



THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA

## Report Office of General Auditor

### Internal Audit Report for October 2019

#### Summary

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Three reports were issued during the month:

1. **Quarterly Consulting and Services Contracts Review Report for Period Ending June 30, 2019**
2. **External Affairs - Quigley Simpson Hepplewhite Audit Report**
3. **Bard Water District's Land Management and Seasonal Fallowing Pilot Program (Fallowing Program) Audit Report**

#### Discussion Section

This report highlights the significant activities of the Internal Audit Department during October 2019. 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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### Quarterly Consulting and Services Contracts Review Report for Period Ending June 30, 2019

We reviewed the reports for consulting and routine services contracts for the period ending June 30, 2019, issued by the Chief Administrative Office. This review included the Annual Report of Professional Services Agreements (Professional Services Report) for Fiscal Year 2018/19 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 2018/19. 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

##### 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 to indicate when a consultant is a former Metropolitan employee. Administrative Code Sections 2721-2723 requires 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 2019, the Professional Services Report disclosed that \$69.73 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 an increase of \$5.15 million.

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 2018/19, 67 of 486 agreements were sole-source totaling \$6.4 million. This is 9 percent of total fiscal year-to-date expenditures of \$69.73 million. In fiscal year 2017/18, 57 of 473 agreements were sole-source agreements totaling \$6.4 million.

We also noted that 129 of 486 agreements were small purchases of less than \$74,999, totaling \$1,242,764 of total fiscal year-to-date expenditures in 2018/19 compared to 122 of 473 totaling \$1,175,339 in fiscal year 2017/18.

See tables below for details:

**Fiscal Year 2018/19**

Fiscal Year-to-Date	General Manager	General Counsel	General Auditor	Ethics Officer
Contract Expenditures	\$69,295,797	\$1,847,785	\$417,400	\$15,107
Active Agreements	362	132	1	2
Terminated Agreements	120	12	-	1

\* Agreements with transactions during the current fiscal year.

Govt. Agencies	RFP	RFQ	Small Purchases	Sole Source
1,063,076	35,447,366	25,612,917	1,242,764	6,362,181
13	50	227	129	67
1.52%	50.84%	36.73%	1.78%	9.12%

Note: The categories do not include General Counsel Expenditures

**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
0.82%	54.03%	33.49%	1.82%	9.84%

Note: The categories do not include General Counsel Expenditures

**Testing Procedures Performed**

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.

**Testing results**

Our review did not reveal any agreements that appeared to be unreasonable or split to override established approval limits. Also, our examination 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 10, 2019.

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

### **Background**

Administrative Code Section 2720(e)(2) requires that the General Manager report to the Organization, Personnel and Technology 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, 2019, the Contracts Report disclosed nineteen contracts that fit these criteria. We noted the total maximum amount payable for these contracts was \$27.5 million. Eleven of these contracts were awarded as a result of competitive bidding, three were cooperative agreements, and five were sole-source contracts authorized under Administrative Code Section 8140 – Competitive Procurement.

### **Testing Procedures Performed**

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.

### **Testing results**

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 10, 2019.

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## **External Affairs - Quigley Simpson Hepplewhite Audit Report**

The Audit Department has completed a review of the accounting and administrative controls over External Affairs - Quigley Simpson Hepplewhite 177668(Quigley) as of March 31, 2019.

### **Scope**

Our review consisted of evaluating the accounting and administrative controls over the consultant selection process, agreement administration, management reporting practices, and

compliance with terms and conditions of the agreement. Furthermore, we evaluated the validity and accuracy of invoice payments and reviewed source documentation and financial records for completeness and propriety.

### **Background**

Metropolitan's External Affairs Group conducts outreach efforts to educate the public on water issues and to raise awareness of conservation efforts throughout its service area. These efforts include the strategic use of media campaigns, including targeted efforts of specific socio-economic and ethnic groups. Towards this goal, in November 2017, External Affairs obtained authorization from the Board to initiate a request for proposals for a consultant contract for a three-year, multimedia water conservation campaign. Accordingly, staff issued RFP 1171 for Water Awareness and Conservation Advertising Services campaign. After narrowing the selection to four finalist agencies, staff recommended Metropolitan enter into a three-year agreement with Quigley-Simpson & Hepplewhite, Inc. The Board approved this action, and in April 2018, Management signed a three-year agreement not to exceed \$14.7 million.

The scope of the agreement is to provide water awareness and conservation campaign advertising services. Specifically, the contract requires Quigley-Simpson to provide creative development and outreach planning, including advertising services for a regional advertising campaign. The campaign focuses on motivating behavioral changes and providing practical advice for consumers to drive down water use. By November 2018, the campaign reached over one billion media impressions, including television, radio, newspaper, and billboard advertising. Coverage included six counties within MWD's service area and provided exposure to audiences in six languages. As of the end of March 2019, Metropolitan has paid \$4.5 million.

### **Opinion**

In our opinion, the accounting and administrative procedures over Quigley include those practices usually necessary to provide for a generally satisfactory internal control structure. The degree of compliance with such policies and procedures provided for effective control for the period March 13, 2018, to March 31, 2019.

### **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, and ensure that follow-up procedures exist for exception processing. The reviewer and approver should review invoiced items for propriety and agree them to source documentation for accuracy.

- We selected seven invoices with labor charges and verified them against timesheets obtained from consultants. We could not trace labor charges to the timesheets in 4 of 7 (57%) of invoices tested.

- We selected 14 invoices with media buys and matched to proof of performance of the time, period, location, and demographic for the advertising performed. During our testing, we were unable to locate “proof of performance” for 3 of 14 invoices tested.

Lack of adequate documentation in support of billed invoices could result in a loss if improper charges were billed to Metropolitan. Lack of evidence in support of media buys and performance metrics could result in incorrect billings and could adversely affect the success of the advertising campaign.

We recommend management remind employees of the importance of compliance with established review procedures and conduct periodic reviews to ensure compliance. Also, we recommend management reinforce procedures that verify the accuracy and propriety of media buys and conduct reviews to ensure compliance.

#### DEFINITION OF RESPONSIBILITIES

The responsibility for establishing and maintaining an adequate internal control structure is that of management. In fulfilling this responsibility, management must exercise due care in assigning levels of authority and in delegating duties and responsibilities. In managing professional service contracts, prudent business practices dictate that the terms and conditions of agreements should be specific as to time/cost expectations and deliverables. These needs are particularly poignant when increased reliance is on external service providers, which render day-to-day control impractical.

During our review, we noted that the terms and conditions of the advertising contract are silent as to the consideration of credits, rebates, benefits, or incentives which may accrue from media companies. That is, consideration of value-added benefits from media entities, whether, in the form of opaque markups, kickbacks, or undisclosed rebates, should be made transparent by the terms of the engagement.

While it is important to note that our review did not reveal undisclosed cost/rebate elements, we believe that contract language should address these considerations. Specifically, we recommend that management define and address agency incentive practices with vendors and specify the District’s expectations regarding the treatment of any such funds. Moreover, we recommend that similar language surrounding protocols for potential conflicts with contractor partners is also advisable. We understand management is in the process of amending the agreement. These amendments will prohibit the consultant from accepting value-added benefits such as rebates from media entities except in cases where those benefits are applied directly to extend or expand advertising and outreach services under this contract and as first approved by Metropolitan.

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## **Bard Water District’s Land Management and Seasonal Fallowing Pilot Program (Fallowing Program) Audit Report**

The Audit Department has completed a review of the accounting and administrative controls over the Bard Water District Land Management and Seasonal Fallowing Pilot Program

(Following Program) as of December 31, 2018.

### **Scope**

Our review consisted of evaluating the accounting and administrative program controls to ensure adequacy, completeness, and compliance with the program and fallowing agreements, as well as Metropolitan's policies and procedures. We also evaluated the propriety and accuracy of payments to the farmers and the Bard Water District (BWD). Additionally, we reviewed the recordkeeping and reporting processes of the Fallowing Program to ensure accurate and complete accounting and reporting of program activities.

### **Background**

In January 2016, Metropolitan and BWD implemented a two-year Fallowing Program. The Fallowing Program's goals were to evaluate water savings during spring and summer months, determine farmer interest, and explore the feasibility of a long-term seasonal fallowing program for Bard Unit's farmlands within BWD. The Bard Unit, operated and maintained by BWD on behalf of the United States Bureau of Reclamation (USBR), consists of 6,400 irrigable acres and is one of two units in the Reservation Division of the Yuma Project. The second unit is the Indian Unit, with 6,100 irrigable acres. The Yuma Project is a USBR project built to irrigate over 68,000 acres of land at Bard and Winterhaven in California and Yuma, Somerton, and Gadsden in Arizona.

Metropolitan entered into annual fallowing agreements with four Bard Unit farmers over two consecutive years and entered into a two-year program agreement with BWD. These agreements had effective dates between January 2016 and December 2017. Under the fallowing agreements, Metropolitan provided a financial incentive of \$300 per acre to the farmers for fallowing their land. In exchange for the funds provided, each farmer agreed to fallow at least ten contiguous acres of its land for a specified period in 2016, 2017, or in both years. The agreement also allowed Metropolitan to enter the fallowed acres for purposes of monitoring and enforcing contract compliance.

Under the program agreement, Metropolitan provided a financial incentive of \$100 per acre to BWD for system costs and improvements. Also, Metropolitan reimbursed BWD for administrative costs and reduced water revenues up to a maximum of \$200,000. In return, BWD administered the sign-up of farmers, developed monthly data on water delivered to farmers and, notified Metropolitan of any violation of the fallowing agreements (i.e., irrigation of fallowed acres).

In 2016, the fallowing of farmlands at BWD's Bard Unit occurred between March and July. In 2017, there were two fallowing periods: March through July and April to August. In 2016, 509 acres were fallowed, with that number increasing to 1,641 acres in 2017. The two-year program resulted in a total water savings of 3,261 acre-feet. Metropolitan has paid approximately \$1.1 million to Bard farmers and BWD through December 31, 2018.

## **Opinion**

In our opinion, the accounting and administrative procedures over the Fallowing 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 January 1, 2016, through December 31, 2018.

## **Comments and Recommendations**

### COMPLIANCE WITH TERMS AND CONDITIONS OF AGREEMENT

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

### *Fallowed Land Agreements*

#### **Agricultural Production**

1. The Bard Water District Land Management and Seasonal Fallowing Pilot Program (Fallowing Program) stipulated acres considered for fallowing participation in 2016 and 2017 needed to be in agricultural production during the period from March through July or April through August, in both 2014 and 2015.

We reviewed 20 parcels fallowed in 2016 and 2017 for validation of agricultural production for the indicated periods in 2014 and 2015. We noted that 15 of the 20 parcels in 2014, and 16 of the 20 parcels in 2015, were not in agricultural production during the entirety of the indicated period.

Further review revealed that the agricultural production assessment was based upon whether there were recorded water deliveries to these parcels during a given month. That is, these properties were in agricultural production during at least one of the months during the specified period.

#### **Bard Water District**

2. Contract terms and conditions provide for compensation to the Bard Water District for each acre fallowed that are intended to reimburse Bard for system costs incurred in the delivery of water and for system enhancements to improve deliveries. However, the agreement did not include provisions for BWD to provide documentation supporting the use of the funds.

Failure to properly understand and comply with the terms and conditions of approved programs and executed agreements could result in a misunderstanding of actual program outcomes, missed opportunities to enhance program structure, as well as a financial loss to Metropolitan.

We recommend that Program Management ensure all communications, agreements, and actions related to a program are clearly and consistently understood and executed.

### ***Water Use Reports***

3. Metropolitan staff manually prepares water use reports based on the monthly water statements from BWD in order to analyze the water use in BWD's farmlands prior to program implementation. We understand that this is the result of the fact that water use reports generated from BWD's water order system prior to and during the program have not been provided.

Lack of system generated water use reports results in inefficient use of staff resources in the completion of program tasks, and may not accurately reflect the results of the pilot program.

We recommend that Program Management specify in the agreement the reports required from BWD to ensure efficient use of program staff resources.

## **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.

### ***Audit Clause***

1. The program and following agreements with BWD and the farmers did not contain an audit clause. The audit clause provides Metropolitan the right to audit BWD's and farmers' invoices and all supporting documentation during the agreements' effective dates and within three years following the agreement expiration.

We recommend the inclusion of an audit clause in future following program agreements.

### ***Recording of Payments***

2. Payments paid to BWD and the farmers for following their lands were recorded to general ledger O&M account 45550 "Contract Payments." The recording of these fees is inconsistent with other following program (i.e., PVID) where compensation paid to the landowners were recorded to account 41000 "Cost of Water and Power."

Failure to record payments made to BWD and the farmers consistent with other like programs could result in a misstatement of program costs and inaccurate reporting.

We recommend that Program Management coordinate with the Controller's Office to ensure consistent accounting of payments under following programs.

***Procedures Manual***

3. Formal documentation of the policies and procedures supporting the following program has not occurred, including the inspection and verification of fallowed lands by project management in years prior to and during the program. Program administrators have compiled various documents such as program information, board letters, program and farmer's agreements, communications between BWD and the farmers to utilize as a resource.

Lack of a procedures manual that reflects current practices may result in inconsistent performance of daily activities and preclude adequate training and guidance for new employees.

We recommend that Project Management develop a formal procedures manual to reflect current practices and processes.