



- Board of Directors
Water Planning and Stewardship Committee

3/14/2017 Board Meeting

8-4

Subject

Adopt CEQA determination and authorize an increase of maximum amount payable under the contract with Richardson & Company LLP for auditing services related to State Water Project charges and related claims from \$3,900,000 to an amount not to exceed \$7,000,000 and extend the term by three years to March 31, 2020

Executive Summary

This is a request to increase the maximum amount payable under a contract with an outside consultant by \$3,100,000 for the purpose of auditing Metropolitan's annual State Water Project (SWP) charges from the California Department of Water Resources (DWR) and supporting staff in the recovery of claimed overcharges.

Details

The California Certified Public Accounting firm Richardson & Company LLP (Richardson) is one of two firms that specialize in the audit of the SWP charges. Richardson & Company LLP and the predecessor firm Richardson and Company have represented Metropolitan since 1991.

The audit is a highly specialized contractual compliance review of a unique and technically complex computational process. The work is not a typical audit of financial statements. The work location is Sacramento, with the audit process annually requiring 6,300 to 6,700 hours, with workload varying over the course of the year. During the peak period an experienced staff of 6 to 10 individuals is performing the work.

Two consulting firms have the SWP contractual and technical accounting knowledge to complete the audit, EY (formerly Ernst and Young), and Richardson. In 1990, as a result of a merger, EY completed the review. EY continues to audit the charges for other State Water Contractors. Metropolitan has a conflict of interest clause in our agreements, restricting Metropolitan's consultant from auditing charges and related work for other water contractors and DWR. As a result of the conflict of interest clause, in 1990 EY decided it would not perform the audit for Metropolitan in the future. EY assisted Metropolitan in transitioning to a new firm, started by former EY employees who worked on Metropolitan's Statement of Charges audit, beginning in 1991. The new firm was Richardson.

Between 1972 and 2001, Metropolitan's consulting agreements were annual rollover agreements with a six-month termination notice. The agreements were consistent with Metropolitan's Administrative Code Section 8140(1)(h), which provides that all contracts estimated to cost \$75,000 or more shall be made upon a competitive procurement method of either competitive sealed bidding or best value procurement, except contracts for insurance or for services of a professional, artistic, scientific, or technical nature, among others. Starting in 2001 and continuing through 2012, Metropolitan sought audit services through three Request for Proposals (RFP) and one Request For Qualifications (RFQ). During each contracting cycle, the solicitation was broadened. The four RFP/RFQs did not result in identifying any accounting firms, other than Richardson, that are professionally and technically qualified, and have an interest in performing the Metropolitan SWP charges audit. In the 2009 and 2012 solicitation processes, Richardson was the only final respondent.

There are a number of factors that reduce interest in responding to the SWP charges audit RFP. The most significant are the cost and risks associated with acquiring the specialized and unique knowledge required to gain

technical competency. Staff has estimated that the investment in knowledge would be in the range of \$1 million over a three-year agreement. In a fixed cost, competitively bid RFP process, the respondent could not expect to recover that investment. The respondent would be competing against a very strong incumbent firm. Richardson is highly experienced, low cost, and an acknowledged expert by DWR, State Water Contractors, and the Sacramento CPA community. The conflict of interest restriction also prevents the consultant from leveraging its investment in knowledge by doing similar work for other water contractors. The large size of the audit, peak staffing requirements, and Sacramento location are also factors.

Before an RFP is released, staff evaluates if it is better to have the audit done by Metropolitan's internal audit staff or continue to use an external consultant. Overall, using an external consultant is the preferred choice. Using Richardson has proven to be the lowest cost, most efficient, and effective choice. Since 1991, the cumulative savings from Richardson's audit services exceed \$289 million. Also, Richardson is assisting in resolving additional claims estimated at \$134 million, including the \$90 million Water Systems Revenue Surcharge claim by Metropolitan. Using the services of Metropolitan's internal audit department is a viable, but more expensive, alternative. The estimated cost is in the range of an additional \$1 million or more over three years. These costs are for additional full-time staff that would be needed for only part of the year, plus office accommodation and support. A more important consideration is the independent third-party professional opinion that an external consultant provides. The independent consultant is focused on identifying errors or inconsistencies and reports whether or not they favor Metropolitan. This approach is of considerable assistance when dealing with DWR in resolution of errors and addressing contentious contract policy issues. DWR knows that the audit process is unbiased. It also provides security assurance to DWR that its largest water services customer and power market competitor is not directly accessing its accounting records.

In fiscal year 2016/2017, Metropolitan budgeted \$840,000 for these auditing services. It is anticipated the cost of these services will increase up to \$950,000 commencing with the 2018 charges and up to \$1,075,000 for 2019 and 2020 charges, due to the proposed SWP contract extension language that includes significant changes in the contract charges calculation provisions. The changes to the calculation provisions mean it will be necessary to audit two different Statement of Charges calculations. The additional work is anticipated to begin during the implementation and transition period. The implementation period is expected to start with the 2018 charges. Three years after the SWP contract extension is in place, it is expected the level of related audit work will decline, but will continue until 2035. The continued work is related to the existing capital and Delta charges that are collected through 2035 and are subject to adjustment of historical costs. Additional work is also anticipated to reach settlement on the Water Revenue Bond Surcharge claim and other protested charges.

The benefits of extending Metropolitan's consultant contract with Richardson include reduced staff cost associated with the RFP process; continued support for claims against DWR for errors in the calculation of the SWP charges; and continuation of reliable and efficient, low-cost audit services. The proposed contract amendment is consistent with Metropolitan's Administrative Code Section 8140(1)(h) because it involves the services of a professional and technical nature.

Policy

Metropolitan Water District Administrative Code Section 8140: Competitive Procurement

California Environmental Quality Act (CEQA)

CEQA determination for Option #1:

The proposed action is not defined as a project under CEQA because it involves continuing administrative activities (Section 15378(b)(2) of the State CEQA Guidelines). In addition, the proposed action is not subject to CEQA because it involves other government fiscal activities, which do not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment (Section 15378(b)(4) of the State CEQA Guidelines).

The CEQA determination is: Determine that the proposed action is not defined as a project under CEQA and is not subject to CEQA pursuant to Sections 15378(b)(2) and 15378(b)(4) of the State CEQA Guidelines.

CEQA determination for Option #2:

None required

Board Options

Option #1

Adopt the CEQA determination that the proposed action is not defined as a project and is not subject to CEQA, and

- a. Authorize the General Manager to amend the agreement with Richardson & Company LLP to extend the term for three years to March 31, 2020; and
- b. Increase the maximum amount payable under the contract with Richardson & Company LLP from \$3,900,000 to an amount not to exceed \$7,000,000

Fiscal Impact: Professional and technical services costs up to \$3,100,000 over a three-year period

Business Analysis: The auditing services provided by the consultant with expertise in auditing SWP contract charges assists staff in evaluating the accuracy of the charges and controlling costs of Metropolitan's largest annual expenditure.

Option #2

Do not authorize the General Manager to amend the agreement and require staff to issue an RFP for State Water Project charges audit services and return to the Board for authorization.

Staff Recommendation

Option #1


 _____ 2/28/2017
 Deven N. Upadhyay Date
 Manager, Water Resource Management


 _____ 3/1/2017
 Jeffrey Knightlinger Date
 General Manager