

Metropolitan Water District of Southern California:

*Its Administrative Controls Need to Be
Improved to Ensure an Appropriate Level of
Checks and Balances Over Public Resources*



June 2004
2003-136

The first five copies of each California State Auditor report are free.
Additional copies are \$3 each, payable by check or money order.
You can obtain reports by contacting the Bureau of State Audits
at the following address:

**California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814
(916) 445-0255 or TTY (916) 445-0033**

OR

**This report is also available
on the World Wide Web
<http://www.bsa.ca.gov/bsa/>**

The California State Auditor is pleased to announce
the availability of an on-line subscription service.
For information on how to subscribe, please contact
the Information Technology Unit at (916) 445-0255, ext. 456,
or visit our Web site at www.bsa.ca.gov/bsa

Alternate format reports available upon request.

Permission is granted to reproduce reports.



CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

June 3, 2004

2003-136

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the Metropolitan Water District of Southern California (district) and its administrative controls for ensuring an appropriate level of checks and balances over public resources.

This report concludes that the district's broad interpretation of the purposes for which it can spend public funds has led to policies governing expenses that generally are not well-defined and do not always ensure that expenses have a direct link to the district's authorized purposes. For example, the district financially sponsors numerous organizations' activities without justifying the direct link to the purposes for which the district was created. Additionally, more than four years after the enactment of legislation that directed it to create an ethics office, the district still is trying to establish an effective one. Further, the district has not always established adequate policies and procedures for its purchasing and consulting contracts, and its personnel policies for hiring and promoting employees are not always current or comprehensive. Finally, the district created the entity now known as the Center for Water Education (center) to establish a water education facility and museum. The center currently depends primarily upon the district for funding and the provision of certain services. Nonetheless, the center's long-term goal is to reduce its reliance on funding from the district. Now that the center is becoming more active, it needs to establish policies and procedures for its contracting activities to ensure that it obtains the best value for the dollars it spends.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

CONTENTS

<i>Summary</i>	1
<i>Introduction</i>	5
<i>Chapter 1</i>	
The District Does Not Always Ensure That It Uses Public Resources to Further Its Authorized Purposes or in a Way That Is Reasonable and Necessary	13
Recommendations	25
<i>Chapter 2</i>	
The District Has Struggled With Its Mandate to Establish an Ethics Office	27
Recommendations	42
<i>Chapter 3</i>	
The District Could Improve Its Controls Over Certain Types of Contracts and Grants	45
Recommendations	55
<i>Chapter 4</i>	
The District's Personnel Policies Are Lacking and Are Not Always Followed	57
Recommendations	67
<i>Chapter 5</i>	
The Center for Water Education Currently Relies Heavily on the District for Funding and Has Yet to Develop Formal Policies and Procedures for Its Contracts	69
Recommendations	76

Response to the Audit

Metropolitan Water District of Southern California 77

***California State Auditor's Comments on the
Response From the Metropolitan Water District of
Southern California***

89

SUMMARY

Audit Highlights . . .

Our review of the Metropolitan Water District of Southern California (district) revealed the following:

- The district's policies governing expenses are generally not well-defined and do not always ensure that expenses have a direct link to the district's authorized purposes.*
 - More than four years after the enactment of Chapter 415, Statutes of 1999 (SB 60), the district still is trying to establish an effective ethics office.*
 - The district has not always established adequate policies and procedures for its purchasing and consulting contracts.*
 - The district's personnel policies for hiring and promoting employees are not always current or comprehensive.*
 - The Center for Water Education, a separate entity created by the district, currently depends primarily upon the district for funding and needs to establish policies and procedures for its contracting activities.*
-

RESULTS IN BRIEF

The Metropolitan Water District of Southern California (district) is a public corporation created under the Metropolitan Water District Act (water act) for the purpose of developing, storing, and distributing water for the district. The district is governed by a 37-member board of directors (board). It is a collection of 26 member public agencies, including 14 cities, 11 municipal water districts, and one county water authority, that provide drinking water to nearly 18 million people in parts of Southern California. In carrying out its functions, the district is considered a public agency and may expend funds and use other resources only to carry out those purposes that are expressly authorized or reasonably implied by the water act.

We believe the district's broad interpretation of the purposes for which it can spend public funds has led to policies governing expenses that generally are not well-defined and do not always ensure that expenses have a direct link to its authorized purposes. For example, the district financially sponsors numerous organizations' activities without justifying the direct link to the purposes for which it was created. In addition, the district's field inspection trips may not be the most cost-effective way to educate the public on its operations. The district also pays for social events such as holiday parties and provides catered meals to executive management and employees. Further, it reimburses board members and executive management for travel expenses without always ensuring that they are reasonable and necessary. We also observed numerous instances where the district leases property to other entities, both public and private, for a nominal amount rather than market value. If such a lease does not serve the district's authorized purposes, it may constitute a gift of public funds in violation of the California Constitution.

Additionally, more than four years after the enactment of Chapter 415, Statutes of 1999 (SB 60), the district still is trying to establish an effective ethics office. It did not hire an ethics officer until more than two years after the effective date of SB 60, and that ethics officer primarily referred complaints to other district offices that cannot demonstrate how these complaints were resolved. Of the employees who responded to our recent survey, 26 percent indicated they are not familiar with the purpose of

the ethics office, and 26 percent indicated the office does not effectively identify, handle, or resolve ethics issues.¹ The district is trying to establish a more structured ethics office, but it is still too soon to determine the success of these efforts.

Another area of concern is the district's contracting process. Although it has established adequate policies and procedures for construction contracts, it has not always done so for its purchasing and consulting contracts. Further, its procedures manuals for consulting and purchasing contracts state that sole-source contracts should be used only in limited situations and require staff to document the justification for not using a competitive process.² The district does not always ensure that this occurs.

The district's personnel policies are not always current or comprehensive and do not always ensure sufficient merit system processes, the basis on which it hires and promotes employees represented by bargaining units. It risks inconsistencies within its merit system and cannot ensure appropriate checks and balances over its hiring and promotion decisions. Further complicating the issue, the district does not always follow the hiring policies it does have, making itself vulnerable to criticism by employees and other interested parties. However, the district is updating its operating policies, including personnel policies.

Finally, the district created the entity now known as the Center for Water Education (center) in October 2001 to establish a water education facility and museum. The center currently depends primarily upon the district for funding and the provision of certain services. Nonetheless, the center's long-term goal is to reduce its reliance on funding from the district. Although law does not prohibit the district from establishing the center as a separate entity, this could raise concern that it was set up this way to circumvent certain laws applicable to the district, such as the Political Reform Act of 1974. Now that the center is becoming more active, it needs to establish policies and procedures for its contracting activities to ensure that it obtains the best value for the dollars it spends.

¹ We sent a survey to 100 employees, 65 of whom responded. Our statistics reflect the responses of the individuals that responded to each question.

² The term *sole-source* is generally used only when referring to the procurement of goods in a noncompetitive manner. However, because the district also describes consulting contracts that were not awarded through a competitive process as sole-source contracts, throughout our report we use the term to refer to both purchasing and consulting contracts that were not awarded competitively.

RECOMMENDATIONS

To ensure that the district expends funds and uses its resources only to carry out its authorized purposes in a reasonable and necessary manner, it should do the following:

- Develop policies that specify limitations on the types of activities it sponsors to ensure that it funds only those organizations whose activities have a direct link to the district's authorized purposes.
- Identify and consider the use of alternative methods for educating the public on its operations that would reach a wider audience and be more cost-effective than field inspection trips.
- Revise its policies to include more specific guidance as to what constitutes a reasonable and necessary use of public funds, including the establishment of restrictions on expenses for parties and catered meals, and ensure that expenses are reasonable and necessary before paying them.
- Grant leases at less than market value only when doing so directly furthers its authorized purposes.

The district should complete the implementation of its new ethics office and ensure that the office complies with the requirements of SB 60.

To strengthen its controls over consulting and purchasing contracts, the district should ensure that it has adequate policies and procedures and that it prepares justifications for contracts that are not awarded competitively.

To ensure consistency and checks and balances, the district should continue its effort to develop comprehensive and up-to-date personnel policies and procedures and ensure that it follows these policies.

Finally, the center should establish formal contracting policies and procedures for all contracts.

AGENCY COMMENTS

The district and the center generally agree with our recommendations and intend to work towards implementing them. ■

Blank page inserted for reproduction purposes only.

INTRODUCTION

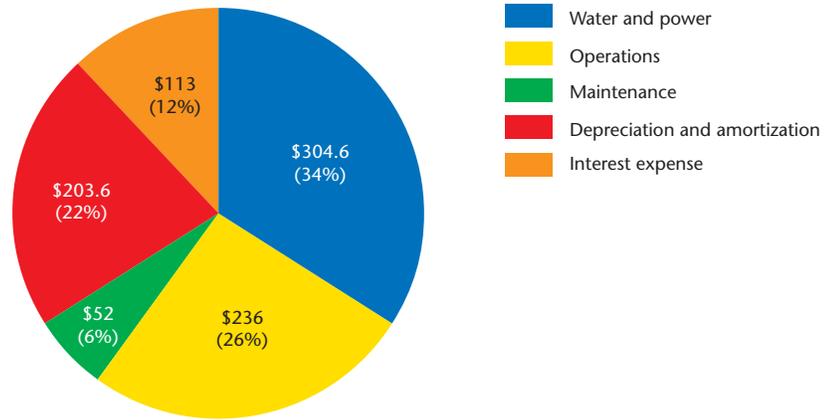
BACKGROUND

The Metropolitan Water District of Southern California (district) is a public corporation organized and created in 1928 under the Metropolitan Water District Act (water act). The water act authorizes creation of the district for the purpose of developing, storing, and distributing water and allows it to provide, generate, and deliver electric power for this purpose. When amending the water act in 1999, the Legislature stated its intent that the district place increased emphasis on sustainable, environmentally sound, and cost-effective water conservation, recycling, and groundwater storage and replenishment measures. The water act empowers the district, among other items, to issue and sell revenue and general obligation bonds; to levy and collect taxes within its territory; to acquire water and other property rights; to perform construction projects and enter into contracts; and to hire employees. In carrying out its functions, the district is considered a public agency and is subject to various restrictions on the use of the public funds in its possession.

The district's mission is to provide its service area with adequate and reliable supplies of high-quality water to meet present and future needs in an environmentally and economically responsible way. It currently delivers an average of 1.7 billion gallons of water per day to a 5,200-square-mile service area in Southern California. The district imports water from two principal sources, the Colorado River and the Edmund G. Brown California Aqueduct, to supplement local water supplies in its service area. In fiscal year 2002–03, the district's expenses totaled \$909.2 million, which were \$71.9 million less than the prior year. In early 2003, the district refinanced general obligation bonds, which it reports will save a total of \$10.96 million, or about \$1.4 million annually, through 2012. Its expenses are primarily water and power, operations, maintenance, depreciation and amortization, and interest. Figure 1 on the following page presents the district's expenses for fiscal year 2002–03.

FIGURE 1

**Metropolitan Water District's Expenses for
Fiscal Year 2002-03
(In Millions)**



Source: Metropolitan Water District audited financial statements for fiscal year 2002-03 and district staff.

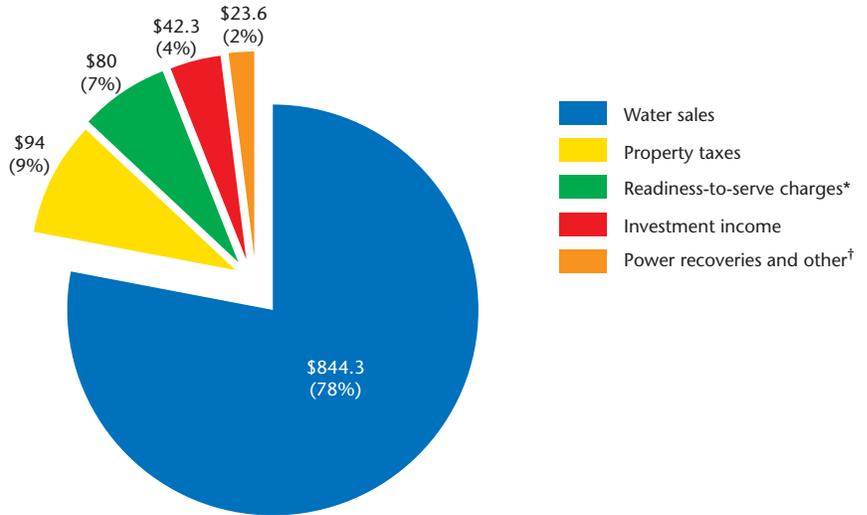
Historically, the district has generated a majority of its revenue from water sales. It receives additional revenue from property taxes, readiness-to-serve charges,³ investment income, and other sources. In fiscal year 2002-03, water sales totaled \$844.3 million and accounted for 78 percent of the district's \$1.08 billion gross revenues. In January 2005, the district will increase water rates by about 4.4 percent, which is expected to generate about \$30 million in additional revenue. According to the district's chief financial officer, the primary cost drivers leading to the need for the rate increase are the cost of water treatment, the cost of power to pump water, and basic operations and maintenance costs. Figure 2 shows the district's sources of revenue for fiscal year 2002-03.

The district is composed of 26 member public agencies: 14 cities, 11 municipal water districts, and one county water authority that provide drinking water to nearly 18 million people. Its member agencies serve residents of more than 300 cities and numerous unincorporated communities. The district's service area includes portions of six counties: Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura. It provides 40 percent to 60 percent of the water used within its service

³ A readiness-to-serve charge is a fixed charge that recovers the cost of holding a portion of the water supply on standby to provide emergency service and operational flexibility.

FIGURE 2

**Metropolitan Water District's Sources of Revenue for
Fiscal Year 2002-03
(In Millions)**



Source: Metropolitan Water District audited financial statements for fiscal year 2002-03.

* Readiness-to-serve charges are fixed charges that recover the cost of holding a portion of the water supply on standby to provide emergency service and operational flexibility.

† Power recoveries are sales of energy generated from operation of the district's hydroelectric generating facilities.

area, with individual member agencies relying on the district to provide 30 percent to 100 percent of their water. Figure 3 on the following page presents the district's service area.

The administration of the district is under the direction of a 37-member board of directors (board) consisting of at least one representative from each member agency. The district's president and chief executive officer, general counsel, general auditor, and ethics officer report to the board. As of January 2004, the district had approximately 1,900 employees. Its four bargaining units represent 98 percent of these employees through established legal agreements that define the terms and conditions of their employment. Figure 4 on page 9 depicts the district's organizational structure.

FIGURE 3

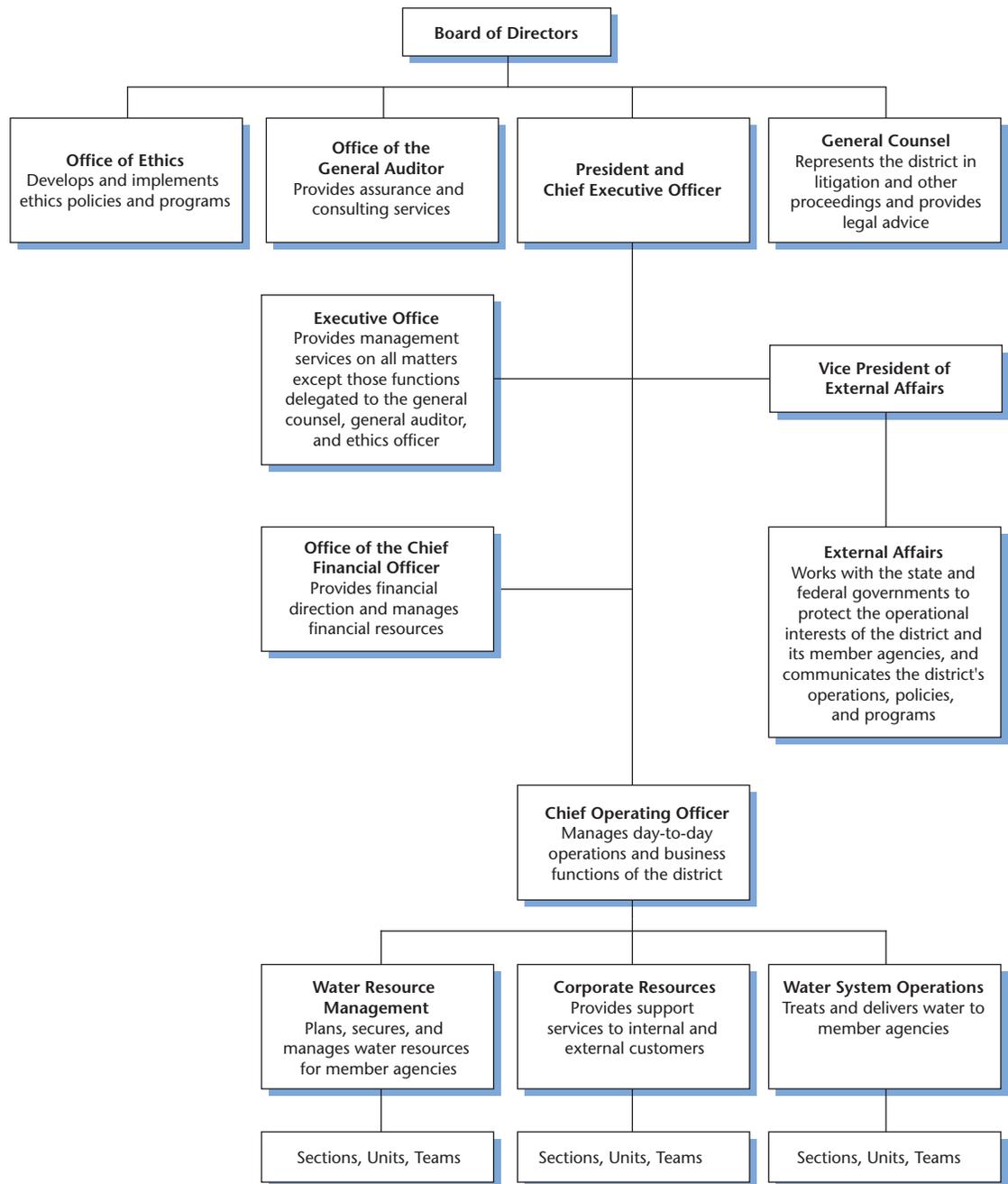
Metropolitan Water District Service Area and Member Agencies



Source: Metropolitan Water District.

FIGURE 4

Metropolitan Water District Organizational Structure



Source: Metropolitan Water District organizational chart and relevant sections of its budget for fiscal year 2003–04.

THE DISTRICT ESTABLISHED A SEPARATE ENTITY TO ENHANCE PUBLIC EDUCATION AND THE UNDERSTANDING OF WATER-RELATED ISSUES

In October 2001, the district's board formed the Foundation for the Southern California Water Education Center, now known as the Center for Water Education (center). It subsequently was incorporated as a nonprofit public-benefit corporation to construct, operate, and maintain a water education facility and museum (facility) and to develop and provide educational, historic, and instructional materials and programs relating to water, water use, water conservation, and water supply. Although the facility is not yet built, the plan is to include meeting rooms and exhibit space intended to enhance public education and to promote the understanding of water-related issues. This facility is to serve as an extension of the district's existing water education program, which reportedly annually reaches 1,000 classrooms and 30,000 K-12 students.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits audit the district and the center. Specifically, the audit committee asked us to evaluate the district's policies and procedures for ensuring an appropriate level of checks and balances over transactions, including its conflict-of-interest policies and employment, promotions, and grievance processes. It also asked us to evaluate the district's ethics office for compliance with the requirements of Chapter 415, Statutes of 1999 (SB 60), and to examine its process for identifying, handling, and resolving ethics complaints or potential ethics violations. In addition, the audit committee asked us to determine the reasonableness of the district's contracting practices. Finally, it requested that we evaluate the activities, purpose, and organization of the center and determine whether it should be recognized as a part of the district or as a separate entity.

To evaluate the district's policies and procedures for ensuring an appropriate level of checks and balances over its transactions, we reviewed relevant laws and district policies and procedures. We also selected transactions from the accounting records of the board and certain departments, such as the office of the chief executive officer and business outreach, to determine compliance

with district policies and relevant laws. We also reviewed district leases for compliance with district policy. Finally, we interviewed various district staff and management.

To determine whether the district has complied with the requirements of SB 60 as they relate to its ethics office, we reviewed SB 60 and interviewed district management. We also interviewed the district's former ethics officer and the current interim ethics officer and reviewed the ethics office complaint log to determine the district's process for identifying, handling, and resolving complaints or potential violations. Further, we conducted a survey of district employees to obtain their opinions regarding the effectiveness of the ethics office and evaluated the reporting structure of the ethics office to determine its appropriateness. Finally, we determined whether the district's conflict-of-interest policies were sufficient to prevent, identify, and resolve conflicts by reviewing relevant policies and interviewing district staff for an understanding of the collection process for statements of economic interest.

To determine if the district has appropriate contracting policies and procedures, we reviewed applicable laws and district policies and procedures. We examined construction, consulting, and purchasing contracts to determine if the district reasonably justified sole-source contracts or sought competitive bidding to ensure that it received the best value. We also interviewed appropriate staff and management to gain an understanding of how the district determines and evaluates the need for a contract, scope of work, and contractor qualifications, and how it monitors contracts and evaluates contractor performance.

As part of our evaluation of its employment processes, the audit committee asked us to review the district's civil service system. Although the water act stated that the board may adopt "a system of civil service," the board chose to create a merit system of employment. According to the general counsel, the district's merit system is similar to civil service. He stated that the merit system has the same employee protections inherent in a civil service system, such as vested property right interests in employment. Additionally, he points out the district's merit system requires job posting and competitive examinations, which are central elements of civil service. However, the general counsel states that the district does not label itself a civil service agency because its system does not have features commonplace in civil service systems throughout California. For instance, the district does not have a civil service commission

with independent jurisdiction to issue regulations and exercise jurisdiction over testing, classification, and discipline issues. Instead, the district's management administers these functions in conjunction with bargaining units.

To determine whether the district's policy and procedures for making hiring, promotion, and grievance decisions within its merit system have an appropriate level of checks and balances, we reviewed applicable policies and procedures and interviewed district staff and executive management. We also reviewed relevant files to examine certain recruitments and hiring decisions for represented and unrepresented employees. We examined personnel files and other documentation to ensure support of promotional decisions, and we reviewed certain grievances to ensure adherence to its policies and procedures. Finally, we interviewed the general counsel and reviewed relevant documentation to gain an understanding of agreements the district enters to settle all issues concerning an employee's separation.

To evaluate the activities, purpose, and organization of the center, we reviewed center contracts and interviewed district management and the center's outside counsel. We also reviewed the district's legal authority to determine whether it had authority to create the center as a separate entity. ■

CHAPTER 1

The District Does Not Always Ensure That It Uses Public Resources to Further Its Authorized Purposes or in a Way That Is Reasonable and Necessary

CHAPTER SUMMARY

The Metropolitan Water District of Southern California (district) may expend funds and use other resources within its possession only to carry out those purposes that are authorized expressly or are reasonably implied by its enabling statute, the Metropolitan Water District Act (water act). The water act authorized the district to be created for the purposes of developing, storing, and distributing water and allowed it to provide, generate, and deliver electric power for this purpose. However, its policies governing expenses generally are not well-defined and at times do not always offer adequate assurance that these expenses have a direct link to the district's authorized purposes. We believe these policies may be lacking specific guidance, in part, because the district has broadly interpreted the purposes for which it can spend district funds. Further, the lack of specificity in its collective policies has allowed the district substantial discretion, resulting in expenses that have a questionable link to the district's authorized purposes and that do not always appear to be reasonable or necessary.

For example, our limited review of operating expenses found that the district financially sponsors numerous organizations' activities without justifying the direct link to the district's purposes or establishing any limits on the types of activities it may sponsor. In addition, the district's field inspection trips may not be the most cost-effective way to educate the public on its operations. The district also pays for social events such as holiday parties and provides catered meals to executive management and employees. Further, we noted questionable travel claims because the district reimburses board members and executive management for travel expenses without always ensuring that these expenses are reasonable and necessary. We question whether these types of expenses represent an appropriate and reasonable use of public funds.

The district also has not established appropriate controls over the use of gasoline credit cards it has issued to certain employees. Finally, we observed numerous instances where the district leases property to other entities, both public and private, for a nominal amount rather than market value, which, if the lease does not serve the district's authorized purposes, may constitute a gift of public funds in violation of the California Constitution.

THE DISTRICT IS LIMITED TO USING PUBLIC FUNDS IN WAYS THAT FURTHER ITS SPECIFIC PURPOSES

In carrying out its functions, the district is considered a public agency and is subject to various restrictions on the use of the public funds within its possession. The district is what is commonly known as a special district. Special districts are "limited-purpose" local governments that deliver specific public services within defined boundaries. The district is limited to carrying out those purposes authorized under the water act and does not possess more general governmental authority, as would the State or counties, which have broad governmental power to undertake activities that affect the general welfare of their citizens. The district must use its public funds in a way that furthers the specific purposes for which it was created rather than to carry out more general governmental purposes. Consequently, the district may expend funds and use other resources within its possession only to carry out the express purposes authorized by the water act or to carry out those powers that are reasonably implied in order to carry out those powers expressly granted by the water act. A power is reasonably implied when it is essential to carry out those powers that the water act expressly grants.

Although the district must use its public funds in a way that furthers the specific purposes for which it was created, it has adopted a broad interpretation of how it can spend its funds.

In addition, the California Constitution, which applies to the district, restricts it from making or authorizing a gift of public money or anything of value to any individual or corporation. If the district does not limit its use of public resources to carrying out its authorized purposes, it may violate the constitutional prohibition against making a gift of public funds.

The district has adopted a broad interpretation of how it can spend its funds. According to the executive vice president, the district is a regional government dependent on the consent of its member agencies to build, maintain, and operate its system, in which water is only the end result of what the district does. Although we recognize that it is a regional government in that

it acts as a regional water agency with broad powers related to carrying out the purposes of such an agency, we question whether some of the district's expenses serve a district-related public purpose, and we question the reasonableness of some of the expenses incurred in performing those functions.

DISTRICT POLICIES DO NOT ALWAYS ENSURE THAT ALL EXPENSES SUPPORT ITS AUTHORIZED PURPOSES

The district's general policy for paying expenses incurred by board members and employees is stated broadly, requiring that payments will be allowed only when such expenses have a significant and meaningful link to its purposes, policies, and interests. The policy points out that only reasonable and necessary expenses will be allowed because public funds are being spent. In addition, the district has established separate policies intended to govern specific types of expenses; however, these policies generally are not well-defined and do not always offer adequate assurance that expenses have a direct link to the district's authorized purposes. And, in the absence of well-defined policies, we observed little evidence that management questioned the propriety of such expenses. For example, the district has sponsored several organizations, both public and private, whose activities do not appear to support the district's authorized purposes because it lacks a clear policy on what types of activities it may sponsor. In addition, the district's policy does not require the district to ensure that guests on field inspection trips are appropriate and relevant. Further, the district has reimbursed its board members and executive managers for expenses that do not appear reasonable or necessary. The district's lack of adequate controls can promote a culture that is contrary to the stewardship imposed on the district as a public agency.

Because it lacks a clear policy on what types of activities it may sponsor, the district has sponsored several organizations whose activities do not appear to support its authorized purposes.

The District Funds Numerous Organizations Without Justifying the Link to Its Authorized Purposes

As mentioned previously, the California Constitution prohibits a public agency such as the district from making a gift of public funds. To avoid violating this prohibition, when the district provides public money or resources to another entity, it must ensure that the money will be used to further the specific public purposes for which the district was created. Because it does not sufficiently ensure that funds given to other entities promote the district's authorized purposes, we question whether it has violated the prohibition against making a gift of public funds.

During fiscal year 2002–03, the district’s external affairs office provided approximately \$464,000 in sponsorships to public and private organizations. According to the vice president of external affairs, these payments primarily represent district sponsorships of other organizations’ events and activities that provide a value or benefit to district affairs from a business, program, or policy perspective. However, when the district sponsors organizations, it does not sufficiently ensure that the payments are for activities that further its authorized purposes.

For example, our limited review of expenses found sponsorships to the Latin Business Association, the National Association of Women Business Owners, the Asian Business Association, and other organizations whose purposes do not appear to directly align with those the district is authorized to carry out. The district paid \$5,000 to purchase a table and place an ad in the event’s program to sponsor the Latin Business Association’s 2003 annual awards gala and another \$5,000 to purchase a table and an ad to sponsor a 2003 legislative action event for the National Association of Women Business Owners. The purpose of the Latin Business Association is to “grow Latino-owned businesses by generating opportunities that impact the bottom line.” The purpose of the National Association of Woman Business Owners is to “empower women entrepreneurs into economic, social, and political spheres of leadership.” Although these may be worthy causes, we question how sponsoring these types of activities has a sufficiently direct link to the district’s authorized purposes to justify the use of district funds.

According to the vice president of external affairs, associations such as those we noted contribute to the district’s interests by allowing it to communicate better with the small-business community. He contends that without these efforts, large, and in many cases out-of-state contractors would have advantages over regional small businesses in learning the processes required to do business with the district. A 2004 report by the Institute for Local Self Government, the nonprofit, nonpartisan research arm of the League of California Cities, points out, however, that special districts have a special burden when it comes to contributing to other organizations. The report states that a special district must demonstrate that the contribution benefits it and must demonstrate that the expense falls within the specifically enumerated powers of that particular type of special district. We acknowledge the district may find merit in promoting good relationships with the small-business community, and we are not questioning its power under the

The Institute for Local Self Government points out that a special district has a special burden when it comes to contributing to other organizations because it must demonstrate that the contribution benefits it and that the expense falls within its specifically enumerated powers.

water act to sponsor various organizations. We are questioning whether certain of these payments have a sufficiently direct connection to these powers.

In another example, the district purchased four tickets totaling \$600, including two tickets for spouses of district employees, for the Asian Business Association's 2001 annual awards black-tie dinner at Universal Studios. Although the vice president of external affairs agrees that black-tie dinners are not always the best venues for communicating about specific contract opportunities, he stated they are networking venues used by other governmental agencies. He also said that providing small-business owners fair contracting opportunities and access to the district's executive management is important. Although we recognize the importance of its efforts to provide small-business owners with these opportunities, we question whether the district could not achieve these same purposes and provide access to its management without spending funds in this manner.

According to the vice president of external affairs, the district seeks annual approval from the board on most sponsorships exceeding \$3,000 as part of its Community Partnering Program, which we discuss in Chapter 3. However, the district, after board approval, paid \$75,000 to the Water for the West Foundation in June 2002 to sponsor its educational efforts and an additional \$25,000 to sponsor the foundation's celebration at the Hoover Dam of the 100-year anniversary of the U.S. Bureau of Reclamation without requiring the foundation to apply through the Community Partnering Program. According to the vice president of external affairs, as of late March 2004 the district knew only that the \$75,000 was "being held" by the Water for the West Foundation for educational purposes and that these educational purposes had yet to be defined. Nearly two years after the district made the payment, these funds have not been spent, and the district has no assurance that the \$75,000 will ever be spent on purposes that are consistent with the district's authorized purposes, or that its payment was a prudent use of public funds. If it does not refine its controls over sponsorships to include measures that hold entities accountable for their use of district funds, its sponsorships may constitute a gift of public funds. In return for the \$25,000 sponsorship for the celebration at Hoover Dam, the district's board received an invitation to the event. The district could not provide us with information to support any additional benefit it gained by sponsoring the celebration, and we question the value the district received for this use of public funds.

Nearly two years after the district paid \$75,000 to a foundation, it knew only that the funds were "being held" for educational purposes and that these educational purposes had yet to be defined.

The district's administrative code does not specifically define the types of public and private organizations whose activities further the purposes and interests of the district and to which it may contribute public funds. The administrative code authorizes the chief executive officer to pay to any other public agency or private organization an amount not to exceed \$25,000 to participate in projects or programs desirable to carry out the objects and purposes of the district if funds are available from those previously authorized by the board. According to the vice president of external affairs, the district has reduced this authority to \$3,000 and brings most sponsorships exceeding \$3,000 to the board for its approval as part of its Community Partnering Program. However, the district has not always brought sponsorships exceeding \$3,000 to the board for its approval. Further, regardless of whether payments are authorized by the board, the district has not shown how sponsoring the types of activities that it does has a sufficiently direct link to its authorized purposes.

The District's Field Inspection Trips May Not Be the Most Cost-Effective Way to Educate the Public on Its Operations

The district's administrative code provides that each of the 37 board members may annually sponsor up to three inspection trips of district facilities, state water projects, and the Colorado River. The stated purpose of these trips is to provide leading citizens and other interested persons, preferably from the agency represented by the director, with firsthand knowledge of the district's operations. Although the district has not established expense limits for board members and their guests, it has established an annual budget for inspection trip expenses. The district reported that it spent nearly \$470,000 in fiscal year 2002–03 on inspection trips and budgeted almost \$450,000 for fiscal year 2003–04 and \$478,000 for fiscal year 2004–05. We question the value the district receives for these expenses.

Although the administrative code encourages board members to select guests who occupy positions of leadership in their communities to go on field inspection trips, guests include spouses and significant others.

One reason these expenses are large is that the district allows up to 36 guests on Colorado River trips, 36 to 40 guests on state water project tours, and up to 45 guests on tours of district facilities. Although the administrative code encourages each board member to strive to select guests who occupy positions of leadership in their communities and other interested persons, the district does not have a formal process for reviewing the appropriateness or relevance of the board members' guests. Rather, board members and member agencies select guests at their own discretion, and guests include spouses and significant others.

Consequently, we could not determine whether inspection trip expenses always served business purposes or were sometimes for the board members' personal benefit. According to the vice president of external affairs, the district sees value in educating stakeholders and local opinion leaders about the vast system and investments required to provide water to Southern California. Although we recognize the importance of educating the public on the district's operations and its investments, we question the necessity, frequency, and expense of these inspection trips. We believe the district could identify and consider the use of other methods to educate the public that could reach a wider audience, be more cost-effective, and thereby constitute a more reasonable and prudent use of public funds.

Parties and Catered Meals Do Not Appear to Be Reasonable and Necessary Expenses

The district's administrative code limits expenses incurred by board members and employees to those that further the district's interests by having a significant and meaningful link to its purposes, policies, and interests. Despite this policy, the district does not always ensure that payments are reasonable and necessary to support its authorized purposes. For example, we noted expenses for parties, events, and catered meals that appear to be an imprudent use of public resources and, in some cases, may constitute a gift of public funds under the California Constitution.

Although the board chair issued a memorandum in December 2003 to remind board members that, because they are spending public funds, only a reasonable level of expense is warranted and all expense claims are subject to public scrutiny, we found expenses that did not seem reasonable or appear to be a prudent use of public funds. For example, the district held its annual holiday recognition dinner for board members and their guests at a private country club, spending \$6,000 in 2001 and \$7,800 in 2002 for dinner, wine, floral arrangements, and musical entertainment. On another occasion, it paid \$9,200 to sponsor a board event at Diamond Valley Lake, which included a luncheon and musical entertainment. Finally, the district hired the firm that formerly serviced its cafeteria to cater an \$8,100 dinner for 200 guests at a rivers council anniversary event. Based on a review of a listing of district expenses, we identified payments the district made on behalf of the board to firms that appear to provide party services, entertainment, and flowers, as well as to a country club, totaling \$32,000 in fiscal year 2001–02 and \$21,000 in fiscal year 2002–03.

Using public funds, the district held its 2001 and 2002 annual holiday recognition dinners for board members and their guests at a private country club.

According to the executive vice president, board members serve as volunteers and receive no compensation other than reimbursement for travel and other expenses that further the interests of the district. He pointed out that board members have very busy schedules, families, and businesses and that the district tries to make service on the board as trouble-free as possible. He also stated, "The overall cost of providing a professional yet prudent work environment, including a few morsels, pales in comparison to the significant benefit this region has received from the dedication and commitment to our mission by the men and women of our board." Although we recognize that the district would like to reward its board members for their service and efforts and we believe it is permissible to reimburse them for reasonable and necessary out-of-pocket expenses, we question whether the district's use of public funds in this manner is reasonable or necessary. The executive vice president contended that there are a limited variety of district functions, such as anniversary lunches, holiday recognition dinners, and receptions honoring elected or appointed officials. Regardless of the limited variety of functions the district pays for, these expenses do not always appear reasonable or necessary.

During our limited review of expenses, we also noted one expense totaling \$450 for a private musical group to perform at a holiday function for district employees. Although this expense is smaller than the expenses for board member events we noted, it raises questions about the district's use of public funds for other events. According to the district's executive vice president, because the water act gives the district authority to exercise all powers that are reasonably implied in the water act and are necessary and proper to carry out the objects and purposes of the district, the district can recognize employee and board member achievements or otherwise treat them in a manner that encourages their outstanding performance and retention. Although we recognize the importance of promoting and rewarding employee performance and acknowledge the district's authority to do so, we question whether rewarding employees in this manner is a reasonable and necessary use of public funds.

The district reimburses its various departments for catered meals using public funds.

The district also reimburses its various departments for catered meals at district facilities. These catered meals are provided primarily by the district's current and former cafeteria service providers. For example, the district's cafeteria service provider caters the office of the chief executive officer's (chief executive office) staff meetings. Based on a review of a listing of district

expenses, we identified payments the chief executive office made to the district's current and former cafeteria service provider totaling \$27,100 in fiscal year 2001–02 and \$15,600 in fiscal year 2002–03. According to the executive vice president, providing catered on-site meals to its employees minimizes breaks between meetings and permits mealtime meetings to occur. We recognize the district's efforts to promote efficiency, but we question whether it is using its public funds in a responsible manner by providing meals to its employees at the public's expense.

The District Reimburses Executive Managers and Board Members for Travel Expenses Without Ensuring That They Are Reasonable and Necessary

Although the district's policy establishes daily reimbursement rates for management and employees who are on travel status, the rates do not apply to board members. In addition, despite this policy, the district allows employees to be reimbursed for actual travel expenses at management's discretion. For example, according to the executive vice president, the district has allowed executive managers to claim reimbursement for actual travel costs for a number of years. He states that executive managers are reimbursed for actual costs because the reimbursement rates for travel in the district's administrative code are outdated. We noted certain reimbursements that indicate that the district is paying travel claims without ensuring that the expenses are reasonable and necessary.

The district reimbursed the chief executive officer for a \$535 dinner bill based on documentation that indicated it was for himself and one member of executive management.

For example, in our limited review of expenses, we noted that the district reimbursed the chief executive officer for a \$535 dinner bill based on supporting documentation that indicated the meal was for himself and one member of executive management. The district did not question the bill, even though district policy requires that travel expenses be reasonable and necessary and that all attendees be listed in the support for reimbursement. When we asked the executive vice president about this payment, he stated that it was for a dinner provided by the district during an evening forum with members of the San Diego City Club. According to the executive vice president, the event was to provide the attendees an opportunity to have an open dialog with the chief executive officer regarding the district's policies and actions related to providing water to San Diego. The executive vice president stated that in addition to the chief executive officer and himself, 16 other individuals attended this meeting. He conceded the travel claim should have noted all the individuals who attended this dinner. He

forwarded a list compiled by the president of the San Diego City Club of the 16 other individuals who attended this event, as well as a receipt subsequently provided by the restaurant. Although the district ultimately was able to justify the expense, we remain concerned that it would pay a \$535 dinner bill when the documentation showed that it was for two people.

Board members did not document justifications for extended hotel stays while attending a conference in Las Vegas; consequently, we could not determine whether the additional nights were for business purposes or personal benefit.

We also noted that the district reimbursed board members for hotel stays that appear to be longer than needed for a conference noted in their travel itineraries. Specifically, 22 board members attended a three-day conference at Caesar's Palace in Las Vegas, Nevada. The conference began at 10:30 a.m. on the first day and ended at 11:30 a.m. on the third day, so two-night accommodations would have been sufficient. Seven of the 22 board members stayed at the hotel for three to four nights at an additional expense to the district of \$1,300. According to the executive vice president, this may have occurred because board members sometimes have additional meetings before and after conferences; nevertheless, they did not document any such justifications for the extended hotel stays. Consequently, we could not determine whether the additional hotel expenses were for business purposes or personal benefit. District reports indicate that the chief executive office spent \$166,000 in fiscal year 2001–02 and \$149,000 in fiscal year 2002–03, and the district reimbursed board members \$221,000 and \$186,000, respectively, in those same two fiscal years for travel expenses. These incidents raise our concern that the district is reimbursing executive managers and board members for travel expenses without ensuring that they are reasonable and necessary.

The District Has Not Established Controls to Ensure Appropriate Use of Its Gasoline Credit Cards

The district does not have an established process for monitoring its gasoline credit card purchases, and the risk that these credit cards could be misused is high. According to the administrative analyst in the business services section in charge of paying gasoline credit card invoices, the district has issued 46 gasoline credit cards to its employees for use when conducting district business. During fiscal year 2002–03, the district paid gasoline credit card invoices totaling nearly \$80,000. However, it does not require cardholders to maintain gasoline logs, receipts, or any documentation that would prove that purchases are strictly for district business purposes. According to the manager of the contracting services unit, the district pays the monthly bill immediately to ensure that the issuer does not deactivate the

Because it lacks a monitoring process, the district has no assurance that gasoline credit card purchases are for business purposes.

cards because of a delinquent payment, which would prevent district employees from accessing gasoline. The Association of California Water Agencies, in a January 2004 report presenting guidelines for the conduct of water agency board members, discourages the issuance of credit cards because of the risks of misuse. Further, in its recent report, the Institute for Local Self Government stated that the high risk of credit card misuse, either intentional or inadvertent, has caused a number of public agencies to stop issuing credit cards to officials or employees. We believe the district could help ensure accountability of these credit cards by continuing to pay monthly bills and performing subsequent audits of purchases by requiring cardholders to maintain receipts and gasoline logs. Because it lacks a monitoring process, the district has no assurance that these cardholder purchases are for business purposes.

In response to our inquiries regarding its oversight of these gasoline credit card purchases, the district is designing a four-month pilot program to hold cardholders accountable for their purchases. As of April 2004, the district proposed the pilot program but had not yet approved it. The program would require cardholders to maintain a gasoline purchase log that includes information such as vehicle license plate number, fuel purchase amount, and the cardholder's respective district job.

THE DISTRICT DOES NOT ENSURE THAT IT RECEIVES THE BEST VALUE WHEN LEASING ITS PROPERTY

The district has the authority to acquire, hold, and lease real property. Although its property management policy indicates that it should seek market value for its real property interests, it has not always done so. We observed numerous instances where the district leased property for a nominal amount to other entities, both public and private. If these leases do not require the lessee to pay market value or some other reasonable consideration, or the leases are for nominal values and do not serve the district's authorized purposes, those uses of the district's resources may constitute gifts of public funds in violation of the California Constitution. To avoid violating this prohibition, the district may lease its land for a nominal consideration only when the lease furthers the purposes for which it was established.

A July 2002 report from the district's office of the general auditor (audit office) found that 52 of the district's 231 active revenue leases⁴ required minimal or no monetary consideration and the district had insufficient documentation to justify an exception to policy granted to these entities and individuals. In response to the audit finding, the property management team stated that district lease rates are not based solely on financial consideration but also on factors such as goodwill; good citizenry; and promoting better relationships with state, county, and local agencies. Although we recognize the importance of these factors, the district's decision to enter into lease agreements for minimal or no monetary consideration without documenting the public purpose the lease is serving contradicts its property management policy, and may violate the California Constitution.

The district's property management policy specifies that the consideration to be paid by others for the use of its property shall be based on an opinion or appraisal by a qualified appraiser. An appraiser determines the property's market value. However, the audit office recommended in its report that the district document exemptions from the district's typical lease rates and include management approval in the file, but it did not follow up on this recommendation. According to the district's general auditor, the auditor who conducted the review of district leases did not document in his work papers whether he had followed up on the recommendation. The general auditor further explained that this auditor no longer works for the district, so he does not know whether follow-up on the recommendation was performed. Its findings have little value if the audit office does not hold departments accountable for implementing its recommendations.

As of March 2004, 72 of the district's 232 revenue leases had zero or \$1 annual rates.

Our review of the district's revenue leases as of March 2004 showed that it continues to enter into agreements at rates significantly below market values. For example, 72 of its 232 current revenue leases are for zero or \$1 annual rates. The district has 16 leases for uses such as office space and parks; 43 licenses for limited uses of its property, including pipelines; 10 permits for use of district land for purposes such as construction; and three easements for access of district property, each at zero or \$1 annual rates. Although some of these revenue leases required one-time payments of \$10 to \$3,000, these

⁴ Active revenue leases include other property agreements such as licenses, easements, and entry permits. Although a lease is a contract for exclusive possession of land, a license, easement, and entry permit convey a limited right to an entity or individual to use district land for a specific purpose without the lessee possessing a real interest in the property.

Many of the 72 leases that had zero or \$1 annual rates appear to be with private organizations and individuals.

revenue leases have term lengths of at least 29 years and in many cases have indefinite terms. The majority of these revenue leases are with public entities such as cities and counties; however, our review showed that many of the 72 agreements appear to be with private organizations and individuals. For example, the district has granted a license to an individual to use its property for equestrian purposes and to a private college to use a district facility for no annual payment. We question the appropriateness of these agreements.

According to the manager of the property management team, district management reviews the merits of each transaction on a case-by-case basis and reduces or waives fees and rents based on the mutual benefits derived by all parties from the issuance of the lease, license, entry permit, or easement. The district's general counsel pointed out that lease rates can be reduced in consideration of defrayed maintenance costs, reduced liability, and protection of district assets, and to sponsor public interest nonprofit organizations that further water education. However, to ensure that the district is not making a gift of public funds, its decision to lease its property at rates less than market value should be based on documentation that the lease serves a valid public purpose by carrying out the district's authorized purposes. Further, the manager of the property management team explained that because the district performs appraisals on transactions only where market value is a consideration, he could not provide us with the appraisal amounts for those properties where the district receives little or no monetary consideration. Therefore, we could not quantify the district's loss of revenue.

RECOMMENDATIONS

This district should amend its administrative code to do the following:

- Provide specific limitations on the types of activities it sponsors to ensure that it funds only those organizations whose activities have a direct link to authorized district purposes. The district also should include a requirement to document and publicly disclose any contributions it provides to other entities by describing the nature of the public benefit achieved by the support and the relationship to the district's authorized purposes.

- Include a requirement that the board periodically review and approve each of the district's sponsorships to ensure that it is funding only those organizations whose activities further the district's authorized purposes.
- Provide specific guidance as to what constitutes a reasonable and necessary use of public funds, including restrictions on expenses such as parties and catered meals.
- Update the travel reimbursement rates and ensure that they represent reasonable limits for travel expenses. Provide similar limits for board members.

The district should identify and consider the use of alternative methods for educating the public on its operations that would reach a wider audience and be more cost-effective than field inspection trips.

Before reimbursing employees or board members for travel or other expenses, the district should ensure that it has sufficient supporting documentation to justify the expenses.

The district should continue to develop its pilot program to ensure that holders of district gasoline credit cards use them only for district purposes.

To ensure that it is not making a gift of public funds, the district should grant leases at less than market value only when they further its authorized purposes. The district should document justifications in the corresponding files. Also, the district should ensure that it provides the board an inventory of all leases that are for less than market value, and the board should consider to what extent it wants to review and approve these leases in the future. ■

CHAPTER 2

The District Has Struggled With Its Mandate to Establish an Ethics Office

CHAPTER SUMMARY

More than four years after the enactment of Chapter 415, Statutes of 1999 (SB 60), the Metropolitan Water District of Southern California (district) still is trying to establish an effective ethics office. It did not hire an ethics officer until more than two years after the effective date of SB 60, and this officer did not independently investigate complaints and concerns (complaints) but primarily referred them to other district offices. For the most part, those offices cannot demonstrate how the complaints were resolved. Of the 65 employees responding to a survey we sent to a sample of 100 district staff, 26 percent indicated that they are not familiar with the purpose of the ethics office. Further, 26 percent of those that addressed the question indicated that the office does not effectively identify, handle, or resolve ethics issues. The district is establishing a more structured ethics office, including implementing a new system to improve the intake and tracking of ethics complaints, but it is too early to tell whether its efforts will be successful. Additionally, although the interim ethics officer only reports to the full board in writing, the district's executive vice president states that once a permanent ethics officer is hired, he or she will become a department head and report both verbally and in writing to the full board, as well as to the ethics subcommittee. Finally, we found that the district does not have an effective system in place to ensure that designated new and departing employees disclose potential conflicts of interest.

FOUR YEARS AFTER SB 60 BECAME EFFECTIVE, THE DISTRICT STILL IS IN THE PROCESS OF ESTABLISHING AN EFFECTIVE ETHICS OFFICE

The Legislature passed SB 60 in September 1999 with the intent of preventing the future occurrence of ethics violations and questionable activities at the district. SB 60 became effective in January 2000. The key component of this legislation was the requirement that the district establish an ethics office. It took

more than two years to establish its first ethics office. This delay may have inhibited the district's ability to identify and prevent potential ethics violations.

Although the district established its first ethics office in March 2002, the office lacked formal internal policies or procedures for the intake, handling, and resolution of ethics complaints. The office did have an ethics complaint log that documented the complaints brought to the office, but the district was unable to identify or provide documentation for a majority of the complaints we asked about. Thus, it may be unable to comply with the SB 60 requirement that it be able to provide the public with the results of the investigations that it undertakes.

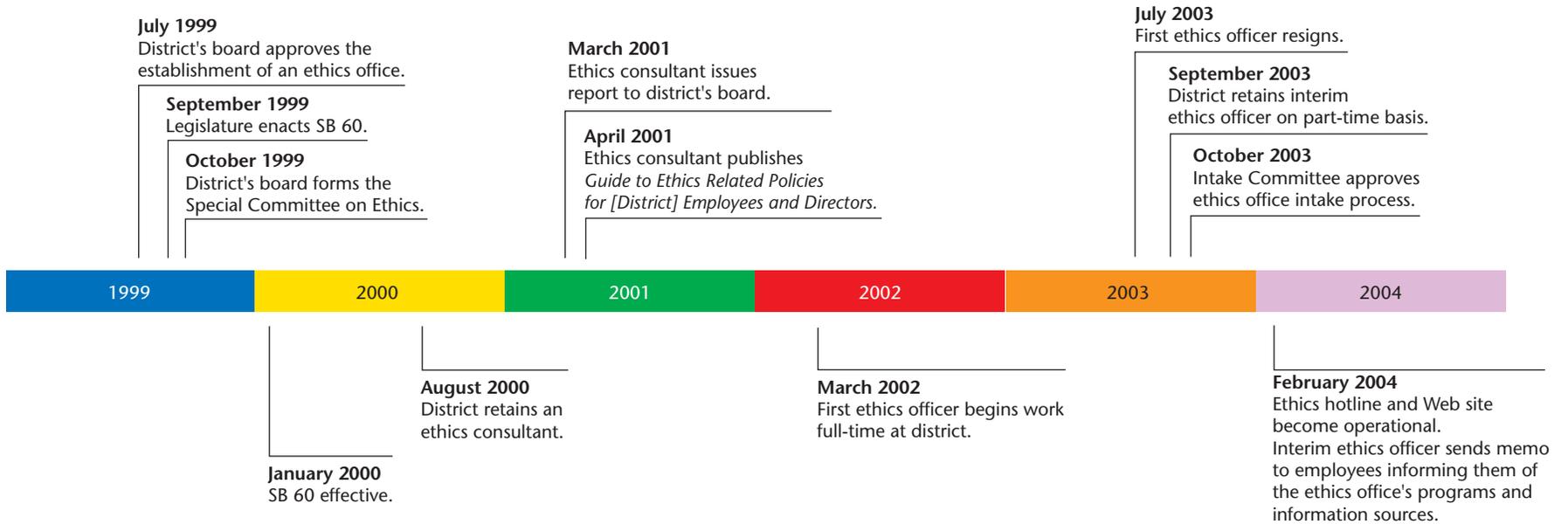
It Took the District More Than Two Years to Open Its First Ethics Office

One reason the Legislature passed SB 60 was to create an independent ethics office.

Although the district undertook various efforts to formulate an ethics office structure in the two years after SB 60 became effective, it did not establish the required ethics office. One reason the Legislature passed SB 60 was to create an independent ethics office in response to allegations that 12 water agencies that were members of the district spent \$12,000 in public funds to compile information on public officials. SB 60 also required the district to adopt rules relating to internal disclosure, lobbying, conflicts of interest, contracts, campaign contributions, and ethics. The legislation mandated the ethics office to educate board members, district staff, and contractors on these rules and to investigate any complaints concerning any violation of these rules. SB 60 also required it to establish a schedule of penalties for ethics violations and to adopt procedures for protecting the confidentiality of sources and for making the results of investigations available to the public. Through SB 60, the Legislature instructed the district to establish its ethics office and adopt the rules described earlier consistent with the intent and spirit of the laws and regulations of the Los Angeles City Ethics Commission, the Fair Political Practices Commission, and the Los Angeles County Metropolitan Transportation Authority. Figure 5 depicts a time line that chronicles the district's efforts to establish the ethics office, and the following discussion elaborates on some of those efforts.

FIGURE 5

Ethics Office Time Line



Source: Metropolitan Water District's chronology of the ethics office and related documentation.

In July 1999, as the Legislature was considering SB 60, the district's board voted to establish an ethics office that would report directly to the board and instructed district management to develop implementation details to present to it at a later date. The board's executive committee was responsible for monitoring the development of the new office. In October 1999, shortly after the passage of SB 60, the board also formed a special committee on ethics to review principles, rules, and other aspects of any proposed ethics programs that would be expanded after the district hired an ethics officer. This committee was also responsible for writing a job description for the ethics officer and hiring an outside agency to recruit for the new position.

In August 2000, the district hired a consultant to provide recommendations on how to establish its ethics office.

In August 2000, the district hired a consultant to provide recommendations on how to establish its ethics office. The consultant's March 2001 report offered suggestions regarding the structure and functions of the ethics office based on the requirements of SB 60. For instance, the consultant recommended that the ethics officer report to the board and conduct investigations of potential ethics violations involving staff but recommended that the district have an external entity investigate cases involving board members and senior management. In April 2001, the consultant also provided the district with a report titled *Guide to Ethics Related Policies for [District] Employees and Directors*, which summarized the significant provisions of the district's ethics policy, as well as relevant operating policies and state law.

The board combined its subcommittee on rules and special committee on ethics into the subcommittee on rules and ethics in February 2001, which later became the ethics subcommittee, and had an attorney in its legal department perform research related to the formation of the ethics office. This attorney presented various plans to the board and formally responded to two ethics-related questions posed by the district.

In addition to the efforts described earlier and depicted in Figure 5 on the previous page, the district contends that an internal fraud hotline established in June 1995 and normal channels such as its human resources office, its equal employment opportunity office, and the legal and audit offices were available to employees for any ethics-related questions or concerns that may have existed before the hiring of the ethics officer. The hotline was administered by the equal employment opportunity office and was to be used

to report fraud, illegal acts, or other improprieties; it was not established to specifically serve as an intake for ethics-related questions and complaints. Although the district contends that employees could approach various existing offices with any ethics-related concerns, these options existed before SB 60 was enacted and did not meet its requirement that the district create a separate ethics office.

The district's failure to establish an ethics office in a timely fashion may have inhibited its ability to identify and prevent potential ethics violations. The district asserts that only two ethics-related issues surfaced before hiring its first ethics officer and that both were resolved by its general counsel. However, it also concedes that it could have established its ethics office more expeditiously but points out that SB 60 did not prescribe any particular form for the ethics office; consequently, the board experimented to find the best approach. As discussed previously, however, SB 60 did instruct the district to create an ethics office consistent with the intent and spirit of the laws and regulations of the Los Angeles City Ethics Commission, the Fair Political Practices Commission, and the Los Angeles County Metropolitan Transportation Authority.

The District's First Ethics Office Did Not Establish an Effective Process for Handling Ethics Complaints

The former ethics officer indicated that the district had no formal process for obtaining, resolving, or following up on ethics-related complaints during her tenure.

The district hired its first full-time ethics officer in March 2002 and charged her with administering, developing, monitoring, and directing its ethics program. The officer was also responsible for providing advice to managers, staff, and contractors or vendors on ethical issues, and for participating in investigations of ethical rules violations for directors, employees, and contractors or vendors. However, she indicated that the district had no formal process for obtaining, resolving, or following up on ethics-related complaints during her tenure. The former ethics officer indicated that, in practice, her office was essentially a "pass through" for complaints and concerns due to a lack of resources. When she received a complaint, she first would determine if it was within the ethics office's realm and whether it potentially violated the district's ethics policy, and then would generally refer it to another department. In fact, she referred both matters not related to ethics and cases involving potential ethical violations to other departments because, according to her, she had limited resources and other departments were more likely to have the resources to carry out an investigation or otherwise resolve the matter. Further, she stated that there

was a lot of uncertainty and debate within the board regarding how the ethics office should be established during her tenure. The former ethics officer stated that she resigned in July 2003 because the board was going to make decisions regarding the ethics office's structure without her input.

The district's executive vice president disagrees that the former ethics officer was unable to carry out investigations or otherwise resolve matters due to a lack of available resources. He stated that the district provided the former ethics officer with support staff although they initially were shared with others, and that resources were available upon request. He also contends that the district relied on the former ethics officer to design a successful ethics program. Further, he noted that, in April 2003, the administrative code was amended to authorize the ethics officer to obtain professional services up to \$40,000 per year per contract so ethics issues could be pursued by the ethics office independently without having to go through another department. However, this amendment to the administrative code did not occur until more than a year after the former ethics officer was hired. Additionally, the extent to which budget considerations would have limited the contracting authority is unknown.

The ethics officer did record incoming ethics-related questions and complaints in a log that summarized information such as the date of contact, a general description of the complaint, and whether a complainant was referred to another department. The former officer indicated that she did not follow up to ensure that complaints she referred to other departments were resolved due to limited resources such as a lack of support staff. We selected a sample of 20 complaints that the former ethics officer referred to other offices and asked those offices how the complaints were resolved. We also asked for supporting documentation. In cases where the individual offices were unable to provide this information, we followed up with the district's executive vice president.

The district was unable to demonstrate adequately how it resolved 16 of the 20 complaints we reviewed.

Ultimately, the district was unable to demonstrate adequately how 16 of the 20 complaints were resolved. Its inability to provide documentation of how an ethics complaint was resolved indicates that it may be unable to comply with the SB 60 requirement that it be able to provide the public with the results of the investigations it undertakes. The executive vice president asserts that this was primarily because the log does not contain sufficient information to identify the entry. Some department heads also indicated that they never received notification from the former ethics officer that she was referring an employee to their respective offices. It

is also possible that some of the complainants referred to other offices chose not to pursue the issue further. Nevertheless, it is clear that the district did not track complaints adequately to ensure their resolution. By way of contrast, the Los Angeles City Ethics Commission, the Fair Political Practices Commission, and the Los Angeles County Metropolitan Transportation Authority ethics office have mechanisms in place to document the nature of complaints brought forth, how they were handled, and how they were resolved.

RESULTS OF OUR SURVEY INDICATE THAT EMPLOYEES MAY NOT BE USING THE ETHICS OFFICE FULLY

Survey responses indicate a significant percentage of employees may not be fully using the ethics office due to a lack of familiarity with the office's purpose, discomfort contacting the office, and a perception that the ethics office is ineffective.

We sent a survey to a sample of 100 district employees to determine whether they were aware of the existence of the ethics office and its purpose, and to gauge the perceived effectiveness of the office. The responses we received indicate that a significant percentage of employees may not be fully using the services of the ethics office due to a lack of familiarity with the office's purpose, discomfort contacting the office, and a perception that the ethics office is ineffective. Reduced confidence in its effectiveness makes employees less likely to forward their concerns to the office, thereby reducing the office's ability to identify, prevent, and resolve potential ethics violations.

Our survey included questions geared toward obtaining information such as the respondents' awareness that an ethics office exists, their familiarity with the purpose of the office and its policies, and whether they had used it. For individuals who had used the ethics office, we asked questions such as their date of contact, the nature of their complaint, and whether the issue was resolved to their satisfaction. In addition, we asked all the surveyed employees to rate the overall effectiveness of the ethics office at identifying, handling, and resolving ethics complaints or potential ethics violations. A total of 65 employees responded to our survey. The Table on the following page summarizes their responses to selected survey questions.

The survey shows that most employees are aware that the district has an ethics office, but 26 percent of respondents are not familiar with its purpose. To follow up, we asked district management about its efforts to inform employees about the office. Documentation provided by district management indicates that the former ethics officer delivered training to the board's executive committee twice in late 2002, as well as to a select group of employees at its headquarters and another office

in May 2003. The district also asserts that the former ethics officer distributed a guide titled *Guidebook to the Office of Ethics*. In addition, it recently informed employees of its hiring of an interim ethics officer to develop policies and procedures dealing with ethics complaints and to set up various aspects of the ethics office's functions. In February 2004, the interim ethics officer sent a memo to employees informing them of the ethics office programs and information sources and announcing initiation of an ethics office hotline.

TABLE

Ethics Office Survey Responses to Selected Survey Questions

Survey Question	Yes	No
Are you aware that the district has an ethics office?	61 (94%)	4 (6%)
Are you familiar with the purpose of the ethics office?	48 (74%)	17 (26%)
Are you comfortable contacting the ethics office?*	38 (59%)	26 (41%)
Have you ever used the services of the ethics office before?	5 (8%)	60 (92%)

Source: Bureau of State Audits' February 2004 survey of a sample of district employees.

* Our survey statistics for this question only reflect the responses of the 64 individuals that responded to it.

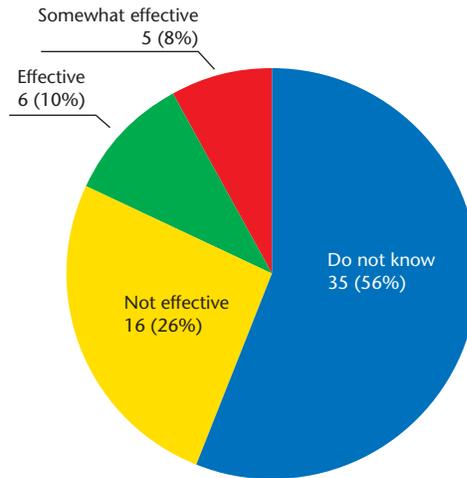
Forty-one percent of respondents indicated they were not comfortable contacting the ethics office. Of the 40 respondents who provided written comments, 12 stated they were uncomfortable contacting the ethics office or perceived the office as not effective because of the chair of the board's or management's potential involvement in the process, or concerns that their confidentiality might not be protected. Only five respondents, or 8 percent, said they had used the services of the ethics office. All five individuals indicated that the ethics officer had not instructed them to contact another district office. Two of these individuals contacted the ethics office to obtain information or advice. The other three contacted it to report potential ethics violations; two of these individuals indicated they did not know whether their concerns had been resolved, while the third indicated that the matter had not been resolved.

When asked to rate their perception of the overall effectiveness of the ethics office at identifying, handling, and resolving ethics complaints or potential ethics violations, only 11 respondents

(18 percent) rated the office effective or somewhat effective, 35 (56 percent) indicated they did not know whether the ethics office was effective at performing these functions, and 16 (26 percent) stated they did not believe that the ethics office performed these tasks effectively. Figure 6 presents the survey responses regarding the perceived effectiveness of the ethics office.

FIGURE 6

Survey Responses Regarding the Perceived Effectiveness of the Ethics Office



Source: Bureau of State Audits' February 2004 survey of a sample of district employees.

Note: This figure reflects the responses of the 62 individuals who responded to this survey question.

When we distributed this survey in early February 2004, the interim ethics officer was in the process of implementing a more structured ethics office, as discussed in the next section. The ethics officer did not send employees new ethics office policies and procedures until late February 2004.

THE DISTRICT IS IMPLEMENTING A MORE STRUCTURED ETHICS OFFICE

In September 2003, two months after its first ethics officer departed, the district contracted with an individual to act as a part-time interim ethics officer. Among other things, the district asked the interim ethics officer to develop policies and procedures for dealing with complaints, to establish and implement a hotline, to produce educational material and conduct related training, and to serve as a resource to directors as they

worked on the permanent staffing of the office. The executive vice president claims the district did not receive any ethics complaints from employees during the two-month period between the resignation of the former ethics officer and the hiring of the interim officer.

The ethics office has recently developed a formal intake process, Web site, and hotline.

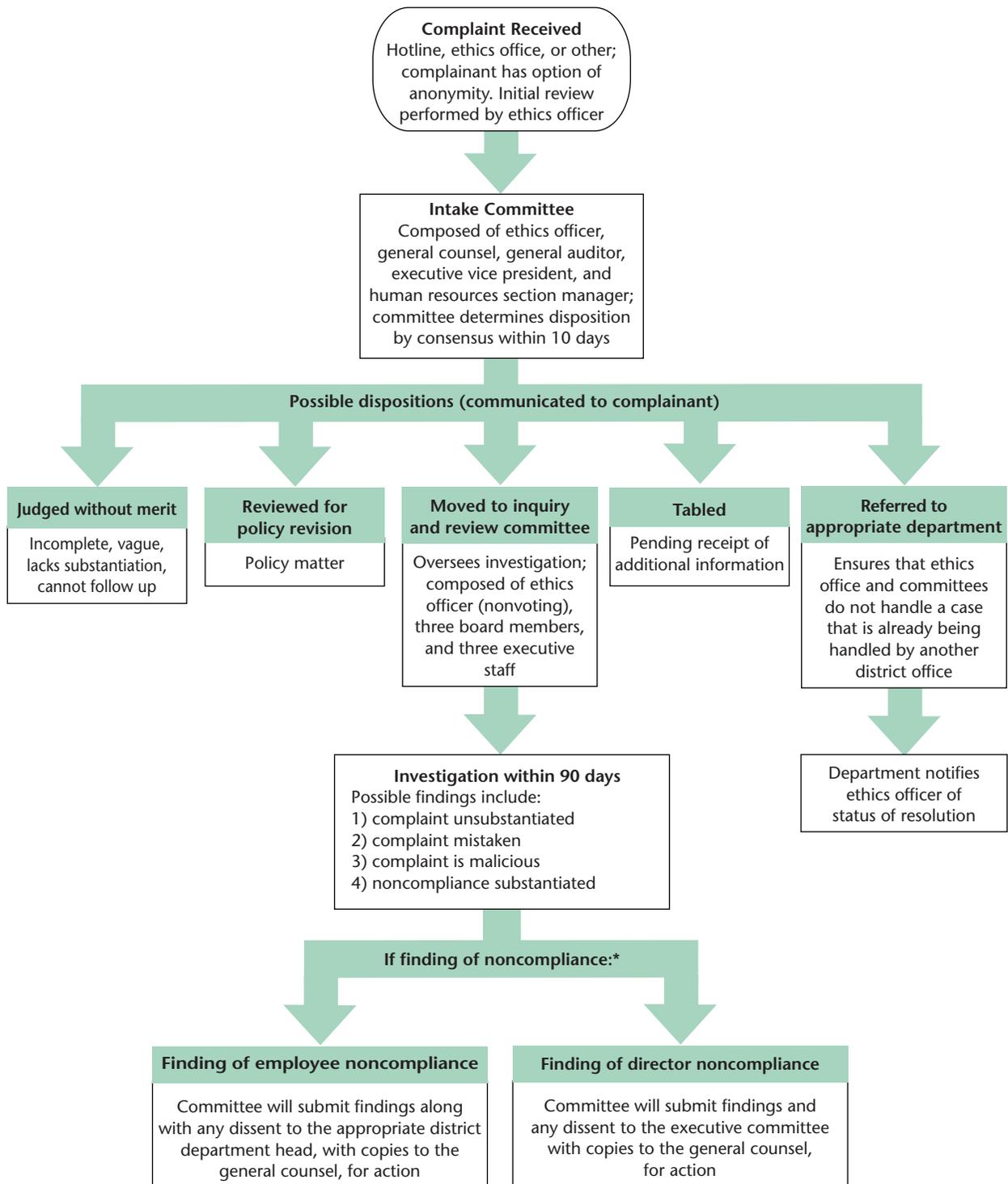
The interim ethics officer is in the process of instituting a more structured, formal process for identifying, handling, and resolving complaints and potential violations. For example, she has developed a formal intake process that includes an intake committee charged with classifying initial complaints and an inquiry and review committee for investigating complaints forwarded by the intake committee, as well as an ethics office Web site and ethics hotline, both of which became operational in February 2004. An independent service provider operates the hotline and is to deliver any complaints received to the ethics officer within 24 hours via e-mail.

Although the intake committee approved the new complaint intake process in October 2003, the district did not complete a log to track ethics complaints until late April 2004. Further, as discussed previously, the district did not contact employees regarding the ethics office's policies and procedures until late February 2004. Individuals can bring ethics-related complaints to the attention of the ethics office through the new ethics hotline or by contacting the ethics officer, the board, or management. However, all complaints are to be brought to the attention of the ethics officer within one business day of when they are received and will be documented on an intake form. The ethics officer performs an initial review and determines the need for any additional information. Figure 7 illustrates the ethics office's new complaint intake process.

The intake committee is composed primarily of executive management, so we are concerned that employees might be hesitant to bring ethics complaints to the ethics office. We also are concerned that the committee's composition might create the perception among employees that the ethics officer is not free to make decisions regarding the appropriate handling of matters brought forth due to management involvement. However, the interim ethics officer indicated some mitigating factors. First, she stated that employees contacting the ethics office can remain anonymous. For example, the interim ethics officer asks individuals who bring forth a complaint whether they want their names to be withheld when the matter is taken to the intake committee. Additionally, although

FIGURE 7

New Complaint Intake Process



* A report on actions to be taken in response to findings must be submitted to the ethics office (with a copy to the general counsel) within 30 days. All reviewed complaints will be analyzed and summarized in the ethics officer's quarterly report to the board of directors.

executive management is involved in the intake process, the intake committee does not vote on the initial disposition of complaints but rather strives for consensus. Further, although the intake committee members provide their views regarding the appropriate disposition of a matter, the interim ethics officer is not bound by their input. She is free to decide the initial dispositions of complaints regardless of agreement from all or any of the members.

We interviewed the interim ethics officer to determine how the inquiry and review committee would handle investigations involving board members and executive management to determine whether such investigations would be objective. An investigation performed by the inquiry and review committee could potentially lack objectivity because the committee is composed of the ethics officer, board members, and executive staff; all these individuals report to the board, or work at the same reporting level as board members or executive management. The interim ethics officer indicated that there has not been cause for an investigation of board members or executive management during her time as interim ethics officer, but she envisions that such an investigation would involve a combination of entities internal and external to the district conducting such investigations. For investigations regarding the review of factual matters, such as whether an individual is qualified for a job, the investigation would be conducted within the district. For investigations that are not of a factual nature, such as the occurrence of a potential conflict of interest, an outside investigator would be hired to conduct the investigation.

The interim ethics officer envisions that certain investigations of board members or executive staff would be conducted by an external investigator; however, no written policies regarding these investigations exist.

Nevertheless, there are no written policies regarding how these investigations are to be conducted, nor under what circumstances an external investigator will be hired. Although each case may be different, written policies and procedures that delineate general protocol for conducting such investigations, including the circumstances under which an external investigator should be hired, would help ensure that the district conducts investigations in a consistent and effective manner.

The interim ethics officer said that, in late April 2004, she completed a log to track all complaints received that includes information such as the date of the complaint, the category, an incident code, further description as needed, and dates of contact with the complainant and disposition. The disposition data may be quite short (policy review, referred to appropriate department) or may be quite extensive if the complaint moves to the inquiry

and review committee. The interim ethics officer plans to provide the board of directors with quarterly reports that summarize complaints received and how they were resolved.

The district plans to hire a permanent part-time ethics officer in summer 2004, as well as a full-time ethics educator. Although it is too soon to tell, it appears that the recent changes to processes of the ethics office may increase its effectiveness in identifying, handling, and resolving complaints.

THE ETHICS POLICIES THAT APPLY TO EMPLOYEES ARE CONTAINED IN TWO INCONSISTENT SOURCES

The district has inconsistent ethics policies pertaining to employees in two different sources. Its administrative code has an ethics policy that applies to board members and employees, and its operating policy addresses only ethics for employees. Although the administrative code and operating ethics policies are very similar, we noted some inconsistencies.

For example, two sections on ethics in the administrative code pertaining to employees are not contained in the operating policy or are not covered in the same level of detail. The administrative code addresses certain restrictions on employment within one year after leaving the district, but the operating policy does not. The administrative code also contains a protection for whistleblowers that is more detailed than a similar operating policy. Conversely, the ethics portion of the operating policy for employees contains sections not addressed in the administrative code. For example, the operating policy contains guidance on outside work activities and nepotism, but the administrative code does not provide any guidance in these areas. These inconsistencies may result in confusion regarding which policies employees should follow. The interim ethics officer stated that she intends to make sure the district's two ethics policies are consistent.

Inconsistencies in the district's ethics policies may result in confusion regarding which policies employees should follow.

THE PERMANENT ETHICS OFFICER WILL REPORT TO THE ETHICS SUBCOMMITTEE AND THE FULL BOARD

The former ethics officer and executive vice president disagree as to the reporting structure in place during the former ethics officer's tenure. Nevertheless, although the district's interim ethics officer reports to the full board only in writing, the district

states that the permanent ethics officer will be a department head and will report to the full board in writing and verbally at board meetings.

The former ethics officer alleges that she informally reported to the district's executive vice president on a weekly or as-needed basis, who then acted as a filter in deciding what the ethics officer would forward to what is currently known as the ethics subcommittee. She asserts that she generally worked out the contents of her reports with the executive vice president before presenting them to what is currently known as the ethics subcommittee. She says she also had to obtain prior approval from the executive vice president for every project, function, or task she performed, including seeking help from other administrative staff. The executive vice president denies that and stated that the former ethics officer reported neither formally nor informally to him or to any other district staff. He states that the former ethics officer reported to both the subcommittee and the full board. He contends that the former ethics officer only provided him with the items required for board packets, as required by all individuals that are submitting written materials to the board.

According to the executive vice president, the permanent ethics officer will be a department head and will report to the full board verbally and in writing.

Meanwhile, according to the executive vice president, the interim ethics officer currently provides written reports to the ethics subcommittee and the full board but only reports verbally to the subcommittee rather than to the full board. However, the executive vice president states that, once hired, the permanent ethics officer will be a department head, and as with other department heads, also will provide verbal reports to the full board during board meetings. If followed, we believe this will be a reasonable reporting structure for the ethics office.

THE DISTRICT HAS NOT ENSURED THAT ALL NEW AND DEPARTING EMPLOYEES IN DESIGNATED POSITIONS DISCLOSE POTENTIAL CONFLICTS OF INTEREST

The district's former ethics officer was in charge of ensuring that employees in designated positions and board members filed statements of economic interest as required by the Political Reform Act of 1974 (political reform act); however, the district did not always ensure that these statements were filed in a timely manner. Section 87300 of the political reform act requires that every agency adopt and promulgate a conflict-of-interest code. The district adopted Section 18730 of Title 2 of the California Code of Regulations as its conflict-of-interest policy.

Because the district has adopted state regulations, its policy is consistent with the political reform act. The district's conflict-of-interest policy for board members specifies when board members should abstain from voting, delineates circumstances that establish a conflict of interest, and states that board members must disclose on record the nature and extent of a conflict of interest under certain circumstances. The district's conflict-of-interest policy for employees states that they may not engage in any act that is in conflict with the proper performance of their duties, delineates the circumstances establishing a conflict of interest, states circumstances under which they must disclose a conflict on the records of the board, and has restrictions upon soliciting job offers from firms that are in negotiation with the district regarding the employee's area of responsibility.

The district's conflict-of-interest code also designates those positions that are required to disclose potential conflicts on statements of economic interest. These disclosures are one mechanism for identifying, preventing, and resolving potential conflicts of interest. However, the district does not always ensure that employees in designated positions file the required disclosures. The political reform act, as well as the district's administrative code, require that all board members and employees in designated positions file statements of economic interest annually and upon assuming or leaving office. Required disclosures include such things as investments, interests in real property, income, and business positions. A new employee in a designated position must file a statement within 30 days after assuming office, and an employee who leaves such a position also must file within 30 days of leaving.

The district has no documentation of the process the former ethics officer undertook in collecting annual disclosure statements.

The district most recently completed disclosure statements for calendar year 2002, when the former ethics officer was responsible for ensuring their completion. However, the district has no documentation of the process the former ethics officer undertook in collecting these annual statements. Additionally, the district did not have a system in place for notifying the former ethics officer of employees assuming or leaving designated positions, making it difficult for the officer to ensure that such employees actually submitted the necessary disclosure statements. Consequently, the officer relied upon word of mouth and other informal means of communication to determine which employees or former employees were required to fill out disclosure statements. As a result, the control mechanism the disclosure statements represent for preventing conflicts of interest was weakened.

The district determined that employees failed to submit 128 assuming or leaving office disclosure statements from January 2003 through March 2004.

As of late March 2004, the district had identified employees who did not submit disclosure statements upon assuming or leaving designated positions from January 2003 to the present. The district determined that employees failed to submit 128 assuming or leaving office statements. Although it did not ensure that all individuals required to fill out these statements submitted them within the 30-day period required by the political reform act, the district is contacting these individuals and retroactively having them fill out the required disclosure statements. Further, as of April 2004, the interim ethics officer planned to have human resources staff ensure that the required disclosure statements are included in the paperwork that employees are required to fill out when starting or leaving.

RECOMMENDATIONS

The district should complete the implementation of its new ethics office and ensure that it complies with the requirements of SB 60. For example, the district should ensure that the electronic log it is developing for tracking complaints also captures the subsequent resolution of each complaint to provide the public with information regarding the resolution of its investigations.

The district should continue its recent efforts at informing district employees about the ethics office and its functions to ensure that employees are using this resource fully.

The district should develop formal written policies and procedures regarding how investigations are to be conducted, and under what circumstances an external investigator will be hired.

The district should review the ethics policies in the administrative code and in the operating policy and ensure that it presents ethics policies consistently.

Once it hires a permanent ethics officer, the district should ensure that he or she reports directly to the entire board both verbally and in writing, in addition to the ethics subcommittee, to ensure the fullest visibility of ethics issues.

The district should complete its process of ensuring that current and past employees who did not file the required statements of economic interest do so. In addition, the district should establish a reliable process for ensuring that all employees in designated positions submit statements of economic interest.

The district should issue an annual report to the public and interested legislators, such as those representing the areas served by the district, on its ethics office's compliance with SB 60. ■

Blank page inserted for reproduction purposes only.

CHAPTER 3

The District Could Improve Its Controls Over Certain Types of Contracts and Grants

CHAPTER SUMMARY

The California Public Contract Code governs the construction contracts of the Metropolitan Water District of Southern California (district), generally requiring competitive bids for all contracts exceeding \$25,000. The district adheres to applicable state laws and has established adequate policies and procedures for issuing such contracts. The Public Contract Code also generally governs the district's purchasing contracts. Although the district's administrative code exempts consulting contracts from competitive bidding, its procedures manuals for consulting and purchasing contracts state that sole-source⁵ contracts should be used only in limited situations and require staff to document the justification for not using a competitive process.

The district does not always ensure that this occurs. District records indicate that it did not use a competitive process to award 67 percent of its consulting contracts that were active at some time during the period July 2002 through September 2003. Further, the district does not have a policy that requires a needs assessment or verification of potential contractors' qualifications in some instances where these steps appear necessary. The district's procedures manuals for purchasing and consulting contracts also are outdated. Finally, the district provides grants, sometimes through contracts, to groups that provide water education, explore new water conservation technologies, or foster appreciation of native and drought-tolerant plants. The district's process to award these funds is not always based on established criteria.

⁵ The term *sole-source* is generally used only when referring to the procurement of goods in a noncompetitive manner. However, because the district also describes consulting contracts that were not awarded through a competitive process as sole-source contracts, throughout our report we use the term to refer to both purchasing and consulting contracts that were not awarded competitively.

THE DISTRICT NEEDS BETTER POLICIES AND PROCEDURES TO CONTROL CONSULTING AND PURCHASING CONTRACTS

We reviewed the district's policies and procedures related to construction, purchasing, and consulting contracts and found that it complied with requirements of the Public Contract Code for the construction contracts we reviewed and has adequate policies and procedures for administering this type of contract. However, the district does not always ensure that sole-source purchasing and consulting contracts are supported by adequate justification. Although the district's administrative code exempts consulting contracts from competitive bid requirements, the consulting manual states that sole-source consulting contracts should be used only in limited instances. The district also does not have a policy that requires staff to perform a needs assessment before entering into consulting and certain purchasing contracts or to verify potential contractors' qualifications before entering into purchasing and sole-source consulting contracts. Further, its procedures manual for purchasing and consulting contracts should be updated.

The District's Construction Contracts Adhere to Public Contract Code Requirements

The district reports that it had 37 construction contracts that were active at some time during the period from July 2002 to September 2003 totaling nearly \$620 million. We reviewed 10 of these contracts totaling \$217 million (35 percent) and found that in each case the district adhered to applicable provisions of the Public Contract Code and district policies. We also noted that the district has established adequate processes for initiating and administering its construction contracts.

For example, the district formally identifies, evaluates, and approves new construction projects annually. As required by the Public Contract Code, it solicits bids for each new project with a projected cost of \$25,000 or more by advertising in various newspapers and trade publications and awards each construction contract to the lowest responsible and responsive bidder. The district verifies that selected contractors hold appropriate and active licenses by contacting the Contractors State License Board, which regulates contractors in 42 construction industry classifications. It also has a process for monitoring each construction contractor's performance. For example, the district's process requires engineers and inspectors to monitor

each project and prepare daily and monthly field reports that record progress, and inspectors perform a final inspection before the district will issue a notice of project completion.

The District Does Not Always Ensure That Sole-Source Contracts Are Justified

The district's administrative code generally requires all contracts valued at \$25,000 or more to be bid competitively but exempts consulting contracts from this requirement. However, its consulting procedures manual states that sole-source contracts should be used only in limited instances. Furthermore, the district's procedures manuals state that a written justification explaining why either a purchasing or a consulting contract was not awarded through a competitive process is required; however, the district does not always ensure that this occurs. Consequently, it may be entering into sole-source contracts that could have been awarded competitively at a better dollar value because competitive processes promote fairness, value, and open disclosure. The district reports that it had 726 consulting contracts that were active at some time during the period July 2002 through September 2003 totaling up to \$374.3 million, including legal contracts of \$34 million.⁶ District records indicate that 485 (67 percent) of its 726 active consulting contracts were sole-source contracts.

District records indicate that 67 percent of the district's consulting contracts that were active at some time during the period July 2002 through September 2003 were sole-source contracts.

Although the district's administrative code does not require competitive bidding for its consulting contracts, its consulting procedures manual states that sole-source contracts should be used only when a limited number of responsible sources exist and no other type of service will satisfy the district's requirement or needs. The consulting procedures manual states further that sole-source contracts should not be used because of poor planning or a lack of effort in using a request for proposal or a request for qualifications evaluation process. For example, when a request for this type of contract is processed through the district's contracting services unit, the requestor is prompted to provide a sole-source justification. In addition, the consulting procedures manual states that if a service or product is to be purchased through a sole-source contract, the requesting party must prepare a written justification explaining why this type of procurement is necessary and must receive appropriate approval from senior management.

⁶ The \$374.3 million only includes the annual amount payable for "rollover" contracts, which are contracts that are automatically renewed annually.

Of the 15 sole-source consulting contracts we reviewed, only five included a reasonable justification explaining why they were not awarded competitively.

In a sample of 20 consulting contracts we reviewed, 15 were sole-source contracts. Of the 15, five included a reasonable justification and four included inadequate justification memos because they did not address the consultant's unique qualifications or the reasons for not competitively awarding the contract. The remaining six did not have any documentation explaining why they were not awarded competitively. For example, the district entered into two sole-source contracts with one consulting firm to provide an interim chief operating officer and an audit manager. For both contracts, the district provided documentation of the experience and qualifications of the consultants provided by this firm but did not address why these consultants were uniquely qualified and, therefore, the only individuals able to provide the contracted services.

According to the executive vice president, it is the district's general practice that staff prepare written sole-source justifications for consulting contracts for management review and approval. However, he asserts that executive managers have the authority to enter into sole-source contracts without such justifications because it would not seem necessary for them to prepare a written justification to themselves. He further stated that the consulting firm in our example had a proven track record of providing top-notch, semiretired, or temporary managers who were immediately available. Finally, he asserts that because this consulting firm provided these services in plain view at the highest level of visibility and with full consideration by executive management, he believes that the district met the intent of its requirement for written sole-source justifications.

Regardless of whether sole-source contracts are initiated by district management or staff, justification for each of these contracts should be documented demonstrating why a competitive process would not be beneficial. When the district does not document its justification for entering into sole-source contracts, it leaves itself vulnerable to allegations of favoritism.

We also noted a similar problem with purchasing contracts, although to a lesser extent. Purchasing contracts are used to buy goods such as materials, equipment, and supplies, as well as nonprofessional services, including landscape maintenance and janitorial services, and are generally subject to the Public Contract Code. The district allows exemptions to its competitive-bid requirement for purchasing contracts exceeding \$25,000 if competitive bidding cannot produce an advantage or if a needed good or service is patented, copyrighted, or otherwise

unique, but its purchasing manual specifies that a justification memo must be prepared in these situations. Two of the 10 purchasing contracts we reviewed were sole-source contracts, but the justification provided for one did not explain why the purchase should be exempted from competitive bidding. This contract was for \$25,000, the minimum contract amount requiring competitive bidding or a sole-source justification.

The district's chief financial officer asserts that this contract was approved because the vendor is one of the foremost authorities in the subject area and that it is the only provider of the services. Although this reasoning appears adequate, it was not documented on the original request, leaving the district vulnerable to allegations of favoritism.

For Certain Contracts, the District Does Not Require a Needs Assessment or Verification of Contractor Qualifications

The district does not have a policy that requires staff to perform a needs assessment before entering into consulting and certain purchasing contracts or to verify potential contractors' qualifications before entering into purchasing and sole-source consulting contracts. Neither the district's administrative code nor its operating policy includes these requirements. Additionally, according to the manager of the contracting services unit, although staff requesting to purchase a specific brand of a good or operating equipment that is not budgeted are required to provide on the request form a description and a reason why the good is needed, other purchases do not have this requirement.

The district has not established a policy requiring a needs assessment for consulting contracts, and it was unable to demonstrate that it conducted such an assessment for 14 of the 20 consulting contracts we reviewed. The executive vice president asserts the district did not document a needs assessment for one of these, a contract with a consultant hired to assess the district's security over its operations, because it did not want to document its security risks. The corporate resources group manager states that contracting decisions are guided by the chief executive officer's annual business plan, which provides high-level priorities for the district. Funds are budgeted for contracts that may be needed in the coming year to implement the business plan. However, the district has not established a policy requiring a needs assessment for individual consulting contracts.

The district was unable to demonstrate that it conducted a needs assessment for 14 of the 20 consulting contracts we reviewed.

Additionally, the district has not established a policy requiring a needs assessment for certain purchasing contracts, and the district's evidence of a needs assessment for one purchasing contract was insufficient. Specifically, the district entered into a sole-source purchasing contract with one vendor to participate in a program, but it did not document why it was necessary to do so. The manager of the procurement team acknowledged that a justification of the need for this contract should have been prepared. When we asked why it was necessary for the district to participate in this program, the chief financial officer stated that participants in the program work with the vendor to better understand earthquakes and how to prevent damage to critical infrastructure. Although this appears reasonable, it was not documented on the request. Without providing a reasonable needs assessment on the request form, the district is vulnerable to allegations of inappropriate use of district funds.

The district also generally lacks written policies and procedures that list the steps that should be taken to check a contractor's qualifications before entering into purchasing and sole-source consulting contracts. District staff responsible for purchasing stated that they verify contractor qualifications by various methods, including calling or checking references, performing credit history checks, performing site visits, reviewing the contractor's history with the district, and considering the contractor's reputation within the industry. According to the manager of the contracting services unit, methods for checking a contractor's qualifications are discussed during regularly scheduled meetings. However, the district was not able to demonstrate that it verified the qualifications of contractors for eight of the 10 purchasing contracts we reviewed. We would not expect the district to verify the qualifications of three of these contractors because they are well-established companies and we do not question their ability to provide the contracted goods and services. The district did not verify the qualifications of two other contractors because the buyer was confident of the contractors' ability to provide the goods or services based on past performance with the district. Nevertheless, the district would benefit from establishing policies and procedures that specify when it is necessary and how to check the qualifications of potential contractors. By doing so, the district would better ensure that it contracts with reputable and qualified contractors and that it receives goods and services that best meet its needs.

Establishing policies and procedures that specify when it is necessary and how to check the qualifications of potential contractors would better ensure the district contracts with reputable and qualified contractors.

The district has no written evidence to show that it verified contractor qualifications for 11 of 12 contracts we reviewed for which doing so appeared necessary.

The district has a process for ensuring that consultants are qualified for contracts awarded through a competitive process. A request for qualifications is used to specifically solicit consultant qualifications, and information solicited on a request for proposal includes specific work the consultant has performed. Five of the 20 consulting contracts we reviewed were awarded through one of these two competitive processes, and the district demonstrated that it evaluated the qualifications of these consultants as part of the process. The remaining 15 contracts were not awarded competitively, so they were not subject to an evaluation process. However, three of these contracts were with former employees who the district asserts were uniquely qualified to provide the contracted services. Therefore, it appears unnecessary to verify their qualifications. Several of the district's contract managers stated that the district verified consultant qualifications by calling references and considering the consultants' history with the district and within the relevant industry. However, the district has no written evidence to show that it verified the qualifications of 11 of the 12 remaining consultants. If it does not ensure that contractors are qualified to perform contracted services, the district risks entering into contracts with parties that may be unable to deliver the contracted services.

The District's Consulting and Purchasing Manuals Need Updating

District staff monitor consulting and purchasing contracts by doing such things as reviewing invoices and progress reports, communicating with contractors, and identifying any problems with goods or services received. However, the district needs to update its manuals to reflect current procedures.

For example, the manager of the contracting services unit acknowledged that the consulting procedures manual that provides general guidance on monitoring is not current but is still in use. The manager of the corporate resources group also states that the purchasing manual, which similarly provides guidance for monitoring purchasing contracts, needs updating to reflect changes to internal procedures and upgrades to the district's financial system. The manager of the contracting services unit stated that he expects the consulting and purchasing manuals to be updated completely by December 2004.

According to the district's manager of the corporate resources group, attending all four internal training classes that make up the contract administration training academy is supposed to be mandatory for all contract managers. An internal memo to district staff communicated this in September 2002. One of the training academy classes provides guidance on monitoring contracts. Contract managers were required to attend all training classes by October 2003 in order to continue performing contract manager responsibilities. Of the 20 consulting contracts we reviewed, two contracts expired before contract managers had the opportunity to attend all four training classes. There were 16 contract managers for the remaining 18 consulting contracts. Of these 16 contract managers, only five attended all four classes. Seven contract managers did not attend any classes.

The manager of the corporate resources group and the manager of the contracting services unit assert that workloads and scheduling conflicts precluded some staff from attending the training courses by the October 2003 deadline. The district is working toward providing the training in alternate formats to train staff unable to attend the classes. We recognize that

scheduling conflicts, staff workload, and other logistical problems can make it difficult for all staff to attend the training classes. However, the district has determined that it is important for contract managers to receive this training, so it should ensure that they do.

Three Programs for Which We Reviewed the Grant Award Process

City Makeover Program—a new program for fiscal year 2003–04 that is part of the Southern California Heritage Garden Program that aims to foster appreciation of California native and drought-tolerant plants in commercial, residential, and public landscapes. Through this program, the district awarded grants using contracts to fund 11 projects for a total of \$495,000 in fiscal year 2003–04.

Community Partnering Program—created in 1999 to provide funds for sponsorships, memberships, and special events for educational water awareness programs and activities of nonprofit organizations that support the district's goals. For fiscal year 2002–03, the program's budget was \$650,000.

Innovative Conservation Program—primarily designed to provide grants to explore new water conservation technologies. The program awarded \$250,000 in fiscal year 2002–03, and grants were awarded by contracts.

THE DISTRICT DOES NOT ALWAYS AWARD GRANTS BASED ON ESTABLISHED CRITERIA

The district sponsors four programs that award grants to groups that provide water education, explore new water conservation technologies, and foster appreciation of native and drought-tolerant plants. We reviewed the district's selection process for three of these programs—the City Makeover Program, the Community Partnering Program, and the Innovative Conservation Program—and found that it did not always award the grants based on established criteria.

We reviewed the selection process the district followed in awarding one grant under the City Makeover Program and found that it was based on

documented criteria that ensured that funds were awarded in support of the program's mission. However, the district could not demonstrate that it awarded grants for the Community Partnering Program and for the Innovative Conservation Program based on established criteria. This can lead to allegations of favoritism.

The district's process for awarding grants under both the Community Partnering Program and the Innovative Conservation Program involve two evaluation panels. An initial evaluation panel composed mostly of individuals representing public and private entities and some district staff reviews applications and scores the proposals based on established criteria. After the initial panel's review, a second panel representing district management reviews the proposals and the scores of the first panel and makes funding recommendations based on program goals and objectives.

The district lists the evaluation criteria for the Community Partnering Program on its Web site for a potential applicant's reference. Members of the Community Partnering Program's initial evaluation panel use a similar set of criteria to evaluate applications; however, we noted instances in which district management made funding recommendations not based on any established criteria. For instance, the initial evaluation panel reviewed one application; some panelists recommended partial funding be awarded and some recommended against funding this organization. However, a second evaluation panel composed of external affairs management ultimately awarded this organization \$5,000. This appears to have been a subjective decision that was not based on established criteria. In another instance, an applicant received \$11,500 through the Community Partnering Program for fiscal year 2002-03. However, the initial evaluation panel did not review or evaluate the applicant's proposal. Rather, external affairs management recommended that this organization receive \$11,500. Again, this appears to have been a subjective decision that was not based on any established criteria.

Evaluation criteria are not provided in advance to potential applicants for the Innovative Conservation Program. A panel of individuals representing outside entities and one district staff member evaluated grant applications for the Innovative Conservation Program based on seven criteria. According to the Innovative Conservation Program project manager, the decision to provide funding is based on points awarded by its

Not all panel members evaluated the grant applications for three of 10 applicants that received funding under the Innovative Conservation Program.

evaluation panel project evaluation scores. However, of the 10 applicants that received funding, three were not evaluated by all panel members. Further, a second panel composed of district management made recommendations to the group manager on which applicants to fund and in what amounts. Also, some applicants that scored higher than others did not receive funding while other lower scoring applicants received funding. Therefore, not all funding decisions were based on established written criteria.

The vice president of external affairs asserts that it is unreasonable to expect that the district would develop specific criteria for evaluating requests for funds for every type of program or project proposed for the Community Partnering Program. He contends that decisions to grant funds under the Community Partnering Program and the Innovative Conservation Program often are based on qualitative factors. However, as major categories of applications are identified, the district does develop specific evaluation criteria. Finally, the vice president states that the volume of applications precludes evaluation panel members from reviewing every application. When we asked why some applications scoring lower than others were funded, the Innovative Conservation Program project manager stated that the evaluation panel's review and scores are the first step in the evaluation process. After the evaluation panel reviews applications, district management reviews the applications in light of program goals and objectives. Further, he stated that some evaluation panel members did not review all proposals due to time constraints; therefore, some projects received fewer points than others. The project manager stated that in the end, district management makes selections based on program goals and objectives.

We recognize the importance of qualitative factors but believe the district should define the various factors it uses to evaluate grant applications and make funding decisions accordingly. Further, when not all evaluation panel members review the same applications, the district lacks assurance that decisions to award grants are made consistently. Finally, funding decisions should be tied to established, documented criteria.

RECOMMENDATIONS

To make better use of the funds it spends on goods and services, the district should do the following:

- Ensure that management as well as staff prepare written justifications for all contracts that are not awarded through a competitive process.
- Develop a written policy that requires staff to perform and document a needs assessment for consulting and purchasing contracts. Ensure that staff follow the policy.
- Develop a written policy that requires staff to verify a contractor's qualifications before entering into purchasing and sole-source consulting contracts, including procedures that describe how various types of contractors' qualifications should be verified. Ensure that staff follow the policy.
- Continue its efforts to update its consulting and purchasing procedure manuals and ensure that its administrative code requirements are consistent with the manuals.
- Ensure that all contract managers attend the contract administration training academy.
- Define the various factors, including qualitative factors, it will use to evaluate grant applications and make funding decisions accordingly. Additionally, individual awards should be supported by documentation of the factors considered. ■

Blank page inserted for reproduction purposes only.

CHAPTER 4

The District's Personnel Policies Are Lacking and Are Not Always Followed

CHAPTER SUMMARY

The Metropolitan Water District of Southern California (district) selects employees for positions represented by bargaining units through a merit system. However, its personnel policies are lacking and do not always ensure sufficient merit system processes such as hiring and promotions. Although the district was able to provide us with hiring policies and procedures from multiple sources, they are not always current or comprehensive. Further, it was not able to provide us with formal written policies and procedures to support all aspects of its different methods of promotion. In their current state, the policies and procedures invite inconsistency, cannot ensure appropriate checks and balances over hiring and promotion decisions, and may lead to employee grievances and disagreements with bargaining units. To further compound potential problems with its hiring process, the district does not always follow existing policies and procedures, exposing itself to criticism by employees and other interested parties. However, the district is updating its operating policies, including personnel policies.

Additionally, the district has established differing board of directors' (board) approval and disclosure policies for separation and settlement agreements, even though both types of agreements often share the same goal of avoiding subsequent legal liability, and both commit the district to financial obligation. Given the similar nature of these agreements, we believe they warrant the same level of board involvement.

THE DISTRICT CREATED A MERIT SYSTEM THAT GOVERNS EMPLOYEE SELECTION

According to the California Government Code, a local agency, such as the district, is not prohibited from establishing its own merit system and determining the personnel standards applicable to its employees. The district established a merit-based

system of employment to determine an applicant's fitness to perform work for positions represented by bargaining units. These positions, which are subject to collective bargaining agreements (memoranda of understanding), often follow a specific competitive recruitment and hiring process. Despite the different memoranda of understanding with the bargaining units, the central components of the process remain the same for those positions. The district's hiring of represented employees, 98 percent of total employees, includes various phases, as shown in Figure 8.

The district hires unrepresented employees at the discretion of senior management and, in some cases, the board.

Many key district positions, such as the general auditor, general counsel, and human resources manager, are unrepresented; to fill these positions the district is not required to follow the competitive recruitment process identified for represented employees. For example, candidates for these positions are not always subject to performance testing or panel interviews. The district hires unrepresented employees at the discretion of senior management and, in some cases, the board. The typical avenues for recruiting and hiring unrepresented employees include appointment, the use of an external recruiting firm, and sometimes the use of the district's human resources section.

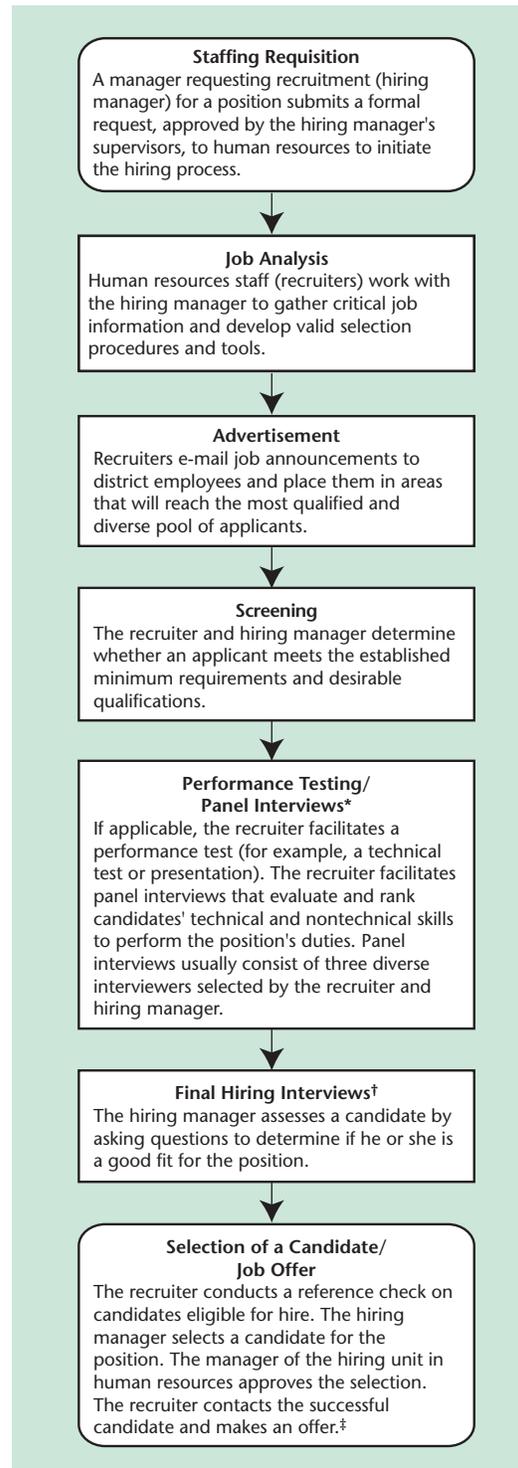
The district also uses a merit system to promote employees. The different methods of promotion include an employee-initiated study of his or her position (a job audit), a management-requested promotion, and the successful recruitment of an internal employee into a higher-level position. See the text box on page 64 for a description of each method.

HIRING POLICIES, CONTAINED IN MULTIPLE SOURCES, ARE NOT ALWAYS CURRENT OR COMPREHENSIVE

The district characterizes its process for hiring represented employees as a selection system designed to determine the fitness of each applicant for the work to be performed. However, the policies and procedures guiding the hiring process are contained in multiple sources that are not always current or comprehensive. For instance, we found that the various hiring policies and procedures sometimes result in conflicting requirements. The policies and procedures do not fully establish guidelines to prevent favoritism or the appearance of favoritism in the selection of new hires. Although the district acknowledges its policies and procedures are lacking and is in the process of updating them,

FIGURE 8

Phases of the Hiring Process for Represented Employees



* Depending on the number of internal candidates, these candidates do not always have a panel interview and may move directly to the final hiring interviews.

† Final hiring interviews are not always necessary if the hiring manager is also a panel interviewer.

‡ External candidates are made a conditional offer based on the successful completion of a security and background check.

these deficiencies can result in inconsistent hiring practices and confusion or disagreements among recruiters, other employees, and bargaining units. They also may lead to grievances.

The District Does Not Maintain a Current Hiring Policy and Procedures Manual

The district does not maintain a single up-to-date policies and procedures manual to govern its hiring process, increasing its risk of inconsistent hiring practices and confusion among staff and interested parties. In fact, the manager of the district's staffing and performance management unit (hiring unit) identified 15 different sources of policy and procedure related to the recruitment and selection of employees and stated there may be additional sources. These 15 sources include the district's administrative code and operating policy, memoranda of understanding with bargaining units, and various internal human resource documents, such as memos and an e-mail. None of these sources provides adequate guidance over all aspects of the hiring process. We would expect the district to have comprehensive and current hiring policies and procedures in a consolidated format to supplement the policies identified in individual memoranda of understanding with bargaining units. Recruiters and other interested parties then could turn to the one source for general hiring policies and procedures and could look to the relevant memoranda of understanding for any deviations from the general policies the district may have agreed to with each bargaining unit. All seven of the district's recruiters state that a comprehensive and current manual would be beneficial.

A district manager identified 15 different sources of policy and procedure related to the recruitment and selection of employees and stated there may be additional sources.

Recruiters assert that the multiple sources of hiring policies and procedures are the result of changes in human resources management. For instance, since January 2002 the manager of the hiring unit has changed four times. According to recruiters, the various managers revised policies and procedures but often communicated revisions verbally in staff meetings or through other written sources, including e-mails and internal memos. The current manager of the hiring unit adds that the policies and procedures have been detailed in various documents to reflect the numerous changes in the hiring process resulting from agreements with bargaining units and grievance resolutions. The frequent change in human resources management and hiring policies further illustrates the need for a consolidated manner of documenting policies and procedures and keeping them current.

The district may change a hiring requirement but not update it in every source, sometimes leading to contradictory guidance and inconsistent hiring practices or confusion among recruiters, hiring managers, and other employees. For example, in the 15 sources identified as the district's hiring policies and procedures, an e-mail from the then manager of the hiring unit discussed the requirement that analysts be present at all hiring interviews; however, a later human resources document updated this policy to require the presence of the analyst only at the hiring manager's request.

Disagreements between the district and bargaining units further illustrate the confusion over relevant personnel policies. For example, the district and its largest bargaining unit disagree as to whether management bulletins, historically containing detailed human resources policies, are valid. The district and the bargaining unit agreed, effective 1996, that the district would delete the management bulletins and place the policies they contained in either the memorandum of understanding or the administrative code. The district believes that it appropriately fulfilled the terms of the agreement. However, the bargaining unit believes the district did not account for these rules, such as the selection of panel interviewers and the facilitation of the panel interview phase, in an appropriate manner. Thus, it does not agree that the bulletins were superceded entirely by the memorandum of understanding or administrative code or that they were rescinded. As of April 2004, disagreement between the district and the bargaining unit continues over this issue.

The District Lacks Comprehensive Hiring Policies and Procedures

The district's policies and procedures do not fully establish guidelines for preventing favoritism or the appearance of favoritism in the selection of new hires.

The district's current hiring policies and procedures are not always comprehensive and do not provide sufficient guidance over certain aspects of the hiring process. For example, the district's policies and procedures do not fully establish guidelines for preventing favoritism or the appearance of favoritism in the selection of new hires. One of the 15 new hires we reviewed involved a candidate for a job who listed as a reference a district employee who participated in the candidate's panel interview and who was one of the managers approving the candidate's selection. The district's hiring policies and procedures do not address the participation of a candidate's references in other aspects of the recruitment process, such as the panel interview, even though this situation presents a potential for preferential treatment.

The district does not deny that its human resources policies and procedures are lacking. In fact, from an internal assessment of human resources in February 2003, the district identified the need for additional policies and procedures to guide staff, noting that “lack of specific policies and procedures or inconsistent application of existing ones often leads to grievances.” Under the direction of its new manager, human resources is in the process of documenting formal policies and procedures and obtaining appropriate approvals.

THE DISTRICT DOES NOT CONSISTENTLY FOLLOW ITS EXISTING HIRING POLICIES AND PROCEDURES

The district does not consistently follow the policies and procedures that do exist for hiring. For example, it does not always meet its time frame for hiring a new employee, and it does not always retain documentation to demonstrate that it followed required procedures, such as conducting hiring interviews, making itself vulnerable to criticism by employees and other interested parties.

In October 2002, the district set a goal in its policies and procedures of completing recruitments within 60 working days. We reviewed five recruitments that followed the hiring process for represented employees and that began after October 2002; the district took 80 to 140 working days to fill four out of the five. Some recruiters state that the 60-day time frame is not reasonable for recruitments involving external applicants. When the recruitment process involves external applicants, advertising the position takes longer and, according to recruiters, usually results in a larger applicant pool than recruitments involving only internal applicants. Nevertheless, two of the four recruitments that did not meet the district’s goal involved only internal candidates, including the one that took 140 days.

Some recruiters contend the district’s use of outdated material, such as job descriptions, may add difficulty to the hiring process and lengthen the time to fill a position.

Some recruiters contend the district’s use of outdated material, such as job descriptions, also may add difficulty to the hiring process and lengthen the time to fill a position. The district’s job descriptions specify the duties and responsibilities, as well as the minimum requirements, for a position. Recruiters acknowledge these job descriptions are outdated, with one recruiter commenting they are sometimes as much as 30 years old. Outdated job descriptions sometimes add difficulty to the hiring process because they may not always set accurate minimum requirements to attract only qualified applicants. For example,

one minimum requirement in a job description established in 1982 for a maintenance mechanic position specifies that an applicant must have four years of experience in general maintenance; however, general maintenance can be interpreted broadly. In fact, some maintenance mechanic positions actually involve the operation of 90-ton hydraulic cranes, which can require more skill than just general maintenance experience. Not setting adequate minimum requirements can result in a large volume of unqualified applicants, which in turn increases the workload for district staff and potentially lengthens the recruitment time frame.

In one recruitment we reviewed, an applicant did not meet the minimum requirements for the position yet passed the screening phase, thereby altering screening standards and risking allegations of unfair employment practices.

Concerns over preferential treatment may occur when the district does not follow its requirement that all applicants meet the minimum requirements of a position. We reviewed six recruitments where an external applicant received a job offer for a represented position. One applicant did not meet the minimum requirements for the position yet passed the screening phase, thereby altering screening standards and risking allegations of unfair employment practices. The candidate was hired for a position that required at least a bachelor's degree with relevant work experience, or two years of directly related experience working for the district, neither of which she had.⁷ The recruiter facilitating this process contended that the applicant's outside work experience substituted for the direct experience with the district and that the hiring manager at the time approved this decision. We do not believe the minimum requirement offers this flexibility because it specifically states the necessary work experience must be as a district employee.

Although the hiring of unrepresented employees is discretionary, the district sets minimum qualifications and sometimes establishes other requirements for its unrepresented positions. One of the three new hires for unrepresented positions we reviewed did not hold a particular professional certification, which was a requirement for the position. Although the job description clearly reads "certification requirement," the hiring manager states that he did not view the certification as a requirement but as a preferred qualification. Nevertheless, actions such as these leave the district open to allegations of unfair employment practices. Further, we believe that when the district identifies certain requirements for its unrepresented positions, it is good business practice to adhere to these requirements.

⁷ This is the same recruitment we cited in an earlier example, in which this candidate's reference was also a panel interviewer, thus creating the appearance of favoritism.

The district also does not consistently maintain documentation to demonstrate the completion of certain hiring procedures. In some instances, it did not retain documentation to support that the screening of applicants and the interviewing of candidates took place. When the district does not document its adherence to its hiring process, it risks criticism of unfair hiring practices.

THE DISTRICT LACKS FORMAL POLICIES AND PROCEDURES FOR CERTAIN TYPES OF PROMOTIONS

Management-requested promotions and job audits, described in the text box, are two processes for promoting an employee. However, the district could not provide written policies and procedures to support its management-requested promotion process and could not demonstrate comprehensive policies and procedures related to the job audit process. Additionally, in our review of management-requested promotions, we could

not always determine the methods that human resources used in their analysis and justification for a promotion, due to the lack of documentation. When the district does not have sufficient written documentation of its processes, it risks inconsistent practices and makes itself vulnerable to criticism of unfair promotional decisions.

The management-requested promotion process provides a manager the means of initiating the promotion of an employee. However, the acting manager of human resources' classification and compensation unit could not provide written policies and procedures to support the process that her staff uses in administering this type of promotion. Further, the district's administrative code and the memoranda of understanding with bargaining units do not support the existence of this process. Although the former manager of the classification and compensation unit provided a document that she prepared in March 2003 to

support such promotions, the document offers only skeletal procedures and was not distributed to staff. Additionally, the supporting documentation for management-requested promotions is minimal, and we could not always determine what staff used in determining the reasonableness of the requested promotion, such as interviews and other support.

Promotional Processes for Represented Employees

Job Audit—an employee requests a study of his or her duties and responsibilities to determine the appropriate job classification. A promotion may result if the job audit concludes that the employee is performing the duties of a higher-level salary position.

Management-Requested Promotion—a manager requests that an employee acquire the duties and responsibilities of a higher-level salary position. A promotion may result if human resources concludes that the employee is performing the duties of a higher-level position.

Recruitment—an employee applies for a vacant position through the hiring process and is successful in obtaining a higher-level salary position.

The district has policies and procedures for its job audit process, but they do not always offer the level of comprehensive guidance that would help prevent inconsistent promotional decisions. For example, as part of the job audit process, the memoranda of understanding with bargaining units require that the district study an employee's position to determine whether he or she is performing the higher-level duties that warrant a promotion. However, job audit policies and procedures do not include comprehensive guidelines on the methodology for completing a study or the development of a job audit report.

INADEQUATE POLICIES AND PROCEDURES AND THEIR INCONSISTENT APPLICATION OFTEN LEAD TO GRIEVANCES

The lack of adequate human resources policies and procedures and the inconsistent application of existing ones often lead to employee grievances concerning the district's merit system processes. Of the 276 grievances that the district reported were filed from January 2001 through February 2004, at least 153 related to either hiring or the district's promotional processes. The grievances alleged that the district failed to adhere to certain policies and engaged in practices that were not objective.

The district's grievance process addresses allegations by employees that they have been adversely affected by violations of written policies and rules. Although the grievance process is fairly well defined, policies do not establish time frames for resolving substantiated grievances. The district currently develops resolution letters to communicate its proposed action for resolving issues; however, these letters do not always establish time frames that hold the district accountable for action in a timely manner.

THE DISTRICT IS UPDATING ITS OPERATING POLICIES

The district appointed a new chief operating officer in December 2003 who, according to the coordinator for this project, decided to review operating policies, including personnel policies, and ensure that they are current and consistent with board directives. The coordinator stated the district developed a team of staff from each department and group to facilitate the review of the current operating policies by the appropriate technical staff and to provide recommendations on revisions to

Of the 276 grievances that the district reported were filed from January 2001 through February 2004, at least 153 related to either hiring or the district's promotional processes.

the chief executive officer. The chief executive officer provides the final approval on all revisions. According to the coordinator, the review will be an ongoing effort.

In January 2004, the new manager of human resources began facilitating the creation of documents to support certain human resources processes such as hiring and promotions.

In January 2004, the new manager of human resources began facilitating the creation of documents to support certain human resources processes such as hiring and promotions. As of April 2004, human resources had created an initial draft document of consolidated policies and procedures for the hiring process. Additionally, it created draft policies and procedures for the job audit process that includes the methodology for completing a job audit study and the development of a job audit report. Human Resources also developed draft policies and procedures that support the management-requested promotion process. As of April 2004, these new policies and procedures were pending appropriate approvals.

AGREEMENTS WITH SEPARATING EMPLOYEES ARE NOT SUBJECT TO THE SAME LEVEL OF BOARD SCRUTINY AS SIMILAR AGREEMENTS

The district has established differing board approval and disclosure policies for similar types of agreements. The district sometimes enters into agreements with separating employees (separation agreements) to avoid litigation. Because the district treats these like contracts rather than settlements, which the district enters to settle or avoid legal claims, separation agreements are not subject to the same level of board review. However, given the similar nature of separation agreements, we believe they warrant the same level of board involvement as settlements.

We reviewed 10 separation agreements the district entered into between July 2001 and October 2003. Although the stated purpose of two of the 10 agreements was to settle all employment issues and to avoid litigation, all 10 included boilerplate language indicating that as part of the agreement the separating employee was giving up his or her right to sue the district, suggesting that all 10 might otherwise have resulted in subsequent legal claims. The district's general counsel acknowledged that separation agreements serve to protect the district from potential claims but also stated that separation agreements are intended primarily to facilitate management transitions in an expeditious manner. Not all 10 separation agreements we reviewed required lump sum payments, and those that did had payments that ranged from about \$38,000 to \$75,000. However, some of these separation

agreements also kept separating employees on the payroll for as long as a year. During this time, some employees received their salary as well as health, dental, and retirement benefits. Some of these agreements also included payments to attorneys representing the separating employees. Consequently, the cost of separation agreements can be much greater than just the initial lump sum payment.

These separation agreements did not receive full board review or approval and were not even reported to the full board because, according to the district's general counsel, the district treats them as contracts. Contracts less than \$250,000 do not require board review or approval. The general counsel asserted that, although the district does not inform the full board of separation agreements, its practice has been to inform the board chair.

Unlike separation agreements, settlements of \$125,000 or more require board review and approval. Further, district policy calls for settlements to be disclosed to a board committee on a quarterly basis regardless of their dollar value. According to the district's general counsel, settlements are different from separation agreements because settlements arise from formal legal claims. Regardless of this distinction, separation agreements and settlement agreements often share the goal of avoiding subsequent legal liability, and both commit the district to financial obligation. For example, in our review of both separation and settlement agreements, we noted instances where the district entered into them to avert "potential civil claims." Because the substance and nature of separation agreements more closely resemble settlements than contracts for goods or services, we believe they should be subject to the same level of board scrutiny as settlements.

RECOMMENDATIONS

To ensure consistent hiring practices and to improve checks and balances in this area, the district should develop comprehensive and current policies and procedures for hiring. To do so, it should take the following actions:

- Continue its efforts to consolidate policies and procedures into a single human resources policies and procedures manual.

- Ensure that policies and procedures fully address the potential for favoritism or the appearance of favoritism, including when a candidate's reference is involved in other aspects of his or her recruitment.
- Work to resolve all disagreements with bargaining units over the existence of management bulletins.
- Update job descriptions to ensure that they are accurate and current.

After the district establishes current and comprehensive hiring policies and procedures, it should work with recruiters to ensure that it has established a reasonable time frame for completing recruitments, including those involving external applicant pools.

The district should ensure that it follows its hiring policies and maintains written documentation that it did so.

The district should develop comprehensive policies and procedures for promotions, which include steps to ensure that it documents reasonable justification for all promotional decisions.

The district should amend its grievance policy to require the establishment of time frames for resolving substantiated grievances.

The district should review and update all its policies and procedures periodically and develop a policy for communicating revisions to staff.

The district should provide a listing of separation agreements to the entire board to aid the board in understanding the use of these agreements. The listing should include the cost of all agreements, including lump sum payments, salary and benefits related to keeping employees on payroll, and payments to attorneys. In addition, because of the similarities between these agreements and settlements, the board should establish a consistent policy for its approval of these agreements. Finally, the board should require the district to disclose all separation agreements to the full board as it already does with settlements. ■

CHAPTER 5

The Center for Water Education Currently Relies Heavily on the District for Funding and Has Yet to Develop Formal Policies and Procedures for Its Contracts

CHAPTER SUMMARY

In October 2001, the Metropolitan Water District of Southern California (district) created the entity now known as the Center for Water Education (center) to establish a water education facility and museum (facility). Currently, the center primarily depends on the district for funding and the provision of administrative and financial accounting services. Nonetheless, it has entered into agreements to receive other funding and has received a small amount of money through endowments and a fund-raiser. The center's long-term goal is to reduce its reliance on district funding.

The center plans to follow the requirements in the California Public Contract Code, including competitive bidding, for letting its future construction contracts, although it is not required to follow the code's requirements. It has not yet formulated policies and procedures for those aspects of the contracting process that occur before and after the bidding phase. As of April 2004, the center had entered into a consulting contract for construction management and planned to seek competitive bids for construction of the facility. It also had entered into various other consulting contracts, but it lacks formal policies and procedures that would govern the award and management of these contracts. The lack of such policies and procedures may be preventing the center from receiving the most qualified contractors and the best prices for its consultants.

THE DISTRICT CREATED THE CENTER AS A SEPARATE ENTITY TO RAISE FUNDS FOR A WATER EDUCATION FACILITY

In October 2001, the district's board of directors (board) adopted a resolution creating the Foundation for the Southern California Water Education Center (foundation). It subsequently was incorporated as a nonprofit public-benefit corporation under Section 501(c)(3) of the Internal Revenue Code. The board created the foundation because a special committee believed a separate entity would have greater success at fund-raising and in seeking public and private grants to support the district's goals of establishing a facility at Diamond Valley Lake near the city of Hemet in Riverside County. Contributions to entities formed under Section 501(c)(3) are tax deductible. The foundation changed its name to the Center for Water Education in 2003.

The district's board believed a separate entity would have greater success at fund-raising and in seeking grants to establish a water education facility.

The center's facility is to be composed of meeting rooms and exhibit space and is intended to highlight the history of water, the environment, and the cultural heritage of western North America, with a focus on the role that water plays in cultural, biological, climatic, environmental, social, and economic continuity and change. The center is the extension of an existing district water education program, which reportedly annually reaches 1,000 classrooms and 30,000 students in grades K-12.

According to the district's executive vice president, the center is evolving into a regional, state, national, and international center for education and the development of policies relating to water management. On liquidation or dissolution, all properties and assets remaining after payments to creditors would be distributed and paid to the district for purposes consistent with those of the center or to an organization dedicated to educational or charitable purposes, provided the organization continues to qualify under Section 501(c)(3).

Its bylaws state that the center was organized for the following purposes:

- To finance or provide financial support for construction of a facility on district property at Diamond Valley Lake.
- To construct, operate, and maintain, or by contract provide construction, operation, and maintenance service to the district for the facility.

- To develop and provide educational, historic, and instructional materials and programs relating to water, water use, water conservation, and water supply.

The bylaws indicate the center has various powers, including creating, promoting, developing, and facilitating water education at the facility. Additionally, the bylaws authorize it to solicit, receive, and administer funds from public and private sources by grant, contract, loan, or gift for the purpose of the facility.

The center's board of directors (center's board) manages its activities and affairs. As of April 2004, the center's board was composed of 11 members. Bylaws allow five to 15 board members to be elected every four years at the annual meeting by a majority of the members then in office. Board powers include appointing and removing all officers, agents, and employees of the center, as well as prescribing powers and duties for them that are consistent with law, and borrowing money and incurring indebtedness on behalf of the center. The chair of the center's board is also the chair of the district's board, and another two of the center's board members are also district board members.

THE CENTER HAS DECIDED TO FOLLOW SEVERAL LAWS THAT APPLY TO THE DISTRICT

There is nothing in law that prohibits the district from establishing the center as a separate entity. However, doing so could raise concern that the center was set up to circumvent certain laws applicable to the district. When a public agency such as the district establishes a separate entity such as the center, the various laws relating to public officials and conflicts of interest also may apply to that entity. For example, when the public agency that creates an entity delegates governmental functions to that entity, it may be subject to some of the same laws as the public agency that created it. One law that applies to the district is the Political Reform Act of 1974 (political reform act), which requires, among other items, the adoption of a conflict-of-interest code and requires public officials to publicly disclose certain investments and income. The attorney for the center sought advice from the Fair Political Practices Commission concerning whether the political reform act applies to its board members. The commission concluded that the act does apply because the center qualifies as a local government agency as defined in the political reform act. Consequently, the center incorporated provisions of the political reform

The Fair Political Practices Commission concluded that the political reform act applies to the center.

act in its bylaws. For example, in December 2003, the center adopted amended bylaws to require its board to adopt a conflict-of-interest code in accordance with the political reform act. In March 2004, the center's board adopted a conflict-of-interest code to identify the proper disclosure requirements and submitted it to the Fair Political Practices Commission for review. The center's attorney expected board members would file statements of economic interest by mid-June 2004 to comply with the conflict-of-interest code requirements of the political reform act.

The center also subsequently decided to follow other laws that apply to the district. For instance, although the center is not subject to the Public Contract Code, which includes requirements for entering into construction contracts, the center's board has decided to follow these requirements. In addition, although the center's attorney does not believe its board is required to follow Section 1090 of the California Government Code, which prohibits government officials from having a financial interest in contracts made in their official capacity, the center has agreed to follow the requirements of this law. However, it is too soon to assess its compliance with these laws.

THE CENTER CURRENTLY RELIES HEAVILY ON THE DISTRICT FOR FUNDING AND SERVICES

Through February 2004, the center received the majority of its funding from the district and had no direct employees. It had an agreement with the district to perform financial and administrative services for a monthly flat fee. The district provides accounting services such as maintaining the center's accounting records and preparing its annual financial statements. The district also facilitates the center's board meetings, monitors its programs, and coordinates its activities and events.

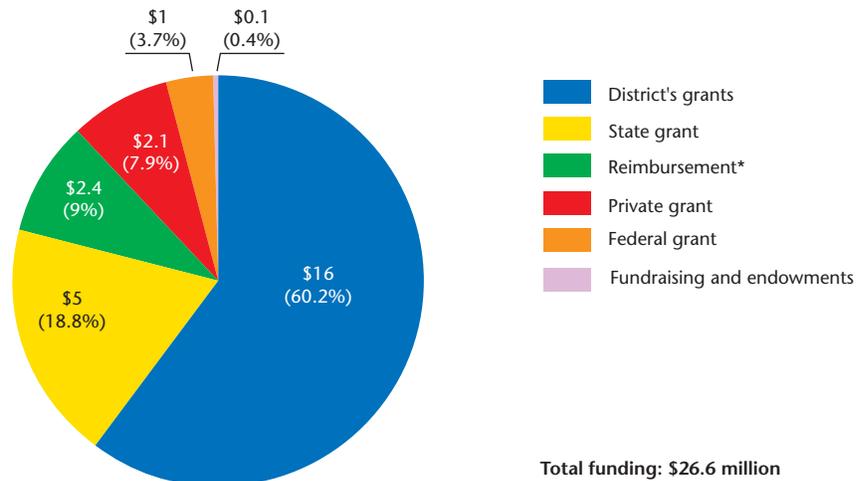
Although it has entered into agreements to receive grants and reimbursements, the center has received only \$3.1 million as of February 2004.

The district entered into two grant agreements with the center in February 2002 and July 2003 that will provide the center with a total of \$16 million. Grant money provided by the district is to be used for the initial organization, planning, design, and construction of the facility. Among the uses defined for the grants provided by the district are contracting for programming and project planning and design, infrastructure and facility design and construction, and legal counsel. Additionally, the district has provided the center with a lease agreement of \$1 per year for the property on which the facility will be located.

The center projects that it had \$26.6 million in promised funding, including the \$16 million in grant agreements from the district, as of February 2004. Although it has entered into agreements to receive funding in the form of grants and reimbursements, it has received only \$3.1 million, including nearly \$100,000 through endowments and fund-raisers. The district provided \$2.5 million of the \$3.1 million. As of February 2004, the center's activities included design development for construction, landscaping, and exhibits, and holding center board meetings; it had spent only \$2 million of the \$3.1 million in funding it had received. The district expects that the center will be more self-sufficient in the future by attracting a higher volume of contributions from other sources. Figure 9 shows that, as of February 2004, the amount that the district had committed to provide represents 60 percent of the center's promised funding. The remainder consists of grants from other entities and a private organization, expected reimbursements, and to a small extent, endowments and fund-raisers. For example, the center held a fund-raising event at Diamond Valley Lake, First to Fish, in September 2003 that brought in about \$25,000.

FIGURE 9

**Center for Water Education Promised Funding
Through February 2004
(In Millions)**



Source: Center for Water Education funding data.

* Reimbursement is from the Western Center Community Foundation for its estimated portion of future construction costs for "shared" facilities. The Western Center Community Foundation is a nonprofit entity sponsoring a Western Center for Archeology and Paleontology on the same site as the Center for Water Education's facility.

THE CENTER HAS NOT DEVELOPED FORMAL POLICIES AND PROCEDURES FOR CONTRACTS

As of April 2004, the only construction-related contract the center had entered into was a consulting contract for construction management. Its attorney stated the center's board has elected to follow the Public Contract Code for its future construction contracts, and thus it plans on seeking competitive bids for construction of the facility. However, it still needs to develop policies and procedures for those aspects of the contracting process that occur before and after the bidding phase. Additionally, the center has not established any formal policies and procedures for its consulting contracts, including a requirement that they be awarded through a competitive process.

As of April 2004, the center had entered into 14 consulting contracts, 11 of which totaled nearly \$7.8 million.

As of April 2004, the center had entered into 14 consulting contracts, 11 of which totaled nearly \$7.8 million. An example of one of these contracts is a \$238,000 agreement in which a consultant is required to complete designs for exhibits at the center's planned facility. The other three contracts are for the district-provided services discussed earlier, for the services of the center's attorney, and for the construction management contract. The district charges a flat monthly fee of approximately \$7,000 for its services, and the attorney bills for any legal services provided based on an hourly rate. The center will pay the construction management consultant a total fee of 4 percent of the total construction costs of the project.

Although the center is not subject to the Public Contract Code, which includes requirements for entering into construction contracts, the center's board decided in an October 2003 board meeting to follow the requirements set forth in this code that pertain to the district when entering into construction contracts. This decision caused the center to terminate the "build" portion of a "design-build" contract it previously entered. The design-build contract originally was let to one contractor, through a noncompetitive process, to conduct the design and construction of the planned facility. Although the design portion of the design-build contract is not subject to competitive bidding requirements, the build (construction) portion of the contract is subject to certain Public Contract Code requirements. For example, the Public Contract Code requires the district to competitively bid construction contracts and award those contracts to the lowest responsible bidder. As a result, because the center has chosen to follow these procedures, it would not meet these requirements of the Public Contract Code if it did not award the "build" portion of a design-build contract to a

contractor through a competitive bidding process. Therefore, it decided to terminate the build portion of its design-build contract and place it up for bid. As of April 2004, the center had entered into a consulting contract for construction management and planned to seek competitive bids for construction of the facility under multiple contracts.

Although the center for its construction contracts has decided to follow the Public Contract Code requirements that apply to the district, it has not supplemented these requirements with formal policies and procedures.

Although the center for its construction contracts has decided to follow the Public Contract Code requirements that pertain to the district, it has not supplemented these requirements with formal policies and procedures for determining the need for contracts and the scope of work and for evaluating the qualifications of potential contractors, nor has it developed policies and procedures for monitoring and evaluating the subsequent performance of contractors. The center also lacks such policies and procedures for its consulting contracts and does not have a policy requiring that its consulting contracts be awarded through a competitive process. It entered its existing consulting contracts using a process in which it contacted a single firm or a small group of consultants regarding a proposed project and made a selection. One current consulting contract, which is estimated to total \$381,000, is for the fees associated with designing and overseeing development of items such as the water feature and associated landscaping fencing for the center's facility. The center awarded this contract after contacting only a single firm.

In a management letter dated September 2003 stemming from its audit of the district's fiscal year 2002-03 financial statements, the external auditor commented that the center lacked formal written policies and procedures for many of its business activities, including procurement. The external auditor noted that while the then-current activity and lack of direct staff may not warrant it having formal policies and procedures in place, continued increase in its activities and budget warranted that the center establish formal policies and procedures to establish a strong internal control environment. The center concurred with the auditor's recommendation and responded that it would establish additional procedures by February 2004. As of April 2004, the center still had not established any procedures, but the district's executive vice president agreed with the recommendation and stated that he is drafting formal policies and procedures for consulting and construction contracts.

Establishing procedures for determining the need for contracts, the scope of work, and the qualifications of potential contractors will help ensure that the center enters into necessary contracts for well-defined work products with qualified contractors. Establishing policies and procedures for monitoring and evaluating the subsequent performance of contractors will help ensure that the center's vendors comply with the terms and conditions of the agreements. Finally, requiring a competitive process for the award of consulting contracts would help to ensure that the center is receiving the best price for these contracts.

RECOMMENDATIONS

The center should establish formal contracting policies and procedures for all contracts. These should include procedures for determining the need for contracts, the scope of work, and the qualifications of potential contractors. These policies also should establish procedures for monitoring and evaluating the subsequent performance of contractors. Finally, the center should require a competitive process for consulting services when appropriate to ensure that it receives the best value for these services.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



ELAINE M. HOWLE
State Auditor

Date: June 3, 2004

Staff: Karen L. McKenna, CPA, Audit Principal
Michael Tilden, CPA
Nicholas Almeida
Erika J. Cruz
Laura G. Kearney
Siu-Henh Ung

Agency's comments provided as text only.

Metropolitan Water District of Southern California
700 N. Alameda Street
Los Angeles, CA 90012

May 20, 2004

Ms. Elaine M. Howle*
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle,

Enclosed please find Metropolitan's response to the State Audit entitled "Metropolitan Water District of Southern California: Its Administrative Controls Need to be Improved to Ensure an Appropriate Level of Checks and Balances Over Public Resources". As requested, we are providing this response by 5:00 p.m. Thursday, May 20, 2004.

I wish to commend your staff on their professionalism and hard work in preparing this Audit Report. As you will see in our response to the recommendations in the Audit Report, we have by and large accepted all the recommendations and intend to implement the suggestions as we are always trying to improve our operations and efficiency.

I would like to state, however, that the tenor of the Report's title and chapter headings leaves much to be desired. While the recommendations and text of the Report find that the district *should* make improvements in its administrative controls to safeguard our responsibilities, the title concludes that the district *needs* to improve its administrative controls. The implication in the title and heading is that the district is out of compliance with some requirement or standard that is not reflected in the text and recommendations.

My concern with the title and headings aside, Metropolitan has accepted the recommendations in the Report and plans to keep your staff closely informed of progress in working towards implementation of the various recommendations. Please feel free to call me if you have any questions.

Sincerely,

(Signed by: Phillip J. Pace)

Phillip J. Pace
Chairman

Attachments

* California State Auditor's comments appear on page 89.

Metropolitan Water District of Southern California Response to State Audit

The Metropolitan Water District of Southern California (Metropolitan) offers the following general comments and specific points regarding the recently concluded audit conducted by the California State Auditor as directed by the State Legislature. In responding to the Audit Report and its recommendations, we believe that the conditions within which the report was performed and the scope of the audit are important to note as the report is finalized, distributed, discussed and presented to the Joint Legislative Audit Committee. During the period of focus in the Audit Report, Metropolitan has successfully accomplished its mandate to provide its service area with a reliable supply of high-quality water to meet present and future needs in an environmentally and economically responsible way, despite record drought conditions in the Colorado River basin and record dry years in Southern California. This accomplishment highlights the fact that Metropolitan's core business functions serve the public well. These core business functions, however, were not the focus of this audit nor are they discussed in the Audit Report. Rather, the audit scope was limited by the Joint Legislative Audit Committee to an evaluation of Metropolitan's support functions such as hiring practices, contracting services, the ethics office, and the Center for Water Education. Specifically, the audit does not review Metropolitan's core business functions of water system conveyance and distribution, water resource management, water conservation and water treatment. That the scope was limited to an assessment of support functions does not diminish in any way the importance or value of the Audit Report, but is critical to understanding the context within which the audit was conducted and the report that was issued.

Metropolitan takes its mission as a public agency entrusted with providing Southern California with a reliable supply of high-quality water very seriously. We also understand that it is an important part of this mission to perform its duties in a cost-effective and transparent manner to ensure that there has been no violation of the public trust. Further, as stated above, the focus of the audit was on Metropolitan's support functions and we are pleased to note that in these areas, after a lengthy and thorough review by the State Auditor, there is no report of a single instance of violation of any law or legal requirement, no theft, no fraud, no misappropriation of funds, no collusion, no improper award of contracts, nor any case of unauthorized behavior in Metropolitan's performance of its mission.

The Audit Report makes a number of recommendations for Metropolitan to consider. These recommendations fall into two general categories. Most of the recommendations call for Metropolitan to enhance its internal control structure by updating policies and procedures and improving documentation and record keeping. These recommendations are useful. Metropolitan continually evaluates and implements methods to improve its business practices and refine its internal control structure, and Metropolitan intends to adopt recommendations that improve business functions.

There are some areas where the Audit Report suggests that a reviewed action may be legal and authorized, but that it may be more prudent and reasonable for Metropolitan to take a different course of action. These are views about which reasonable minds may differ. With regard to these recommendations, Metropolitan intends to bring those recommendations to its Board of Directors so that there can be an open public discussion on the issues, and then report back to the Legislature on the results of that discussion and what actions Metropolitan will take in those areas.

There are also concerns expressed in the Audit Report about business practices that Metropolitan feels increase efficiency and cut red tape. Metropolitan takes exception to characterizations that such practices “may” lead to gift of public funds, or violations of the law or the California Constitution when there is no finding or evidence that this occurred. However, it could just as easily be stated that these practices “may” lead to greater efficiencies and lower costs for the public. Metropolitan strongly believes in upholding the law and protecting public resources, while simultaneously striving for some of the efficiencies that can be found in the private sector. In Metropolitan’s view, some of these business practices achieve those results and it is not in the interests of the tax and rate paying public to turn every local agency into a model that operates like the State of California, which at this time is undertaking its own efficiency review of its operations.

Below are Metropolitan’s responses to the specific recommendations provided in the Audit Report. Because of the relatively short time frame to respond to the Audit Report – 5 business days – Metropolitan was not able to prepare a detailed plan with dates for implementation of recommendations at this time. Metropolitan will develop a workplan with milestones that will be submitted to the State Auditor as part of the State Auditor’s follow-up process.

Chapter 1: The District Does Not Always Ensure That It Uses Its Public Resources to Further Its Authorized Purposes Or In A Way That Is Reasonable and Necessary

1. The district should amend its administrative code to do the following:

- Provide specific limitations on the types of activities it sponsors to ensure it only funds organizations whose activities have a direct link to authorized district purposes. The district should also include a requirement to document and publicly disclose any contributions it provides to other entities by describing the nature of the public benefit achieved by the support and the relationship to the district’s authorized purposes.

Response: Metropolitan concurs that there should be complete documentation and public disclosure of all its sponsorships and contributions and that more detailed documentation of the public benefit achieved by such support is appropriate. Metropolitan already brings most sponsorships to the Board for approval, while reporting on all contributions and sponsorships on a monthly basis to the Board. A consolidated annual report would be prudent and will be implemented in line with this recommendation. In the example in the Audit Report of the sponsorship for Water for the West, that was taken directly to the Board, debated at a public meeting and approved. Metropolitan intends to continue its practice of Board approvals, monthly reports to the Board and will develop an annual report on sponsorships.

Setting of specific limitations on the types of activities Metropolitan sponsors to those with a direct link to Metropolitan’s activities is a matter of interpretation and a policy question for Metropolitan’s Board to consider. Specifically we note that the audit highlighted Metropolitan’s contributions to the Latin Business Association, Association of Women Business Owners and Asian Business Association and questioned whether those contributions were appropriate given Metropolitan’s function as a supplemental water provider. Metropolitan’s Board has previously considered this issue, and determined

that support for small business, as well as minority and women owned business, helps Metropolitan perform its mission by ensuring that Metropolitan can find competitive local businesses in its region from which to purchase goods and services. Southern California has a vibrant economy that relies heavily on small businesses. Community reinvestment activity returns benefits to Metropolitan and the public in the form of increased competition and by using ratepayer funds locally within Metropolitan's own region to keep economic benefits in its service area. Increased competition benefits the public and ratepayers by lowering Metropolitan's costs for goods and services. Metropolitan has recently entered into Memoranda of Understanding with the State of California, County of Los Angeles, City and County of San Diego and other public agencies to partner in promoting and expanding community reinvestment. This recommendation and the expressed concern with small business sponsorships will be reported to the Board for further public consideration. Any changes in Metropolitan's practices will be reported to the State Auditor as part of the follow-up process.

- Include a requirement that the board periodically review and approve each of the district's sponsorships to ensure it is only funding those organizations whose activities further the district's authorized purposes.

Response: Metropolitan concurs with this recommendation. Currently, Metropolitan seeks approval from the Board on most sponsorships and reports all sponsorships to the Board on a monthly basis. A consolidated annual report would be prudent and will be implemented in line with this recommendation.

- Provide specific guidance as to what constitutes a reasonable and necessary use of public funds, including restrictions on expenses such as parties and catered meals.

Response: Metropolitan concurs with this recommendation. Currently, Metropolitan has guidelines in its administrative code regarding expenses and use of funds, but such policies can be upgraded and more detail provided.

The "catered meals" noted in the Audit Report primarily consist of sandwiches and sodas from Metropolitan's cafeteria that are provided to the public and staff during working meetings to save time for work at these meetings. It is Metropolitan's view that the efficiencies and time saved constitutes a far greater value to the public than the cost for those items. Regarding "parties", Metropolitan pays for employee service award lunches, a company picnic and an end of year holiday party. Metropolitan believes that these are appropriate expenditures that enhance employee morale and productivity. A review of this policy will be discussed with the Board and any changes in policy will be reported to the State Auditor as part of the follow-up process.

- Update the travel reimbursement rates and ensure they represent reasonable limits for travel expenses. Provide similar limits for board members.

Response: Currently, Metropolitan has travel reimbursement rates in place for most employees. As travel rates are included in some of the memoranda of understanding with various bargaining units, revisions to those rates would be subject to meet and

confer negotiation requirements. Metropolitan also has a policy of reimbursing actual and reasonable expenses for management and directors. Metropolitan intends to review both the set rates for certain groups of employees and the policy regarding reimbursement of reasonable, actual expenses and determine what changes are appropriate.

2. The district should identify and consider the use of alternative methods for educating the public on its operations that would reach a wider audience and be more cost-effective than field inspection trips.

Response: Metropolitan believes that this is a policy recommendation concerning the efficacy of providing inspection trips of facilities for the public. The Legislature has determined that Metropolitan may conduct efforts to inform the public of its operations as part of Metropolitan's powers and duties. Metropolitan's Board has held lengthy discussions on the best way to inform the public about Metropolitan's operations. Metropolitan's Board has determined that employing a variety of public information tools is the best way to reach a wide audience. Those tools include water efficiency ad campaigns, school programs, sponsorships of small business organizations (about which separate concerns were also expressed) and facility inspection trips. In terms of expenditures, the actual cost of the trips is a minor part of the overall education budget at the District. Although budgeting for inspection trips has been Metropolitan's practice, it is appropriate in light of this recommendation to revisit this matter with the Board for further public discussion. The results of that discussion and any changes to Metropolitan's practices will be reported to the State Auditor as part of the follow-up process.

3. Before reimbursing employees or board members for travel or other expenses, the district should ensure that it has sufficient supporting documentation to justify the expenses.

Response: Metropolitan concurs with this recommendation. Currently, Metropolitan has travel reimbursement rates in place and policies governing documentation of such expenses for all employees as well as directors. The Audit Report noted a few lapses in documentation in this area but did not cite cases of inappropriate expenses paid. Metropolitan intends to revise and update its existing guidelines to ensure there is appropriate justification and documentation of such expenses.

4. The district should continue to develop its pilot program to ensure holders of district gasoline credit cards strictly use them only for district purposes.

Response: Metropolitan concurs with this recommendation and this process is underway.

5. To ensure it is not making a gift of public funds, the district should only grant leases at less than market value that further its authorized purposes and document justifications in the corresponding files. Also, the district should ensure that it provides the board an inventory of all leases that are for less than market value, and the board should consider to what extent it wants to review and approve these leases in the future.

Response: Metropolitan concurs with this recommendation. Metropolitan's policy is to lease land at market value. In response to the audit process, Metropolitan staff has reviewed all the leases that have nominal or reduced rates to determine whether they conform to this policy. This review has shown that all such leases are indeed returning appropriate value to Metropolitan. For instance, many of these leases are to public agencies that work with Metropolitan such as our lease for office space to the State of California Department of Parks at nominal rent while the Parks Department works with Metropolitan on public recreation and water quality issues at Diamond Valley Lake and Lake Perris. There are a number of leases where use of low value property is granted in exchange for maintenance and care of the land, relieving Metropolitan of cost and obligations equal to or greater than fair rental value. Metropolitan intends to provide the Board with a report on all such leases and adopt guidelines to ensure that appropriate documentation of justification for all such leases is provided.

Chapter 2: The District Has Struggled With Its Mandate to Establish an Ethics Office

1. The district should complete the implementation of its new ethics office and ensure that it complies with the requirements of SB 60. For example, the district should ensure that the electronic log it is developing for tracking complaints also captures the subsequent resolution of each complaint to provide the public with information regarding the resolution of investigations it undertakes.

Response: Metropolitan concurs with this recommendation and has already developed the suggested tracking log with the information included in the log. The Ethics Office has been reporting on these complaints to the Board of Directors and the public, and will continue this practice.

2. The district should continue its recent efforts at informing district employees about the ethics office and its functions to ensure that employees are fully using this resource.

Response: Metropolitan concurs with this recommendation and intends to continue its efforts on keeping its employees informed of its ethics programs.

3. The district should develop formal written policies and procedures regarding how investigations are to be conducted, and under what circumstances an external investigator will be hired.

Response: Metropolitan concurs with this recommendation and is in the process of developing these policies.

4. The district should review the ethics policies in the administrative code and in the operating policy and ensure that it presents ethics policies in a consistent manner.

Response: Metropolitan concurs with this recommendation and has already undertaken this review. The administrative code and policies are in the process of being revised at this time.

5. Once it hires a permanent ethics officer, the district should ensure that he or she reports directly to the entire board both verbally and in writing, in addition to the ethics subcommittee, to ensure the fullest visibility of ethics issues.

Response: Metropolitan concurs with this recommendation. The former Ethics Officer always reported directly to the Board and the Ethics Subcommittee and it is intended that the new Ethics Officer will do the same.

6. The district should complete its process of ensuring that current and past employees who did not file the required statements of economic interest do so. In addition, the district should establish a reliable process for ensuring that all employees in designated positions submit statements of economic interest.

Response: Metropolitan concurs with this recommendation and has always required appropriate employees to file such statements. Some employee statements were missed recently due to a miscommunication between the previous Ethics Officer and the Human Resources section but that has been resolved.

7. The district should issue an annual report to the public and interested legislators, such as those representing the areas served by the district, on its ethics office's compliance with SB 60.

Response: Metropolitan concurs with this recommendation and will prepare and distribute reports on the compliance efforts of the Ethics Office.

Chapter 3: The District Could Improve Its Controls Over Certain Types of Contracts and Grants

1. To make better use of the funds it spends on goods and services, the district should do the following:

- Ensure that management as well as staff prepare written justifications for all contracts that are not awarded through a competitive process.

Response: Metropolitan concurs with this recommendation. With regards to professional services and certain other contracts, the law does not require formal competitive bidding. When public bidding is not conducted, other forms of a competitive process are employed. Metropolitan requires Requests for Proposals or Requests for Qualifications for certain consultant services contracts. In other areas of professional services contracts, several firms

or individuals are asked for qualifications and rates before a final selection is made. Virtually every contract referred to in this section of the Audit Report went through one of these forms of competitive process. Metropolitan concurs that it would be helpful for all these practices to be formally documented in the contracting process.

Metropolitan also notes that the Audit Report states that: "The district had 726 consulting contracts that were active at some point during the period July 2002 through September 2003 totaling up to \$374.3 million, including legal contracts of \$34 million." (At page 55.)* While the ultimate value of these consulting services contracts reaches the total amounts stated, these figures capture funds expended by Metropolitan before the period reviewed, in some cases over ten years earlier. Consequently, to provide a fuller understanding of the amounts contracted for from July 2002 through September 2003, it should be noted that Metropolitan budgeted, contracted for and spent \$122,448,410 on consulting services during this period. The Legal Department budgeted, contracted and spent \$6,266,687 over this same period.

- Develop a written policy that requires staff to perform and document a needs assessment for consulting and purchasing contracts. Ensure that staff follows the policy.

Response: Metropolitan concurs with this recommendation. While a needs analysis is currently required for all such contracts, and documentation of needs is required in the budgeting process, updating written policies and enhancing documentation is useful.

- Develop a written policy that requires staff to verify a contractor's qualifications before entering into purchasing and sole-source consulting contracts, including procedures that describe how various types of contractors' qualifications should be verified. Ensure that staff follows the policy.

Response: Metropolitan concurs with this recommendation. While verifications of contractor qualifications are conducted for all such contracts, updating written policies and enhancing documentation is useful.

- Continue its efforts to update its consulting and purchasing procedure manuals and ensure that its administrative code requirements are consistent with the manuals.

Response: Metropolitan concurs with this recommendation and is in the process of reviewing and updating, where appropriate, its purchasing procedure manuals.

- Ensure that all contract managers attend the contract administration training academy.

Response: Metropolitan concurs with this recommendation and is requiring all of its contract managers to attend this training.

* Now page 47 as page numbers have changed.

- Further, the district should define the various factors, including qualitative factors, it will use to evaluate grant applications and make funding decisions accordingly. Additionally, individual awards should be supported by documentation of the factors considered.

Response: Metropolitan concurs with this recommendation. Documentation of factors considered is appropriate where grants are awarded and Metropolitan intends to require such documentation as part of its future grant programs.

Chapter 4: The District's Personnel Policies Are Lacking and Are Not Always Followed

1. To ensure consistent hiring practices and to improve checks and balances in this area, the district should develop comprehensive and current policies and procedures for hiring. To do so, it should take the following actions:

- Continue its efforts to consolidate policies and procedures into a single human resources policies and procedures manual.

Response: Metropolitan concurs with this recommendation. Metropolitan's Human Resources section is in the process of consolidating all its policies and procedures into a single manual.

- Ensure policies and procedures fully address the potential for favoritism or the appearance of favoritism, including when a candidate's reference is involved in other aspects of his or her recruitment.

Response: Metropolitan concurs with this recommendation. Metropolitan has a strong, clear and consistent policy requiring equal opportunity for all applicants and employees. Metropolitan's procedures are crafted to allow the highest level of access possible and to preclude favoritism. Metropolitan is committed to this approach in employment opportunity and continuously reviews its policies and procedures to ensure that this policy is fully endorsed and implemented at all levels.

- Work to resolve all disagreements with bargaining units over the existence of management bulletins.

Response: Metropolitan concurs with this recommendation. Metropolitan will continue to meet and confer with the bargaining units at Metropolitan to try and resolve this matter.

- Update job descriptions to ensure they are accurate and current.

Response: Metropolitan concurs with this recommendation. Metropolitan's Human Resources section is in the process of updating all its job descriptions to ensure that they reflect current working conditions.

2. After the district establishes current and comprehensive hiring policies and procedures, it should work with recruiters to ensure that it has established a reasonable goal for completing recruitments, including those involving external applicant pool.

Response: Metropolitan concurs with this recommendation. Metropolitan's Human Resources section has set a goal of completing all recruitments in 60 days. That goal is being reviewed to see if it accurately reflects what is reasonable in normal circumstances.

3. The district should ensure that it follows its hiring policies and maintains written documentation that it did so.

Response: Metropolitan concurs with this recommendation. Metropolitan's Human Resources section has a practice of reviewing its efforts to ensure that it is in compliance with Metropolitan's policies and procedures and will continue to do so.

4. The district should develop comprehensive policies and procedures for promotions, which include steps to ensure that it documents reasonable justification for all promotional decisions.

Response: Metropolitan concurs with this recommendation. Metropolitan's Human Resources section is in the process of reviewing all of its policies and procedures for promotions to ensure that they reflect current practice and are appropriate.

5. The district should amend its grievance policy to require the establishment of time frames for resolving substantiated grievances.

Response: Metropolitan will consider this recommendation. The timeframes for conducting grievances are delineated in the various memoranda of understanding with Metropolitan's bargaining units. However, once a grievance is resolved through the process, implementation of the resolution depends on the factual nature of the resolution. Certain complex grievance resolutions require substantial effort and time to implement. In some cases, Metropolitan may not have unilateral control over implementation of a resolution since we may need to comport with the schedules of the grievants and union representatives. It may not be possible to establish a "one size fits all" schedule for implementation of grievance resolutions. Metropolitan intends to review the grievance process and determine whether changes are possible and appropriate.

6. The district should periodically review and update all its policies and procedures, and develop a policy for communicating revisions to staff.

Response: Metropolitan concurs with this recommendation. Metropolitan's Human Resources section periodically reviews all of its policies and procedures and reports on such updates to the Board. Fuller reporting to employees will be included as part of such efforts going forward.

7. The district should provide a listing of separation agreements to the entire board to aid the board in understanding the district's use of these agreements. The listing should include the cost of all agreements, including lump-sum payments, salary and benefits related to keeping employees on payroll, and payments to attorneys. In addition, because of the similarities between these agreements and settlements, the board should establish a consistent policy for its approval of these agreements. Finally, the board should require the district to disclose all separation agreements to the full board as it already does with settlements.

Response: Metropolitan concurs that fuller reporting of separation agreements is appropriate. Metropolitan's Board will consider what form and level of detail such disclosure should take and report back to the Legislature and the State Auditor on its conclusions.

Chapter 5: The Center for Water Education Currently Relies Heavily on the District for Funding and Has Yet to Develop Formal Policies and Procedures for Its Contracts

1. The center should establish formal contracting policies and procedures for all contracts. These should include procedures for determining the need for contracts, the scope of work, and the qualifications of potential contractors. These policies should also establish procedures for monitoring and evaluating the subsequent performance of contractors. Finally, the center should require a competitive process for consulting services when appropriate to ensure that it receives the best value for these services.

Response: The center concurs in this recommendation. The center is in the process of preparing its formal policies and procedures to govern contracting, which will be completed in the near future. Please see the attached separate response by the center to the Audit Report for more information.

The Center for Water Education
700 North Alameda Street
Los Angeles, CA 90012

The Center for Water Education
Response to State Audit

The Center for Water Education (“The Center”) is pleased with the audit’s finding that the District had the authority to form The Center as a separate legal entity and that the audit did not find any problems with the Chair of the District serving as the Chair of the Center or having members on both Boards.

The Center has taken efforts to avoid the appearance that it was created to circumvent the laws that would be applicable to the District. As with the District, the Brown Act and Public Records Act have always applied to The Center, guaranteeing openness and access to the public. The Center’s Bylaws have always gone beyond the conflict provisions of law applicable to nonprofit, public benefit corporations by incorporating the basic prohibition of the Political Reform Act providing that Directors may not participate where they had a material financial interest. The Center also requested a formal opinion from the FPPC and has since adopted a Conflict of Interest Code in accordance with the determination that The Center is a “local agency.”

The focus of the audit was less on the activities, purpose and organization of The Center, as it was on the contracting procedures and policies of The Center. As recognized in the audit report, although not required by law, The Center is following the Public Contract Code in the construction of the Museum Campus. The Center also followed the Government Code provisions in the selection of its Construction Manager. While The Center has solicited proposals in some circumstances for consultants, The Center is in agreement with the recommendation that it would be beneficial to develop policies and procedures for the selection and evaluation of other contractors and consultant. It should be noted that this process is already underway.

COMMENTS

California State Auditor's Comments on the Response From the Metropolitan Water District of Southern California

To provide clarity and perspective, we are commenting on the Metropolitan Water District of Southern California's (district) response to our audit report. The numbers correspond with the numbers we have placed in the district's response.

- The district states that virtually every contract referred to in this section of the report went through some form of competitive process. However, of the 20 consulting contracts that we reviewed, the district acknowledged that nine were sole-source contracts by preparing sole-source justifications for them. As we discuss on page 48 of the report, four of these justifications did not address the consultant's unique qualifications or the reasons for not competitively awarding the contract. Further, an additional six contracts did not have any documentation explaining why they were not awarded competitively.
- On page 49 of the report, we present the district's perspective that contracting decisions are guided by the chief executive officer's annual business plan, which provides high-level priorities, and that funds are budgeted for contracts that may be needed in the coming year to implement the business plan. However, as we also state on page 49, the district does not have a policy that requires staff to perform a needs assessment before entering into consulting and certain purchasing contracts. In addition, the district was unable to demonstrate that it conducted a needs assessment for 14 of the 20 consulting contracts that we reviewed.
- We are not suggesting that the district establish a "one size fits all" schedule for implementing grievance resolutions. Rather, we are simply recommending that the district amend its grievance policy to require that time frames be established for resolving substantiated grievances. We acknowledge that the time frames may vary depending on the nature of each grievance.

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press