolitan furnished valves. Reach 1 is 99% complete, with project costs of \$37.6 million incurred through July 31, 2018.

Opinion

In our opinion, the accounting and administrative controls over the Rehabilitation of the SLF PCCP Reach 1 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 from January 13, 2015 to July 31, 2018.

Comments and Recommendations

RECORDING CONTRACT RETENTION

Retention money is an amount held back from a payment made under a construction contract. It is usually a percentage of the amount payable of each instalment and is held to ensure that a contractor performs all of its obligations under the contract, and is then released either on practical completion or after the end of a defects notification period. Metropolitan requires 5% of each progress invoice payment to be withheld for this purpose. Withheld amounts should be recorded in the asset account "Construction in Progress" with a corresponding credit to "Accounts Payable".

Our review revealed that Kiewit's Partial Estimate 4 was paid on February 22, 2018; retention of \$65,023.75 was withheld from the payment. Kiewit's Partial Estimate 7 was paid on May 22, 2018; retention of \$183,469.25 was withheld from payment. Retention for both of these payments was not recorded in the general ledger until September 1, 2018.

Failure to properly record retention could result in inaccurate financial records.

We recommend that the Controller and Accounts Payable strengthen procedures to properly record retention transactions and to conduct periodic tests to ensure compliance.

Diemer Administration Building Seismic Upgrades Audit Report

The Audit Department has completed a review of the accounting and administrative controls over the Diemer Administration Building Seismic Upgrades Contract 1843 as of June 30, 2018. Specifically, we reviewed Metropolitan's construction contract with Woodcliff Corporation.

Scope

Our review consisted of evaluating internal controls over contract administration and reporting practices. Specifically, we reviewed the contractor selection process, tested compliance with the terms and conditions of the contract, and evaluated the validity and propriety of invoice payments for assurance that the amounts billed were properly calculated and adequately supported.

Background

The Robert B. Diemer Water Treatment Plant (Diemer) was placed into service in 1963 with an initial capacity of 200 million gallons per day (mgd) and was expanded in 1969 to its present capacity of 520 mgd. Diemer delivers a blend of waters from the Colorado River Aqueduct (CRA) and State Water Project to Metropolitan's Central Pool and to an exclusive service area in Orange County. Diemer is located in Yorba Linda, approximately one-half mile south of the Whittier Fault, which is capable of generating a 6.8 magnitude earthquake.

The Diemer Administration Building is a three story 35,000 square foot reinforced concrete structure which was completed in 1963 as part of the original plant construction. The building houses the plant's control room, Incident Command Center, water quality laboratory, staff meeting rooms, and administrative offices.

When Diemer was constructed in the early 1960's, it was designed to meet existing building codes. Since that time, industry knowledge of earthquakes and seismic design has greatly improved and building codes have become more stringent. Metropolitan staff conducted detailed structural evaluations of the Diemer Administration Building based on current codes and recently updated geotechnical information and concluded that it required structural upgrades to withstand a major earthquake.

In August 2016 the board awarded a \$4,426,000 contract to Woodcliff Corporation to upgrade the Diemer Administration Building. The work included construction of new 12 inch thick interior concrete walls extending from the basement to the roof; strengthening the clerestory roof system, perimeter walls, and concrete foundations; reinforcement of structural elements such as floors, piers, and beams; relocation of existing mechanical and electrical equipment; repair of architectural features along with modifications for compliance with the Americans With Disabilities Act; installation of an HVAC system in the control room; installation of a fire alarm and notification system, including permitting and approval by the Orange County Fire Authority. As of September 2018, the work was substantially complete and the building is operational. Metropolitan paid Woodcliff Corporation \$4.6 MM, including extra work orders totaling \$205,534.

Opinion

In our opinion, the accounting and administrative procedures over the Diemer Administration Building Seismic Upgrades Contract 1843 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 September 1, 2014 through June 30, 2018.

Comments and Recommendations

PROCESSING CONTRACT RETENTION

Retention refers to amounts withheld from progress invoice payments to contractors under a construction contract. Metropolitan requires 5% of each progress invoice payment to be withheld to ensure the contractor completes all of their contractual obligations. Retention is released upon practical completion or after the end of a defects notification period. Pursuant to California Public Contract Code §22300 and upon written request of the contractor, Metropolitan deposits withheld retention to an escrow account. In these instances, progress invoice payments and retention payments should be processed simultaneously, in accordance with their due dates.

Procedures established for handling retention invoices do not ensure they are processed in a complete and timely manner. We examined 11 retention invoice vouchers and found two late payments to the escrow account. One retention voucher, totaling \$14,231.50, was paid to escrow 7 days after the due date; another, totaling \$16,604.27, was paid 39 days after the due date. We also found one retention voucher, totaling \$20,692.16 that was paid 13 days before its due date.

Failure to process retention in a complete and timely manner could result in non-compliance with contract terms.

We recommend that the Controller and Accounts Payable strengthen procedures to ensure complete and timely processing of retention invoices and that they conduct periodic tests to ensure compliance.

Review of Colorado River Water Users Association Financial Report

At the request of the Metropolitan Water District of Southern California Board of Directors, we examined the Colorado River Water Users Association Financial Report for the period April 1, 2017 through March 31, 2018. The following summarizes the scope of work performed and results obtained:

Scope

We performed the following procedures to gain reasonable assurance that information included in the Colorado River Water Users Financial Report for the period April 1, 2017 through March 31, 2018 is accurate and is supported by appropriate documentation:

- a) We agreed information from the Financial Report to source documentation, including bank statements and receipts.
- b) We performed selective analysis and computations and confirmed a sample of transactions with third parties.
- c) We examined monthly bank reconciliations and assessed the reasonableness of reconciling items and the accuracy of balances.

Background

The Colorado River Water Users Association (CRWUA) was founded in 1945 and incorporated in the State of Nevada on December 6, 1968. Its mission is to provide a forum for exchanging ideas and perspectives on Colorado River use and management with the intent of developing and advocating common objectives, initiatives and solutions.

From April 1, 2017 through March 31, 2018, CRWUA reported total receipts of \$472,389 and total disbursements of \$468,341. As of March 31, 2018, CRWUA's total fund available was \$579,793.

Opinion

Our review was conducted in accordance with the Institute of Internal Auditor's International Standards for the Professional Practice of Internal Auditing applicable to review engagements. The scope of a review engagement is limited in nature and thus provides less assurance than an audit conducted in accordance with Generally Accepted Auditing Standards. As such, review procedures performed would not necessarily disclose all material weaknesses in the internal control structure over the agreement with lessees. Accordingly, we do not express an audit opinion on the internal control structure over the Colorado River Water Users Association taken as a whole.