

WATER REPLENISHMENT DISTRICT OF SOUTHERN CALIFORNIA

Although the District Has Addressed Many of Our Previous Concerns, Problems Still Exist

REPORT NUMBER 2002-016, JUNE 2004

Water Replenishment District of Southern California response as of June 2005

Audit Highlights . . .

Although it has implemented many recommendations of our May 2002 report, the Water Replenishment District of Southern California (district) has not fully addressed all our concerns. Specifically, our review revealed that the district:

- Adopted a reserve-funds policy that calls for increasing its reserve funds, but since adopting the policy, the district allowed its reserve funds to further deplete.*
- Likely overstated its reserve-funds targets by using some faulty assumptions in calculating them.*
- Included goals and objectives in its strategic plan, but did not include outcomes by which the district and public can measure the district's progress in meeting them.*
- Spent district funds on items such as gifts and flowers that its policies specifically prohibit.*
- Incurred costs for items such as award dinners, and food and beverages for meetings that do not appear to be the most prudent use of its funds.*

The voters of Los Angeles County established the Water Replenishment District of Southern California (district) in 1959 to counteract the effects of overpumping groundwater from the West Coast and Central basins (basins). The California Water Code (water code) grants the district broad powers to do what is necessary to replenish and maintain the integrity of the basins. In December 1999, the Bureau of State Audits (bureau) issued a report concluding that the district's poor management had led to its charging an excessively high replenishment assessment rate (assessment rate) to entities who pump groundwater. Because that report raised significant issues, the Legislature amended the water code to ensure that the district implemented the bureau's recommendations. The Legislature also directed the bureau to perform a second audit. In May 2002 the bureau issued a report concluding that since 1999 the district had eliminated excessive water rates and it had depleted its reserve funds to a level that threatened its ability to maintain the current quantity of groundwater in its basins because it lacked a long-term vision of its finances.¹ We also concluded that the district had not adequately planned for its capital improvement projects nor implemented adequate accounting and administrative controls over its operating expenses. The Legislature amended the water code again in 2002 and required the bureau to perform this follow-up audit of the district's operations and management.

¹ In this report, the term *reserve funds* refers to the district's current net assets, or current assets less its current liabilities, that are not legally restricted.

Finding #1: The district's reserve-funds policy lacks credibility.

In March 2003, to ensure adequate funds to meet its statutory responsibilities, the district adopted a policy that targets a minimum of \$18.4 million and a maximum of \$28.9 million in reserve funds. However, the policy lacks credibility largely because the district has since allowed its reserve funds to diminish even further. Having established a low assessment rate for fiscal year 2003–04, the district projects its reserve funds will fall to \$3.5 million by June 30, 2004, less than the maximum that the water code currently allows and a fraction of the district's targets. Also, the district has likely overstated these reserve-funds targets by using some faulty assumptions in calculating them. Moreover, to fully implement its reserve-funds policy, the district would need a statutory change to increase its reserves from the current limit—a change that the district is not currently seeking. Without a sound reserve-funds policy, the district cannot ensure that it has an adequate amount of reserves to continue to meet its responsibilities.

To ensure that the district has sufficient funds to meet its statutory responsibilities and to show its commitment to its reserve-funds policy, we recommended that the district set its assessment rate at a level that will support the district's planned activities and allow it to replenish its reserve funds, if necessary, and keep them at an appropriate level. We also recommended that the district reevaluate the assumptions that underlie the amount it targets to have available as reserve funds and, if necessary, seek legislative approval to revise the amount allowed as reserve funds.

District's Action: Partial corrective action taken.

The district stated that during its annual budget process for fiscal year 2005–06, it set its assessment rate at \$134.66 per acre-foot of water, which it reports is adequate to keep its reserve fund at an appropriate level. The district also told us that it is continuing to reevaluate its reserve-funds policy and will pursue legislation for reserves over \$10 million if required to meet its needs.

Finding #2: Some key information is missing from the district's strategic and capital improvement plans.

Both our earlier audits highlighted the district's lack of up-to-date strategic and capital improvement plans and recommended that the district develop them. Although the district has developed strategic and capital improvement plans, both need refinement. The district's strategic plan includes goals and objectives but lacks outcomes by which to measure the district's progress in meeting them. In its capital improvement plan—which should prioritize capital improvement projects—the district specifies its funding needs and scheduling of proposed projects as recommended, but does not identify those projects the district believes it should complete first, possible funding sources available for each project other than issuing bonds, and the projects the district's board of directors (board) has formally approved.

To ensure that the district and the public can assess the district's progress in achieving the goals and objectives described in its strategic plan, the district should refine its plan to include measurable outcomes.

To make its capital improvement plan more informative to the district and its ratepayers, the district should consider doing the following when it updates its capital improvement plan:

- Rank projects by their importance to identify the projects it believes it should complete first to meet its statutory requirements.
- Include alternative sources of funding for the projects in addition to issuing bonds.
- Distinguish between board-approved projects and proposed projects.

District's Action: Partial corrective action taken.

The district reported that it is planning to evaluate its capital improvement plan with respect to scheduling the existing projects and adding new projects, and, at that time, it plans to incorporate measurable outcomes in its strategic plan. Additionally, the district indicated it has included in its capital improvement plan a ranking of projects and an indication of which projects the board has approved. The district also stated that it continues to seek alternative sources of funding and has put into place a process to discuss this funding with the technical advisory committee. Further, it plans to include any alternative sources of funding in its capital outlay schedule.

Finding #3: The technical advisory committee's evaluation of capital improvement projects is incomplete.

The Legislature created a technical advisory committee (committee) comprising representatives of the ratepayers to review the district's proposed capital improvement projects and provide recommendations to the board. The committee has worked with the district to develop a process to review and approve capital projects and to periodically update the capital improvement plan. Recently, the committee completed its initial review of 11 projects, nine of which the district included in its final capital improvement plan, but the district has not yet had an opportunity to implement the committee's updating procedure. The statute mandating the committee will sunset on January 1, 2005. However, according to the district's general manager, the district intends to revise its administrative code to ensure that the committee remains a part of its process for reviewing and approving its capital improvement projects. If the district does not revise its administrative code and the statute sunsets, the ratepayers may lose important opportunities to provide input to the district on future capital projects and during the district's process for periodically updating the capital improvement plan.

To ensure that the district continues to collaborate with ratepayers on projects, we recommended that the district pursue its plan to revise its administrative code to make the technical advisory committee part of its process for reviewing and approving capital improvement projects. If the district fails to implement this recommendation, the Legislature should consider extending the committee at least until the committee has had the opportunity to participate in the process of periodically updating the district's capital improvement plan.

District's Action: Corrective action taken.

The district's board passed a resolution in May 2004 to extend the existence of the technical advisory committee for the purpose of evaluating projects proposed by the district.

Finding #4: The district has established purchasing procedures but has not adequately enforced them.

The district amended its administrative code in January 2003 to provide better guidance to staff on allowable and unallowable expenses. However, because the district does not always follow its policies, it incurs costs that may not further its public purpose. We reviewed 57 district payments to employees and vendors and found that, in violation of its own code, the district has purchased gifts and paid for questionable telephone expenses.

Specifically, although the district's administrative code clearly states that neither employees nor the district's board should obligate the district for any unallowable expenses, such as gifts, our sample of 40 vendor payments during 2003 showed that for three of these payments, the district spent a total of \$194 on flowers and gifts for a director and a person who was not an employee. Moreover, the district's administrative code provides a \$200 monthly communications allowance for directors. According to the administrative code, the communications allowance covers equipment and services such as cellular phones, cellular service, and fax machines. It also states that directors are to use this allowance in lieu of payment or reimbursement for any telephone calls, Internet fees, or similar expenditures. Nevertheless, the district reimbursed or paid \$921 in 2003 for telephone calls directors made when they were traveling on district business, even though these directors also received the \$200 monthly communications allowance.

Finally, in our 2002 report we noted that the district lacked written accounting procedures to govern cash disbursements and purchasing. Although the district has since adopted procedures, it does not follow them consistently, thereby diminishing their value. Specifically, during our review of 57 of the district's payments, the district did not appropriately approve eight of the payments.

We recommended that the district reaffirm its commitment to following the policies in its administrative code, and ensure that its directors and staff abide by its policies, especially policies defining unallowable purchases such as gifts, use of the communications allowance, and obtaining appropriate approvals.

District's Action: Corrective action taken.

The district reported that it has reaffirmed its commitment to following the policies in its administrative code by distributing copies of the administrative code that relate to unallowable purchases, reminding directors and staff of the district's policies and its commitment to them. The district also reported that its finance committee is reviewing the existing policy and will make a recommendation to the board if further action is needed.

Finding #5: The district's administrative code could provide better guidance on reimbursements.

As we mentioned in our 1999 and 2002 audit reports, the district's accounting policies do not require staff to match approved travel documents to expense claims filed by board members or district staff. Adding this requirement to the process of reviewing expense claims is a simple control to ensure that the district pays only for authorized travel and does not duplicate payments. However, the district never addressed our concerns by revising its accounting policies or its administrative code. Absent an adequate review policy, the district reimbursed one director twice for a \$550 conference registration fee, as we observed in our sample of 17 employee reimbursements.

Moreover, to ensure that out-of-pocket expenses are business related or benefit its public purpose, the district developed a business expense form for board members and staff to use when requesting any reimbursement for this type of expense. Although the district's finance committee requested that board members use the form, we found that the directors do not consistently do so. Three of the 17 reimbursements we reviewed related to this issue, and in all three cases, the directors did not complete the expense form for reimbursements totaling \$503, including \$148 for local meals and meetings between two directors or a director and staff. Without these expense forms, the district cannot be sure it has benefited from costs it reimburses.

We recommended that the district update its accounting procedures to require staff to match travel expenses to approved travel documents. Additionally, we recommended that the district amend its administrative code to require board members and staff to consistently use the business expense form to document the public purpose of any out-of-pocket expenses.

District's Action: Corrective action taken.

The district has updated its accounting procedures to require staff to match travel expenses to approved travel documents. The district also reported that it revised its administrative code in December 2004 to require board members and staff to submit expense claims on forms supplied by the district and that these forms will include a description of the business purpose of the expense.

Finding #6: The district has incurred costs that may not be the most prudent use of its funds.

During our review of the district's administrative costs, we identified various expenses that may not be the most prudent use of the district's public funds, especially given the district's decreasing reserve funds and its desire to maintain a low replenishment assessment rate. In reviewing the district's 2003 administrative payments, we found the district spent about \$1.19 million on legal services, more than \$17,500 for catered meals and other snacks and beverages for its staff, \$2,250 for award dinners and more than \$23,000 to send one director to 17 conferences. By modifying its administrative policies to limit or prohibit certain purchases, the district could better control its administrative costs.

To ensure that it uses public funds prudently, we recommended the district take the following steps:

- Perform a detailed review of the reasonableness of its costs for contracted legal services, and consider whether hiring an in-house lawyer is more cost-effective.
- Reassess its use of public funds for such purposes as award dinners, catered meals, high-cost airfares, and lodging for local conferences, and revise its administrative code to limit or prohibit such costs.
- Amend its administrative code to provide better guidance on reimbursable travel expenses, including a limit on the number of conferences directors and staff may attend, and a process for justifying exceptions to that limit.

District's Action: Partial corrective action taken.

The district reported that it has reviewed the reasonableness of its costs for contracted legal services and that, in an effort to better manage legal fees, it has established limits of authority to improve internal controls over contacting district counsel.

Further, the district reported that it has reassessed its use of public funds for purposes such as award dinners, catered meals, high-cost airfares, and lodging for local conferences and has reaffirmed its commitment to following its policies. However, according to the district, its board found that the administrative code appropriately



addresses the state auditor's issues and concluded that no further revisions to the administrative code were necessary. Because the administrative code does not limit or prohibit certain purchases that may not be the most prudent use of its funds, we do not agree with the district that the administrative code addresses our concerns.

Finally, the district reported that in March 2005, the board adopted a resolution that sets an annual travel budget for each director.

Finding #7: The district has improved its contract management practices but can improve in one area.

Although the district made some improvements to its contract management practices, the district needs to make an additional refinement to ensure that it pays only for services it actually receives. The district entered into agreements with four legislative advocacy firms for fixed monthly fees of up to \$10,000 per month, but did not require the consultants to submit written, detailed monthly activity reports to enable the district to evaluate whether the value received was consistent with the fees paid. According to the general manager, its legislative advocacy firms routinely report to the general manager and external affairs staff, often several times a week, on activities they undertake for the district or on developments that affect the district. With this constant communication, the general manager believes the district can make informed decisions to terminate or renew these contracts based on performance. Also, an appropriate staff member approves the invoice before the district pays the firm for its services. Although the district's discussions with these contractors and its approval of the invoices are forms of contract management, these procedures do not provide assurance to those who may scrutinize the district's expenses that the district received services to justify payments in excess of \$272,000 during 2003.

To ensure that it appropriately manages its contracts for professional services, we recommended that the district require contractors to submit detailed, written monthly activity reports for professional services at fixed monthly fees.

District's Action: Corrective action taken.

The district adopted a procedure that requires contractors to submit written monthly activity reports for professional services that contractors provide at fixed monthly fees.

