



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Report
Office of General Auditor

Internal Audit Report for February 2020

Summary

One report was issued during the month:

Metropolitan's Leased Lands-Palo Verde Irrigation District (PVID) Forbearance and Fallowing Program Audit Report

Discussion Section

This report highlights the significant activities of the Internal Audit Department during February 2020. 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.

Metropolitan's Leased Lands-Palo Verde Irrigation District (PVID) Forbearance and Fallowing Program

The Audit Department has completed a review of the accounting and administrative controls over Metropolitan's Leased Lands-Palo Verde Irrigation District (PVID) Forbearance and Fallowing Program as of December 31, 2018.

Scope

Our review consisted of evaluating the Program's accounting and administrative controls over the fallowing process for Metropolitan's leased lands in the PVID area to ensure they are adequate, complete, and comply with the tenant farm leases and the PVID forbearance and fallowing program agreement, as well as Metropolitan's policies and procedures. We also evaluated the propriety and accuracy of rent and water toll reimbursements to the lessees.

Background

As a means to develop a flexible water supply of up to 125,000 acre-feet per year, in 2004, Metropolitan entered into a 35-year forbearance and fallowing program with PVID called the PVID Forbearance and Fallowing Program (Program) with the focus on non-irrigation of qualified farmlands in the Palo Verde Valley area. Under this Program and at Metropolitan's request, participating landowners agree not to irrigate their qualified land, and PVID authorizes the diversion of saved Colorado River water to Metropolitan. In return, Metropolitan makes payments to participating landowners for encumbering and fallowing their land and to compensate PVID for related administrative costs.

Metropolitan presently owns approximately 29,180 acres of land (21,092 water toll acres) within the Palo Verde Irrigation District (PVID), having added the acquisition of land from Verbena LLC in 2015 to the land purchased in 2001 from San Diego Gas & Electric Co (SDG&E), making Metropolitan the largest landowner in the region. By owning land in the Palo Verde Valley area, Metropolitan's participation in the Program is as a participating landowner governed by and in accord with the provisions of the Program agreement and the provisions of the landowner agreement other than those provisions relating to Program encumbered land and payments to participating landowners.

Of the 29,180 owned acres, approximately 18,100 acres (approximately 16,800 water toll acres) are leased to four agricultural tenants. For the SDG&E acquired property, the current leases with these tenants are effective from January 2017 to December 2026 and have annual rent paid at \$175 per water toll acre with an increase to \$193 commencing January 1, 2022. For the Verbena LLC acquired property, the current leases are effective from January 2017 to December 2021 or December 2026 and have annual rent paid at \$150 per water toll acre with a 2% increase per year beginning on January 1, 2018.

The leases with the tenants allow Metropolitan to call for fallowing of up to 50 percent of the land under the Program. During a fallowing call, Metropolitan reimburses tenants the prorated rent of up to the agreed-upon rate per irrigated acre (currently \$150 or \$175) and a water toll of up to \$80 per irrigated acre. The leases also allow Metropolitan to require the tenants to implement a broad range of conservation and specified farming measures, such as irrigation efficiency, crop selection, crop stressing, and use of bio-solids. Metropolitan estimates that at a maximum fallowing call, the conserved water savings from these lease lands would be 33,000 acre-feet.

From July 1, 2013, to December 31, 2018, Metropolitan reimbursed \$5.1 million to lessees for the rent and water tolls paid on the fallowed acres.

Opinion

In our opinion, the accounting and administrative procedures over Metropolitan's Leased Lands-PVID Forbearance and 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, 2013, through December 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.

We reviewed the Program's procedures manual and the tracking and monitoring spreadsheet for water stored at Lake Mead and noted the following:

1. The PVID Procedures Manual was last modified in May 2006, as such
 - Changes in organizational structure, staff assignments, and related responsibilities were not reflected in the manual.
 - The procedures and staff responsible for issuing following calls to lessees of Metropolitan's owned lands and the calculation and processing of lessees' rent and water toll reimbursements were not identified.
 - The nature and extent of inspecting and verifying fallowed lands (Metropolitan's or other landowners' owned) were not specified in detail. We understand that Metropolitan's and PVID's staff conduct periodic physical inspections of randomly selected fallowed lands utilizing geographic information system (GIS) and aerial imagery through Google search to verify if such lands were fallowed.
 - Policy establishing how to account for withdrawals that occur in the annual end of year balance for PVID's intentionally created surplus (ICS) stored at Lake Mead (179,024 and 67,643 acre-feet through December 31, 2017, and 2016, respectively) is not addressed. The end of year balance is used to establish the remaining deferred costs (annual fees paid to PVID landowners) that should be recorded in the general ledger asset account 13119 "Deferred Land Fallowing Operating Costs" at the end of each fiscal year. Any expired or unexpired deferred costs are added or deducted from the operating cost account 41000 "Cost of Water and Power."
2. Based upon review of the tracking and monitoring spreadsheet "Disposition of Fallowing Savings from the Metropolitan-Palo Verde Irrigation District Fallowing Program" through June 30, 2018, we noted that although the spreadsheet reflected the correct end of year balance for water stored in Lake Mead each year, the spreadsheet did not reflect the activity (upward adjustment of 62,999 acre-feet) to mathematically derive the end of year balance in 2016. The spreadsheet is used to track the PVID's ICS end of year balance at Lake Mead, including the annual water savings from fallowing, water deliveries to the service area, system benefit assessment, evaporation loss, and Metropolitan diversion.

We recommend that Program Management update the procedures manual and incorporate the current practices for fallowing Metropolitan's leased lands. We also recommend that Program Management coordinates with WRM's assigned staff to update the spreadsheet "Disposition of Fallowing Savings from the Metropolitan-Palo Verde Irrigation District Fallowing Program" to ensure data completeness.

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, 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.

Untimely Submission of Invoices

In analyzing 15 reimbursement invoices for rent and water tolls for acres fallowed, we noted that all 15 invoices were submitted to accounts payable for processing from three days prior to up to 90 days after the established contractual due date, resulting in a late payment to the lessee in 14 instances. The farm lease agreement requires the lessee to invoice Metropolitan within 30 days following the commencement date of the fallowing, and on or before February 1 of each subsequent year of that fallowing call.

We recommend that WRM Program Management implement a process to ensure timely submission to accounts payable of reimbursement invoices.