

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Its Administrative Controls Need to Be Improved to Ensure an Appropriate Level of Checks and Balances Over Public Resources

REPORT NUMBER 2003-136, JUNE 2004

Metropolitan Water District of Southern California's response as of June 2005

Audit Highlights . . .

Our review of the Metropolitan Water District of Southern California (district) revealed the following:

- The district's policies governing expenses are generally not well-defined and do not always ensure that expenses have a direct link to the district's authorized purposes.***
- More than four years after the enactment of Chapter 415, Statutes of 1999 (SB 60), the district still is trying to establish an effective ethics office.***
- The district has not always established adequate policies and procedures for its purchasing and consulting contracts.***
- The district's personnel policies for hiring and promoting employees are not always current or comprehensive.***

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The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits audit the Metropolitan Water District of Southern California (district) and the Center for Water Education (center). Specifically, the audit committee asked us to evaluate the district's policies and procedures for ensuring an appropriate level of checks and balances over transactions, including its employment, promotions, and grievance processes. It also asked us to evaluate the district's ethics office for compliance with the requirements of Chapter 415, Statutes of 1999 (SB 60), and to examine its process for identifying, handling, and resolving ethics complaints or potential ethics violations. In addition, the audit committee asked us to determine the reasonableness of the district's contracting practices. Finally, it requested that we evaluate the activities, purpose, and organization of the center and determine whether it should be recognized as a part of the district or as a separate entity. We found that:

Finding #1: The district does not always ensure that it uses public resources to further its authorized purposes or in a way that is reasonable and necessary.

The district may expend funds and use other resources within its possession only to carry out those purposes that are authorized expressly or are reasonably implied by its enabling statute, the Metropolitan Water District Act (water act). The water act authorized the district to be created for the purposes of developing, storing, and distributing water and allowed it to provide, generate, and deliver electric power for this purpose. However, its policies governing expenses generally are not well-defined and at times

- ☑ *The Center for Water Education, a separate entity created by the district, currently depends primarily upon the district for funding and needs to establish policies and procedures for its contracting activities.*
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do not always offer adequate assurance that these expenses have a direct link to the district's authorized purposes. We believe these policies may be lacking specific guidance, in part, because the district has broadly interpreted the purposes for which it can spend district funds. Further, the lack of specificity in its collective policies has allowed the district substantial discretion, resulting in expenses that have a questionable link to the district's authorized purposes and that do not always appear to be reasonable or necessary.

For example, the district financially sponsors numerous organizations' activities without justifying the direct link to the district's purposes or establishing any limits on the types of activities it may sponsor. In addition, the district's field inspection trips may not be the most cost-effective way to educate the public on its operations. The district also pays for social events such as holiday parties and provides catered meals to executive management and employees. Further, it reimburses members of its board of directors (board) and executive management for travel expenses without always ensuring that such expenses are reasonable and necessary. We also observed numerous instances where the district leases property to other entities, both public and private, for a nominal amount rather than market value, which, if the lease does not serve the district's authorized purposes, may constitute a gift of public funds in violation of the California Constitution.

To ensure that the district expends funds and uses its resources only to carry out its authorized purposes in a reasonable and necessary manner, we recommended that it do the following:

- Develop policies that specify limitations on the types of activities it sponsors to ensure that it funds only those organizations whose activities have a direct link to the district's authorized purposes. It should also require the board to periodically review and approve each of the district's sponsorships.
- Identify and consider the use of alternative methods for educating the public on its operations that would reach a wider audience and be more cost-effective than field inspection trips.
- Revise its policies to include more specific guidance as to what constitutes a reasonable and necessary use of public funds, including the establishment of restrictions on expenses for parties and catered meals, and ensure that expenses are reasonable and necessary before paying them.
- Grant leases at less than market value only when doing so directly furthers its authorized purposes.

District's Action: Partial corrective action taken.

➡ The district established a new operating policy and procedures manual regarding district-funded sponsorship requests. Under this policy, sponsorships will be reported to the board on a monthly and annual basis. The procedures manual outlines a “due diligence” process for approving sponsorship requests. As part of this process, staff are to describe the proposed event and its relevance to the district’s mission and initiatives as well as other information such as community value and partnership potential. However, this new policy and the respective procedures still do not include limitations on the types of activities that the district may sponsor.

➡ In addition, the district’s board conducted a hearing in November 2004 to invite public comment on the district’s use of field inspection trips. Subsequently, the board reaffirmed its policy on field inspection trips. Consequently, we are still concerned that the district’s field inspection trips may not be the most cost-effective way to educate the public on its operations.

➡ The district revised its operating policies for reimbursable expenses and business travel in December 2004, requiring that sufficient documentation be provided for reimbursable expenditures. The policies state that business travel expenses are eligible for reimbursement if they are reasonable and necessary for an activity that has a significant and meaningful link to the district’s purposes, policies, and interests and if they are in accordance with its administrative code. However, these policies do not contain specific guidance as to what constitutes a reasonable and necessary use of public funds, nor do they establish restrictions on expenses for parties or catered meals.

Finally, the district states that it has reviewed all leases that have nominal or reduced rates and has determined that it is receiving fair value when leasing property. Notwithstanding, the district reports that it implemented new procedures for managing its real property in October 2004. Under these procedures, a market appraisal will generally be used to determine the rents and fees that the district charges others to use its land. Any request to reduce those charges is required to be accompanied by an investment and value analysis approved by the district’s chief operating officer along with an explanation to justify below market rates. This analysis must show that the beneficial returns to the district equal or exceed the standard charges.

Finding #2: The district has struggled with its mandate to establish an ethics office.

More than four years after the enactment of SB 60, the district still is trying to establish an effective ethics office. It did not hire an ethics officer until more than two years after the effective date of SB 60, and that ethics officer did not independently investigate complaints but primarily referred them to other district offices that cannot demonstrate how these complaints were resolved. Of the 65 employees who responded to a survey we sent to a sample of 100 district staff, 26 percent indicated they are not familiar with the purpose of the ethics office. Further, 26 percent of those that addressed the question

indicated that the office does not effectively identify, handle, or resolve ethics issues. The district is establishing a more structured ethics office, including implementing a new system to improve the intake and tracking of ethics complaints, but it is still too soon to determine the success of these efforts.

We recommended that the district complete the implementation of its new ethics office and ensure that the office complies with the requirements of SB 60. For example, the district should ensure that the electronic log it is developing for tracking complaints also captures the subsequent resolution of each complaint to provide the public with information regarding the resolution of its investigations. The district should also issue an annual report to the public and interested legislators on its ethics office's compliance with SB 60. Finally, the district should continue its recent efforts at informing district employees about the ethics office and its functions to ensure that employees are using this resource fully.

District's Action: Partial corrective action taken.

The district states that the electronic tracking log it developed contains the information that we recommended it include. In addition, the district states that reports on the compliance efforts of its ethics office as well as activity status reports are provided to the board and any public attendees of board meetings on a monthly basis. The district also states that its Ethics Quarterly Report is posted on its ethics Web site. However, the district has not stated that it issued or plans to issue an annual report to the public and interested legislators on its ethics office's compliance with SB 60. Finally, the district reports that it intends to continue its efforts to keep employees informed of its ethics programs.

Finding #3: The district could improve its controls over certain types of contracts and grants.

Although the district has established adequate policies and procedures for construction contracts, it has not always done so for its purchasing and consulting contracts. Additionally, its procedures manuals for consulting and purchasing contracts state that sole-source contracts should be used only in limited situations and require staff to document the justification for not using a competitive process. The district does not always ensure that this occurs.

Further, the district does not have a policy that requires a needs assessment or verification of potential contractors' qualifications in some instances where these steps appear necessary. The district's procedures manuals for purchasing and consulting contracts also are outdated. Finally, the district provides grants, sometimes through contracts, to groups that provide water education, explore new water conservation technologies, or foster appreciation of native and drought-tolerant plants. The district's process to award these funds is not always based on established criteria.

To strengthen its controls over consulting and purchasing contracts, the district should ensure that it has adequate policies and procedures and that it prepares justifications for contracts that are not awarded competitively. We also recommended that the district define the various factors, including qualitative factors, it will use to evaluate grant applications and make funding decisions accordingly.

District's Action: Partial corrective action taken.

➤ In December 2004, the district revised its policies and procedures governing its use of consulting and purchasing contracts and states that this information is available electronically to all district employees. The revised procedures address the circumstances under which justifications for contracts are needed and discuss what the justifications are to address. However, as we noted in our report, the district previously had procedures requiring justifications and they were not always followed. Thus, it is unclear if the district's revised procedures will ensure that justifications for contracts are prepared as needed.

➤ In addition, the district stated that it established a new operating policy and procedures manual regarding district-funded sponsorship requests that also pertains to grant applications. However, the new policy and procedures manual does not appear to define the specific factors, including qualitative factors, which the district will use to evaluate grant applications.

Finding #4: The district's personnel policies are lacking and are not always followed.

The district's personnel policies are not always current or comprehensive and do not always ensure sufficient merit system processes, the basis on which it hires and promotes employees represented by bargaining units. In their current state, the policies and procedures invite inconsistency, cannot ensure appropriate checks and balances over hiring and promotion decisions, and may lead to employee grievances and disagreements with bargaining units. Further complicating the issue, the district does not always follow the hiring policies it does have, making itself vulnerable to criticism by employees and other interested parties. However, the district is updating its operating policies, including its personnel policies.

Additionally, the district has established differing board approval and disclosure policies for separation and settlement agreements, even though both types of agreements often share the same goal of avoiding subsequent legal liability, and both commit the district to financial obligation. Given the similar nature of these agreements, we believe they warrant the same level of board involvement.

To ensure consistency and checks and balances, the district should continue its effort to develop comprehensive and up-to-date personnel policies and procedures and ensure that it follows these policies.

We also recommended that the district provide a listing of separation agreements to the entire board to aid the board in understanding the use of these agreements. In addition, because of the similarities between these agreements and settlements, the board should establish a consistent policy for its approval of these agreements. Finally, the board should require the district to disclose all separation agreements to the full board as it already does with settlements.

District's Action: Corrective action taken.

The district states that it revised its hiring and promotion policies and procedures that include documentation standards. It reports that these policies have been adopted. In addition, the district reports that its general counsel presents formal reports on its use of separation agreements to the board on a quarterly basis.

Finding #5: The Center for Water Education currently relies heavily on the district for funding and has yet to develop formal policies and procedures for its contracts.

In October 2001, the district created the entity now known as the center to establish a water education facility and museum (facility). Currently, the center primarily depends on the district for funding and the provision of administrative and financial accounting services. Nonetheless, it has entered into agreements to receive other funding and has received a small amount of money through endowments and a fund raiser. The center's long-term goal is to reduce its reliance on district funding.

The center plans to follow the requirements in the California Public Contract Code, including competitive bidding, for letting its future construction contracts, although it is not required to follow the code's requirements. It has not yet formulated policies and procedures for those aspects of the contracting process that occur before and after the bidding phase. As of April 2004, the center had entered into a consulting contract for construction management and planned to seek competitive bids for construction of the facility. It also had entered into various other consulting contracts, but it lacks formal policies and procedures that would govern the award and management of these contracts. The lack of such policies and procedures may be preventing the center from receiving the most qualified contractors and the best prices for its consultants.

We recommended that the center establish formal contracting policies and procedures for all contracts. These should include procedures for determining the need for contracts, the scope of work, and the qualifications of potential contractors. These policies also should establish procedures for monitoring and evaluating the subsequent performance of contractors. Finally, the center should require a competitive process for consulting services when appropriate to ensure that it receives the best value for these services.

Center's Action: Corrective action taken.

The district reports that the center has adopted formal contracting policies and procedures for all contracts.