



## **Internal Audit Report for December 2018**

### **Summary**

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Three reports were issued during the month:

- 1. Risk Management of the Self-Insurance Fund Audit Report**
- 2. Recycled Water Onsite Retrofit Program Audit Report**
- 3. Quarterly Consulting and Services Contracts Review Report for Period Ending June 30, 2018**

### **Discussion Section**

This report highlights the significant activities of the Internal Audit Department during December 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.

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## **Risk Management of the Self-Insurance Fund**

The Audit Department has completed a review of the accounting and administrative controls over Risk Management of the Self-Insurance Fund as of March 31, 2018.

### **Scope**

Our review consisted of evaluating the accounting and administrative controls over the risk management process. In addition, we evaluated compliance with policies and procedures as well as the Administrative Code.

### **Background**

The Risk Management Unit (Risk Management) is responsible for managing all aspects of Metropolitan's casualty insurance and risk management programs to minimize exposure to loss. The unit achieves these objectives by assessing risk and recommending strategies to minimize or transfer contract risk on all agreements, and procure excess and specialty insurance policies to supplement the self-insured property and liability claims program. Risk Management's responsibilities over the property and liability claims program include processing property and liability incident reports, managing liability claims against Metropolitan by third parties, and monitoring incident investigations. They are also responsible for coordinating efforts between the General Counsel, Controller's Section, Fleet Maintenance, Employee Relations and Security.

Metropolitan uses a third party administrator to investigate incidents, assess liability, negotiate settlements and make settlement recommendations. Additionally, the contractor prepares

periodic reports on losses, closed claims, and on the outstanding balance in the loss reserve account. For the period July 1, 2015 to March 31, 2018, York Risk Services Group and Hazzelrigg Claims Management Services were the claims administrators and together with Risk Management processed 1,681 incidents and made settlement payments of \$571,099. Finally, as of March 31, 2018 Metropolitan had 43 open claims.

Metropolitan is self-insured against third party liability for 100% of property damage and for the first \$5 million per occurrence for workers' compensation claims. This self-insurance liability is capped at \$25 million per year.

### **Opinion**

In our opinion, the accounting and administrative procedures over Risk Management of the Self-Insurance 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 control for the period of July 1, 2015 to March 31, 2018.

### **Comments and Recommendations**

#### **POLICIES AND PROCEDURES**

Policies and procedures should be established and documented to provide a framework for achieving Metropolitan's goals and objectives. Procedures provide employees with guidance for the consistent performance of daily operations, assist in training new employees, and provide a source of reference for experienced personnel. Risk management should ensure procedures over handling incidents and claims are revised on a periodic basis to ensure sound business practices.

Risk Management policies and procedures require files to be maintained on all claims. Our review of 35 claims disclosed a missing incident file for one closed claim. Additionally, our review revealed that written procedures have not been updated since 2005.

Failure to follow and update procedures to reflect current practices may result in inconsistent performance of daily activities and preclude adequate training and guidance for new employees.

We recommend that management remind personnel of the importance of compliance to established procedures and conduct periodic tests to ensure compliance. We also recommend management update claims procedures to reflect current practices.

#### **COMPLIANCE WITH TERMS AND CONDITIONS OF THE AGREEMENTS**

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

Our review of 25 invoices totaling \$902,965 revealed that 5 invoices were paid after the due date.

Failure to comply with the terms and conditions of the agreements could result in penalties or loss of reputation with business partners.

We recommend that Management remind agreement administrators the importance of complying with the terms and conditions of the agreements and conduct periodic reviews to ensure compliance.

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## **Recycled Water Onsite Retrofit Program**

The Audit Department has completed a review of the accounting and administrative controls over the Recycled Water Onsite Retrofit Program (Retrofit Program) as of July 31, 2018. Specifically, we reviewed compliance to the terms and conditions of the contract with the Electric & Gas Industries Association (“EGIA”) for the administration of the program.

### **Scope**

Our review consisted of evaluating the accounting and administrative controls over payments made to EGIA to manage the processing of consumer applications for rebates under the consumer incentive program. We also tested compliance with the program’s terms and conditions and evaluated the validity and propriety of incentive payments made by EGIA to customers on behalf of MWD for assurance that the amounts billed were properly calculated and adequately supported.

### **Background**

Metropolitan’s 2010 Integrated Water Resources Plan (IRP) envisioned a 20 percent reduction in urban per capita water use by 2020. An important component of meeting that goal entailed increased use of recycled water. However, production records for fiscal year 2012/13 indicated that Metropolitan’s recycled water projects produced only 70 percent of their capacity. Staff concluded that financial assistance for customer-borne site conversion costs, such as system design, permitting, construction, and connection fees, would stimulate recycled water usage.

On February 11, 2014, the Board authorized \$3 million for a three-year On-site Retrofit Pilot Program (Pilot Program), offering direct financial incentives to property owners (public or private) to convert potable water irrigation or industrial water systems to recycled water. The Pilot Program provided up to \$195 per acre-foot (AF) up to the actual cost of the retrofit. Only new conversions were eligible and payments were not to be made until all invoices and eligible costs were verified and the connection and use of recycled water became operational.

Subsequently, in April 2016, the Board authorized \$10 million to fund the Retrofit Program in fiscal years 2016/17 and 2017/18. Finally, in April 2018, the Board authorized an additional \$3 million per year for the budget period 2018/19 through 2019/20.

To help administer the Recycled Water onsite Retrofit Program, Metropolitan contracted with the Electric & Gas Industries Association (“EGIA”) to manage the processing of consumer applications for rebates. These services included reviewing and processing applications, interactions with consumers to obtain information and documentation, and for processing rebate payments to consumers.

The following table shows the number of applications received, amount paid, and acre feet per year (AFY) that were converted to recycled water as of September 2018.

	No. Of Applications	Amount Paid	AFY
Completed/Paid	323	\$9,204,808	10,788
In-Progress	33	\$1,036,467	1,064
Withdraw/Cancel	172	-	-
Total	528	\$10,241,275	11,852

### **Opinion**

In our opinion, the accounting and administrative procedures over the Retrofit Program 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 February 1, 2014 through July 31, 2018.

### **Comments and Recommendations**

#### REVIEW AND APPROVAL OF INCENTIVE REIMBURSEMENTS

Review and approval controls are designed to verify the accuracy of billings for services, provide assurance as to the propriety of transactions, confirm compliance with contractual terms and conditions, and ensure that follow-up procedures for exceptions exist. The Resource Implementation Section should review expenditures listed on reimbursement requests for propriety and agree them to source documents to ensure the accuracy and completeness of transactions.

Customers submit applications for reimbursement under the Retrofit Program directly to EGIA. EGIA reviews each application to ensure the project is operational, compliant with terms and conditions of the program and that supporting documentation has been submitted. If approved, EGIA submits a reimbursement request, including a summary of charges to be reimbursed along with copies of the documentation, to Metropolitan’s Resource Implementation Group. After review and approval, Metropolitan issues payment to EGIA, who reimburses the customer. Our review of 15 incentive reimbursements disclosed one that resulted in an \$826 overpayment to EGIA. The overpayment occurred because EGIA submitted a duplicate invoice from

McMaster-Carr totaling \$646 and there was a \$180 transposition error on the summary of charges.

Failure to thoroughly review EGIA reimbursement requests could result in financial loss to Metropolitan, non-compliance with Retrofit Program requirements and non-compliance with the contract between Metropolitan and EGIA.

We recommend that Resource Implementation Management establish procedures to ensure that reimbursement requests are reviewed for completeness, accuracy, compliance with the Retrofit Program, and compliance with the agreement between Metropolitan and EGIA. Additionally, we recommend that management request a refund of the \$826 overpayment.

## COMPLIANCE WITH RETROFIT PROGRAM REQUIREMENTS

Compliance with Retrofit Program requirements is necessary to ensure its objectives are achieved and that EGIA and Metropolitan fully discharge the duties and obligations with the contract.

During our review, we conducted site inspections of two Retrofit Program participants. At one of the two sites, we could not locate Recycled/Reclaimed Water tags on the control valve box for which the participant had been reimbursed.

Failure to ensure compliance with Retrofit Program requirements could result in failure to meet objectives and/or financial loss to Metropolitan.

We recommend that management take steps to ensure that program requirements are met and that reimbursed expenses are supported by completed work.

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## Quarterly Consulting and Services Contracts Review Report

We reviewed the reports for consulting and routine services contracts for the period ending June 30, 2018 issued by the Chief Administrative Office. This review included the Annual Report of Professional Services Agreements (Professional Services Report) for Fiscal Year 2017/18 and the Report of Contracts for Equipment, Materials, Supplies, and Routine Services of \$250,000 or Above (Contracts Report) for the Fourth Quarter of Fiscal Year 2017/18. The purpose of this review is to gain reasonable assurance that information included in these reports is accurate, complete, and in compliance with the Metropolitan Water District Administrative Code.

### PROFESSIONAL SERVICES AGREEMENTS REPORT

#### Scope

Our procedures included a cursory review of the reasonableness of the professional service expenditures and analysis of consultants with multiple active agreements, to determine whether

an agreement was split into smaller contract amounts to circumvent established approval limits. We also evaluated whether statistics in the Professional Services Report were adequately supported, and assessed the timeliness of board reporting.

**Background**

Administrative Code Section 2720(e)(2) requires that the General Manager report to the Organization, Personnel and Technology Committee on the employment of any professional and technical consultant, the extension of any professional and technical consulting agreement, and on the Exercise of Authority under Sections 8121(c) and 8122(h) during the preceding calendar quarter. The Administrative Code also requires the Professional Services Report indicate when a consultant is a former Metropolitan employee. Administrative Code Sections 2721-2723 require the General Counsel, General Auditor and Ethics Officer report quarterly to their respective committee concerning any expert or professional service agreements executed pursuant to their authority under the Administrative Code.

The Professional Services Report is prepared on a quarterly and annual basis to comply with these Administrative Code requirements and identify those contracts administered by the General Manager, General Counsel, General Auditor, and Ethics Officer.

During the fiscal year ending June 2018, the Professional Services Report disclosed that \$64.58 million was paid for consulting and professional services. We compared the amounts expended on professional services during this fiscal year against the prior fiscal year and noted a decrease of \$24.62 million. The Electric & Gas Industries Association Agreement (EGIA) 129415, under the Water Resource Management Group for Metropolitan’s Regional Conservation Rebate Program, totaled \$51.1 million for the prior fiscal year. This agreement was closed and replaced with EGIA agreement 168959, which accounted for 100% of the decrease in expenditures.

It should be noted that totals reported under the General Counsel’s authority exclude payments related to the San Diego County Water Authority litigation, which is accounted for under the Self-Insurance Retention Fund. For fiscal year 2017/18, 57 of 473 agreements were sole-source agreements totaling \$6.3 million. This represents approximately 10 percent of total fiscal year expenditures. In fiscal year 2016/17, 54 of 493 agreements were sole-source agreements totaling \$4.8 million. The increase of, \$1.5 million was primarily due to payments to Suez Treatment Solutions Agreement 127494. For the fiscal year 2017/18 payments to Suez totaled \$1.1 million whereas payments in fiscal year 2016/17 were zero.

We also noted that 122 of 473 agreements were small purchases of less than \$24,999, totaling \$1,175,339 of total fiscal year-to-date expenditures in 2017/18 compared to 123 of 493 agreements totaling \$1,200,217 in fiscal year 2016/17. See tables below for details:

**Fiscal Year 2017/18**

Fiscal Year-to-Date	General Manager	General Counsel	General Auditor	Ethics Officer
Contract Expenditures	\$64,230,671	\$3,204,181	\$324,715	\$22,910

Active Agreements	354	125*	1	3
Terminated Agreements	113	26	2	0

\* Agreements with transactions during the current fiscal year.

Govt. Agencies	RFP	RFQ	Small Purchases	Sole Source
\$530,869.06	\$34,889,927	\$21,627,114	\$1,175,339	\$6,355,047
13	45	236	122	57
1%	54%	33%	2%	10%

Note: The categories do not include General Counsel Expenditures

### **Opinion**

Our review did not reveal any agreements that appeared to be unreasonable or split to override established approval limits. In addition, our review did not reveal any material differences between the reported amounts and supporting documentation. Finally, we noted that the Professional Services Report was issued on September 11, 2018.

### **CONTRACTS FOR EQUIPMENT, MATERIALS, SUPPLIES, AND ROUTINE SERVICES OF \$250,000 OR ABOVE REPORT**

#### **Scope**

Our procedures included a cursory review of the reasonableness of expenditures. We also verified that all contracts of \$250,000 or more for the specified items were included in the Contracts Report and were adequately supported. Further, we reviewed sole-source agreements for justification and approval. Finally, we assessed the timeliness of board reporting.

#### **Background**

Administrative Code Section 2720(b)(2) requires that the General Manager report to the Finance and Insurance Committee on the execution of any contract authorized under Section 8122(g) – Contracts for Equipment, Materials, Supplies and Routine Services. This Administrative Code section states that the General Manager may execute contracts for the purchase of materials, supplies, and other consumable items such as fuels and water treatment chemicals generally identified in the budget regardless of dollar value, provided that sufficient funds are available within the adopted budget for such purchases.

The Contracts Report is prepared on a quarterly basis to report on contracts that comply with these Administrative Code requirements. During the quarter ending June 30, 2018, the Contracts Report disclosed twelve contracts that fit these criteria. We noted the total maximum amount payable for these contracts was \$19.9 million. Nine of these contracts were awarded as a result of competitive bidding and three were sole-source contracts authorized under Administrative Code Section 8140 – Competitive Procurement.

**Opinion**

Our review did not reveal any discrepancies between the contracts and amounts shown in the Contracts Report and supporting documentation. We also noted that policies and procedures for competitive bidding, cooperative agreements and awarding sole source agreements are in place. Finally, we noted that the quarterly report was issued to the board on September 11, 2018.