



# Central Basin

Municipal Water District

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December 3, 2015

Re: Audit Report of Central Basin Municipal Water District

Dear Central Basin Stakeholder:

### Board of Directors

#### Division I

James B. Roybal

#### Division II

Robert Apodaca

#### Division III

Arturo Chacon

#### Division IV

Leticia Vasquez

#### Division V

Phillip D. Hawkins

### General Manager

Kevin P. Hunt, P.E.

The Central Basin Municipal Water District (District) serves a vital role in meeting the water supply needs of nearly 2 million people in 24 cities and 6 unincorporated areas in Southeast Los Angeles County. We do so by partnering with 47 retail water providers (including cities, special districts, mutual water companies and investor-owned utilities) and one wholesale water provider. Maintaining the public's trust is of utmost importance to the District.

On March 4, 2015 the Joint Legislative Audit Committee requested that the State Auditor conduct an audit of the District. This request was in response to negative media reports concerning operations, governance and financial management. The District viewed the audit as an opportunity to work collaboratively with the State Auditor, to identify opportunities for improvement and also to highlight progress that has taken place at the District. For these reasons, the District testified in support of the requested audit.

Attached to this letter, you will find a copy of the Audit Report that was publicly released on December 3, 2015. We wanted to ensure that you received a copy as soon as it was published. As we move forward we will keep our stakeholders informed by posting audit related materials on our website.

Central Basin, the Board of Directors and staff have worked closely and cooperatively with the Office of the State Auditor over the past several months. We commend the State Auditor's staff for their high level of professionalism and for their recognition of areas where the District has made progress. Furthermore, we value the insight provided by the Audit Report.

We are in the process of reviewing and responding to the recommendations listed in the State Audit Report. It is unfortunate the actions of the District over the past several years generated genuine

### Serving the Cities of

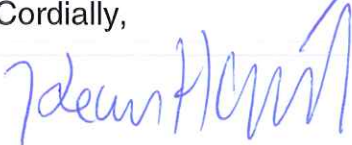
- |                  |                  |
|------------------|------------------|
| Artesia          | La Mirada        |
| Bell             | Lynwood          |
| Bellflower       | Maywood          |
| Bell Gardens     | Montebello       |
| Carson           | Monterey Park    |
| Cerritos         | Norwalk          |
| Commerce         | Paramount        |
| Compton          | Pico Rivera      |
| Cudahy           | Santa Fe Springs |
| Downey           | Signal Hill      |
| East Los Angeles | South Gate       |
| Florence-Graham  | Walnut Park      |
| Hawaiian Gardens | Whittier         |
| Huntington Park  | Willowbrook      |
| La Habra Heights | Vernon           |
| Lakewood         |                  |

concerns from members of our legislature delegation which resulted in the audit. However, we believe that the audit, coupled with on-going efforts that the District has undertaken over the past few years, will result in improved governance and an even stronger, more responsive and transparent Central Basin. Such is our commitment that over the last few years, the District has worked diligently to improve governance, operations, financial stability and transparency, including:

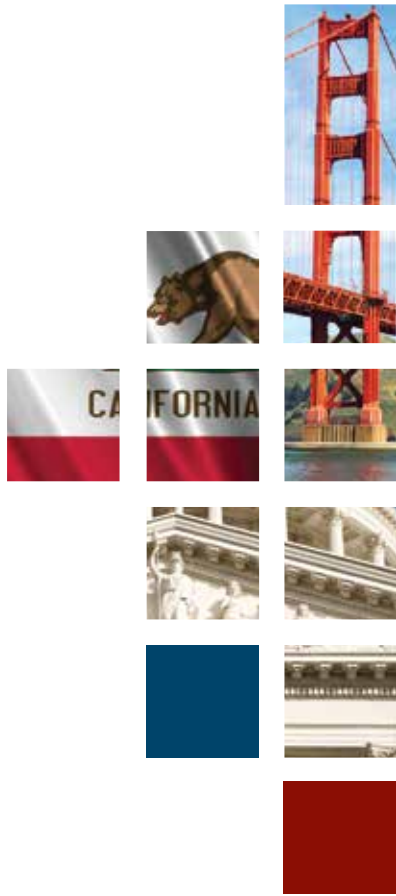
- Establishing a fully independent review of all ethics inquiries that includes a hotline and independent investigative firm
- Strengthening financial disclosure and accountability for Director and staff expenditures
- Adopting and implementing a strategic plan to guide District goals and activities
- Implementing a transparent budgeting process that provides significant opportunity for stakeholder input
- Hosting a monthly meeting with District retail agencies to discuss emerging water issues and to seek resolutions so that we may continue our ability to protect our region's water reliability
- Reducing legal expenditures, from FY 12 to FY 15, by over \$2 million annually and improving the District's debt coverage ratio from 0.11 in FY 13 to 1.58 in FY 15
- Adopting a Reserves Policy and beginning work on a long-term financial plan that will provide for financial stability and provide direction on District funding priorities
- Hiring and retaining highly qualified and experienced professionals to serve as part of the professional management of the District
- Increasing expertise in the technical operations of the District including Water Resources and Engineering
- Partnering with retail agencies in the Central Basin service area to meet and exceed the Governor's Executive Order for water use reduction

We thank the auditors for their diligent work on the State Audit Report. We are committed to addressing all the auditors' recommendations before the dates requested, starting with a Board Workshop that is scheduled for 11 am on Friday, December 4, 2015.

Cordially,



Kevin P. Hunt, P.E.  
General Manager



## Central Basin Municipal Water District

Its Board of Directors Has Failed to Provide the Leadership Necessary for It to Effectively Fulfill Its Responsibilities

Report 2015-102

COMMITMENT  
INTEGRITY  
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December 3, 2015

2015-102

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 California State Auditor presents this audit report concerning the Central Basin Municipal Water District's (district) planning, operations and management, long-term financial viability, and control environment.

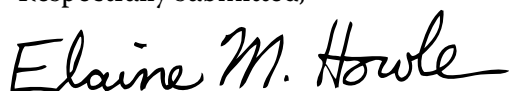
This report concludes that the district's board of directors (board) has failed to provide the leadership necessary for the district to effectively fulfill its responsibilities. For example, we found that the board failed to ensure that the district maintained stability in key executive management positions throughout our review period. Further, we found that the board failed to take basic steps to ensure the district's long-term financial viability, including engaging in long-term financial planning and performing the necessary study to ensure the district's water rate structure is appropriate and that it will collect sufficient revenues to meet its costs. Finally, the board's actions contributed to the district losing its insurance coverage, forcing the district to purchase insurance with higher premiums for considerably less coverage than in previous years.

The board also violated state law in 2010 when it improperly approved the establishment of a legal trust fund without adequate public disclosure. Further, it lacked a means of ensuring expenditures made from the \$2.75 million trust fund were appropriate. In addition, the district consistently engaged in questionable contracting practices. For example, we found that the district often inappropriately circumvented its competitive bidding process when it awarded contracts to vendors. The district also spent thousands of dollars of public funds on purposes unrelated to its mission, some of which very likely constitute gifts of public funds, which are prohibited by the California Constitution.

Additionally, the district did not always follow its policies for hiring employees, which led it to hire certain individuals who did not possess the necessary qualifications for their positions and to incur unnecessary expenses. In one instance, the district paid more than \$22,000 for an employee to obtain a bachelor's degree, when possession of such a degree was already a minimum requirement to qualify for his high-level position. Ultimately, this individual did not obtain his degree during his employment with the district. We also found that some of the benefits the district offers its board members may be overly generous, as it provides them with full health benefits and a generous automobile allowance, even though their work is essentially part-time. Finally, we noted multiple instances in which the district paid for unreasonable travel and meal expenses for both its board members and staff.

Although the district has recently taken some steps to address these issues, the magnitude of the problems we found suggests that the district could benefit from a different governance structure. The district's board is currently publicly elected, yet the board's customers, to which it should be held accountable, are those various entities the district wholesales water to which is, in turn, then sold throughout the district. If the Legislature chooses to change the governance structure, it could consider a structure in which the board would be composed of members appointed by the district's direct customers. Such a change would not be a novel approach—as we note, it is already used by certain other water agencies in the region—and it would enable the district's customers to hold the board accountable when it takes actions or makes decisions that are not in the best interests of the district.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
State Auditor

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# Contents

Summary	1
Introduction	9
<b>Chapter 1</b>	
The Central Basin Municipal Water District's Board of Directors Has Consistently Failed to Provide Appropriate Leadership and Oversight	21
Recommendations	42
<b>Chapter 2</b>	
The Central Basin Municipal Water District Has Established Inadequate Policies Related to Contracting and Expenditures and Has Circumvented Other Policies	45
Recommendations	62
<b>Chapter 3</b>	
The Central Basin Municipal Water District Did Not Always Follow Established Hiring Policies and Needs to Ensure Certain Benefits and Expenditures are Appropriate	65
Recommendations	80
<b>Response to the Audit</b>	
Central Basin Municipal Water District	83
California State Auditor's Comments on the Response From the Central Basin Municipal Water District	97

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## Summary

### Results in Brief

The Central Basin Municipal Water District (district) was established by a vote of the people in 1952 to help mitigate the overpumping of groundwater in southeast Los Angeles County. The district wholesales imported water from the Metropolitan Water District of Southern California (Metropolitan) to cities, other water districts, mutual water companies, investor-owned utilities, and private companies in southeast Los Angeles County. In addition, it operates a system for obtaining and distributing recycled water. A publicly elected board of five directors (board) governs the district. The board appoints a general manager who oversees the district's day-to-day operations and its staff.

In recent years, the district's actions have called into question the efficiency and effectiveness of its operations. News reports have focused public attention on a number of issues at the district, some of which we explore in detail in this report. Because of these issues and others, the County of Los Angeles Department of Public Works (Public Works) published a report in October 2014 that outlined the concerns it identified with the district's operations. As a result of these concerns, the report explored the steps necessary to dissolve the district and transfer its work elsewhere. However, the report stopped short of making such a recommendation and instead recommended this audit.

Our audit found that the board's poor leadership has impeded the district's ability to effectively meet its responsibilities. For example, the board failed to ensure that it provided the district with stability in its key executive management position. The district's administrative code establishes the general manager as the district's chief executive and notes that hiring the general manager is a critical function of the board. Nonetheless, between 2010 and 2015, six different individuals filled this role. Lack of agreement among the board members was a factor contributing to the instability in this position. The district's current general manager is on a two-year contract and is contemplating retiring at the end of the contract term in May 2017. However, the district does not have a formal policy for recruiting and hiring a general manager in the future. If the board does not fill the general manager position either prior to the current general manager's retirement or within a reasonable amount of time thereafter, the board will likely hinder the district's ability to effectively meet its responsibilities.

In addition, the board has not established the essential policies necessary to safeguard the district's long-term financial viability. Contrary to a recommendation directed to all government agencies

### Audit Highlights . . .

*Our audit of the Central Basin Municipal Water District (district) revealed the following:*

- » *The district's board of directors' (board) poor leadership has impeded the district's ability to effectively meet its responsibilities:*
  - *The board has not maintained stability in the district's key executive management position.*
  - *It has not established essential policies to safeguard the district's long-term financial viability.*
  - *The board's actions caused the district to lose its liability insurance coverage, resulting in higher costs for less coverage.*
- » *The board violated state law when it improperly approved the establishment of a legal trust fund without adequate public disclosure. Further, it lacked a means of ensuring the expenditures made from the \$2.75 million trust fund were appropriate.*
- » *The district consistently engaged in questionable contracting practices by avoiding competitive bidding and inappropriately using amendments to extend and expand contracts.*
- » *The district spent funds on purposes unrelated to its mission that likely constitute gifts of public funds.*
- » *The district did not always follow its policies for hiring employees—it hired unqualified staff and created an unnecessary position.*

*continued on next page . . .*

- » *Some of the benefits the district offers to its board members may be overly generous. For example, it provides full health benefits and a generous automobile allowance, even though board members essentially work part-time.*
- » *The district paid for unreasonable travel and meal expenses for both its board members and staff.*
- » *Although the district has made changes to improve its ability to operate efficiently and effectively, it could benefit from a different governance structure.*

from a national organization that promotes the professional management of governmental resources, the district has not engaged in long-term financial planning to help it develop strategies to overcome financial challenges and achieve long-term sustainability. In addition, the district has not performed the study necessary to ensure that its water rate structure is appropriate and that it will collect sufficient revenues to meet its costs. In fact, in planning its annual budgets, the district overestimated its revenues in four of the past five years, and consequently its expenditures exceeded its revenues in three of those years.

Also, the district's debt coverage ratio, which measures its ability to produce enough cash to cover its debt payments, has fallen below the level required by its debt agreements twice in the past five fiscal years. This is partly because the board has not ensured that the district has a formal debt management policy, despite the district's external auditors' recommendations that it implement one. Various factors contributed to the decline in the district's debt coverage ratio—including that the district faced sustained high legal costs and a decline in water revenues—and the credit rating on the district's debt was downgraded in August 2013 and again in October 2015. According to a former general manager's memo, because of the August 2013 downgrade, the district could face an increase in total interest costs when it issues new debt to restructure its outstanding debt. The current general manager stated that as a result of the October 2015 downgrade, the district will likely incur additional costs when it restructures its debt.

Further, the board's actions caused the district to lose its insurance coverage. Specifically, in 2014 the board did not respond to the conditions required by its then-insurer in a timely manner, and consequently the insurer canceled the district's insurance coverage, including its general liability and employment practices liability coverage. Subsequently, in September 2014, after the district had obtained new insurance coverage from private insurance companies, the district's insurance broker warned the district that any changes to senior staff could adversely impact the district's employment practices liability insurance coverage. Despite this warning, the board subsequently fired the district's then-general manager, and the insurance company did not renew the district's insurance coverage in 2015. As a result, the district had to obtain new coverage yet again and currently pays thousands more for \$1 million less general liability and employment practices liability insurance coverage than previously.

The board also violated state law in 2010 when it approved the establishment of a legal trust fund (trust fund) without adequate public disclosure. State law requires the district to hold open and public meetings, although it makes some exceptions to this

requirement. For example, the board may meet in closed session to discuss ongoing litigation or pending litigation if public deliberation on the matter would prejudice its litigation position. The board relied on its outside legal counsel's advice and cited this exception when it met in a closed session in June 2010, reporting that its discussion and actions were related to pending litigation. However, a later investigation by an external law firm found reason to believe that the board used the discussion and vote in that closed meeting to create a programmatic environmental impact report pertaining to groundwater storage, to finance many other nonlitigation expenses, and to avoid criticism. State law does not allow public entities to use the litigation exception as a subterfuge to reach nonlitigation-oriented policy decisions.

Further, the district did not disclose to the public the \$2.75 million in transfers it made to the trust fund. In addition, because the board did not approve the expenditures the district's outside legal counsel made from the fund, the board lacked assurance that all of the trust fund expenditures related to the purposes for which the fund was established. Moreover, the board's actions caused the district to incur more than \$500,000 in ongoing costs for the subsequent investigation into the trust fund and for a lawsuit that a current board member filed to recover, in part, the money the board transferred to the fund.

Additionally, the district often inappropriately avoided its competitive bidding processes when it awarded contracts to vendors during the period we audited. According to its procurement policy, the district is committed to obtaining the best value for the services it purchases and to using a competitive bidding process to procure these services. However, for 13 of the 20 contracts we reviewed that the district executed between July 2010 and June 2015, we determined that the district did not use its competitive bidding process. We further determined that the district did not adequately justify why it failed to competitively bid for 11 of these contracts, although its policies suggest using such justifications. When the district does not clearly identify and justify its reasons for avoiding its competitive bidding process, it leaves itself vulnerable to allegations of favoritism or conflicts of interest. For instance, in early 2015 the Fair Political Practices Commission fined a former general manager and a former board member for accepting gifts in excess of applicable limits from a contractor doing business with the district. By circumventing its competitive bidding process, the district cannot demonstrate that it obtained the best value for the services it purchased with public funds.

In addition to failing to follow its contracting practices, the district spent thousands of dollars of district money on purposes unrelated to its underlying authority, some of which very likely constitute

gifts of public funds. Allowable district expenditures include those that serve a public purpose and are within the scope of the district's jurisdiction and specific purposes. However, it did not appear that the district met this criteria when it gave \$9,000 to outside organizations for holiday turkeys in fiscal year 2012–13. It also currently allocates \$3,000 in community outreach funds to each board member annually, which various board members had the district donate on their behalf to golf tournaments, a legislative member's breakfast panel, religious organizations, local high school sports programs, local pageants, and car shows. The district also spent unreasonable amounts of money on installation ceremonies for its board members and does not expressly limit the amounts that can be spent on these ceremonies. We found no clear correlation between any of these expenditures and the district's mission.

Finally, on several occasions during our period of review, the district failed to follow its policies for hiring employees. Its administrative code states that the district must use a competitive process for hiring employees based on their qualifications and ability. Further, it outlines the use of an interviewing panel for senior manager positions. The district also maintains job descriptions that detail the minimum qualifications applicants must possess before being hired. Nevertheless, we noted that the district did not follow its policies for hiring four individuals into senior manager positions. Despite the fact that the district's general manager is responsible for hiring, the board hired one of these employees—an assistant to the general manager who earned about \$98,000 annually—without first authorizing the position. The district also hired two individuals who did not possess the required minimum levels of education for their positions as specified in their job descriptions. Further, the district chose to prepay \$22,000 in college tuition, registration, and fees so that one of these individuals could earn the degree required for the position. The district authorized this payment, even though its policies limit payment for educational expenses to 90 percent of the cost of college courses and allows such payments only after employees complete their coursework. The district ultimately terminated this employee before he completed his coursework. When the district fails to follow its hiring policies, it risks not hiring the most qualified individuals for the job and unnecessarily spending the district's funds.

As we previously mentioned, Public Works explored the possibility of dissolving the district in its 2014 report. We believe such an extreme action might be viewed as premature given that the district and the board have recently made some changes to the district's policies and practices that, if followed, will improve the district's ability to operate efficiently and effectively. Nonetheless, the magnitude of the problems we found suggests that the district

could benefit from a different governance structure. Specifically, because the board is publicly elected, it is not directly accountable to its customers, which are the various entities that sell water throughout the district. Other water agencies in the region, including Metropolitan and the San Diego County Water Authority, have boards composed of members appointed by their customers. If the Legislature chose to change the district's governance structure, modifying the structure to increase the board members' accountability to the entities they serve would help to ensure that the board makes decisions that reflect the district's best interest.

### **Recommendations**

To ensure the efficient and effective delivery of imported and recycled water in southeastern Los Angeles County, the Legislature should pass special legislation to preserve the district as an independent entity but modify the district's governance structure. In doing so, the Legislature should consider a governance structure that ensures the district remains accountable to those it serves; for example, the district's board could be changed from one elected by the public at large to one appointed by the district's customers.

To ensure the stability of the district's operations, by June 2016 the district's board should establish a formal policy for hiring for the general manager position. Because the current general manager is on a contract set to expire in May 2017, the board should initiate the hiring process for a new general manager or begin the process of renegotiating the contract with the current general manager in the fall of 2016.

To ensure its long-term financial sustainability, the board should complete a long-term financial plan no later than December 2016.

To ensure its water rate structure is appropriate to provide the revenue necessary to cover its legitimate costs, the district should complete its planned water rate study no later than the spring of 2017.

To ensure that it continues to take steps to improve its financial condition and avoids additional costs due to downgrades of its debt credit ratings, the district should immediately create a formal debt management policy. This policy should clearly define its credit objectives and provide guidelines for suitable debt agreements. This policy should also require the district to periodically monitor the specific financial ratios, such as its debt coverage ratio, that are relevant to its credit rating.

To help it maintain its current insurance coverage and better position it to negotiate for more cost-effective and appropriate coverage in the future, the board should review the district's insurance coverage annually and renegotiate costs and coverage amounts as necessary, particularly as the district resolves outstanding legal claims against it.

To ensure it holds itself accountable to the public, the district should follow the law and operate in an open and transparent manner by, among other things, disclosing to the public the true nature and purpose of all of its expenditures.

To make better use of the funds it spends on services, the district should amend its administrative code by June 2016 to limit its sole-source contracts to emergency circumstances and circumstances in which only one vendor can meet the district's needs. Further, before executing any sole-source contracts, the district should require written justification demonstrating the reasons for not competitively bidding the services.

To ensure its expenditures do not constitute gifts of public funds, the district should do the following:

- Immediately eliminate its allocation of funds to individual board members for community outreach.
- Develop policies that specify limitations on the types of activities it will provide funds for in the future to ensure that it benefits only those organizations whose activities have a direct link to its authorized purposes.
- Revise its administrative code by June 2016 to include more specific guidance as to what constitutes a reasonable and necessary use of public funds. The guidance should establish restrictions on the amount spent for board member installation ceremonies.

To ensure it considers the most qualified candidates for positions, the district should follow its established hiring policies. Specifically, it should use a competitive hiring process and ensure that its board first formally approves all positions for which the district recruits. Further, the district should consider for employment only individuals who meet the established minimum qualifications for the positions for which they have applied.



### **Agency Comments**

The district generally agreed with our recommendations and indicated that it plans to take various actions to implement them. However, the district disagreed with our recommendation to the Legislature that it should modify the district's governance structure.

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# Introduction

## Background

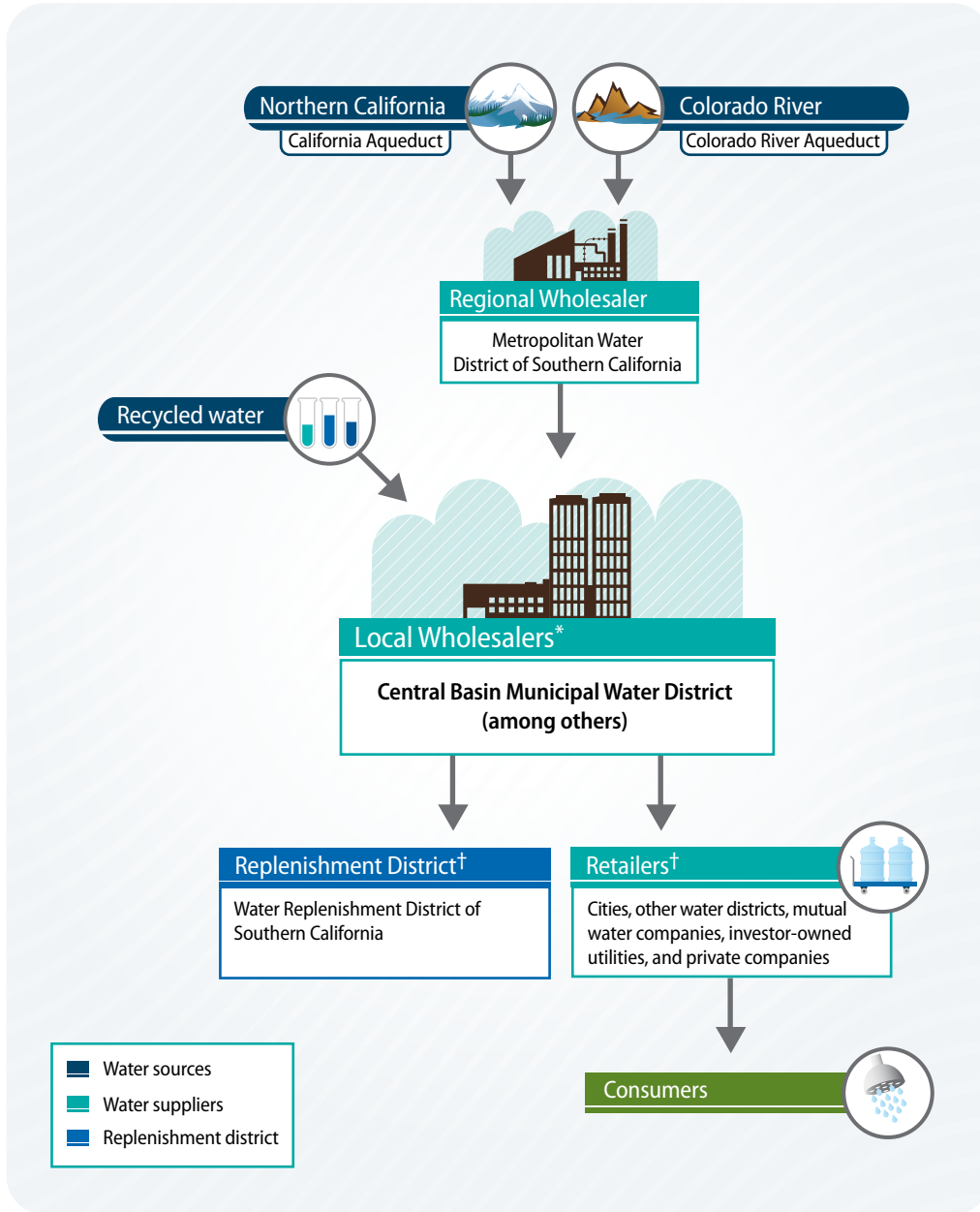
To help mitigate the overpumping of groundwater in southeastern Los Angeles County, the public voted to establish the Central Basin Municipal Water District (district) in 1952 under the Municipal Water District Law of 1911. The district's founders realized they would have to curtail the region's use of relatively inexpensive yet diminishing local groundwater by providing it with imported water. The district's stated mission is to exercise the powers given to the district under its establishing act, utilizing them to the benefit of parties within the district and beyond. The district's mission includes acquiring, selling, and conserving imported water and other water that meets all required standards and furnishing it to customers in a planned, timely, and cost-effective manner that anticipates future needs.

In 1954, the district became a member agency of the Metropolitan Water District of Southern California (Metropolitan), an agency that provides the Southern California region with water that it imports from Northern California and from the Colorado River. The district purchases the imported water from Metropolitan and wholesales it to cities, mutual water companies, investor-owned utilities, and private companies. Further, the district supplies water for groundwater replenishment and provides the region with recycled water for municipal, commercial, and industrial use. Figure 1 on the following page provides an overview of the system of water supply and delivery in Southern California.

The district currently serves a population of more than two million people in 24 cities in southeast Los Angeles County and in some unincorporated areas of the county. Its mission statement indicates that it provides leadership, support, advice, and information on water issues to the people and agencies within and outside its boundaries, as appropriate. For example, the district supplies information on drought-conservation measures to the public and provides water education courses and materials to students. According to its comprehensive annual financial report, the district's 227-square-mile service area used approximately 241,000 acre-feet of water in fiscal year 2013–14.<sup>1</sup> Figure 2 on page 11 shows the district's boundaries and the cities included within those boundaries.

<sup>1</sup> An acre-foot of water is approximately 326,000 gallons, which the district states is enough to meet the water needs of two average families in and around their homes for one year.

**Figure 1**  
Central Basin Municipal Water District’s Role in Water Delivery

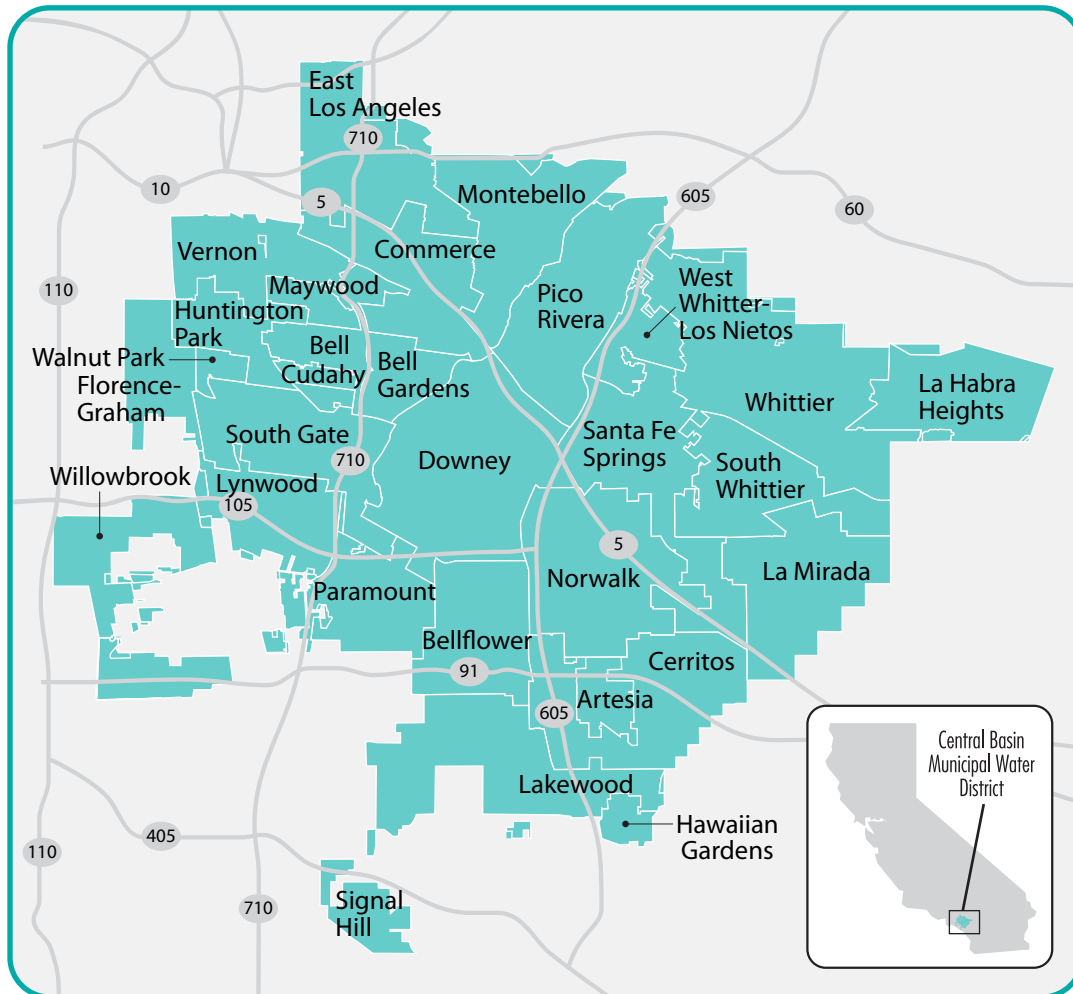


Sources: Documents obtained from the websites of the named entities.

\* Members of the Metropolitan Water District of Southern California (Metropolitan).

† Nonmembers of Metropolitan.

**Figure 2**  
Central Basin Municipal Water District's Service Area



Source: Central Basin Municipal Water District's website.

### The District's Governance and Administration

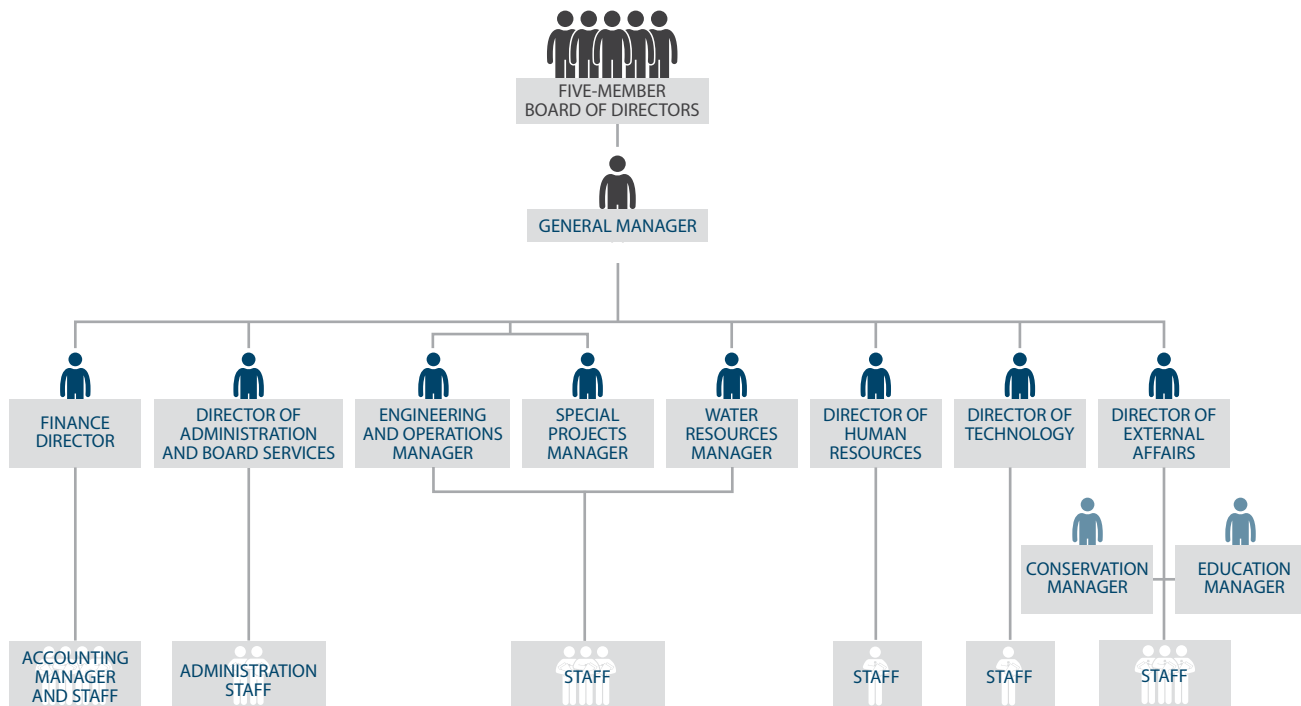
A five-member board of directors (board) governs the district. Each board member represents one of five divisions within the district and is elected to a four-year term by the voters within that division. No limits exist on the number of terms a board member may serve; according to the district's website, the longest-serving member of the board was in his fifth four-year term as of September 2015. Board elections are nonpartisan and held during November general elections.<sup>2</sup> According to state law, the board is ultimately

<sup>2</sup> In 2012 the district received approval from Los Angeles County to change its election to June for that year only.

responsible for the performance of the district's powers, privileges, and duties. Toward this end, the district's administrative code states that the board's responsibilities include ensuring that the district is managed well, determining its objectives and policies, approving its annual budget, and appointing its general manager. As we discuss further in Chapter 3, board members receive compensation for their service in the form of a payment for each day they attend meetings and other events on district business. They also receive medical and other health benefits equivalent to those of full-time employees of the district.

The general manager is the chief executive of the district and is responsible to the board for the district's administrative affairs. The general manager prepares and recommends the district's annual budget, hires its employees, and manages its day-to-day operations, among other duties. As of July 2015 the district had a total of 23 authorized positions, including the general manager. Figure 3 presents the organization of the district.

**Figure 3**  
Central Basin Municipal Water District Organizational Chart



Source: Central Basin Municipal Water District's website.

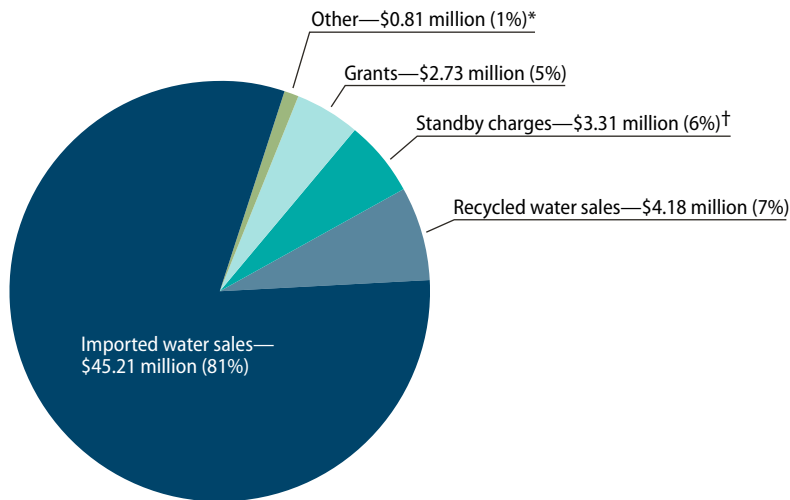


For more than 15 years the district shared administration with a companion organization, the West Basin Municipal Water District (West Basin). West Basin performs similar functions to the district but for communities in southwest Los Angeles County. Between 1990 and 2006 the two districts shared staff and an office building. However, in 2006 West Basin took action to end the partnership. West Basin purchased the office building, and the district relocated its headquarters to the City of Commerce, California.

### District Revenue

The district’s primary source of operating revenue is the sale of imported water and, to a lesser degree, recycled water. Figure 4 shows the distribution of district revenue by source during fiscal year 2014–15. Its revenue from the sale of imported water was about \$45 million, or 81 percent of its total revenues, in fiscal year 2014–15, while its sales of recycled water accounted for about \$4 million, or 7 percent of its total revenues, in the same period.

**Figure 4**  
Central Basin Municipal Water District’s Revenue Sources by Major Category For Fiscal Year 2014–15



Source: Central Basin Municipal Water District’s (district) fiscal year 2014–15 draft financial statements as of October 2015.

\* The district derives other revenues from deliveries of treated water, investment income, and other miscellaneous sources.

† Standby charges are imposed by the district on landowners and used by the district to help pay its debt service costs on its water recycling facilities and the purchase of its headquarters building.

The district's other significant source of revenue is standby charges that the district imposes on landowners with the annual approval of its board. Los Angeles County includes the charge on each property owner's property tax bill. The standby charge's purpose is to minimize the effects of the drought on the area through the construction of recycled water distribution systems that could provide an alternative source of water. The district currently uses revenue from the standby charges to pay debt service on the debt it issued to finance the construction of its water recycling facilities, as well as to pay for the acquisition of its headquarters building. The district's standby charges accounted for about \$3 million, or 6 percent of its total revenues, in fiscal year 2014–15.

### **Recent Scrutiny of the District**

The district and its board have come under scrutiny in recent years. News reports have alleged that the district misused public funds, including that it established a legal trust fund in a manner that violated state open meeting law, that it inappropriately reimbursed meal expenses, and that it engaged in inappropriate contracting practices and employment practices. We address these allegations in this report. In addition, the district has been involved in a number of lawsuits over the past several years. Although many of these lawsuits have been settled or dismissed, a small number related to the district's employment practices are still pending.

In October 2014 the County of Los Angeles Department of Public Works published a report on the district that sought to ensure it addressed its ongoing problems so that it could continue to provide water and service to its customers. The report recommended an independent management audit of the district's operations and included a discussion of the process necessary to dissolve the district and transfer its functions to another entity. We discuss this report further in Chapter 1.

### **Scope and Methodology**

The Joint Legislative Audit Committee (audit committee) directed the California State Auditor's office to perform an audit of various aspects of the district's operations, including its contracting, expenditures, strategic planning, financial viability, and human resources. Table 1 includes the audit objectives the audit committee approved and the methods we used to address them.

**Table 1**  
**Audit Objectives and the Methods Used to Address Them**

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	We reviewed relevant state laws and regulations.
2 Assess whether the Central Basin Municipal Water District (district) has appropriate policies, processes, and oversight for various aspects of its operations. Specifically, perform the following covering the five-year period from 2010 to 2015:  a. Assess whether the district's board of directors (board) has sufficient policies and practices to guide its spending decisions. In addition, determine whether the board exercises sufficient oversight regarding expenditures.	<ul style="list-style-type: none"> <li>• For our audit period of July 1, 2010, through June 30, 2015:</li> <li>• We interviewed relevant district staff and reviewed documentation related to the district's process for setting its annual budget and the board's process for approving the budget.</li> <li>• We reviewed the district's administrative code and accounting policies.</li> <li>• We reviewed minutes and agendas for meetings of the district's board, which included the consent calendar items from its finance committee.</li> <li>• We reviewed expenditure lists the district provided to the board and the public, which we discuss further in Table 2 on page 19.</li> </ul>
b. Assess whether the district has sufficient processes and controls to ensure expenditures and other financial activities are appropriate.	<ul style="list-style-type: none"> <li>• We interviewed relevant district staff and reviewed documentation related to the district's process for approving expenditures.</li> <li>• We determined whether the district had and followed a debt management policy.</li> </ul>
c. Review the district's contracting procedures and determine whether they are consistent with applicable contracting requirements and with procedures used by other municipal water districts. From a selection of contracts, determine whether the district complied with the applicable laws, policies, and regulations.	<ul style="list-style-type: none"> <li>• We judgmentally selected 20 contracts active primarily during our audit period and determined the extent to which the district followed legal requirements and its own policies and practices for contracting. We ensured that we reviewed contracts for a variety of different services, including engineering and construction services, legal services, lobbying services, and public affairs services, as well as contracts that had received significant media attention.</li> <li>• We judgmentally selected and reviewed five contracts the district entered into before our audit period that were still active during our audit period. We selected these contracts based on their amendment histories and on the media attention they received.</li> <li>• We identified best practices for contract management using the Project Management Institute's <i>Project Management Body of Knowledge</i>, the <i>State Contracting Manual</i>, and contracting policies from other water agencies, including the Western Municipal Water District and the Municipal Water District of Orange County, as well as the San Diego County Water Authority.</li> </ul>
d. Assess whether the district has adequate resources and policies to address personnel matters, including the conduct of its board members.	<ul style="list-style-type: none"> <li>• We determined that the district maintained codes of conduct for both its staff and its board throughout the audit period.</li> <li>• We reviewed district policies and interviewed relevant staff regarding how the district investigates violations of its policies and codes of conduct.</li> <li>• We reviewed district records and noted that board members and senior managers attended ethics and sexual harassment training as required.</li> <li>• We ensured board members and relevant staff filed required conflict-of-interest forms. We reviewed those forms to determine whether the individuals reported significant relationships that conflicted with board decisions. We had no findings in this area; however, we note the results of an investigation by the Fair Political Practices Commission in Chapter 2.</li> </ul>

AUDIT OBJECTIVE	METHOD
<p>e. Assess whether the district operates transparently, including complying with laws governing public meetings, public records, and fee-setting, and whether it publicly reports on all its spending.</p>	<ul style="list-style-type: none"> <li>• We interviewed relevant staff regarding the district's compliance with state open meeting laws and training on such laws for board members.</li> <li>• We reviewed the district's tracking of its compliance with state requirements regarding advanced posting of meeting agendas. According to the director of administration and board services, the district did not have any process for tracking its compliance with posting requirements until March 2013; however, our review of its tracking process subsequent to that date found no reportable concerns.</li> <li>• We reviewed a selection of eight public records act requests. We identified instances in which the district did not clearly indicate it had fully addressed requests and another in which the district missed a deadline by several days. Although in our judgment these issues do not rise to the level of reportable findings because the district still responded to the requests, we discussed ways to improve the district's process with its staff.</li> <li>• We reviewed minutes of board meetings and determined the board conducted public meetings before considering changes to its fees.</li> <li>• We noted that the district includes lists of expenditures in its monthly board agendas, which are publicly available on the district's website.</li> </ul>
<p>3 Assess whether the district's expenditures and revenues are reasonable. Specifically, perform the following covering the five-year period from 2010 to 2015:</p> <p>a. To the extent possible, assess the reasons for any trends in revenues generated through customer rates during the past five years.</p>	<ul style="list-style-type: none"> <li>• We reviewed the district's comprehensive annual financial reports for the fiscal years 2010–11 through 2013–14 and its draft fiscal year 2014–15 financial statements as of October 2015 to determine the reasons for increases or decreases in revenues generated through customer rates.</li> <li>• We analyzed reasons for large changes in the district's revenues generated through customer rates.</li> </ul>
<p>b. For major categories of expenditures, assess the reasons for any major trends, including those expenditure trends related to legal matters and those not directly related to the district's primary mission.</p>	<ul style="list-style-type: none"> <li>• We analyzed reasons for large changes in district expenditures, including its legal services expenditures.</li> <li>• We interviewed relevant district staff and reviewed the district's audited financial statements to determine the reasons for increases or decreases in major expenditure categories.</li> </ul>
<p>c. For a sample of expenditures, determine whether they were legally allowable, reasonable, and consistent with the mission of the agency.</p>	<ul style="list-style-type: none"> <li>• We reviewed the district's administrative code, prior external audit findings, and other policy documents.</li> <li>• We interviewed relevant staff regarding the district's internal controls over expenditures.</li> <li>• We judgmentally selected 50 expenditures from the audit period and tested them for compliance with applicable laws, policies, and best practices.</li> <li>• We selected 35 expenditures for testing from the district's file room and 15 expenditures from the public expenditure lists created from its accounting system. We found that the public expenditure lists were incomplete because they did not include certain transfers the district made to a legal trust fund, which we describe further in Chapter 2.</li> </ul>
<p>4 To the extent the district has a strategic plan, determine the following:</p> <p>a. Whether the strategic plan contains goals and objectives that support the mission of the organization.</p> <p>b. How often the district evaluates its success in achieving its goals and objectives, and updates the strategic plan to reflect changes, including changes in regulatory requirements, goals, and milestones.</p>	<ul style="list-style-type: none"> <li>• We reviewed the district's strategic plans the board considered in October 2010 and May 2015 and determined they contained key elements of strategic plans and reflected the district's mission. However, as we describe in Chapter 1, the board did not approve or ensure the district appropriately implemented its October 2010 strategic plan.</li> <li>• We interviewed relevant staff regarding the development and implementation of the district's strategic plans, including the district's plans for periodic review.</li> <li>• We reviewed proposed metrics for both the 2010 and 2015 plans. Because the district did not adequately implement its 2010 plan, we reviewed its planned approach to evaluating its current strategic plan and determined it is reasonable.</li> </ul>

AUDIT OBJECTIVE	METHOD
<p>5 Assess whether the district has qualified staff to manage its operations. Specifically, perform the following:</p> <p>a. To the extent possible, determine whether technical staff has sufficient qualifications and resources to adequately maintain its infrastructure over the long term.</p>	<ul style="list-style-type: none"> <li>• We interviewed the district’s director of human resources and engineering staff.</li> <li>• We obtained and reviewed position descriptions for the district’s engineering staff and its general manager.</li> <li>• We compared the position descriptions to the staff’s qualifications.</li> <li>• We reviewed the district’s contract for operations and maintenance of its recycled water pipeline.</li> <li>• We determined that the district recently hired additional technical staff and that its current staff are qualified. We have no reportable findings in this area.</li> </ul>
<p>b. To the extent possible, assess the qualifications and sufficiency of the district’s management staff responsible for essential operations.</p>	<ul style="list-style-type: none"> <li>• We interviewed the district’s director of human resources.</li> <li>• We reviewed the district’s organizational chart and human resources files to compare position descriptions to stated qualifications for a selection of current district managers.</li> <li>• We determined the selected current managers were qualified and that the district had sufficient staff for its essential operations.</li> <li>• We interviewed the district’s current general manager regarding his tenure and the board’s plans for hiring general managers in the future.</li> </ul>
<p>c. Identify the total compensation of each member of the board of directors and top managers.</p>	<ul style="list-style-type: none"> <li>• We interviewed the director of human resources.</li> <li>• We reviewed district policies regarding compensation, expenditure reports, and payroll data to determine board member compensation.</li> <li>• To identify the amounts board members received for per diem and allowances, such as the automobile or transportation allowance, we relied on monthly reports of expenditures the district generated from its accounting systems and presented to the board.</li> <li>• We noted that board members generally receive health and other benefits to the same extent that staff do, and we describe these benefits in Chapter 3.</li> <li>• We reviewed data the district reported to the California State Controller’s Office (State Controller) regarding the compensation of its top managers.</li> <li>• We compared the salaries of selected district managers to the State Controller’s data to ensure the district accurately reported its compensation to the State Controller.</li> </ul>
<p>d. Determine whether the total compensation received by each of the district’s top managers is comparable to that received by top managers in similar public agencies or municipal water districts in the region.</p>	<ul style="list-style-type: none"> <li>• We selected four additional water agencies in Southern California. We reviewed data the district and the four additional water agencies reported to the State Controller regarding the compensation for selected management positions.</li> <li>• We reviewed the district’s surveys of certain water agencies’ compensation and benefits.</li> </ul>
<p>6 Assess the district’s financial viability and control environment. Specifically, for the five-year period from 2010 to 2015, determine the following:</p> <p>a. Whether the district retained a qualified, independent auditor for its annual financial audits and whether completed audits were publicly available.</p>	<ul style="list-style-type: none"> <li>• We reviewed the district’s contracts with its auditors for fiscal years 2010–11 through 2014–15.</li> <li>• We reviewed licensing records for the district’s auditors. The district contracted with three different audit firms between fiscal years 2010–11 and 2014–15. We noted the firms were licensed and had no complaints on file.</li> <li>• We reviewed the district’s website and determined the district made its annual financial audits publicly available.</li> </ul>
<p>b. What deficiencies were reported by its independent auditor and how the district has addressed such deficiencies.</p>	<ul style="list-style-type: none"> <li>• We reviewed the district’s independent auditors’ reports for fiscal years 2010–11 through 2013–14.</li> <li>• We noted that the district received an unqualified opinion on its financial statements every year for fiscal years 2010–11 through 2013–14. The district’s external auditor had not issued an opinion on the district’s fiscal year 2014–15 financial statements as of October 2015.</li> <li>• We noted that the district adequately addressed all deficiencies its independent auditors reported except for the following: <ul style="list-style-type: none"> <li>– The district does not have a debt management policy. We discuss this further in Chapter 1.</li> <li>– The district did not have meal expense limits in place until July 2015. We discuss this further in Chapter 3.</li> </ul> </li> </ul>

AUDIT OBJECTIVE	METHOD
c. How often the district changed auditors and the reasons for changing auditors.	<ul style="list-style-type: none"> <li>We reviewed the district's contracts with its auditors for fiscal years 2010–11 through 2014–15.</li> <li>The district contracted with three audit firms, changing auditors twice during our audit period. In the first instance, according to board memoranda, the district selected a different firm than the one that had been its auditor for the previous 10 years. In the second, a board memorandum stated that the firm told the district it could not complete its contract. We had no reportable findings in this area.</li> </ul>
d. The district's debt ratio coverage for bond commitments and the reasons for any year in which the ratio fell below the generally accepted level.	<ul style="list-style-type: none"> <li>We interviewed relevant staff and reviewed documentation related to the district's debt coverage ratio. We also examined the reasons why the debt coverage ratio fell below the accepted level.</li> <li>We interviewed relevant staff and reviewed documentation to determine how the district's inability to meet its required debt coverage ratio affected its credit rating and debt costs.</li> </ul>
e. To the extent possible, assess whether the five-year trends in revenues and expenditures indicate long-term financial viability.	<ul style="list-style-type: none"> <li>We analyzed the information we gathered for Objectives 3a, 3b, and 6d, as well as pertinent information contained in the district's audited financial statements and other records, to determine the extent to which this information indicates the district's long-term financial viability.</li> <li>We determined whether the district had and used a long-term financial plan. We describe our findings in this area in Chapter 1.</li> </ul>
7 Review and assess any other issues that are significant to the district's operations and management.	<ul style="list-style-type: none"> <li>We interviewed relevant staff and reviewed documentation related to the district's attempts to obtain and retain insurance coverage for its operations.</li> <li>We reviewed state law and interviewed staff at the Los Angeles County Local Area Formation Commission to determine the process through which the district's governance may change or the district may dissolve.</li> <li>We interviewed the five current members of the board to obtain their perspectives on the district's operations and its challenges over the last five years. While we did not directly quote any of the board members' interviews in our report, we used their comments to help inform our audit fieldwork.</li> </ul>

Sources: The California State Auditor's analysis of Joint Legislative Audit Committee audit request 2015-102 and information and documentation identified in the table column titled *Method*.

### Assessment of Data Reliability

In performing this audit, we relied upon reports generated from the information systems listed in Table 2. The U.S. Government Accountability Office, whose standards we are statutorily required to follow, requires us to assess the sufficiency and appropriateness of computer-processed information that is used to support our findings, conclusions, or recommendations. Table 2 shows the results of this analysis.



**Table 2**  
**Methods Used to Assess Data Reliability**

INFORMATION SYSTEM	PURPOSE	METHOD AND RESULT	CONCLUSION
<p><b>Central Basin Municipal Water District's (district):</b></p> <ul style="list-style-type: none"> <li>– New Logos Database data, for the period July 2012 through June 2015</li> <li>– Master Accounting Series 90 data, for the period July 2010 through June 2012</li> </ul>	<p>To make a judgmental selection of expenditures</p>	<ul style="list-style-type: none"> <li>• This purpose did not require a data reliability assessment. Instead, we needed to gain assurance that the population of expenditures was complete for our review purposes.</li> <li>• We obtained reasonable assurance by comparing total disbursements presented on the expenditure lists to the district's monthly bank reconciliations or payment register reports.</li> </ul>	<p>As part of our audit work, we identified certain transactions not present on the district's expenditure lists. Nevertheless, we noted that these lists materially agreed with monthly bank reconciliations or payment register reports, and were thus adequate to use for selecting expenditures for review.</p>
	<p>To calculate per diem payments the district made to its board members</p>	<p>To determine accuracy, we judgmentally selected 50 board-approved per diem payments from the district's records and compared them to claim forms detailing the meetings board members attended. To determine completeness, we reviewed district records and noted directors generally received per diem payments in each pay period between July 2010 and June 2015.</p>	<p>Sufficiently reliable for the purposes of this audit.</p>
<p><b>The district's:</b></p> <ul style="list-style-type: none"> <li>– New Logos Database data, for the period July 2012 through June 2015</li> <li>– Access Database data, for the period July 2010 through June 2012</li> </ul>	<p>To make a judgmental selection of contracts</p>	<p>This purpose did not require a data reliability assessment. Instead, we needed to gain assurance that the population of contracts was complete for our review purposes. To determine completeness, we haphazardly selected 39 contracts from the district's files and ensured they were present in either the New Logos or Access database, as appropriate.</p>	<p>Complete for the purposes of this audit.</p>

Sources: California State Auditor's analysis of various documents, interviews, and data obtained from the district.

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# Chapter 1

## THE CENTRAL BASIN MUNICIPAL WATER DISTRICT'S BOARD OF DIRECTORS HAS CONSISTENTLY FAILED TO PROVIDE APPROPRIATE LEADERSHIP AND OVERSIGHT

### Chapter Summary

The board of directors (board) of the Central Basin Municipal Water District (district) has failed to lead the district in a manner that encourages its efficient operation, effective management, and adherence to laws and rules. For example, the board has not maintained stability in the district's top executive position: Over the five years of our review, six different individuals filled this role, a level of turnover that significantly affected the district's ability to perform its necessary functions. Further, the board did not establish an effective structure for reporting and investigating ethics violations by board members and staff. In fact, the Fair Political Practices Commission (FPPC) uncovered such violations. Also, the board did not ensure that it approved or that the district implemented its previous strategic plan; it did not require the district to create a long-term financial plan; and through its lack of action, it contributed to the district suffering two credit rating downgrades. Finally, the board's actions led to several changes in its liability insurance, resulting in higher costs for less coverage.

Because the district has lacked effective leadership, the public's confidence in it has eroded, and it has risked being unable to meet its obligations to its customers. The district has recently taken some positive steps to correct these issues, such as retaining an experienced general manager on a two-year contract and creating a new strategic plan. However, given the magnitude of its past problems, we believe considering ways to improve the district's governance is necessary. Although the public currently elects the district's board, the district does not serve the public directly but instead sells water to various entities that in turn sell water to the public. Thus, those who select the board are not those whom it directly serves. If the Legislature chose to change the district's governance structure, it could consider a structure through which board members would be directly accountable to the entities the district serves. Such a change would enable those entities to hold the board responsible when it takes actions or makes decisions that are not in the district's best interest.

### **The Board's Dysfunctional Oversight Has Threatened the District's Ability to Meet Its Responsibilities**

The board's poor leadership and decision making significantly impeded the district's ability to effectively and efficiently perform its necessary functions over the course of our audit period from July 2010 through June 2015. Specifically, during this time, the board failed to ensure that it provided the district with stability in either the general manager or finance director position. In addition, the board did not establish a structure for investigating or referring ethics complaints against board members and staff related to violations of the district's code of conduct or conflict-of-interest code that minimizes political influence. Finally, the board failed to approve or implement a strategic plan dated October 2010, and it is too soon to tell whether the district will effectively implement a subsequent strategic plan it adopted in May 2015. When the board fails to exercise appropriate leadership, it impedes the district's ability to operate in an efficient and effective manner.

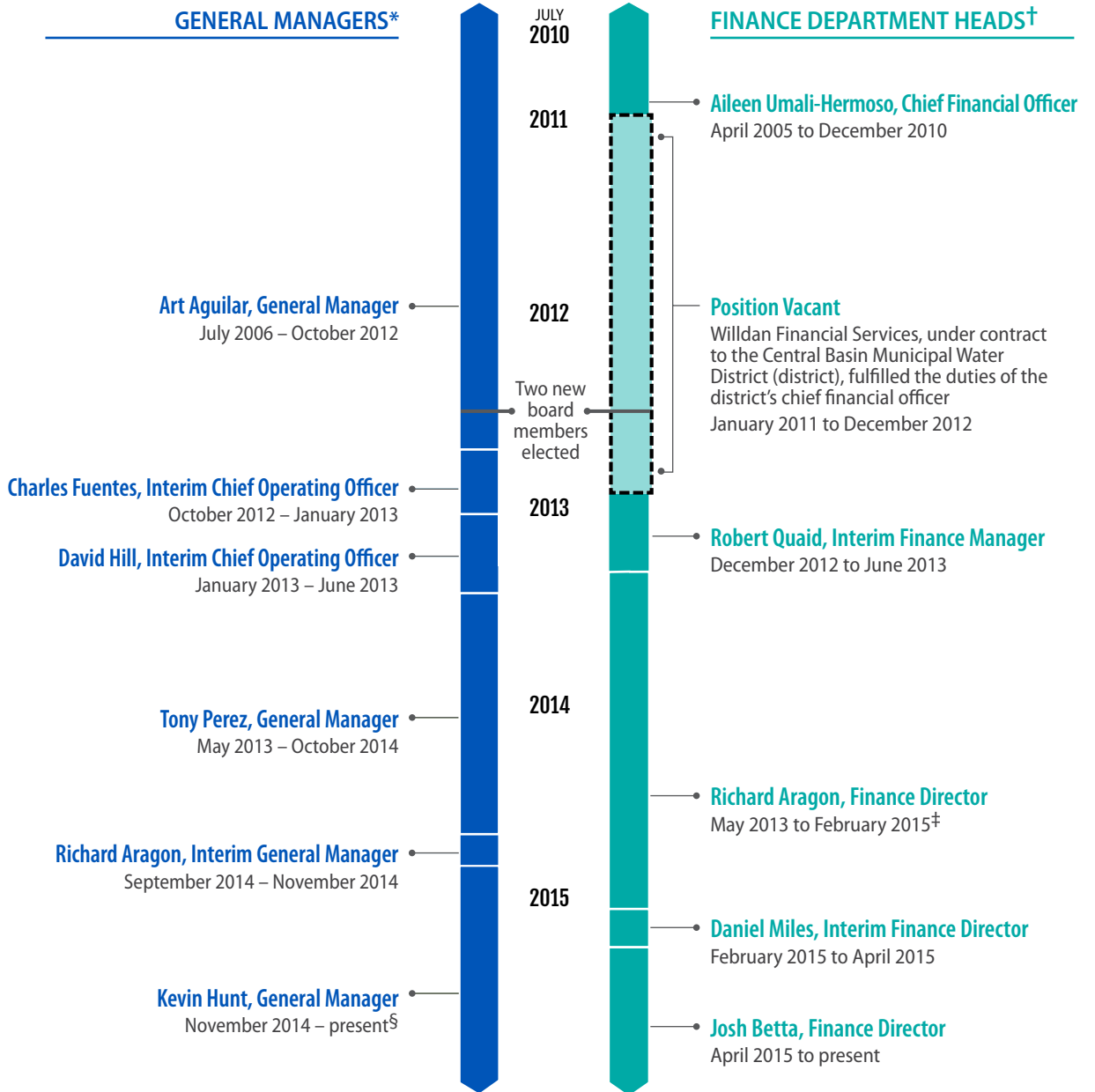
### ***The Board Has Not Ensured That the District Has Consistent Leadership***

Between July 2010 and June 2015 the board and the general manager demonstrated a lack of leadership by not maintaining stability in the district's key executive management and finance positions, hindering the district's ability to effectively manage and meet its responsibilities. Figure 5 presents the length of time these two critical positions were either vacant or filled by one of numerous individuals over the five-year period.

As shown in Figure 5, the district has faced high turnover in its top executive position. State law requires municipal water district boards to appoint a general manager. The board has full authority over the employment of the general manager, who in turn has full charge and control of the operation of the district, including the authority to employ and discharge all personnel except for those the board is required to appoint. However, between July 2010 and June 2015, the district had six individuals in this critical leadership role, including four general managers or interim general managers and two interim chief operating officers (interim chiefs). According to the position description, the interim chiefs served at the pleasure of the board until the board finalized the recruitment for the general manager position. The interim chiefs were not to have the authority to hire or fire staff or to enter into new contracts without board approval. Further, they could not participate as candidates for the general manager position.

***Between July 2010 and June 2015, the district had six individuals in critical leadership roles, including four general managers or interim general managers and two interim chief operating officers***

**Figure 5**  
Timeline of Changes in Key Leadership Positions at the Central Basin Municipal Water District



 Position vacant

Sources: District human resources records, interviews with district staff, and the County of Los Angeles's final official election results for June 5, 2012.

\* In certain cases during our audit period, this position was referred to as the interim chief operating officer and some of the position's duties were restricted.

† In certain cases during our audit period, this position was referred to as the chief financial officer, interim finance manager, finance director, and interim finance director.

‡ As shown in the figure, Richard Aragon briefly served as interim general manager during this time.

§ Kevin Hunt was initially hired as the interim general manager, a position he held from November 10, 2014, through May 10, 2015, until the district hired him as the current general manager on May 11, 2015.

Lack of agreement among the board members was a contributing factor to instability in the district's top executive position. In October 2012, the district's long-standing general manager retired. According to the district's director of human resources, the board appointed an interim chief in October 2012. However, the board terminated him less than four months later in January 2013, during a contentious board meeting shortly after two new board members took office. The board approved the termination by a three-to-two vote.

The board subsequently appointed a series of individuals to the top executive role. In January 2013 the board appointed a second individual to the position of interim chief. He returned to his former position as the district's water resources and planning manager after the board hired a new general manager effective May 2013. The board placed this general manager on paid administrative leave in September 2014 and terminated his employment in October 2014. As with the first interim chief in 2013, this termination occurred during a contentious board meeting and was the result of a three-to-two vote by the board. Also in September 2014, the board appointed the district's then-finance director to also serve as an interim general manager. In November 2014 the board appointed another interim general manager and approved a recruitment process for hiring the general manager in that same year. The board subsequently entered into a two-year employment contract in May 2015 with the individual it had previously appointed as interim general manager.

The district's current general manager's two-year contract expires in May 2017, and he stated that he is contemplating retiring at that time. If he chooses to retire at the completion of his contract, the general manager anticipates the board would start the recruitment process between June 2016 and October 2016. The most recent hiring process the district conducted for a general manager included establishing an independent ad hoc hiring committee, selecting a recruitment firm, and having the board interview the top candidates. However, the district does not have a formal policy for recruiting and hiring a general manager in the future, and the current general manager acknowledged that the district would benefit from such a policy. In our judgment, establishing a formal policy for the hiring process of the general manager position and beginning the hiring process a year in advance of the end of the current general manager's contract provides the district ample time to identify and select a replacement, should the current general manager retire. If the board does not fill the general manager position either prior to the current general manager's retirement or within a reasonable amount of time thereafter, the board will likely hinder the district's ability to effectively meet its responsibilities.

***If the board does not fill the general manager position either prior to the current general manager's retirement or within a reasonable amount of time thereafter, the board will likely hinder the district's ability to effectively meet its responsibilities.***



In addition, the district had five different individuals and one financial services firm perform the role of finance director or a similar position between 2010 and 2015. In December 2010, the district's chief financial officer resigned after more than five years in the position, and the district hired a financial services firm to perform the duties of the chief financial officer. Despite the financial services firm's recommendation in March 2012 that the district recruit and hire a full-time dedicated finance director, the district did not fill the role with an interim finance manager until December 2012. According to the district's director of human resources, she raised the question of hiring a finance director on multiple occasions, and the general manager at that time told her that the financial services firm was performing the job adequately and had some remaining work to complete. Nevertheless, the fact that the same financial services firm recommended that the district hire a finance director suggests that the district should have prioritized filling this position. The district finally hired a finance director in May 2013. He remained in the position until February 2015, when the district hired an interim replacement until it recruited a new finance director in April 2015.

*The district had five different individuals and one financial services firm perform the role of finance director or a similar position between 2010 and 2015.*

The lack of stability in these two key management positions has threatened the day-to-day operations of the district. As we note later in this chapter, a lack of stable management was a factor in the district's losing its insurance in 2014. Further, together these positions help establish an environment that promotes effective stewardship of both resources and staff. As we note in Chapter 2, the district's management of its contracts and expenditures needs improvement, and in Chapter 3 we discuss that the lack of a general manager contributed to staff not receiving timely performance evaluations. If the board struggles to maintain consistency in these critical positions in the future, the district may continue to lack the leadership necessary to meet its responsibilities.

***The Board Lacks an Effective Structure to Investigate Its Own and District Staff's Noncompliance With Laws and Rules***

The board has not adequately maintained a mechanism to respond to complaints regarding its members' or district staff's violations of laws and district codes related to ethics. From the beginning of our audit period in July 2010 until the end of July 2015, the district's administrative code called for an ethics committee to investigate ethics complaints against board members and staff. According to the administrative code in force prior to July 2015, this committee was to include two board members. Further, the administrative code indicated that certain district staff and the district's counsel were to be members of the committee but was silent as to whether they would be voting members. However, according to the human

resources director, district staff only provided information to the ethics committee and, according to our review of the district's board minutes, these staff were not voting members.

Until July 2015 the district's administrative code stated that the ethics committee would meet twice yearly. However, this committee did not meet regularly. Specifically, according to the district's director of human resources, she informed the then-general manager in July 2011 that the ethics committee was listed in the administrative code as a standing committee that met every six months. She explained that the ethics committee met the following month, although it conducted no business during that meeting, and that it met again in February 2012. It scheduled another meeting for October 2012, but this meeting did not occur because not enough committee members attended. The ethics committee did not schedule another meeting until August 2013, 18 months after its February 2012 meeting. The director of human resources did not know why the ethics committee did not meet regularly during this time but commented that the board had not established the practice of ensuring the committee met every six months.

***In August 2013 the ethics committee violated the Brown Act when it conducted a meeting in open session even though the posted agenda indicated that this meeting was to be in closed session.***

When the committee finally did meet to conduct business in August 2013, the meeting generated controversy. First, the chair of the ethics committee chose to conduct the meeting in open session, even though the posted agenda indicated that this meeting was to be in closed session. By conducting an open meeting without correctly noting that in the advance agenda, the committee violated the Ralph M. Brown Act (Brown Act). We discuss additional concerns with the board's adherence to the Brown Act and make a related recommendation in Chapter 2. Further, at its meeting the ethics committee discussed a letter from the district attorney's office regarding its investigation into the alleged release of confidential information by the then-board president to a local newspaper. During this meeting, the committee authorized the general manager to seek an investigator to review the matter further. After the investigation was completed, the committee voted in September 2013 to refer the then-board president's alleged disclosure of confidential information to the Los Angeles County Grand Jury. As of September 2015, published reports of the Los Angeles County Grand Jury had not addressed this issue.

Shortly after the September 2013 meeting, the then-board president—who had the authority to appoint members of committees—stated in a memorandum to the general manager that he was very concerned about the ethics committee and the manner in which it was using its role to investigate board members. He stated that he was reconfiguring the ethics committee immediately by placing himself on the committee as the chair, adding another

board member, and replacing the two sitting board members. In October 2013, in another memorandum to the general manager, the then-board president stated that there was dissension and turmoil caused by the ambiguity of the administrative code and the ethics committee, and this was having a pernicious and destructive impact on staff morale. At a subsequent October 2013 meeting, the board temporarily suspended the ethics committee until it could resolve the ambiguity in the district's administrative code.

Although the board temporarily suspended the ethics committee in October 2013, it did not approve revisions to the district's administrative code regarding the committee until July 2015. According to the district's director of human resources, a former general manager postponed finalizing a new policy because he was concerned that board members would use a reinstated ethics committee to act on political disagreements. The board finally approved amendments to the administrative code in July 2015, establishing a new ethics committee; however, the committee's structure remained fundamentally the same. Like its predecessor, it consists of two board members, and the ambiguity regarding staff membership—whether they are voting members or only provide information to the committee—remains. The director of human resources stated that the district plans to address this ambiguity in the administrative code and make staff nonvoting members of the committee, although she did not give a timeline. Because the board did not make significant structural changes to the new ethics committee, it will be subject to the same issues the former ethics committee faced.

The district recognizes the inherent conflicts of interest in its current ethics committee structure and is making changes. In August 2015 the general manager made a presentation to the board on this topic, and the board's agenda included an informational document regarding its new ethics committee. The informational document acknowledged that the most significant difficulty in crafting an ethics enforcement policy is the inherent conflict of interest in asking board members and the general manager to investigate their peers, coworkers, friends, or bosses. To address this, the general manager discussed in the meeting the possibility of contracting with an independent law firm to conduct preliminary investigations. Also, the informational document suggested that the new ethics committee consider its role and alternative ways for it to function effectively. Finally, the general manager noted in the meeting that district staff recently met with the ethics officer for the Metropolitan Water District of Southern California (Metropolitan) and learned that Metropolitan participates in an independent, anonymous ethics hotline. Metropolitan's ethics officer made a presentation to the board in

***The district recognizes the inherent conflicts of interest in its current ethics committee structure and is making changes.***

*In October 2015 the board adopted a plan to implement a hotline for reporting potential ethics violations and to contract with a law firm to conduct an independent review of those alleged violations.*

September 2015. At a meeting in October 2015, the board adopted a plan to implement a hotline for reporting potential ethics violations and to contract with a law firm to conduct an independent review of those alleged violations.

Further, board members and staff have attended ethics training; however, the training by itself may not prevent ethical violations. As we will discuss in Chapter 2, in 2015 a former general manager and a former board member received fines from the FPPC of about \$30,000 each for violating the Political Reform Act by, for example, receiving gifts in excess of established limits from a district contractor. Although a functioning independent ethics committee may not have prevented or detected these specific violations, the lack of such a body would prevent the district and the board from receiving and acting on complaints of similar potential violations.

### ***The Board Failed to Demonstrate Any Commitment to the Strategic Planning Process in the Past***

Until recently, the board demonstrated a lack of leadership by not ensuring the district had an approved strategic plan or made progress in achieving the plan's goals and objectives. According to the Government Finance Officers Association (GFOA), strategic planning is a comprehensive and systematic management tool to help an organization assess its current environment, anticipate and respond appropriately to changes in that environment, envision the future, increase effectiveness, develop commitment to its mission, and achieve consensus on strategies and objectives for achieving that mission.<sup>3</sup> The GFOA recommends that all governmental entities use some form of strategic planning to provide a long-term perspective for service delivery and budgeting, thus establishing logical links between their authorized spending and broad organizational goals.

However, the board did not demonstrate a commitment to the strategic planning process and missed opportunities to identify whether the district was making progress in achieving its goals and objectives. Specifically, the board considered a five-year strategic plan in October 2010 that included a mission statement, a vision of the district in 2015, goals, and a set of metrics to help assess and guide the district's progress toward that vision. However, according to the director of human resources, the board never approved this strategic plan. Nevertheless, she explained that when she began working at the district in January 2011, the then-general

<sup>3</sup> The GFOA represents public finance officials throughout the United States and Canada. The GFOA's mission is to enhance and promote the professional management of governmental financial resources. One of the ways in which it does this is by providing best practice guidance to its members.

manager directed her to use this plan and implement its objectives. The director of human resources stated that staff initiated implementation of the strategic plan in the summer of 2011, but that continued execution of the plan was put on hiatus once the then-general manager left the district in 2012. Not only did the district lack this critical organizational planning tool for several years, but the board failed to demonstrate its commitment to the strategic planning process by not approving the strategic plan or ensuring its appropriate implementation.

Despite these past shortcomings, the board recently adopted a new strategic plan that, if properly implemented, appears adequate. The current general manager stated that one of his first priorities after joining the district in November 2014 was to develop a new strategic plan for the district. The district engaged a consultant to coordinate and facilitate the development of a strategic plan in January 2015. The plan was developed with input from the district's customers, board members, and a project team that included the current general manager as well as various district managers. The new plan covers three years and reflects the district's overall mission and responsibilities. The board adopted this strategic plan in May 2015, and the district implemented it beginning in fiscal year 2015–16. District staff developed a performance measurement scorecard that provides a basis for the district's periodic review of its progress toward its strategic planning objectives. According to the general manager, the district will review this scorecard on a quarterly basis. Additionally, he explained that the district will use the budgetary process to update the board and identify strategic plan goals for the upcoming year. In October 2015 district staff presented a status update to the board that indicated steady progress has been made under the major goals included in the strategic plan. To the extent the board ensures that the district follows through on its plans to monitor and publicly report on its progress in achieving the strategic plan's goals and objectives, the board will help ensure the district is transparent in its actual achievement of the strategic plan.

*The board adopted a new strategic plan in May 2015 that covers three years and reflects the district's overall mission and responsibilities and, if properly implemented, appears adequate.*

### **The Board Has Failed to Take Critical Steps Necessary to Ensure the District's Continued Financial Sustainability**

The board has not established the essential policies necessary to safeguard the district's long-term financial viability. It has not ensured that the district engages in long-term financial planning to protect its long-term financial viability or that the district conducts a water rate study to ensure it collects sufficient revenue to cover its operating expenses. These deficiencies, at least in part, contributed to the district's inability to meet the debt coverage ratio required by its debt agreements, and as a result the district's credit

rating was downgraded in 2013. These deficiencies may also have contributed to the downgrade in 2015. The downgrades may lead to an increase in the costs the district pays on its debt. In addition, the board's inaction at a critical moment led to the avoidable loss of the district's insurance coverage, resulting in a substantial increase in costs and reduction in coverage for the district's subsequent liability insurance policies.

### ***The District Has Not Developed a Long-Term Financial Plan***

Although the GFOA recommends that all government entities regularly engage in long-term financial planning, the district failed to do so throughout our audit period. Long-term financial planning could help the district develop strategies to overcome financial challenges and achieve long-term sustainability. Instead, the district has forecast its revenue and expenditures on a year-to-year basis during its budget process. According to the current finance director, one of the reasons the district did not engage in long-term financial planning was its lack of consistent leadership in the finance director and general manager positions, which we describe earlier in this chapter.

In August 2015 Moody's Investors Service (Moody's) placed \$48.4 million of the district's debt credit rating on review for a possible downgrade, in part because of the district's lack of future year financial projections.<sup>4</sup> Moody's subsequently downgraded the credit rating on this debt in October 2015 citing other reasons, as we discuss in the next section. According to an article the GFOA published on building a financially resilient government, credit rating agencies point to long-term financial planning as evidence of management's dedication to the practices that maintain long-term financial health. The credit rating downgrade—the second the district has received in the past three years—may cause the district to incur additional costs. We describe the credit downgrades and their financial consequences in the next section. Not surprisingly, the district's recently adopted strategic plan includes an objective related to conducting long-term financial planning. In October 2015 the board authorized the general manager to engage a consultant to prepare a 10-year financial forecast. The general manager stated that his goal is for the district to have a completed long-term financial plan by the end of 2016.

The district's lack of a long-term financial plan to guide its revenue estimation process contributed, at least in part, to the district overestimating its revenues during the last four fiscal

***The district's lack of a long-term financial plan to guide its revenue estimation process contributed to the district overestimating its revenues during the last four years in our audit period.***

<sup>4</sup> Moody's is a provider of credit ratings, research, and risk analysis. The purpose of its credit ratings is to provide investors with a simple system of gradation by which they may gauge the future relative creditworthiness of securities.

years in our audit period. When the district does not develop reasonable revenue estimates during its budgeting process, it risks that its revenue will not cover its expenses. The current general manager, who has more than 20 years of experience in the water industry, explained that in his experience it is normal for actual revenues from water sales to vary somewhere between 10 percent and 15 percent of estimates. However, as shown in Table 3, the yearly variance in the district’s budgeted-to-actual revenues was greater than 20 percent in three of the five fiscal years within our audit period. The district did not have an individual in the finance director position when it prepared its budgets for fiscal years 2011–12 and 2012–13—two of the fiscal years in which its actual revenues were at least 20 percent less than its corresponding estimates—and instead engaged a consultant to perform its financial management duties. According to the current general manager, the district’s former management was too optimistic when developing revenue estimates. Additionally, he explained that the 21 percent variance in fiscal year 2014–15 was primarily the result of lower replenishment water sales than the district had estimated because an invasive shellfish contaminated the source of the district’s replenishment water.

**Table 3**  
**Differences Between Budgeted and Actual Revenues at Central Basin Municipal Water District**  
**Fiscal Years 2010–11 Through 2014–15**  
**(In Millions)**

	2010–11	2011–12	2012–13	2013–14	2014–15
Budgeted revenues	\$58.3	\$64.1	\$66.0	\$52.0	\$71.4
Actual revenues	60.9	50.8	45.1	46.3	56.2
Difference (Shortfall)	2.6	(13.3)	(20.9)	(5.7)	(15.2)
Difference as a percentage of budgeted amount	4%	21%	32%	11%	21%

Sources: Central Basin Municipal Water District budget documents, comprehensive annual financial reports for fiscal years 2010–11 through 2013–14 and draft financial statements as of October 2015 for fiscal year 2014–15.

Despite large variances in the district’s past budgeted-to-actual revenues, it appeared to follow a reasonable methodology when preparing its budget for fiscal year 2015–16. Specifically, in a memorandum to the board, district staff reported that the district surveyed its customers to determine a baseline projection for potable water sales and then reduced the projection to reflect allocations from the district’s regional wholesaler. Staff also reported that they adjusted the projection to reflect the State’s recent mandated water conservation order due to the drought. The current general manager believes that this methodology will

***The district has not conducted a water rate study to determine the appropriateness of its water rate structure to ensure it meets its operating costs on a long-term basis.***

provide a reasonable estimate for the district's revenue in fiscal year 2015–16. We believe the district's approach was logical, especially since the drought has made it problematic to use historic trends to predict future water sales.

Although the district appears to now have a reasonable methodology for forecasting its revenue on a short-term basis, it has not conducted a water rate study to determine the appropriateness of its water rate structure to ensure it meets its operating costs on a long-term basis. As a wholesaler, one of the district's main sources of revenue to cover its expenses is the surcharge it adds to the water it purchases from the regional wholesaler and sells to its customers. The district risks running deficits when declining water sales lead to lower surcharge revenues than it estimated and it does not reduce its expenses accordingly. Nonetheless, the district's board has not increased the district's surcharge since fiscal year 2011–12. According to the current general manager, the district intends to contract with an outside consultant to provide technical analysis of its water rate schedule to determine the appropriateness of its rates. He further stated that the district should not adjust its surcharge until it develops a long-term financial plan to forecast its revenues and expenses; the water rate study it plans to conduct can then help it set its water rates to meet these revenue forecasts. The general manager plans to have the water rate study completed by spring 2017.

Largely because the district collected less revenue than it had budgeted, its expenses exceeded its revenues in three of the past five fiscal years. The district incurred deficits in each of the fiscal years 2011–12 through 2013–14, with the largest of nearly \$5 million occurring in fiscal year 2012–13. These deficits were due to a combination of factors, including reduced water sales, increased expenses, and an early debt payment. For instance, the district made a \$3.9 million payment in June 2013 to pay off part of its debt early in order to reduce its overall debt load. In addition, the district's imported water revenue declined by more than \$12 million between fiscal years 2010–11 and 2013–14. During the same time period, its general and administrative expenses increased by more than half a million dollars, in part because its legal costs were greater than \$1.5 million every year from fiscal year 2010–11 through 2013–14. In particular, the district reported historically high general and administrative expenses in fiscal year 2012–13 due to litigation involving another water agency. Further, during fiscal year 2013–14, the district's legal expenses accounted for almost \$2.6 million, or 60 percent, of its general and administrative costs. The district has now settled most of its litigation issues, and its fiscal year 2014–15 legal expenses of \$677,000 were \$900,000 less than its legal expenses in any of the other years during our audit period.



Finally, until recently, the board did not ensure the district had an adequate reserve policy. An article the GFOA published about building a financially resilient government highlights that public entities must maintain a reserve policy as a component of long-term financial planning. By not following a reserve policy in the past, the board did not demonstrate a commitment to financial prudence and careful stewardship of district assets, and the district risked potential adverse impacts from unanticipated expenditures. The current general manager stated he wrote the district's current reserve policy soon after he began providing interim general manager services to the district in November 2014; the board approved the updated reserve policy in April 2015. According to the district's current reserve policy, its reserves are funds it sets aside to achieve its objectives, respond to operational uncertainties, and address emergencies. The district's updated policy establishes funding levels for several designated reserves, which are earmarked for purposes such as cash flow, legal expenses, and building replacement. The current general manager stated that in his experience, an adequate reserve policy is necessary for the financial health of the district and is an important tool to assist with the budgeting process.

According to the finance director, the district will reassess its reserve levels, which totaled nearly \$15 million at the end of fiscal year 2014–15, on an ongoing basis during its budget process. Nevertheless, because the district averaged a \$2.9 million deficit between fiscal years 2011–12 and 2013–14, and if these deficits continue, the district may not achieve its reserve goals.

***The District Could Incur Additional Costs on Its Debt Due to Credit Rating Downgrades in 2013 and 2015***

The district may incur an increase in its debt costs due to downgrades by Moody's to its credit rating. In August 2013 and again in October 2015, Moody's downgraded the credit rating on the district's debt. As a result of these downgrades, Moody's current rating indicates the district's debt is upper-medium grade and subject to low credit risk. Nevertheless, in 2014, a former general manager stated he estimated that the district had already incurred costs and would incur additional costs due to the August 2013 credit rating downgrade. In addition, the current general manager stated that due to the October 2015 downgrade, the district will likely incur additional costs when it restructures its outstanding debt.

Moody's stated that it downgraded the district's credit rating on \$53 million of its debt in August 2013 in part to reflect the precipitous decline in the district's debt coverage ratio in fiscal year 2012.

***The district averaged a \$2.9 million deficit between fiscal years 2011–12 and 2013–14. If these deficits continue, the district may not achieve its reserve goals.***

Essentially a calculation of the district's net revenues divided by its net debt-service costs, the debt coverage ratio serves as a benchmark to measure the district's ability to produce enough cash to cover its debt payments. When the district issued debt in the past to fund its capital projects, such as its recycled water distribution system, it entered into debt agreements with financial institutions that required it to maintain a minimum debt coverage ratio of 1.15. As shown in Table 4, the district's debt ratio coverage dropped below the 1.15 ratio required by its debt agreements twice within the past five fiscal years, falling as low as 0.20 in fiscal year 2012–13 but improving since then. According to the district's comprehensive annual financial report for the fiscal year ending June 30, 2013, this decrease occurred in part because the district faced sustained high legal costs and in part because of a decline in water revenues in fiscal year 2012–13. Moody's also stated that the other reason for its 2013 downgrade of the credit rating on the district's debt was the litigation surrounding one of its primary customers. Moody's indicated that it was concerned about the district's ability to restore debt-service coverage and cash reserves to their historic levels.

**Table 4**  
**Central Basin Municipal Water District's Debt Coverage Ratio**  
**Fiscal Years 2010–11 Through 2014–15**

REQUIRED DEBT COVERAGE RATIO*	2010–11	2011–12	2012–13	2013–14	2014–15
1.15	1.91	0.64	0.20	1.33	1.75

Sources: Central Basin Municipal Water District's (district) comprehensive annual financial reports for fiscal years 2010–11 through 2013–14 and the California State Auditor's analysis of information in the district's draft financial statements as of October 2015 for fiscal year 2014–15.

\* The required debt coverage ratio is set by the district's debt agreements.

After Moody's downgraded its rating of the district's debt in August 2013, the then-general manager prepared a memorandum to the board in April 2014 in which he estimated that the downgrade would cause the district's costs related to one of its credit agreements to increase by a two-year total of \$65,000 from fiscal year 2013–14 through fiscal year 2014–15. The memorandum also stated that because of the downgrade, the district could face an increase in total interest costs when it issues new debt to restructure its outstanding debt. Specifically, the former general manager estimated that the credit downgrade could result in additional interest costs of between \$100,000 and \$500,000 over the life of the district's restructured debt. The district's current finance director, who was not a district employee at the time, explained that he does not have information related either to the decrease in the debt ratio coverage in fiscal years 2011–12 and 2012–13 or to the costs resulting from the credit rating downgrade. The current general manager

explained that he would like to restructure the district's debt. The district's financial advisor has recommended the district wait until the conclusion of our audit before proceeding with its plans for debt restructuring.

Additionally, Moody's stated that it downgraded the district's credit rating on its debt again in October 2015 because it believed that debt service coverage levels will likely be lower than previously anticipated, given declining operating revenues caused largely by the conservation efforts associated with prolonged drought conditions. The current general manager stated that, as a result of this downgrade, the district will likely incur additional borrowing costs when it issues new debt to restructure its outstanding debt, although it is too early to determine what the actual effect will be. The district's finance director believes this downgrade will not affect the district's current debt costs because the district's debt service coverage remains above the target set by the district's bond agreements.

The district may have struggled with its debt coverage ratio because the board has not ensured the district has a formal debt management policy. In 2011, 2012, and 2013, two different external auditors recommended that the district implement a formal debt management policy. According to the GFOA, a government's adherence to such a policy signals to rating agencies that it is well managed and therefore is likely to meet its debt obligations in a timely manner. The GFOA recommends the policy should include, among other things, debt structuring practices and the potential credit rating impacts of weak debt coverage ratios. Although two district managers wrote memoranda to the board during our audit period that indicate their awareness of the district's debt coverage ratio requirements, the current general manager confirmed that the district has never implemented a formal debt management policy. The current finance director stated he is uncertain why the board did not address the external auditors' past findings but that he is aware of the GFOA's recommendation. He explained that his goal is for the district to maintain a debt coverage ratio of over 1.50. However, the district's lack of a formal debt management policy may put it at risk of making financial decisions that could impair its ability to meet its required debt coverage ratio of 1.15, let alone its higher goal for this ratio.

*The district's lack of a formal debt management policy may put it at risk of making financial decisions that could impair its ability to meet its required debt coverage ratio.*

***The Board's Inaction Resulted in the District's Loss of Insurance Coverage and Subsequent Higher Insurance Costs***

The district's costs for its liability insurance increased significantly in 2014 and 2015 when the board failed to take action to preserve its insurance policies. Because an agency such as the district can

be exposed to significant liability, we believe it is a good business practice for it to maintain both general and employment practices liability insurance. Until May 2014 the district procured its insurance through the Association of California Water Agencies Joint Powers Insurance Authority (Insurance Authority), a public entity that is a partnership of water agencies that provides risk-sharing pools to meet its members' needs for property, liability, workers' compensation, and employee benefits insurance coverage. However, in March 2014 the Insurance Authority notified the district of its plans to recommend to its executive committee that it cancel the district's participation in the insurance program, citing its concerns with the magnitude and frequency of employment practices claims against the district. The Insurance Authority specifically stated that its greatest concern was that many of these claims stemmed from the board's actions. In that same month, the Insurance Authority's executive committee voted to recommend to its board of directors the cancellation of the district's participation in insurance programs for liability, property, and workers' compensation—a recommendation the Insurance Authority's board of directors approved in May 2014.

***The board failed to act on an opportunity to negotiate its coverage with the Insurance Authority before the district's insurance was canceled.***

However, the board failed to act on an opportunity to negotiate its coverage with the Insurance Authority before the district's insurance was canceled. In April 2014 the Insurance Authority offered the district the opportunity to apply to continue the district's participation in its liability and property insurance programs so long as the district agreed to certain conditions. Specifically, these conditions included the district accepting a six-month suspension of its employment practices liability coverage, withdrawing from the workers' compensation insurance program, assuming responsibility for certain costs resulting from a number of lawsuits, and securing a four-fifths vote by the district's board before it could terminate a general manager. Had the district agreed to these conditions, based on its assessment, it would have had to temporarily obtain workers' compensation and employment practices liability insurance from another insurance provider. However, the district then would have had the opportunity to apply to have its insurance coverage reinstated by the Insurance Authority.

During March and April 2014 district staff informed the board on several occasions of the causes and consequences of the potential loss of the district's insurance coverage, as well as proposed solutions. At a board meeting in late April 2014, the board postponed its decision on its response to the Insurance Authority's proposal. Instead, it stated that it would consider the district's insurance coverage at a special meeting that was scheduled just days before the Insurance Authority's May 5, 2014, meeting when it was to consider the district's response to its proposal. However, the special meeting was canceled because not enough board members

attended. As a result of the board's inaction, it failed to reach an agreement on the Insurance Authority's proposed conditions or to submit a counterproposal before the meeting. Consequently, the Insurance Authority's board of directors voted in May 2014 to cancel the district's insurance coverage effective in June 2014. Before its cancellation became effective, however, the district withdrew from the Insurance Authority's coverage in order to obtain coverage from alternate carriers in May 2014.

The district subsequently obtained new insurance; nonetheless, the board's poor management practices caused the district to lose a part of that coverage. As previously mentioned, the Insurance Authority proposed as one of its conditions that the board require a four-fifths vote to terminate its general manager. However, the board did not agree to this condition before the Insurance Authority canceled its coverage. After the district had obtained new insurance coverage from private insurance companies, the district's insurance broker warned the district in September 2014 that any change to senior staff would create a level of uncertainty in the insurance markets that would affect the pricing for the district's employment practices liability insurance. Despite this warning, the board terminated the district's then-general manager the next month in October 2014. In response, he filed a legal claim in February 2015 for more than \$8.2 million against the district and three board members for wrongful and illegal termination. At that time, the insurance company that provided the district with its employment practices liability coverage notified the district that it would not renew the district's policy when it expired in May 2015, citing its annual reevaluation of risks in light of changing conditions in the insurance market. As a result of the board's poor decision making, the district is currently paying substantially more for less general liability and employment practices liability insurance coverage than it had before, as noted in Table 5 on the following page.

If the board fails to maintain the district's current insurance coverage, it will place the district at risk of becoming uninsurable. According to correspondence from the district's insurance broker in May 2015, marketing of its employment practices liability insurance coverage has been quite challenging. In fact, the insurance broker notified the district that it had approached numerous companies to obtain quotes for the district's coverage, but only two responded while all the others declined. In other words, the coverage the district obtained in June 2015 was the less expensive of the only two quotes it received, in part due to the district's history of litigation.

***If the board fails to maintain the district's current insurance coverage, it will place the district at risk of becoming uninsurable.***

**Table 5**  
**Central Basin Municipal Water District's General Liability and Employment Practices Liability Insurance Coverage and Costs**  
**October 2013 Through June 2016**

COVERAGE PERIOD	OCTOBER 1, 2013, THROUGH MAY 15, 2014*	MAY 15, 2014, THROUGH MAY 15, 2015	MAY 15, 2015, THROUGH MAY 15, 2016
General liability coverage	<b>\$2 million per occurrence</b> Carrier: Association of California Water Agencies Joint Powers Insurance Authority (Insurance Authority) Deductible: \$10,000	<b>\$1 million per occurrence</b> Carrier: Allied World Assurance Company Deductible: \$1,000 Premium: \$49,950	<b>\$1 million per occurrence</b> Carrier: Allied World Assurance Company Deductible: \$10,000 Premium: \$49,096
Employment practices liability coverage		<b>\$2 million per claim</b> Carrier: ACE Municipal Advantage Self-Insured Retention:† \$100,000 Premium: \$69,826‡	<b>\$1 million per claim</b> Carrier: Kinsale Insurance Company Deductible: \$250,000 Premium: \$150,000
<b>Total annual premium</b>	<b>\$70,420§</b>	<b>\$119,776‡</b>	<b>\$199,096</b>

Sources: Central Basin Municipal Water District (district) insurance policies and its comprehensive annual financial reports for fiscal years 2010–11 through 2013–14.

\* The district maintained insurance through the Insurance Authority from the beginning of our audit period in July 2010 through May 2014.

† The district's former employment practices liability insurance had a self-insured retention rather than a deductible. The insurance carrier's liability only applies to the part of damages and claim expenses that are in excess of the retention.

‡ The district made an additional \$6,000 payment for a one-month extension to this insurance policy, which is not included in the amount above.

§ The \$70,420 was the cost to the district of the policy through September 2014. However, the Insurance Authority voted to cancel the policy effective in June 2014, but the district withdrew from coverage earlier in May 2014.

Further, according to the current general manager, the district losing its insurance would expose it to substantial liability and severe operational impacts. For example, between 2013 and 2015, the district's insurers paid out about \$1 million in claims against the district, amounts the district would have had to pay on its own in the absence of any insurance coverage. As of September 2015 the district had three employment practices lawsuits pending against it, including the more than \$8.2 million lawsuit from the former general manager, which demonstrates the magnitude of the financial risk the district could face in the absence of adequate insurance coverage.

### A New Method of Governance Would Improve the District's Leadership

As described in this chapter, the board has failed to lead the district in a manner that encourages its efficient operation and effective management. Further, as we will show in Chapters 2 and 3, the board has violated its own policies related to contracting and hiring, and it also violated state open meeting law when it inappropriately approved the establishment of a legal trust fund in 2010. The

board's poor decisions over the past five years have eroded the public's trust in the district and cost the district many thousands of dollars in misspent funds.

As previously discussed, the district and board recently made certain changes that have improved—or have the potential to improve—the management of the district. Most significantly, in the past year, the board hired a general manager with significant experience managing another water district and a finance director with experience in local government. Also, in July 2015 the board approved various changes to the district's administrative code that, if followed, will help the district to address some of the issues we describe in this and subsequent chapters. Finally, since October 2014 the district has generally held monthly meetings for its customers to update them on the district's activities and other issues of interest. Such meetings provide an opportunity for the district to report to and receive feedback from its customers.

Although these are positive steps, we remain skeptical of the board's ability to consistently ensure the district's stability and to provide it with effective, ongoing leadership. For instance, days after an October 2014 report by the County of Los Angeles Department of Public Works (Public Works) noted the improved stability of the district's operations and senior management team, the board voted to terminate the employment of the individual serving as general manager at that time. At this time, we have little assurance that the board will not make similar decisions in the future that could undo the positive effects of the recent changes.

Overall, Public Works' report was critical of the district, and it included an exploration of the steps necessary to dissolve it. However, the report stopped short of recommending such an extreme action. Public Works noted that the Local Agency Formation Commission for the County of Los Angeles (LAFCO) controls the process for dissolving the district. Under state law, a petition for dissolution of the district could be filed by a resolution of the legislative body of an affected agency such as a city, county, or the district itself. A petition may also be filed by 10 percent of the voters in the district, or LAFCO itself may initiate a proposal. State law then requires LAFCO to hold a public hearing on the proposal and inform the affected entities, including providing written notice of the hearing to landowners and registered voters. Further, LAFCO may terminate the proposed dissolution or place the matter up for a vote by the voters in the district, depending on whether protests are received to the proposal under various specified conditions.

If the district were dissolved, another entity would need to take over its responsibilities. According to state law, the choice of a successor to the district would be based on the existing jurisdiction

***Although the district and board have made positive steps to improve the management of the district, we remain skeptical of the board's ability to consistently ensure the district's stability and to provide it with effective, ongoing leadership.***

***Should the board not succeed in maintaining a stable leadership team, experience additional lawsuits, or lose its insurance coverage again, it will risk not being able to operate effectively as an independent entity.***

within the district—such as the county or an individual city—that has the greatest assessed value of taxable property, or the terms and conditions of the petition for dissolution could name the entities to take responsibility for the district’s duties. Public Works’ report also noted that a reorganization of the district—for example, breaking it into smaller pieces—is also under the jurisdiction of LAFCO and would be subject to steps similar to those required to dissolve it. The report did not indicate whether Los Angeles County would be willing or able to take on the district’s work itself, nor did it recommend another entity to assume those responsibilities. Instead, the report recommended this audit.

Given the concerns we raise in this report, a dissolution or restructuring may become necessary in the future. Should the board not succeed in maintaining a stable leadership team, should the district experience additional lawsuits, or should it lose its insurance coverage again, it will risk not being able to operate effectively as an independent entity. However, because of the district’s recent progress, a complete dissolution may be premature at this time.

A less extreme option to address the lack of leadership of the district would be to change its governance structure. Currently, the five divisions within the district elect the board members by popular vote, but electing new board members has proven to be ineffective at improving the board’s leadership. For example, in 2012 two board members were defeated and replaced with two new individuals, yet some of the same problems we discuss in this report continued well beyond 2012. In fact, the financing of board members’ political campaigns may also have contributed to some of the missteps we describe in this report, as their campaigns receive donations from entities doing business with the district.

To address the problems we found, we believe that board members need to be answerable to those who select them. Although the voters in the district elect the board members, the district’s direct customers are not members of the public; rather, they are the cities, other water districts, mutual water companies, investor-owned utilities, and private companies to whom the district sells imported and recycled water. Because these entities do not select the board members, the board members are only indirectly accountable to those they actually serve. As a result, the board may face few or no repercussions if it chooses to ignore the input of the district’s customers. Further, the board’s responsibilities are narrow in scope. Specifically, the district’s role is to purchase water from a limited number of sources and resell it to entities who in turn sell it directly to the public. Such a role does not require broad policy making, but instead requires significant input from its customers



regarding water purchases and sales. The district and its residents would be better served if its direct customers were able to select its policymakers.

Consequently, we believe an option for improving the district's governance would involve a board appointed by its customers, a structure for which precedent exists. For example, Metropolitan, which delivers water to numerous member public agencies including the district, has a board composed of representatives from its member agencies. The San Diego County Water Authority also has a board appointed by its member agencies. If the Legislature chooses to act on our recommendation, it could preserve the district as an independent entity, allowing the district to continue to provide both imported and recycled water without confusion or disruption. However, the Legislature could modify the district's governance structure to adopt an appointed board, thus improving the board's accountability to the entities the district serves. Further, because the local entities the district serves would appoint the board members from within their communities, the board would continue to represent the interests of the residents of the district.

The district's current general manager expressed reservations about an appointed board. He acknowledged that an appointed structure is possible but stated that such a move may simply replace one set of problems with another. For example, he said that state law does not provide for private water companies or mutual water companies having a seat on the board. Instead, the underlying city is represented, which would create a disconnect between service and rate setting and affect 25 percent of the district's service area. Further, the general manager stated that the district's electors are not its direct customers; however, they are all rate payers through the district's standby charge. Also, he stated that the district serves residents through 47 water retailers and one water wholesaler. All of the district's customers benefit from district activities, including its Metropolitan representation and its efforts regarding water conservation, water recycling, water resources planning, and water education. Further he stated that rate setting by more than 40 agencies—which is the model Metropolitan follows—that benefit in different ways from their associations with the district would be difficult and divisive. The electorate provides a balance for the various water entities the district serves and helps to ensure that they do not unduly influence the board. He said that, depending on how the district's customers were to select their appointed representatives, larger or wealthier water districts could attempt to establish policies that disadvantage smaller or less wealthy districts. Finally, he noted that the district has been in existence for more than 60 years and the structure has worked fine for most of that period. In the opinion of the current general manager, the

*We believe an option for improving the district's governance would involve a board appointed by its customers, a structure for which precedent exists.*

problems in the last five years are a result of actions by individual board members and not a failure of the institutional structure. Nevertheless, as we previously discussed, the district's board is not directly accountable to those the district serves, and the decisions it needs to make are narrowly defined according to the district's mission. Given the significant problems we outline in this report and the lack of leadership displayed by the board, in our judgment it is time to consider an alternate governance structure to improve the accountability of the board to its customers and ensure the district continues to focus on its responsibilities.

## **Recommendations**

### ***Legislature***

To ensure the efficient and effective delivery of imported and recycled water in southeastern Los Angeles County, the Legislature should pass special legislation to preserve the district as an independent entity but modify the district's governance structure. In doing so, the Legislature should consider a governance structure that ensures the district remains accountable to those it serves; for example, the district's board could be changed from one elected by the public at large to one appointed by the district's customers.

### ***District***

To ensure the stability of the district's operations, by June 2016 the district's board should establish a formal policy for hiring for the general manager position. Because the current general manager is on a contract set to expire in May 2017, the board should initiate the hiring process for a new general manager or begin the process of renegotiating the contract with the current general manager in the fall of 2016.

To better address potential ethical violations, the district should implement by June 2016 a means for investigating board members' and staff's potential violations of the district's code of conduct and conflict-of-interest code that would insulate those investigations from undue influence from either the board or the general manager.

To evaluate its progress toward its goals and objectives, the district should use its recently adopted strategic plan and issue an annual report that describes the steps it has taken toward achieving the goals and objectives in the strategic plan.

To ensure its long-term financial sustainability, the board should complete a long-term financial plan no later than December 2016.

To ensure its water rate structure is appropriate to provide the revenue necessary to cover its legitimate costs, the district should complete its planned water rate study no later than the spring of 2017.

To strengthen its financial stability against present and future uncertainties, the district should follow its recently adopted reserve policy.

To ensure that it continues to take steps to improve its financial condition and avoids additional costs due to downgrades of its debt credit ratings, the district should immediately create a formal debt management policy. This policy should clearly define its credit objectives and provide guidelines for suitable debt agreements. This policy should also require the district to periodically monitor its specific financial ratios, such as its debt coverage ratio, that are relevant to its credit rating.

To help it maintain its current insurance coverage and better position it to negotiate for more cost-effective and appropriate coverage in the future, the board should immediately adopt a policy requiring a four-fifths majority to terminate the district's general manager. Further, the board should review the district's insurance coverage annually and renegotiate costs and coverage amounts as necessary, particularly as the district resolves outstanding legal claims against it.

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## Chapter 2

### **THE CENTRAL BASIN MUNICIPAL WATER DISTRICT HAS ESTABLISHED INADEQUATE POLICIES RELATED TO CONTRACTING AND EXPENDITURES AND HAS CIRCUMVENTED OTHER POLICIES**

#### **Chapter Summary**

The Central Basin Municipal Water District (district) has not always demonstrated good stewardship of the public funds entrusted to it. Its board of directors (board) violated state law when it set up a legal trust fund (trust fund) in 2010 that it did not disclose to the public. Further, the board's inadequate oversight of the millions of dollars of expenditures its outside legal counsel subsequently made from the trust fund may have led to payments for services unrelated to the fund's purposes. In addition, the district consistently engaged in questionable contracting practices during our audit period. Specifically, it improperly avoided competitive bidding when selecting vendors in more than half the contracts we reviewed, and it inappropriately used amendments to extend and expand other contracts. Its inadequate contract management may also have led it to pay for unnecessary or unperformed services. Finally, some of the district's expenditures very likely could be viewed as gifts of public funds.

#### **The Board Established an Improper Legal Trust Fund and Did Not Disclose Its Actions to the Public**

In June 2010, the board improperly approved the establishment of a trust fund for which it authorized the use of an unspecified amount of money, ultimately totaling millions of dollars, without adequate disclosure to the public. Because the board took this action in a closed session, we believe it violated state open meeting law. Further, the board allowed its outside legal counsel to make expenditures from the trust fund with no board oversight; thus, it has no assurance that its outside legal counsel used the trust fund only for purposes that aligned with the fund's original intent.

According to a board member at the time, the board voted in a closed-session meeting on June 28, 2010, to approve the establishment of the trust fund whose proceeds would be used to develop a programmatic environmental impact report (PEIR) to support a groundwater storage program. The money in this trust fund was to be held by outside legal counsel retained by the district at that time. According to the former board member, the board also authorized its then-general manager and the outside legal counsel

to use whatever financial resources they deemed necessary to develop the PEIR. However, the published agenda for this meeting indicated that the purpose of the closed session was to discuss an issue under the pending litigation exception.

The California Constitution provides that the constituents of public agencies have the right of access to information concerning those entities' conduct, and therefore the entities' meetings and writings must be open to public scrutiny. To ensure that public entities, in this case the district's board, meet this goal, the Ralph M. Brown Act (Brown Act) requires them to hold open and public meetings unless a specific closed-session exception applies. The board's meeting minutes from June 28, 2010, indicate that the board believed it did not have to meet in open session under the Brown Act to discuss the establishment of the trust fund because the Brown Act makes an exception for pending litigation. This exception authorizes legislative bodies to discuss pending litigation, including anticipated litigation, in closed session with legal counsel if public deliberation on the matter would prejudice the legislative body's litigation position. However, the pending litigation exception permits public entities to receive legal advice and make litigation decisions only; the Brown Act does not allow them to use the exception as a subterfuge to reach nonlitigation-oriented policy decisions.

Although the board had previously been involved in a legal dispute regarding the storage of groundwater, we did not observe evidence that suggested such litigation could reasonably be anticipated when the board took this action. An investigation performed by a law firm subsequent to the establishment of the trust fund stated that, while the board's decision to create a groundwater storage plan was within the district's legal authority at the time, if this action were to be reviewed by a governmental authority, that authority would conclude that this action should have been taken in open session.

***We believe the board should have held the vote to establish the trust fund in open session.***

We also believe that the pending litigation exception did not apply in this case and that the board should have held the vote to establish the trust fund in open session. Although the board's official minutes from the June 2010 meeting state that in closed session it authorized its then-general manager to provide resources and enter into an agreement as necessary for ongoing litigation, the law firm's investigation found reason to believe the board used the discussion and vote to finance many nonlitigation expenses, avoid criticism, and create a PEIR. Although the investigation concluded that the board relied on its outside legal counsel's advice when it decided that it was permitted to discuss and cast its vote in closed session, we believe it was the board's responsibility to be

intimately familiar with the laws governing its operations, including the Brown Act, and that it should have questioned its outside legal counsel's advice on this matter.

Further, the district did not disclose to the public the \$2.75 million in transfers it made to the trust fund. It omitted the first \$2 million in transfers from its public expenditure reports, and it reported the final transfer of \$750,000 as a generic "legal services" expense. These omissions deprived the district's constituents of their constitutional right of access to information concerning the district's conduct.

Once the board approved the establishment of the trust fund, the district violated another state law that requires the general manager to select competent environmental professionals when it instead allowed the district's outside legal counsel to make this selection and contract with vendors to provide various services, including creating the PEIR. In fact, as reported in the law firm's investigation, the district's outside legal counsel selected the vendors, drafted contracts, and processed payments from the fund. According to a board member who approved the establishment of the trust fund, he did not have specific knowledge of how the outside legal counsel spent the resources of the trust fund because those expenditures did not come before the board for its approval. This acknowledgment indicates that the board did not ensure district staff or outside legal counsel provided it with the information necessary for it to fulfill certain of its duties, such as safeguarding the assets of the district.

In addition, because the board did not approve the expenditures the district's outside legal counsel made from the fund, the board could not ensure the district's outside legal counsel entered into only contracts related to the fund's purpose. As indicated in the law firm's investigation, the outside legal counsel tracked the expenditures outside of the district's ordinary course of business. Because of this lack of oversight, the district's outside legal counsel may not have spent all the money in the trust fund on the purpose for which it was established. As shown in Table 6 on the following page, the outside legal counsel paid a total of roughly \$2.3 million from the trust fund to the engineering services firm that was primarily responsible for creating the PEIR. However, according to the contracts or other available documentation, it also paid more than \$400,000 to seven other consultants for services, summarized in Table 6.

The district appears to have received very little value from its trust fund expenditures. In August 2012, after the district's outside legal counsel had spent most of the trust fund, the governor approved statewide legislation that effectively denied the district the authority to manage, control, or administer the importation of water for the storage of groundwater. Nevertheless, the engineering services firm had created a draft PEIR by this time. As noted by the law

*The district did not disclose to the public the \$2.75 million in transfers it made to the trust fund—it omitted \$2 million from its public expenditure reports, and it reported \$750,000 as a generic "legal services" expense.*

firm's investigation, the district categorized this cost as a five-year capital asset rather than as a litigation expense. The district's decision to categorize the cost of the PEIR as an asset instead of as a litigation expense further demonstrates that the pending litigation exception described earlier did not apply and that the board violated the Brown Act when it established the fund.

**Table 6**  
**Summary of Expenditures From the Central Basin Municipal Water District's Legal Trust Fund**

CONTRACTOR	TOTAL AMOUNT PAID	TYPE OF FIRM	CONTRACTED SERVICES
HDR Engineering, Inc.	\$2,298,750	Engineering services	To create a programmatic environmental impact report (PEIR) and to provide water resources consulting services.
Mark Fabiani LLC and CSL Strategies LLC	270,000	Strategic communications	To provide advice, counsel, and litigation support regarding the representation of the district in various litigation and other related matters, including both ongoing and potential or anticipated litigation.
Matrix New World Engineering, Inc.	38,725	Engineering services	To conduct a peer review of the PEIR.
Horvitz & Levy LLP	33,185	Law	To conduct all necessary legal research and prepare and file in the California Supreme Court a letter asking it to depublish the Court of Appeal's opinion in a lawsuit to which the district was not a party.
Irell & Manella LLP	25,000	Law	To provide legal consulting services in connection with appellate proceedings in a lawsuit between the local replenishment district and local cities.
The Calderon Group	20,000	Consultant	To provide advice and consultation services related to ongoing litigation, as well as to provide advice and/or settlement negotiation consultation concerning the storage and extraction of groundwater resources.
Fitzgerald Public Finance	15,625	Financial services	To provide advice with regard to financial matters as needed related to ongoing litigation, as well as to evaluate financial implications and resources of the storage and extraction of groundwater for anticipated litigation.
Iverson, Yoakum, Papiano & Hatch	553	Law	To provide advice with regard to legal matters related to ongoing litigation, as well as to evaluate an opinion on other legal issues involving litigation.
<b>Total</b>	<b>\$2,701,838*</b>		

Sources: Accounting records, contracts, and other available documentation provided by the Central Basin Municipal Water District (district).

\* The remaining balance of approximately \$48,000 plus interest left in the trust fund after the final disbursement by the district's outside legal counsel was transferred back to the district by the end of January 2013.

Finally, as a result of the board establishing the trust fund in closed session and not disclosing its actions to the public, the district incurred significant investigative and legal costs. Specifically, according to the district's records, it has spent more than \$500,000 on a law firm's investigation and on legal costs related to a whistleblower lawsuit filed by a current board member. In particular, in 2013 a current board member who was not involved in establishing the fund filed a lawsuit under the California False Claims Act (CFCA) against certain former district contractors and employees pertaining to the establishment and



use of the trust fund.<sup>5</sup> The purpose of the lawsuit is to recover the money transferred to the fund and to recover certain damages and expenses related to the district officials' actions. As of November 2015 the outcome of this lawsuit was still pending.

### **The District Did Not Consistently Use Competitive Bidding and May Not Have Received the Best Value for Its Expenditures**

The district did not consistently adhere to robust contracting policies and practices between fiscal years 2010–11 and 2014–15. Specifically, we found that the district did not adequately adhere to its own policies when it did not competitively bid 11 of the 20 contracts we selected for review. Further, it used amendments to circumvent the competitive bidding process in four out of five additional contracts that we reviewed. When the district does not make full use of its competitive bidding process, it cannot ensure that it receives the best value for the public funds it awards and it increases the risk that its board members or staff will develop conflicts of interest with vendors.

#### ***The District Inappropriately Avoided Competitively Bidding Its Contracts***

Competitive bidding is a vital component of the district's contracting practices. The district states in its procurement policy that it is committed to obtaining the most reasonable value for the goods and services it purchases. Further, the district states that it will procure the services of consultants and contractors through a competitive bidding process. The text box describes the district's competitive bidding requirements for services at different purchasing levels. When the district purchases services without using competitive bidding by entering into a contract with a singular or sole-source service provider, it skips key steps in its vendor selection process. These steps, such as soliciting bids and evaluating vendors, help the district to ensure it meets its commitment to obtain the most reasonable value for its purchases. Figure 6 on the following page illustrates the

#### **Central Basin Municipal Water District Procurement Authorization Requirements for Contracts for Professional Services**

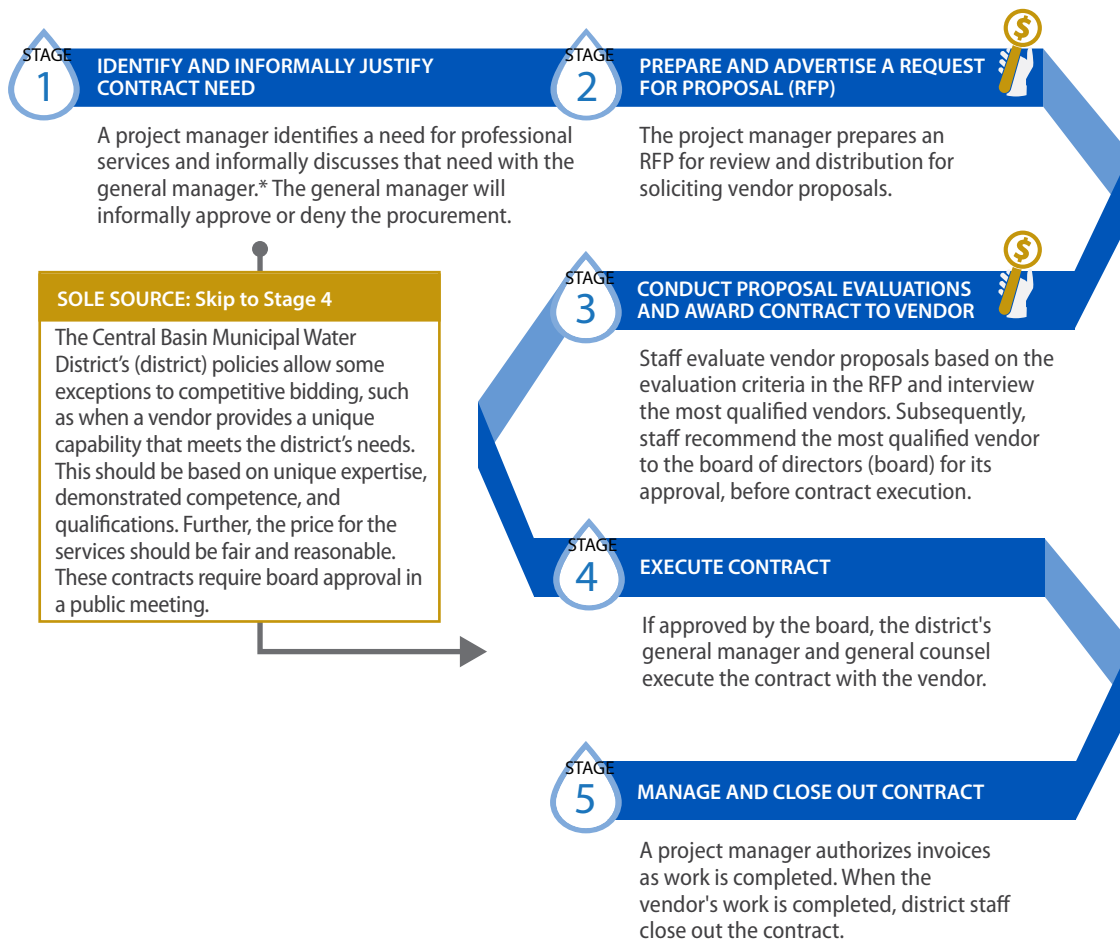
- Services up to \$5,000 require a single price quote and purchase order approved by the department manager and the general manager.
- Services over \$5,000 and up to \$25,000 require an informal solicitation with at least three competitive proposals or quotes, a justification for the contract award, and a contract executed by both the general manager and the Central Basin Municipal Water District's (district) general counsel.
- Services over \$25,000 require a formal solicitation process and board approval prior to execution of the contract by the general manager and district general counsel.

Source: The district's administrative code.

<sup>5</sup> The CFCA permits private residents to initiate and prosecute false claims actions on behalf of the state or local government entity whose funds are at issue. Private suits under the CFCA are permitted as *qui tam* actions, in which prevailing private litigants are entitled to a percentage of the proceeds recovered as payment for their efforts in successfully prosecuting fraudulent claims against the government. The district declined to join the board member as a plaintiff in the lawsuit, and the board member is pursuing the lawsuit as a private resident on behalf of the district.

district's contracting process for obtaining services valued at greater than \$25,000 and the critical stages in this process that the district bypasses when it chooses to use sole-source contracts.

**Figure 6**  
**Summary of Key Stages in the Central Basin Municipal Water District's Procurement Process for Professional Services Contracts Greater Than \$25,000**



Sources: The district's administrative code, procurement procedures, interviews with district staff, and the California State Auditor's observations during its testing of the district's contracts.

\* The general manager can also be a project manager.

Despite a policy to competitively bid its contracts, the district frequently purchased services through sole-source contracts, often without providing sufficient justification for circumventing the competitive bidding process. Specifically, 13 of the 20 district contracts we reviewed were sole-source. The district's procurement policy suggests that the district's justification for using a sole-source contract when purchasing services demonstrates either that a vendor has a unique capability that meets the district's needs or that

it is an emergency. According to the district's policy, the district should base the determination to award a sole-source contract because of a unique need based on the vendor's unique expertise, demonstrated competence, and qualifications. However, the district did not include adequate justifications for 11 of the 13 sole-source contracts we reviewed.

The district's justifications for these 11 contracts did not contain all of the information its policy suggests its justifications should include. For example, in July 2012 a former general manager approved a sole-source contract with the overall objective of providing professional assistance to the district's public relations efforts and to support the district and board by creating the public perception that district staff are committed to the betterment of the community. The general manager at the time entered into this contract under his authority for an amount not to exceed \$24,960. In his justification for the contract, he stated that communication with local agencies became strained two to three months earlier and a sole-source contract was necessary because staff could not take the normal amount of time to solicit firms for this service. Similarly, in February 2013 a former public affairs manager justified a sole-source contract not to exceed \$9,000 for specialized media and public relations services by stating that the district was in a transitional period, had come under increased legislative and media scrutiny, and needed a crisis media expert immediately to assist with correcting misperceptions and misinformation. Neither of these justifications provided any description of the vendors' unique expertise or demonstrated competence and qualifications, nor did they indicate an emergency. When the district does not adequately justify the reasons it enters into sole-source contracts, it cannot demonstrate it received the best value for the services it procures and it leaves itself vulnerable to allegations of favoritism.

Other public entities have more restrictive requirements for sole-source contracts than the district. For example, the San Diego County Water Authority's policy allows for noncompetitively bid procurements only when a contract's requirements are so critical or call for such specialized expertise that only one source is capable of providing the services. State law also limits the circumstances under which a state agency may procure goods and services without a competitive bidding process. For example, a state agency can use a sole-source contract in an emergency, when immediate acquisition is necessary for the protection of the public health, welfare, or safety. Further, the *State Contracting Manual* requires a department that awards a sole-source contract to submit detailed information explaining why it circumvented the competitive bidding process, including its reasons for restricting the purchase to one vendor, the events leading to the purchase, a description of the vendor's uniqueness, the consequences of not purchasing from

*The district did not include adequate justifications for awarding 11 of the 13 sole-source contracts we reviewed.*

***When the district cannot clearly identify and justify its reasons for avoiding a competitive bidding process, it leaves itself vulnerable to allegations of favoritism.***

the vendor, market research to substantiate lack of competition, and an evaluation of other items it considered. By contrast, the policies the district had in effect since the beginning of our audit period suggested but did not require that it justify sole-source contracts based on a vendor's unique ability or based on emergency circumstances. When the district cannot clearly identify and justify its reasons for avoiding a competitive bidding process, it leaves itself vulnerable to allegations of favoritism. Moreover, it also cannot demonstrate that it is obtaining the best value for the services it purchases with public funds.

### ***The District Inappropriately Used Amendments to Extend and Expand Contracts***

The district's inappropriate use of amendments to extend and expand contracts left it unable to demonstrate that it did not pay more than it should have for services. Although the district's administrative code requires board approval of contract amendments that exceed the contract amounts the board originally approved, it does not offer guidance on the circumstances under which the district should amend an existing contract rather than use competitive bidding. According to the *State Contracting Manual*, a contract amendment that changes a contract's original scope of services constitutes a noncompetitively bid contract award. It defines changes to quantity, pricing, and products as scope changes. Although we could not identify a similar district policy or process related to amendments that change a contract's scope of work, the district's current general manager stated that the district should reopen a contract to competitive bidding when the scope of work is so different that it constitutes a new project altogether. However, we noted instances in which the district appeared to circumvent the competitive bidding process by amending existing contracts to add new services. We also found an instance in which a former general manager failed to adhere to board instructions when amending a contract.

The district circumvented the competitive bidding process through contract amendments on several occasions during our audit period. In fact, we found that four out of five contracts with significant amendment histories that fell within our audit period contained amendments that the district could have opened for competitive bidding. For example, in October 2009 the district entered into a \$920,000 contract with a nonprofit foundation to purchase and install 3,000 high-efficiency toilets for residents of a city within the district's service area. Four months later, however, the district amended the contract to include marketing and outreach services to the city's residents to promote the program and educate the community about the city's water conservation

efforts, and increased the contract amount by \$27,400. Because these services are a separate product from purchasing and installing toilets, the district could have competitively bid these services. In another example, the board failed to competitively bid strategic planning duties for the 2010 strategic plan we discussed in Chapter 1. Specifically, the district engaged the services of a human resources consultant to provide various human resources work in October 2008. However, in November 2009 the board approved changing this vendor's contract to include providing services related to strategic planning for the district's management team and board—a separate work product from the original scope of work. Ultimately, the board never approved the strategic plan or ensured its proper implementation. When the district chooses not to use competitive bidding to purchase additional goods or services and instead adds them to existing contracts through amendments, it risks paying for services that are not the best value for the district and creates the appearance of favoritism when other potential bidders are not given the opportunity to compete.

Because the district does not maintain and adhere to clear contract amendment policies, it risks spending millions of dollars on professional services of substandard value. Unaudited district records from the database it has used since 2012 indicate that the amendments it executed during the most recent three years of our audit period constituted a sizable portion of its contracts' overall costs. Our review found that the district had 264 contracts that were active between July 2012 and July 2015. We calculate that during these three years, the district executed a total of 134 amendments to 65 of these contracts. These 134 amendments increased the total cost of the associated contracts by roughly \$14 million, from more than \$15 million to almost \$30 million. When the district avoids seeking competitive bids on new work and instead amends existing contracts, it increases the risk that it is spending millions of dollars on services that may not provide the best value.

We also identified an instance in our review of 20 contracts that were active between July 2010 and June 2015 in which the district mishandled an amendment. In April 2012 the board voted to amend a \$36,000 contract with a consultant who provided public affairs and public policy outreach services, increasing the contract's value by \$6,000, and extending its term by two months. Although the contract's total value after the amendment should have been \$42,000, the general manager at the time did not adhere to the board-approved changes and instead amended the contract by increasing its value by \$42,000, for a total contract value of \$78,000. He also increased the contract's term by 14 months rather than two months. According to district records, the district ultimately paid the vendor \$30,000 during the amended term of the contract,

***Between July 2012 and July 2015, the district executed a total of 134 amendments to 65 of these contracts, increasing the total cost of the associated contracts by roughly \$14 million to almost \$30 million.***

or \$24,000 more than the amount of the amendment authorized by the board. According to district records, staff noticed this discrepancy in an audit of the district's contracts and in February 2013 asked the board to retroactively approve the additional payments. Although the board later approved the payments, the initial mistake was a violation of the district's administrative code that cost the district more than the original contract amount.

The district can do more to ensure that it executes accurate amendments that its board has approved. For example, according to its administrative code, the San Diego County Water Authority requires its general manager to provide annual reports to the district's board of directors on all the contracts and contract amendments greater than \$10,000 made or awarded by the general manager. The San Diego County Water Authority's administrative code states that the report must identify the original amount and term of each contract, its total number of amendments, its cumulative dollar value, and any extensions to its term. By requiring a similar report, the board could ensure that it has the opportunity to review the amendment history of contracts to identify errors in contract execution and to uncover instances in which the district could have used competitive bidding.

#### ***The District Repeatedly Circumvented Competitive Bidding in Its Contract With One Firm***

The district spent several million dollars on a contract with one firm—Pacifica Services Incorporated (Pacifica)—that exemplifies the concerns related to competitive bidding that we have previously described. According to its marketing materials, Pacifica is a professional consulting firm that specializes in providing engineering, environmental, and related management services to various clients, including private-sector entities and federal, state, and local public agencies. In October 2007 the district entered into a \$600,000 contract with Pacifica to perform a variety of activities that included assisting the district with recycled water operations, providing technical assistance for the district's southeast water reliability project, and managing the district's move to a new headquarters. However, the district did not use its competitive bidding process when it awarded this contract to Pacifica. Further, it subsequently amended the contract numerous times, in some cases changing the original scope of work. The contract ended in 2013.

When we reviewed the contract files and board approvals for the district's original contract with Pacifica, we could not find any requests for proposals, Pacifica's proposal, or other competitive bidding process documents that would accompany a competitively bid contract. When we asked the district's interim engineering and

operations manager why the district did not get competitive bids for this contract, she stated that the district executed the contract before her employment. Other district staff we interviewed who were employed at the time of the contract's execution also did not know why the contract was not competitively bid because they told us they were not directly involved with it. The district could not provide any evidence that the services procured from Pacifica were unique and that a sole-source procurement was justified. Consequently, the district cannot demonstrate that it received the best value for the public funds it spent on the services in this contract.

The district ultimately amended its contract with Pacifica eight times, two of which we identified as opportunities to competitively bid as separate contracts. In October 2009 the district amended Pacifica's contract, adding nearly \$1.9 million to its value and 18 months to its contract term so that Pacifica could provide project management services during construction of the district's southeast water reliability project. The district had not specifically included this project in the contract's original scope of work. Further, in July 2011 the district executed another amendment for \$278,000 for engineering design, project management, and construction management services for new projects not included in the contract's original scope of work. In fact, at the time it executed this amendment, the district recorded in the board's action calendar that the contract's original scope of work was nearing completion, which suggests that the district could have competitively bid for these services. When we asked the district's interim engineering and operations manager about these amendments, she stated that she was not a part of the district's management when Pacifica contracted with the district. Because the services the district covered in these two amendments could have been competitively bid as new contracts, the district cannot ensure that it received the best value for the more than \$2.1 million it spent on them.

Moreover, circumventing competitive bidding processes can lead to the district developing inappropriate relationships that influence how it recommends and approves its contract awards. Early in 2015 the Fair Political Practices Commission (FPPC) found that during the majority of the period of the district's contract with Pacifica, the district's former general manager accepted gifts from this contractor in excess of annual gift limits and failed to report to the public in a timely manner 31 gifts totaling approximately \$3,500. These gifts included rounds of golf and a company holiday party. The FPPC further determined that the former general manager made, participated in, or attempted to use his official position to influence eight district decisions to award Pacifica more than \$6 million in contracts. The FPPC also found that one of the district's board members during this same time period committed similar violations by voting to approve these contract awards,

***In 2015, the FPPC found that the district's former general manager accepted gifts from Pacifica in excess of annual gift limits and failed to report to the public in a timely manner 31 gifts totaling approximately \$3,500.***

***By the time the district made its final payment to Pacifica in April 2013, district records indicate it had paid the firm nearly \$4.2 million, or roughly \$3.6 million more than the original contract amount.***

accepting gifts from Pacifica in excess of gift limits, and failing to report 28 gifts totaling approximately \$4,400. The FPPC fined the former general manager and former board member \$30,000 and \$31,500, respectively, for the violations.

The Pacifica contract and a subsequent legal settlement ultimately cost the district more than \$5 million. By the time the district made its final payment to Pacifica in April 2013, district records indicate it had paid the firm nearly \$4.2 million, or roughly \$3.6 million more than the original contract amount. Further, in July 2013 the district sued Pacifica for fraud and misrepresentation. The district settled its dispute with Pacifica in June 2014 and agreed to pay an additional \$875,000 to the firm. Because the district did not use its competitive bidding process when it awarded and amended its contract to Pacifica, it cannot know whether it received the best value for the services it purchased. Finally, neither the district nor the public can know to what degree the district's decisions to enter into the contract and to add subsequent amendments were motivated by conflicts of interest rather than what was best for the district.

### **The District Has Poorly Managed Its Contracts and Did Not Always Follow Best Practices or Its Own Contracting Procedures**

In addition to failing to use competitive bidding, the district often used procurement processes that did not follow best practices we identified from the *State Contracting Manual*, a global project management organization, and other water agencies. Further, it sometimes circumvented its own policies for managing its contracts. We noted that the district's legal counsel did not always sign contracts when required to do so. When the district does not adequately manage its contracts, it increases the risk that it will pay for inadequate services, unnecessary services, or even services not rendered.

### ***The District's Management of Its Contracts Did Not Follow Best Practices***

Although the district's contracting processes should closely align with procurement and project management standards and best practices, they often have not. A global organization recognized for its development of standards for project management, the Project Management Institute publishes the *Project Management Body of Knowledge* (PMBOK), which provides guidelines for managing individual projects, including project procurements. According to PMBOK, an organization's management of project procurement includes four processes: planning, conducting, administering, and



closing procurements. However, we noted numerous instances where the district did not conduct its procurements according to the best practices that PMBOK describes for these processes.

For example, the district failed to include in many contracts' scopes of work information that would allow it to effectively administer the contracts. The district's procurement process calls for its project managers to develop a scope of work that clearly defines all expected tasks and deliverables for a proposed procurement; the scope of work should then form the basis for vendor solicitations and the contract. Similarly, PMBOK defines scope as the sum of the products, services, and results to be provided by a project. Although the district is not bound by the *State Contracting Manual*, the manual's requirements further illustrate best practices in this area. According to the *State Contracting Manual*, a scope of work includes measurable results, timelines or progress reports, and an evaluation component. Nonetheless, we found that the scopes of work for 19 of the 20 contracts we reviewed did not include all of these elements.<sup>6</sup> In fact, 15 of the 20 contracts did not contain any of these elements. Altogether, the 19 contracts constituted nearly \$3.7 million the district awarded to vendors.

When the district does not provide clear and concise language in its scopes of work, it increases the risk that it will not procure services of sufficient or relevant value. For example, in May 2011 the district entered into a \$36,000 contract with a consultant to provide public affairs and public policy outreach services. When the former general manager recommended to the board that it approve this contract, he stated that the district was looking to develop potential projects and agreements in the San Gabriel Valley area and that he believed this consultant provided the unique services for this endeavor. However, the scope of work in the contract the general manager executed did not contain any evaluation component; any timelines or required progress reports to inform the district of the consultant's progress; or any specific results to measure the consultant's performance, despite requiring a review after six months to determine whether to extend the contract term further. When we asked the district to provide us with any reviews or evaluations it performed that were related to this contract, it was unable to do so. After a subsequent amendment in June 2012, this contract ultimately cost the district \$66,000. However, because the scope of work lacked any mechanisms that would enable the district to monitor and review the adequacy of the services the consultant provided, the district cannot demonstrate to its stakeholders that the costs it incurred for this contract provided any value.

***For 20 contracts we reviewed, 15 did not contain any of the recommended elements of a scope of work—measurable results, timelines or progress reports, and evaluation components.***

<sup>6</sup> The remaining contract was a lease agreement for overflow parking. In our judgment, such an agreement does not need measurable results, timelines, progress reports, or evaluation components because there are no professional services being provided.

In addition to the inadequate scopes of work in its contracts, the district could not always produce documentation demonstrating that it had verified vendors' work products before approving their invoices for payment. As PMBOK indicates, project managers should monitor payments to vendors to ensure that they have met their contracts' payment terms and that their compensation is linked to their progress, as defined in the contract. PMBOK emphasizes that one of the principal concerns when making payments to vendors is ensuring a close relationship between the payments and the work accomplished. The *State Contracting Manual* also notes that keeping an auditable paper trail of contract administration is a best practice, stating that departments are responsible for maintaining records in sufficient detail to allow anyone who reviews the documentation to understand how each procurement was requested, conducted, awarded, and administered. However, when we reviewed 30 invoices from the contracts that we had selected, we found 13 instances in which the district paid its vendors without sufficient evidence that they had provided the contracted services. For example, we identified nine invoices totaling about \$125,000 that the district paid in advance for work the consultants in question had not yet performed. These consultants' contracts each indicated that the district would pay them after they rendered the services. When the district disregards legally agreed-upon payment processes and approves invoices for services yet to be completed, it risks paying for substandard or incomplete services.

When we asked the current general manager about the issues we identified with the district's contract administration, he stated that when the district split with West Basin Municipal Water District (West Basin) in 2006, West Basin kept most of its previously shared technical staff and projects. He further explained that Central Basin has historically tended to focus on public relations projects and contracts because the former general manager was a journalist by trade. He stated that, as a result, many employees have not had the necessary training to manage contracts and therefore do not know how to properly do so. The current general manager explained that the district is planning a comprehensive training on contract management, based on the Project Management Institute's curriculum. Nevertheless, when the district does not effectively administer its contracts, it increases the risk that it will pay for inadequate services or even services never rendered.

#### ***The District Circumvented Other Established Procedures Related to Contracting***

The district did not always follow its procurement policies when executing contracts between fiscal years 2010–11 and 2014–15. According to its administrative code, the district requires that

both the general manager and the district's general counsel execute all procurements of professional services over \$5,000. Further, the district's administrative code requires the general manager to report all sole-source contracts and contracts entered into under the general manager's authority to the board's finance committee, composed of two board members, on a quarterly basis. Nevertheless, we identified instances where the district violated each of these provisions.

Specifically, three of the 20 contracts we reviewed did not include the general counsel's signature, even though it was required in each case. If the district's general counsel does not review contract language, the district risks engaging in contracts or contract terms that could lead to overpayments or lawsuits. For example, we found that one of the three contracts that lacked the general counsel's signature resulted in the district settling with the vendor who had filed a lawsuit. Specifically, according to an email from a former general manager, in one case a former interim chief operating officer and the then-board president entered into a verbal agreement with a law firm for \$20,000 for investigative and legal services. The subsequent written contract, executed in March 2013, did not include a contracted amount and was not executed by the general counsel. When the district refused to pay more than the verbally arranged amount, the firm took the district to court, and the district eventually settled with the firm for a payment of more than \$23,000.

In addition, former district general managers did not always report certain contracts to the district's finance committee. Specifically, former general managers did not correctly report seven of the 20 contracts we reviewed to the finance committee. For example, in August 2012 the then-general manager approved a contract with a consultant for services related to client relations and government affairs for an amount not to exceed \$24,960. Although the general manager entered into a sole-source contract for this procurement and executed it under his authority, he approved a report to the finance committee in October 2012 that stated the district had not entered any contracts under his authority or entered any sole-source contracts from July through September 2012.

When we asked the district's contracts and procurement analyst (contracts analyst) why some contracts were not accurately reported to the finance committee during our review period, she stated that prior to July 2014 the former general managers were in charge of finalizing and submitting these reports. Based on our review of the reports, it appears the general managers did not always ensure that they were accurate. The contracts analyst explained that the district created a new report template and process, which it implemented in July 2014. Based on our review, we believe that if appropriately

*If the district's general counsel does not review contract language, the district risks engaging in contracts or contract terms that could lead to overpayments or lawsuits.*

followed, this process, which now includes approval of the report by the finance director, should help ensure the accurate reporting of contracts to the finance committee in the future. Nevertheless, when district leaders enter into contracts without publicly reporting them, the district decreases transparency while increasing the opportunity for waste and fraud.

#### Allowable District Expenditures

- An expenditure must serve a public purpose that is within the scope of the district's jurisdiction and specific purpose.
- For an expenditure made to a private party, the district must receive consideration.

Sources: *Golden Gate Bridge and Highway District v. Dale W. Luehring* (1970) 4 Cal.App.3d 204, 84 and *Robert E. Winkelman v. City of Tiburon* (1973) 32 Cal. App. 3d 834, 108.

#### The District Spent Funds on Purposes Unrelated to Its Mission That Likely Constitute Gifts of Public Funds

The California Constitution prohibits governmental agencies such as the district from making gifts of public funds. Rather, the district must use its public funds to carry out those purposes the Municipal Water District Law of 1911 authorizes. The district may not spend public funds for purposes that do not return benefits to the district that are reasonably related to the laws under which the district was established.

Allowable district expenditures are defined in the text box. Expenditures that do not demonstrate a clear relationship to the district's purpose, which is to provide an adequate supply of water within its service area, constitute a gift of public funds.

Nevertheless, the district's board members have spent thousands of dollars of district funds on purposes unrelated to the district's underlying authority. The district's current administrative code allows each board member to spend up to \$3,000 annually for outreach-related purposes in their respective divisions. For example, the district may sponsor programs, conferences, and events on behalf of a particular board member's own choosing. However, our review of the district's records found that the purposes for which the board members directed the use of the funds did not always clearly support the district's authorized activities. For instance, on behalf of various board members, the district donated funds to golf tournaments, a legislative member's breakfast panel, religious organizations, local high school sports programs, local pageants, organizations that feed those in need, car shows, and other purposes unrelated to providing an adequate supply of water in the district. In addition to these board member-directed expenditures, the district also spent more than \$9,000 on holiday turkeys in fiscal year 2012–13 to provide to organizations in the community, a purpose that is also unrelated to the district's mission. As a result, these expenditures very likely constitute gifts of public funds.

After we began our audit, the district updated its administrative code to clarify that the board members should use the \$3,000 allocated to each of them annually for purposes that promote discussion and educational activities for regional water conservation, water public policy, and water-use efficiency issues. However, we fail to see the value of providing any district funds to board members to spend at their discretion, particularly because the board's role is the governance of the district, not its administration. Further underscoring our point, the district already has a public affairs department whose responsibility is to inform community stakeholders about the district's programs and the water issues that impact the region.

The district's current general manager agrees that the district should eliminate the board members' outreach funds because they are difficult to administer and subject to potential abuse. For example, a neighboring water district, West Basin, also allocated outreach funds to its board members until early 2015, when its ethics committee recommended—based on an independent audit—that the district eliminate these funds. West Basin's board approved the elimination of these funds after one of its board members accepted a plea bargain on charges of misuse of public funds in September 2014. Similar to West Basin, the district's current general manager suggested to the board in April 2015 that it should eliminate the outreach funds; however, rather than eliminating the funds, the board members agreed to reduce them from \$5,000—the amount each board member was authorized to receive during fiscal year 2014–15—to the current annual amount of \$3,000.

The district has also spent an unreasonable amount of money on board member installation ceremonies that provided little or no benefit to the district. The current general manager stated that, in his experience, the practice in most of the Southern California region is for water agencies to swear board members into office at regular board meetings. In contrast, we found that the district has spent significant, and we believe unreasonable, amounts on its board member installation ceremonies. For instance, in January 2013 the district spent more than \$6,500 on catering expenses and the equipment rental for an installation event for three board members. Further, the district's records show that in January 2011 it spent more than \$6,400 on catering expenses for an installation event for two board members. According to the district's director of administration and board services, the district has budgeted as much as \$10,000 per board member in the past when it has held these ceremonies off-site, requiring the rental of a hall. Further, she stated that the district does not expressly limit the amounts it can spend on these ceremonies. The current general manager believes that board member installation ceremony expenses should be minimal and that a budget of \$10,000 per board

***The district has spent unreasonable amounts on its board member installation ceremonies. In January 2013 it spent more than \$6,500 on catering expenses and the equipment rental for an installation event for three board members.***

member is unreasonable. The district's most recent installation ceremony—in December 2014 for two board members—cost less than \$1,300. However, until it places reasonable and specified limits on these costs, the district risks spending unreasonable amounts on these ceremonies, which can undermine public confidence in its stewardship of the public's funds.

### **Recommendations**

To ensure it holds itself accountable to the public, the district should follow the law and operate in an open and transparent manner by, among other things, disclosing to the public the true nature and purpose of all of its expenditures. To ensure its board makes informed decisions on when it is proper to hold discussions and take votes in closed-session meetings, the district should require its board members to attend training—as soon as possible and biennially thereafter—specifically focused on the Brown Act and its closed-meeting requirements.

To make better use of the funds it spends on services, the district should amend its administrative code by June 2016 to limit its sole-source contracts to emergency circumstances and circumstances in which only one vendor can meet the district's needs. Further, before executing any sole-source contracts, the district should require written justification demonstrating the reasons for not competitively bidding the services. The justification should include the background of the purchase, a description of the vendor's uniqueness, an explanation of the consequences of not purchasing from the vendor, market research to substantiate a lack of competition, and an analysis of pricing and alternatives.

To ensure that it does not unnecessarily use amendments that limit competitive bidding for its contracts, the district should amend its administrative code by June 2016 to require that it rebid contracts if it significantly changes those contracts' scopes of work, specifically the nature of the services or work products.

To ensure its contract amendments reflect the authorization of the board, the district should revise its administrative code to require the general manager to submit a quarterly report to the district's board detailing all its contracts, contract amendments, and contract and amendment dollar amounts.

To ensure it receives the best value from its contracts, the district should do the following by June 2016:

- Adopt and implement a policy requiring that it include in all its contracts' scopes of work specific, well-defined deliverables, measurable results, timelines or progress reports, and evaluations of the contractors once they complete the work.
- Ensure project managers verify services were rendered before approving invoices for payment.
- Create processes for project managers to organize and retain contract files that include important documents such as vendor performance and deliverable verification and acceptance.

To ensure its employees are able to properly administer contracts, by September 2016 the district should follow through with its plan to require that staff responsible for project management attend training by a reputable trainer on contract management.

To minimize its risk when contracting with vendors, the district should adhere to its administrative code and execute all contracts only after approval by its general counsel. Further, the district should amend its administrative code to prohibit engaging in a verbal contract. Finally, the district should continue to report to its finance committee all sole-source contracts and contracts entered under the general manager's authority.

To ensure its expenditures do not constitute gifts of public funds, the district should do the following:

- Immediately eliminate its allocation of funds to individual board members for community outreach.
- Develop policies that specify limitations on the types of activities it will sponsor in the future to ensure that it funds only those organizations whose activities have a direct link to its authorized purposes. For example, it should eliminate its purchase of holiday turkeys.
- Revise its administrative code by June 2016 to include more specific guidance as to what constitutes a reasonable and necessary use of public funds. The guidance should establish restrictions on the amount spent for board member installation ceremonies. It should also include a process for the district to ensure that expenses are reasonable and necessary before it pays them.

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## Chapter 3

### **THE CENTRAL BASIN MUNICIPAL WATER DISTRICT DID NOT ALWAYS FOLLOW ESTABLISHED HIRING POLICIES AND NEEDS TO ENSURE CERTAIN BENEFITS AND EXPENDITURES ARE APPROPRIATE**

#### **Chapter Summary**

The Central Basin Municipal Water District (district) did not always follow its policies for hiring employees. For example, it did not use a competitive process to hire certain former staff members, which led it to employ individuals who did not possess the necessary qualifications for their positions. In one instance, the district paid more than \$22,000 for an employee to obtain a bachelor's degree when the high-level position for which he was hired required him to already have one. Further, the district's board of directors (board) improperly hired another employee for a position that it never formally created and that appears to have been unnecessary for district operations. In addition, the district did not always conduct annual performance evaluations as its administrative code requires.

Although the district's compensation for its staff and board generally appears reasonable, we found that some of the benefits it offers may be overly generous. Specifically, it provides board members with full health benefits, even though their work is essentially part-time. It also pays its board members a generous automobile allowance. Finally, we found multiple instances in which it paid for unreasonable travel and meal expenses for both its board members and staff.

#### **The District Has Hired Some Unqualified Staff and Failed to Perform Regular Performance Evaluations**

Although the district has established appropriate policies related to hiring employees, it did not always follow them. Specifically, it hired individuals who did not meet the minimum qualifications for their positions. It also created a new position without following its approved process, which includes board authorization. Further, in some instances, it incurred unnecessary expenses because of its failure to follow its hiring policies. For example, the district violated its policies when it prepaid more than \$22,000 for a new employee to complete his bachelor's degree when such a degree was a minimum qualification for the position; this individual subsequently was laid off by the district before completing his degree. Additionally, the district's administrative code requires it to provide employees with

performance evaluations every fiscal year and generally to base their raises on performance. However, we found the district did not always perform these required evaluations.

### ***The District's Failure to Follow Its Policies Led It to Hire Some Unqualified Staff***

The district failed to follow its policies for hiring employees in several instances during our audit period from July 2010 through June 2015. State law gives the board the authority to hire the general manager and gives the general manager full power and authority to employ and discharge all other employees, with certain exceptions. The district's administrative code states that the district must use a competitive process for hiring employees that is based on their qualifications and ability. It also outlines the use of an interviewing panel for senior manager positions. Further, the district maintains job descriptions that detail the minimum qualifications job applicants must possess before being hired. However, in our review of the hiring process for individuals in certain positions, we identified four instances in which the district did not follow its established policies when hiring staff, as shown in Table 7. The district's failure to follow its hiring policies resulted in legal disputes and caused it to incur unnecessary expenses in salary and benefits.

**Table 7**  
**The Central Basin Municipal Water District's Failure to Adhere to Its Hiring Process for Four Selected Positions**

POSITION	DATES OF EMPLOYMENT	FINAL APPOINTMENT MUST BE MADE BY THE GENERAL MANAGER, BUT THIS PROCESS WAS NOT FOLLOWED	CENTRAL BASIN MUNICIPAL WATER DISTRICT (DISTRICT) DID NOT FOLLOW A COMPETITIVE HIRING PROCESS	THE INDIVIDUAL WAS UNQUALIFIED	THE POSITION WAS NOT APPROVED BY THE BOARD AS REQUIRED
Interim chief operating officer	October 2012 through January 2013	NA	●	●	
Business development manager	April 2011 through July 2013			●	
Assistant to the general manager	December 2012 through January 2013	●	●		●
Public affairs manager	December 2012 through March 2013	●	●		

Sources: California State Auditor's analysis of minutes from the district's board meetings, the district's administrative code, its human resources records, and interviews with the district's human resources director.

NA = Not applicable.

Although the district's current senior managers meet the qualifications required for their positions, the district hired certain individuals in the past who did not possess bachelor's degrees in the fields their positions required. For example, in 2010 the board created a business development manager position. Although the

position required a bachelor's degree, the resume of the individual the district hired for the position in April 2011 shows that he did not possess one. The individual's annual salary—nearly \$113,000 by the time of his layoff in July 2013—made him one of the highest paid senior managers at the district, despite his not meeting his position's minimum qualifications.

The district further violated its policies when it paid in advance for this individual's education. As a condition of the business development manager's employment, the district required him to pursue and complete a bachelor's degree. Nevertheless, the district hired and continued to employ him for more than a year without his having such a degree. He eventually requested that the district pay his registration, tuition, and fees to obtain the required degree. Although these costs totaled more than \$22,000, the district violated its administrative code by paying the amount in advance of the individual successfully completing any of the required coursework. Specifically, the district's administrative code allows it to reimburse individuals for only 90 percent of the cost of college courses and then only upon the individuals' completion of the courses with a passing grade. However, according to course records he provided to the district, this employee did not begin his coursework until after the district made the payment for his entire degree program, and he did not complete the program while he was employed by the district. According to the director of human resources, the former general manager authorized this payment at his own discretion.

In July 2013—a little more than two years after hiring the business development manager—the district eliminated the position and laid off the individual. The director of human resources explained that the district did not seek reimbursement from him because he did not leave the district voluntarily. Regardless, the district hired this individual in violation of its own policies and then inappropriately paid his tuition and fees.

The district also hired another individual for a high-level position who did not meet that position's minimum qualifications. Specifically, in September 2012 the board approved the October hiring of an interim chief operating officer who, according to his resume, did not hold a bachelor's degree in business management, business administration, engineering, or public administration as the position description required. Rather, his resume indicated that he attended college and studied Latin American studies and general education. Also, according to the director of human resources, the district did not follow a formal recruitment process for this individual and thus cannot demonstrate that it used a competitive process to hire him.

***The district hired an individual for a senior management position who did not meet the position's minimum qualifications.***

***By not following the district's administrative code, the board risked hiring and paying an individual to fill a position for which the district had not budgeted sufficient funds.***

Further, the board did not follow the appropriate hiring process when it approved the hiring of an assistant to the general manager in December 2012. This appointment violated the district's policies in a number of different ways. First, the district's administrative code provides the general manager with authority over appointing and terminating subordinate employees. Nonetheless, in December 2012 the board voted in closed session to approve the hiring of an individual for the position of assistant to the general manager, with an annual salary of about \$98,000. In addition, the administrative code requires the district to follow a competitive process when hiring district employees and states that the general manager must make the final appointment for senior manager positions based in part on the recommendations of an interviewing panel. However, according to the director of human resources, the board did not use any competitive process or perform any interviews when hiring for this position.

The board also violated district policy by hiring the assistant to the general manager without having previously approved the creation of the position. According to the district's administrative code, the general manager must propose a labor budget to the board for its approval each year. The director of administration and board services acknowledged that the assistant to the general manager position was not in the district's labor budget at the time the board approved the hiring of the individual for this position. By not following the district's administrative code, the board risks hiring and paying an individual to fill a position for which the district has not budgeted sufficient funds. Further, the current general manager believes that such a position is unnecessary for an office of the district's size.

The board's approval of hiring the assistant to the general manager was only one of two instances in which it did not follow the administrative code as it relates to hiring employees that occurred in the same month. Specifically, in the same closed session in December 2012, the board appointed a public affairs manager without following a competitive hiring process. The district terminated both this individual and the assistant to the general manager less than three months after their appointments.

Two of these hires resulted in legal disputes, while another caused it to incur unnecessary expenses in salary and benefits. Subsequent to their dismissal, the former interim chief operating officer and the former assistant to the general manager filed two lawsuits and one made a demand for additional claims against the district for wrongful termination and retaliation. The district signed settlement agreements with the former interim chief operating officer for \$80,000—which the district's insurance paid—leaving one remaining lawsuit still pending. Furthermore, the district paid the former assistant to the general manager more than \$6,000 in salary and benefits for less than one month of employment in an

unapproved position that was likely unnecessary. Finally, if the district had hired a business development manager with the requisite degree, it would not have incurred the more than \$22,000 in education expenses described previously.

To avoid similar situations in the future, the board approved changes to the district's administrative code in July 2015 that expressly prohibit board members from participating in any aspect of its employment and personnel matters except those pertaining to the general manager. The director of human resources confirmed that these changes were made to address the issues created by these past board decisions. At the same time, the board also approved changes to the administrative code to create a specific requirement for it to approve employee positions and classifications as part of its review of the general manager's proposed labor budget. Nevertheless, the board and the district must follow these and all other established policies if they are to avoid the risks associated with hiring individuals in a manner that is inconsistent with the district's administrative code.

***The District Did Not Consistently Evaluate the Performance of Its Senior Managers***

The district did not consistently review its senior managers' performance, and it issued raises to some of these employees without having completed the required evaluations. The district's administrative code specifies that district employees will receive performance evaluations each fiscal year in May. Further, the code notes that the evaluating manager will review each employee's compensation and will base decisions regarding raises on performance. However, the district did not provide some of its managers with the required performance evaluations. We reviewed the performance evaluations of six senior managers employed continuously by the district from fiscal year 2010–11 through fiscal year 2013–14 and expected to find a total of 24 performance evaluations for the four fiscal years. Instead, we found the district had completed only 14 evaluations and did not perform the other 10. Nonetheless, during this same time period, the district provided raises to most of these managers without the corresponding required evaluations. Although district policy allows for merit increases between evaluations, the policy states that such increases are rare.

According to the district's director of human resources, the district's former general managers were responsible for completing the necessary evaluations but failed to do so. She explained that the former general manager, who began his service in May 2013, believed he did not have a basis for evaluating senior managers in that year. She also stated that the former general manager in fiscal years 2010–11 and 2011–12 simply did not complete many of the

***In July 2015, the board approved changes to the district's administrative code that prohibit board members from participating in any aspect of its employment and personnel matters except those pertaining to the general manager.***

evaluations he was required to perform. Nevertheless, if it fails to provide regular performance evaluations, the district risks not identifying and correcting concerns with performance in a timely manner. Further, the district may provide raises to individuals whose performance does not merit a pay increase.

**Although the District's Compensation for Its Board Members and District Managers Is Generally Reasonable, Some of the Benefits It Provides Board Members May Be Overly Generous**

The district provides compensation and benefits to its board members and staff that are generally reasonable; however, benefits may be excessively generous in some cases. Board members receive payment for days on which they attend meetings or certain other events related to district business, such as conferences, a monthly automobile or transportation allowance for the use of their personal vehicles, and an allowance for their personal communication devices. Although they are not full-time employees, they also receive many of the same benefits as full-time staff at the district, including fully paid medical, dental, and vision insurance for themselves and their dependents. We noted that although some water agencies provide benefits to their board members, others do not; given that fact, the district could reconsider the necessity and reasonableness of some of the benefits it provides to its board members.

*Although board members are not full-time employees, they receive many of the same benefits as full-time district staff, including fully paid medical, dental, and vision insurance for themselves and their dependents.*

**Although the District's Per Diem Compensation for Its Board Members Is Slightly Above the Average Provided by Other Water Districts, Its Senior Managers' Salaries Are Below Average**

The district's payments to its board members are above average relative to those provided by comparable water agencies but do not appear unreasonable. State law allows water districts to compensate their board members by paying them for the days they attend board meetings and the days they render services by request of their respective boards of directors. The district's administrative code refers to these payments as per diems. The district's administrative code authorizes board members to claim a maximum of 10 per diems each calendar month, although any board member who also serves as a representative to the Metropolitan Water District of Southern California may claim an additional 10 per diems for meetings associated with that agency. According to a 2014 district compensation survey of 10 municipal water agencies, the district's per diem of approximately \$233 was the third highest of the 10 agencies. The district's survey noted that per diems ranged from \$150 at the San Diego County Water Authority to roughly \$241 at the Western Municipal Water District, with a median per diem of about \$206. Although the district's per diem is about 13 percent above the median, it does not appear unreasonable.

In total, the district may spend up to about \$200,000 annually on board members' per diems. According to the director of administration and board services, the district uses this amount when creating its annual budget. Table 8 shows the total per diem payments the district made to all of its board members in each of the last five fiscal years.

**Table 8**  
**Summary of the Central Basin Municipal Water District's Per Diem Compensation to Its Board of Directors Fiscal Years 2010–11 Through 2014–15**

BOARD MEMBER	DIVISION REPRESENTED	2010–11	2011–12	2012–13	2013–14	2014–15	TOTAL FOR FIVE YEARS
Edward Vasquez	Division I	\$26,348	\$27,048	\$13,524	–	–	\$66,920
James Roybal	Division I	–	–	13,524	\$27,048	\$27,980	68,552
Robert Apodaca	Division II	22,851	24,716	27,514	30,079	27,747	132,907
Arturo Chacon	Division III	18,654	20,053	19,353	21,918	21,918	101,895
Rudy Montalvo	Division IV	24,949	26,115	9,560	–	–	60,624
Leticia Vasquez	Division IV	–	–	20,752	55,494*	37,074	113,321
Phillip Hawkins	Division V	31,759	31,245	23,783	21,918	24,716	133,421
<b>Totals</b>		<b>\$124,561</b>	<b>\$129,177</b>	<b>\$128,010</b>	<b>\$156,457</b>	<b>\$139,435</b>	<b>\$677,640</b>

Source: The Central Basin Municipal Water District's (district) financial records.

\* In fiscal year 2013–14 Leticia Vasquez's per diem compensation was larger than that of any board member in any other fiscal year. During this fiscal year, she attended meetings as both a district board member and a member of the Metropolitan Water District of Southern California, and the total per diem compensation she received was within legally allowed limits.

While the district's per diems for board members appear reasonable, the salaries it pays its senior managers are lower than those certain other water agencies pay. State law allows the district to hire staff as needed to conduct the district's business. As we previously discussed, the general manager must submit salary classifications and a labor budget to the board for its approval each fiscal year. The general manager then sets the individual salaries of staff. We conducted a review of salary data from the California State Controller's Office (State Controller) and found that the district's current pay for senior managers overall is lower than that at certain other water agencies, which may in part reflect the fact that it has the smallest number of staff. For example, as shown in Table 9 on the following page, the maximum salary for the water resources manager at the district was just under \$125,000 based on data from 2013, which were the most recent available and complete data as of the end of September 2015. This amount is below the average maximum salary of roughly \$157,500 for the five agencies we reviewed. The district's director of human resources has also conducted past surveys indicating that the district's salary ranges for its senior managers were generally below average.

**Table 9**  
**Comparison of Yearly Manager Salaries at the Central Basin Municipal Water District and Four Other Water Agencies in the Region for Various Manager Positions**  
**For the Years 2012 and 2013**

	2012										2013													
	GENERAL MANAGER*		DIRECTOR OF HUMAN RESOURCES		FINANCE DIRECTOR		WATER RESOURCES MANAGER		DIRECTOR OF EXTERNAL AFFAIRS		NUMBER OF CUSTOMERS <sup>‡</sup>	NUMBER OF STAFF <sup>‡</sup>	GENERAL MANAGER*		DIRECTOR OF HUMAN RESOURCES		FINANCE DIRECTOR		WATER RESOURCES MANAGER		DIRECTOR OF EXTERNAL AFFAIRS		NUMBER OF CUSTOMERS <sup>‡</sup>	NUMBER OF STAFF <sup>‡</sup>
	SALARY	MINIMUM	MAXIMUM	MINIMUM	MAXIMUM	MINIMUM	MAXIMUM	MINIMUM	MAXIMUM	MINIMUM			MAXIMUM	MINIMUM	MAXIMUM	MINIMUM	MAXIMUM	MINIMUM	MAXIMUM	MINIMUM	MAXIMUM	MINIMUM		
Central Basin Municipal Water District	\$237,839	\$79,140	\$118,710	NA <sup>†</sup>	NA <sup>†</sup>	\$83,316	\$124,974	\$79,140	\$118,710	48	23	\$185,000	\$79,140	\$118,710	\$87,492	\$131,238	\$83,316	\$124,974	\$79,140	\$118,710	48	23		
West Basin Municipal Water District	239,187	NA	NA	\$124,827	\$166,957	124,827	166,957	124,827	166,957	11	43	244,693	106,047	145,815	134,939	185,541	114,520	157,465	124,828	171,639	11	43		
Western Municipal Water District	265,375	89,206	122,658	113,407	155,931	124,750	171,531	NA	NA	13	125	269,881	90,990	125,111	127,245	174,961	127,245	174,961	127,245	174,961	13	125		
Municipal Water District of Orange County	215,064	NA	NA	116,330	157,046	100,664	135,897	100,664	135,897	28	30	225,000	NA	NA	127,556	172,201	102,678	138,615	102,678	138,615	28	30		
San Diego County Water Authority	256,624	123,030	166,096	139,909	188,876	139,909	188,876	123,030	166,096	24	253	291,019	123,030	166,096	142,008	191,709	142,008	191,709	133,625	179,716	24	253		
<b>Average</b>	<b>\$242,818</b>	<b>\$84,173</b>	<b>\$120,684</b>	<b>\$123,618</b>	<b>\$167,203</b>	<b>\$114,693</b>	<b>\$157,647</b>	<b>\$106,915</b>	<b>\$146,915</b>	<b>-</b>	<b>-</b>	<b>\$243,119</b>	<b>\$112,692</b>	<b>\$138,933</b>	<b>\$123,848</b>	<b>\$171,130</b>	<b>\$113,953</b>	<b>\$157,545</b>	<b>\$113,503</b>	<b>\$156,728</b>	<b>-</b>	<b>-</b>		

Sources: Data from the California State Controller's Office, documentation provided by the Central Basin Municipal Water District, and information obtained from the water agencies' websites.  
Note: 2012 and 2013 are the most recent years for which data for all five water agencies are available.

NA = Not applicable.

\* The listed water agencies set their general managers' salaries by contract.

† Central Basin did not have a finance director in 2012 and contracted for its financial management services in that year.

‡ Data for the number of customers and staff are from the most recent information we were able to obtain. However, due to the structure of the agencies, we believe that these numbers have not changed significantly since 2013.



Additionally, based on information as of September 2015 from the websites of the four other agencies we reviewed, the current salary of the district's general manager—\$220,000 annually—is less than the general managers' salaries for the four other agencies we reviewed. The board hires the general manager and negotiates an employment contract with that individual. The fact that the current general manager's salary is less than that of the other agencies we reviewed is not surprising given that the district has the least number of full-time staff. For example, the Municipal Water District of Orange County reported on its website as of September 2015 that its general manager receives a salary of nearly \$238,000 but manages 30 full-time staff members as opposed to the district's 23 staff. The survey the district conducted indicates that its general manager's salary is 7 percent below that of the average of seven other water agencies.

***Some of the Benefits the District Pays to Board Members May Be Overly Generous, but Its Staff Benefits Are Reasonable***

The district spends tens of thousands of dollars annually providing benefits to board members that appear to be excessively generous, especially given that the board members' work is essentially part-time. State law allows district boards to approve benefits in addition to the per diem we previously described as long as the amounts of most benefits do not exceed those that their staff receive. The district's administrative code states that board members and their eligible dependents may receive medical, dental, and vision health care coverage and that the district will contribute to their insurance premiums in an amount it determines yearly. However, for most benefit categories, the district contributes the maximum possible—it pays all of the costs for board members' and their dependents' medical, dental, and vision coverage, as well as for their \$10,000 life insurance policies. As of 2015 the cost for a board member's medical, dental, and vision premiums with family coverage could be as much as approximately \$2,000 per month. In addition, the district contributes a maximum of between \$4,000 and \$12,000 each year to each board member's health expense reimbursement account, with the maximum determined by the board member's number of dependents. The board member can use this account to pay for any eligible out-of-pocket health care expenses not fully covered by the insurance policies. Overall, these benefits are equivalent to those the district provides to its full-time employees. The only exceptions are that the employees receive greater life insurance and disability insurance benefits.

Although state law does not prohibit the district from providing full-time benefits to board members for part-time duties, we believe that it risks providing benefits that are overly generous.

***Board member benefits are equivalent to those the district provides to its full-time employees, with the exceptions of life insurance and disability insurance benefits.***

***The district's administrative code allows it to pay board members a \$600 monthly automobile or transportation allowance that is significantly more generous than what other water agencies offer.***

In reviewing the most recent compensation data from the State Controller for 2013, we noted that the majority of water agencies' board members in California do not provide any health benefits to their board members. For example, according to the websites of the Santa Margarita Water District and South Coast Water District, they do not provide board members any health, life, or retirement benefits. Based on district accounting records, the district spent more than \$70,000 on medical, dental, vision, and life insurance benefits for board members in fiscal year 2014–15. According to the district's director of human resources, the board has reviewed its benefit compensation during its annual budget review but has not voted to make any significant changes.

In addition to benefits, the district's administrative code allows it to pay board members a \$600 monthly automobile or transportation allowance that is significantly more generous than what other water agencies offer. Currently all board members receive this monthly benefit as reimbursement for any vehicle expenses they incur while conducting district business.<sup>7</sup> According to a survey another water district in Southern California conducted regarding the compensation and benefits selected water agencies provided to their board members in 2014, most water agencies reimburse board members for mileage only, and the two agencies that reported providing automobile allowances offered much lower amounts. Specifically, Upper San Gabriel Valley Municipal Water District reported an automobile allowance of \$335, and West Basin Municipal Water District reported an allowance of \$411. According to district records, it paid nearly \$36,000 to board members for the automobile or transportation allowance in fiscal year 2014–15. The director of human resources stated that the district has not formally considered a proposal to change the automobile allowance to a mileage-based system. Further, in the past the district provided its automobile allowance without requiring proof that board members possessed valid California driver's licenses and carried automobile insurance. However, the district updated its administrative code in July 2015 to ensure board members demonstrate they have a valid driver's license, automobile insurance, and an acceptable driving record.

Finally, the district pays board members compensation for the use of their personal communication devices. Until July 2015 the administrative code allowed board members to receive this benefit in an amount the board determined. In July 2015 the district revised its administrative code by fixing the amount at \$200 per month. In fiscal year 2014–15 district records indicate that it paid a total of \$12,000 to its board members for the yearly communications

<sup>7</sup> According to the district's administrative code, board members who are unable to drive due to a qualifying disability may use the automobile or transportation allowance for alternative transportation expenses if they provide medical certification on an annual basis.

allowance, or an average of \$2,400 per board member. However, the director of human resources confirmed that during the past five years the district has not conducted an assessment to determine whether this amount was necessary or reasonable. Without conducting an analysis of the need for a communications allowance, the district cannot be certain whether the amount it pays is appropriate.

In contrast to the benefits the district provides to its board members, the benefits that it pays to its staff appear reasonable given their full-time status and salary levels. For example, full-time district employees receive the same medical, dental, vision, and health reimbursement account benefits as board members. However, staff also receive other benefits, including short- and long-term disability insurance coverage and life insurance policies for up to \$150,000, for which the district pays the premiums. Staff also participate in the State's pension program, under which retirees can receive a percentage of their final compensation as retirement benefits. Although the general manager receives a communication allowance and an automobile allowance, other staff—unless approved by the board—do not receive such allowances. However, the district reimburses them for mileage when on district business, and senior managers receive cellular phones for business use. Additionally, in the most recent district survey of employee salaries and benefits conducted in 2012, district salary ranges for 11 of 12 of the positions compared, excluding the general manager, were at or below the median of the ranges reported by eight nonunion agencies with fewer than 300 employees. Although the district's salaries for nearly all of its staff are reportedly lower than those at other water agencies, the director of human resources told us that the district's benefits have generally been effective in retaining staff, but have not been as effective for recruiting new staff following the statewide pension reforms in 2013. She explained that she plans to conduct a salary and benefits survey with the help of a consultant by the end of 2016.

The current general manager participates in district-sponsored benefit plans, including medical, dental, and vision, at the same level as other staff. However, the district has entered into contracts with past general managers that have provided for additional benefits beyond those the district provides to its staff. Because the board negotiates the general manager's compensation separately from the staff's compensation, it has the ability to make such offers. For example, in 2011 the board approved a new contract for the then-general manager that included the district contributing about \$158,000 over three years to his retirement account. According to district records, it paid \$99,000 into this account, the maximum allowed during 2011 and 2012, before the general manager retired in October 2012. The district's records indicate that it then paid him

*The district has entered into contracts with past general managers that have provided for additional benefits beyond those the district provides to its staff.*

the remaining \$59,000, plus roughly \$34,000, which, according to the director of human resources, was to offset his taxes on the remainder, as allowed for by the provisions of his contract. Further, in 2013 the board approved a contract with its then-general manager that included the offer of lifetime retiree health benefits to the general manager and his spouse if he remained with the district for five consecutive years. However, he remained with the district for only about 17 months and did not receive the lifetime retiree health benefits. We observed similar provisions in two other comparable districts' contracts with their respective general managers. Nevertheless, according to the director of human resources, instead of contributing to the former general manager's retirement, additional consideration could have been given to negotiating a higher salary.

#### **The District Has Made Questionable and Inappropriate Expenditures for Travel and Meal Costs**

*We identified instances in which the district paid amounts for travel and meal expenses in excess of what we consider reasonable.*

In our limited review of the district's expenditures, we identified instances in which the district paid amounts for travel and meal expenses in excess of what we consider reasonable. For example, we found instances in which the district paid travel expenses for board members and employees to attend conferences and seminars having no clear connection to its mission or purpose. In addition, when we reviewed six flight expenses, we found that three included higher-class airfares than the district's policies allow. Moreover, the district often paid for expenses that exceeded the meal reimbursement limits that the Internal Revenue Service (IRS) has established and, to the extent these meal expenses were incurred by board members, they violated state law. Further, the district paid for business meals that it could have avoided by holding meetings at its office. When the district pays for unreasonable travel and meal expenses, it wastes public funds.

Although the district's administrative code states that it will only allow payment for travel and other expenses that are reasonably necessary to represent its interests and objectives, we identified instances in which the district did not ensure its payments for travel were necessary or prudent. As shown in Table 10, we found that the district pays expenses for board members and staff to attend conferences and seminars unrelated to its responsibilities, let alone water policy. For instance, the district paid for board members to attend a legislative caucus related to another state's immigration law. It also paid for one of its general managers to attend a scholastic press association seminar. We believe that these expenses had no direct connection to furthering the district's mission and that the district's payment of these costs demonstrates that it did not use public funds in a reasonable manner.

**Table 10**  
**Examples of the Central Basin Municipal Water District's Inappropriate Travel Expenses**  
**2010 Through 2015**

EXPENSE INCURRED FOR	YEAR	CENTRAL BASIN MUNICIPAL WATER DISTRICT'S (DISTRICT) POLICY	DESCRIPTION	INAPPROPRIATE COSTS
Legislative Caucus	2010	Payment for travel and other expenses shall be allowed when reasonably necessary to represent the interests and objectives of the district.	The district paid for travel expenses for two board members to attend a legislative caucus in Arizona related to that state's proposed immigration law. We do not believe this trip was necessary for the district's interests. The district's current general manager also believes Arizona's immigration laws have nothing to do with district business.	\$784
Journalism seminar	2010, 2012		The district paid for travel expenses for the then-general manager to attend a scholastic press association seminar in San Luis Obispo. For the 2012 seminar, the director of administration and board services stated that the former general manager explained that he would use previous board agendas in his teaching materials for high school students. We do not believe this trip was related to district business.	2,461
Rental car	2011	Before July 2015, the district's administrative code did not require vehicles to be rented under the name of a board member or employee. Nevertheless, we believe it is reasonable to conclude that this was the expectation.	The district reimbursed rental car expenses to a board member despite the fact that the rental agreement indicated that a different individual rented the vehicle. The board member provided no proof, except for a signed note, that he actually incurred the expense. We believe the district should not have paid this claim. The director of administration and board services stated that, due to this incident, the district revised its administrative code in July 2015 to require vehicles are rented only under the name of a board member or an employee.	239
Airfare	2012, 2014	The district's administrative code requires air travel in coach or an equivalent class unless otherwise justified, such as when a traveler has a physical disability or for prolonged travel in excess of four hours.	Three of the six airfares we reviewed were above the coach or base-level economy fare for flights between the Los Angeles region and Sacramento. Using the same airline as the district for travel between the same airports in August 2015, we calculated the cost difference in flights when opting for base-level economy flights could save roughly \$150 per flight. The district's director of administration and board services acknowledged that for shorter flights a base-level economy class fare should be used. She also stated that moving forward, the district will document exceptions in writing and take them to the board for approval.	450 (estimated)
Lodging	2010–2015	State law requires board members traveling on business for the district to use the group or government rate for lodging when available or, if not, to obtain board approval in a public meeting before the expense is incurred. The district's administrative code requires staff to use the government or group rate when possible.	In our limited review of 20 lodging expenses, we noted that the majority—14—lacked any documentation that the traveler had used one of the rates prescribed by state law or the district's administrative code. Seven of the claims lacked documentation that the board preapproved exceptions for board members and three lacked documentation that the general manager preapproved exceptions for staff. The director of administration and board services stated that, with respect to board members' and staff lodging, the district has used the government or group rate in the past, but did not preserve independent evidence of this, such as the conference brochure, other than hotel receipts, which do not always indicate that a government or group rate was used. Moving forward, she stated staff would include documentation that conference rates were used.	Unknown*

Sources: Government Code Section 53232.2, the district's administrative code, and district financial records.

\* Because the district could not demonstrate that it used government or group rates for these 14 lodging expenses, it was not possible to calculate the inappropriate cost incurred.

***Our review of 20 lodging expenses found that the majority—14—lacked any documentation that the travelers had used one of the rates prescribed by state law or the district's administrative code.***

In addition, the district's administrative code requires board members and staff to exercise sound judgment when traveling in order to incur reasonable costs to the district. However, as shown in Table 10 on the previous page, we identified occasions when district representatives did not take appropriate steps to ensure the reasonableness of the district's costs. For example, the code requires travelers to fly coach or an equivalent class unless otherwise justified, such as when a traveler has a physical disability or for prolonged travel in excess of four hours. However, three of the six airfare expenses we reviewed included higher-class airfares, which often include privileges such as priority boarding and premium beverages, for short flights between the Los Angeles region and Sacramento. Additionally, state law requires board members traveling on business for the district to use the group or government rate for lodging when available or, if not, to obtain board approval in a public meeting before the expense is incurred. The district's administrative code also requires the district's staff to use the government or group rate when possible. However, our review of 20 lodging expenses found that the majority—14—lacked any documentation that the travelers had used one of the rates prescribed by state law or the district's administrative code. Finally, in 2011 the district reimbursed a board member for the cost of a car he purportedly rented while attending a water conference in Las Vegas. However, according to the car rental agreement and receipt, another individual who was not a representative of the district rented the vehicle. Other than a signed note from the board member claiming that he rented the car, the expense claim lacked any documentation showing that the board member had actually paid for the rental car. As a result of these incidents, we are concerned that the district is paying travel expenses for its board members and staff without ensuring that those expenses are reasonable and necessary.

In addition, we found that the district often paid for inappropriate and questionable meal costs for board members, employees, and others. As shown in Table 11, we found that the district often paid for meals in excess of IRS limits and, to the extent these meal expenses were incurred by board members, they violated state law. In addition, the district paid for meals in the local area for meetings that participants could have held at its office, thus avoiding such costs. Finally, the district paid for meals to third parties which, based on state law and California Attorney General opinions, we believe were not permissible.

**Table 11**  
**Examples of the Central Basin Municipal Water District's Inappropriate Meal Expenses**  
**Fiscal Years 2010–11 Through 2014–15**

ISSUE	NUMBER OF EXPENSES WITH ISSUE (OUT OF 95)*	DESCRIPTION	TOTAL INAPPROPRIATE COSTS
Meal expenses above IRS rates	39	<p>California law allows local governments, such as the Central Basin Municipal Water District (district), to set limits on actual and necessary meal costs incurred in the performance of official duties that are reimbursed to board members. If a local government does not set its own meal reimbursement limits, state law requires the local government to use limits established by the Internal Revenue Service (IRS) unless the meal expenses have been preapproved by the board at a public meeting. Our limited review found no documentation that any of the meals we examined were preapproved by the board. According to the director of administration and board services, the district was not aware of the state law requirement to impose limits on meal expenses. In addition, the district did not have limits on other meal expenses, such as those charged to a district credit card or incurred by staff, or those for meals provided to third parties, until July 2015.</p> <p><b>Example #1:</b> In October 2011 a board member charged \$61 on the district credit card for a second dinner on the same day he had already incurred dinner-related expenses while attending a seminar.</p> <p><b>Example #2:</b> In May 2012 a former general manager spent \$101 on breakfast for himself and three guests without identifying who the guests were or providing justification for the business purpose of the meal; the IRS breakfast rate at the time was \$10 per person.</p>	\$1,461
Meals in the local area†	20	<p>The district's external auditor noted in its audit of the fiscal year ending June 30, 2011, that in recent years, many governments have greatly restricted the practice of charging local meals to government agencies, but the district placed no limitations on local meals. Although the district revised its administrative code in July 2015 to state that board members and employees should make every effort to hold meetings at the district's headquarters to limit unnecessary expenses, the administrative code is still permissive and, as a result, district staff and board members may continue to incur unnecessary expenses.</p> <p><b>Example #1:</b> In April 2012 the district paid for a dinner meeting in Los Angeles between a board member and the district's then-business development manager at a total cost of nearly \$190, even though these two individuals could have easily held a meeting at the district's office.</p> <p><b>Example #2:</b> In January 2015 the district paid almost \$70 for a lunch meeting in Los Angeles between two board members, even though the district's office could have been used.</p>	1,113
Meals provided to third parties	24	<p>State law permits reimbursement only for "actual and necessary" expenses incurred by board members or staff in the performance of their official duties. Based upon state law and California Attorney General opinions, we believe that actual and necessary expenses do not include meals purchased for third parties, such as constituents, public officials, or business owners, even if those meals are for a business purpose. Therefore, they are not permissible.</p> <p><b>Example #1:</b> In December 2010 the district paid about \$565 for a dinner, or an average of about \$81 per person, for board members attending a conference. The dinner included costs for two spouses. The director of administration and board services stated the district's administrative code at that time allowed for these expenses because they were seen as a benefit to the district. We disagree with this assertion, and we note that the then-general manager stated at a board meeting in December 2010 that the administrative code did not allow for reimbursement of spouses' expenses. The director of administration and board services further elaborated that spouses' expenses are no longer paid for and the administrative code has been amended to reflect this change.</p> <p><b>Example #2:</b> In July 2014 the district paid nearly \$220 for a dinner while attending a conference for the then-general manager, a board member, a Montebello school board member, and a Pico Rivera council member. In addition, the claim for the dinner expense lacks any description of the business purpose of the meal and how it furthered the interests of the district.</p> <p><b>Example #3:</b> The district paid over \$100 for a dinner in February 2015 for a district board member and a board member from a neighboring water district. The claim lacks any description of the business purpose of the meal and how it furthered the interests of the district.</p>	986

Sources: California Government Code, Section 53232.2, California Court decisions, California Attorney General opinions, the district's administrative code, and financial records.

\* Some meal expenses are included under more than one issue. For instance, the district paid \$188, or \$94 per person, for a dinner meeting between a board member and a business development manager in the local area. We included \$116 in the *meal expenses above IRS rates* row, which reflects the amount the district paid above the IRS dinner rate for two people. We included the full \$188 in the *meals in the local area* row since this meeting was held in Los Angeles.

† The district defines the local area as Los Angeles County and Orange County.

Further, until recently, the district did not address a recommendation that it establish meal expense limits. Specifically, in 2011 the district's external auditor at the time recommended the district set limits on the costs of meals, whether incurred locally or while traveling. The district disagreed with this recommendation, stating that some district business required travel around the country, which made setting limits on meals difficult because of cost variances between cities, states, and regions. However, we disagree, particularly given that the federal government has established meal rate limits for its employees that vary by city and that California sets a fixed meal reimbursement limit for state employees regardless of where they travel within the United States. Moreover, we believe that by failing to implement the external auditor's recommendation, the district missed an opportunity to demonstrate to the public that it was spending its funds in a prudent manner. After we began our audit work and raised these concerns with district staff, the district finally adopted meal cost limits in July 2015 that are comparable to the IRS's established rates. The district's new limits apply to both board members and staff.

Finally, board members have consistently violated state law by failing to report back to the board on meetings or conferences they attend at the district's expense. Both state law and the district's administrative code require a board member who travels to a meeting or a conference at the district's expense to make a brief oral or written report to the other board members at the board's next regularly scheduled meeting. Our review of 12 conferences attended by board members between July 2010 and June 2015 at the district's expense found no evidence in half of these instances that board members provided the required reports at the subsequent board meetings. When board members do not provide these required reports, they deprive other board members and district officials of the opportunity to learn from their experiences, and they also fail to justify to the public the value of the expenses they incurred.

### **Recommendations**

To ensure it considers the most qualified candidates for positions, the district should follow its established hiring policies. Specifically, it should use a competitive hiring process and ensure that its board first formally approves all positions for which the district recruits. Further, the district should consider for employment only individuals who meet the established minimum qualifications for the positions for which they have applied. If the district believes certain qualifications are not necessary for a position, it should indicate in the position description that such qualifications are desirable but not required.



To ensure that it does not inappropriately grant undeserved raises to its staff, the district should follow its policy to provide annual performance evaluations to all employees.

To ensure it is efficiently using its resources, the district should do the following:

- Eliminate its board members' automobile or transportation allowances and instead reimburse them based on their business mileage or transit use.
- Periodically analyze and, beginning in June 2016, report to the board whether all elements of its board member compensation, including health and related benefits, are appropriate and reflect the common practices of special districts.
- Adopt a policy that its general managers will participate in benefits at the same level as district staff and that the board will negotiate the general managers' contracts on the basis of salary and not other benefits, such as retirement.

To ensure that its travel expenses are reasonable and necessary, the district should take steps, such as issuing a clarifying memorandum or providing additional training, to ensure all board members and staff, especially those who process reimbursement claims, are aware of what the district considers to be proper expenses incurred while traveling, including only paying for the following:

- Air travel that is coach or an equivalent class.
- Meetings and conferences that have a direct connection to water policy or the district's mission. It should update its list of such preapproved meetings accordingly.
- Lodging expenses that reflect group or government rates, unless there is documentation that such rates are unavailable.

To ensure it reimburses only reasonable and necessary meal expenses, the district should take steps, such as issuing a clarifying memorandum or providing additional training, to ensure that all board members and staff, especially those who process reimbursement claims, are familiar with its meal reimbursement limits.

The district should revise its administrative code by June 2016 to prohibit paying for or reimbursing meals that occur within the local area that involve meetings either between only district representatives or between district representatives and the district's contractors.

The district should revise its administrative code by June 2016 to prohibit paying for the costs of meals provided to third parties.

To ensure it complies with state law and its own administrative code, the district should require board members to report back to the board on meetings and conferences they attend at the district's expense. The district should record these reports in meeting minutes or document them in expense files before it reimburses the board members for their travel expense claims.

We conducted this audit 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. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
State Auditor

Date: December 3, 2015

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For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.



# Central Basin

Municipal Water District

October 29, 2015

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Re: Response to audit report received on October 23, 2015

### Board of Directors

**Division I**  
James B. Roybal

**Division II**  
Robert Apodaca

**Division III**  
Arturo Chacon

**Division IV**  
Leticia Vasquez

**Division V**  
Phillip D. Hawkins

For 63 years, the Central Basin Municipal Water District (District) has successfully secured water supply reliability for our residents, businesses, water retailers and wholesalers and other stakeholders. It has also provided regional water policy representation at the Metropolitan Water District of Southern California, supplied both potable and recycled water, engaged our citizens through education and public information programs, and provided innovative water conservation programs. The District serves more than 2 million residents in 24 cities and unincorporated portions in Southeast Los Angeles County through 47 water retailers and one water wholesaler.

It is unfortunate that the actions of the District over the past several years generated genuine concerns of State Legislators which resulted in this audit. We recognize that the report reflects considerable effort and resource expenditures by the State. We believe that the audit, coupled with on-going efforts that the District has undertaken over the past few years, will result in improved governance and an even stronger, more responsive and transparent Central Basin.

### Serving the Cities of

Artesia	La Mirada
Bell	Lynwood
Bellflower	Maywood
Bell Gardens	Montebello
Carson	Monterey Park
Cerritos	Norwalk
Commerce	Paramount
Compton	Pico Rivera
Cudahy	Santa Fe Springs
Downey	Signal Hill
East Los Angeles	South Gate
Florence-Graham	Walnut Park
Hawaiian Gardens	Whittier
Huntington Park	Willowbrook
La Habra Heights	Vernon
Lakewood	

We would like to thank the Office of the State Auditor for recognizing progress that the District has made. Specifically:

- Ensuring that current staff meet qualifications
- Currently meeting debt coverage
- Approval and initial implementation of a three-year strategic plan
- The most recent hiring process for General Manager which included: establishing an independent ad hoc committee, selection of a recruitment firm and interviewing of top candidates by Board of Directors
- Acknowledgement that many of the District's lawsuits have been resolved
- Adoption of a Reserves Policy
- Monthly meeting with water retailers and wholesalers to discuss Central Basin and regional water issues and receive feedback

\* California State Auditor's comments begin on page 97.

Response to Draft State Audit  
Page 2 of 3

- ①
- Strengthening Administrative Code, Board and Staff Code of Conduct and Conflict of Interest policies

In addition, we are pleased to report the following recent areas of progress:

- Revision of the District's Ethics Policy to include independent review of potential ethics violations and a confidential hotline (adopted October 26, 2015)
- Recognition of the District for excellence in the areas of transparency, financial reporting and information technology
  - Certificate for Excellence in Transparency (Special District Leadership Foundation)
  - Certificate of Achievement for Excellence in Financial Reporting (Government Finance Officers Association)
  - Excellence in Information Technology Practices Award (Municipal Information Systems Association of California)
- Initiating the process to develop 10-year financial forecast (long range financial plan). (Contract awarded October 26, 2015)

The District recognizes that the audit report provides valuable insight on how we can improve our governance and performance; therefore we are committed to presenting all of the audit report's recommendations to our Board of Directors, as listed below:

- Establish a formal policy for the hiring of the General Manager by June 2016
- Complete a long-term financial plan by December 2016 (in process)
- Complete a water rate study no later than Spring 2017
- Create a formal debt management policy immediately
- Review the District's insurance coverage annually
- Disclose to the public the nature and purpose of all expenditures (implemented)
- Require Brown Act and closed meeting training to the Board every two years
- Limit sole source contracts to emergency or circumstances in which only one vendor can meet the District's needs
- Require written justification for not competitively bidding services
- Rebid contracts if the scope of work significantly changes
- Submit a quarterly report to the Board detailing contracts, contract amendments and dollar amounts
- Revise policies to provide greater contract management control by June 2016
- Require project management training for project managers
- Execute contracts after receiving approval by General Counsel (implemented)
- Update policies to prohibit engaging in verbal contracts
- Report on all sole-source contracts and contracts entered under General Manager's authority
- Revise Administrative Code by 2016 to include more specific guidance as to what constitutes reasonable and necessary use of public funds
- Eliminate Director's outreach funds (immediately)
- Use competitive hiring process (implemented)

Response to Draft State Audit  
Page 3 of 3

- Ensure that the Board formally approves of all positions for which the District recruits (implemented)
- Consider for employment individuals who meet the established minimum qualifications (implemented)
- Provide annual performance evaluations to all employees (implemented)
- Report to the Board whether elements of its Board member compensation, including health and automobile allowance, is appropriate and reflect common practice of special districts by June 2016
- Adopt a policy that general manager benefits are same as staff and negotiations will be solely based on compensation.
- Adopt policy requiring Board members to report back on meetings and conferences they attend
- Provide a clarifying memo and training to ensure Board members and staff are aware of proper expenses when traveling and for meal reimbursement
- Revise Administrative Code to prohibit paying or reimbursing meals in the local area that involve meetings between any District representatives or District representatives and contractors by June 2016
- Revise its Administrative Code to prohibit providing costs of meals for third parties

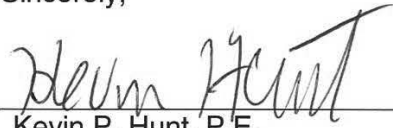
We want to express our appreciation for the professional manner in which your staff interfaced with our staff throughout the audit process. They were unfailingly polite, conscientious and committed to excellence. In the attached addendum we look at each recommendation of the Audit report and make more specific comments on the District's approach moving forward.

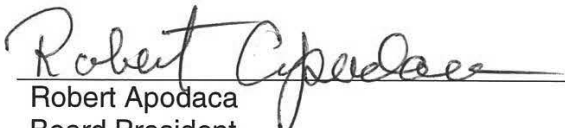
We believe, however, that the recommendation that the Legislature consider enactment of special legislation may be premature and unnecessary, in light of your recommendations with suggested future time frames for completion by the District. The Central Basin Municipal Water District Board Directors are elected by the citizens of the service area. Denying 2 million citizens the right to direct representation on major water policy issues is contrary to the basic tenets of American government and should only be a last resort, if ever. Furthermore, for decades the existing statutes have provided the sole and exclusive authority and procedure for such a change of organization (Government Code Section 56100); for the Legislature to deviate from long established processes would be an unnecessary consumption of time and attention of the Legislature when faced with many issues of statewide significance.

②

③

Sincerely,

  
\_\_\_\_\_  
Kevin P. Hunt, P.E.  
General Manager  
Central Basin Municipal Water District

  
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Robert Apodaca  
Board President  
Central Basin Municipal Water District

## Addendum

### Chapter 1 Recommendations and District Response

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*Preliminarily, we understand that when an audit has been directed to cover multiple years, the resulting report is written in summary form and fails to reflect the operational improvements over time. For example, many of the individuals who were involved in questionable circumstances described in your report are no longer with Central Basin Municipal Water District (District).*

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*In another example, the report states that for 13 of 20 contracts reviewed, the District did not use its competitive bidding process; the statement fails to reflect those occurred during the earlier part of the audit period and leaves the reader with the impression that the process was ignored throughout the period, without recognizing the improvements in our compliance in the latter portion of the audit period.*

*As the new General Manager, I solicited a number of qualified law firms to serve as General Counsel and succeeded in obtaining the services of Nossaman LLP, which has the breadth and depth of experience in not only water law but also in public agency law; and together, with our staff, have undertaken the updating of the District's Administrative Code, Ethics Policies and procedures, and proposed training of staff and the Board of Directors.*

### Legislature

1. To ensure the efficient and effective delivery of imported and recycled water in southeastern Los Angeles County, the Legislature should pass special legislation to preserve the district as an independent entity but modify the District's governance structure. In doing so, the Legislature should consider a governance structure that ensures the district remains accountable to those it serves, for example, by changing the District's board from one elected by the public at large to one appointed by the District's customers.

*The Central Basin Municipal Water District has existed for 63 years, providing potable water through retailers to over 2 million residents living in 24 cities in Los Angeles County. Those residents, who pay charges to the District to partially fund its operations, directly elect the five member board of directors as provided statewide for such municipal water districts. Statutes for over 50 years have addressed uniform processes for making changes to such an organization.*

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*The current law, known as the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000, would already be an appropriate means to effect change, if any is warranted. Local Agency Formation Commissions, existing in each county, have long been delegated the authority and responsibility to address*

*such issues at the local level. In light of the actions which have been taken and are scheduled to be taken, the necessity of new legislation is not evident, would be duplicative and would invade the long delegated authority held by the Local Agency Formation Commission.*

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*In addition, considering the demographics of the 2 million residents in the 24 cities in Los Angeles County, disenfranchising the residents in those communities from the decades long system of directly electing the board of their respective municipal water districts would raise a number of legal issues, including those of constitutional proportions. In addition, since the number of retailers who obtain water from the District approaches almost double in numbers the size of the staff of the District, any organization of a governing board from these retailers would almost be guaranteed to increase the size of their organization (and therefore its cost of operation) and be subject to a number of conflicts not encountered by the current system of having voters exercise their constitutional right to elect their local government officials.*

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## District

1. To ensure the stability of the district operations, the district should establish a formal policy for the hiring of the General Manager position by June 2016. The Board should initiate the hiring process for a new General Manager or begin the process of renegotiating the contract with the current General Manager in the fall of 2016.

*The District recognizes that a formal policy for the hiring of a General Manager position should be implemented to further ensure stability by June 2016. Moreover, the District plans to formalize its recruitment process for the General Manager prior to fall 2016.*

2. To better address potential ethical violations, the Board should adopt by June 2016 a means for investigating board members' and staff's potential violations of the district's code of conduct and conflict-of-interest code that would insulate those investigations from undue influence from either the board or the General Manager.

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*The report accurately identifies that the District maintained an Ethics Committee. Due to concerns over the Committee's ability to operate with complete independence, the District felt it was necessary to restructure the Committee in such a way to provide complete independence from staff and/or its Board. The District has recently adopted a new independent structure and policies to provide the tools necessary for proper oversight and notification of potential improprieties and ethical violations. This includes a confidential hotline with an independent legal firm review to validate and/or investigate any reported ethical violations and provide a structure for response, allocations of resources, and determination of required actions if any are necessary.*



3. To evaluate its progress toward its goals and objectives, the district should use its recently adopted strategic plan and issue an annual report that describes the steps it has taken toward achieving the goals and objectives in the strategic plan.

*The District adopted a new strategic plan in July 2015 and completed its first quarterly report on October 26, 2015. The District is committed to providing the highest level of transparency in all its reporting including the strategic plan; furthermore, the reporting for the strategic plan will include quarterly and annual reporting as part of its process to highlight the progress that has been made.*

4. To ensure its long-term financial sustainability, the board should complete a long-term financial plan no later than December 2016.

*The District recognizes the necessity for long term financial planning and selected a firm on October 2015, to complete a 10-year financial plan and forecast.*

5. To ensure its water rate structure is appropriate to provide the revenues necessary to cover its legitimate costs, the district should complete its planned water rate study no later than the spring 2017.

*As part of its long term financial planning the District plans to engage in a rate study. This rate study will be used to help guide evaluation of all the District's rates and revenue sources. This has been identified in the District Strategic Plan and is scheduled to be complete before spring 2017.*

6. To strengthen its financial stability against present and future uncertainties, the district should follow its recently adopted reserve policy.

*The District intends to follow the reserves policy to ensure the financial stability and future success of the District.*

7. To ensure that it continues to take steps to improve its financial condition and avoids additional costs due to downgrades of its debt credit ratings, the district should immediately create a formal debt management policy. This policy should clearly define its credit objectives and provide guidelines on suitable debt agreements. This policy should also require it to periodically monitor its specific financial ratios, such as its debt coverage ratio, that are relevant to its credit rating.

*As part of the District's Strategic Plan, a debt management policy is scheduled to be completed by the end of 2015. At minimum, the policy will define the credit objectives while providing guidelines on suitable debt agreements. Additionally,*



*the policy will also address the monitoring of specific financial ratios such as debt coverage.*

8. To maintain its current insurance coverage and better position it to negotiate for more cost-effective and appropriate coverage in the future, the board should immediately adopt a policy requiring a four-fifths majority to terminate the district's general manager. Further the board should review the district's insurance coverage annually and renegotiate costs and coverage amounts as necessary, particularly as the district resolves outstanding legal claims against it.

*The District will discuss and deliberate the policy implementation of requiring a four-fifths majority vote to terminate the District's general manager.*

*The District is committed to obtaining the lowest cost insurance possible while meeting its obligations to its customers and the public at large. The District has and will continue to annually review its coverages to ensure viability, adequacy and lowest cost possible.*

## Chapter 2 Recommendations and District Response

*The District takes pride in its continual effort to provide the highest level of open governance and transparency by providing the communities it serves with access to its financial reports, operations, and procedures. The following section will provide information on the additional steps the District has taken and will take to further foster an open governance.*

1. To ensure it holds itself accountable to the public, the district should follow the law and operate in an open and transparent manner by, among other things, disclosing to the public the true nature and purpose of all of its expenditures.

*In recognizing this recommendation, the District remains committed to operating in an open and transparent manner. This includes disclosing all expenditures through the demands list, budget versus actual reporting, debt coverage ratio reporting, budget versus actual sales, and revenue reporting. In addition, the District conducts a semi-annual review of its budget, monthly water sales productions, and annually publishes a Comprehensive Annual Financial Report. The District also hosts a monthly meeting with water retailers and wholesalers to discuss Central Basin and regional water issues including detailed budget processes and changes.*

*To further operate in an open and transparent manner, the District also provides online access (via its website) to Board Agendas, financial reporting and budget related documents. Additionally, the District's commitment to promote transparency and good governance has been recognized by the Special District*

*Leadership Foundation with the Transparency Certificate of Excellence that was awarded to the District in September 2015. Furthermore, for the 10<sup>th</sup> consecutive year, the District received the Certificate of Achievement for Excellence in Financial Reporting (for its Comprehensive Annual Financial Report) from the Government Finance Officers Association. Both of these awards are a testament to the District's commitment to operate in an open and transparent manner.*

2. To ensure its board makes informed decisions on when it is proper to hold discussions and take votes in closed-session meetings, the district should require its board members to attend training – as soon as possible and biennially thereafter – specifically focused on the Brown Act and its closed meeting requirements.

*The District agrees with this recommendation; in addition to the required ethics training (AB1234), the District will require Brown Act training for its Board members and staff every two years.*

3. To make better use of the funds it spends on services, the district should amend its administrative code by June 2016 to limit its sole-source contracts to emergency circumstances and circumstances in which only one vendor can meet the district's needs. Further, before executing any sole source contracts, the district should require written justification demonstrating the reasons for not competitively bidding the services. The justification should include the background of the purchase; a description of the vendor's uniqueness; an explanation of the consequences of not purchasing from the vendor; market research to substantiate a lack of competition; and an analysis of pricing and alternatives.

*To integrate more refined policies pertaining to sole source contracts, the District is currently revising its policy to strengthen sole sourcing language to specifically limit to emergency circumstances or occasions when the service is so critical or unique that only one vendor meets the District's needs. The District will implement these changes no later than June 2016.*

4. To ensure that it does not unnecessarily use amendments that limit competitive bidding for its contracts, the district should amend its administrative code by June 2016 to require that it rebid contracts if it significantly changes those contracts' scope of work, specifically the nature of the services or work products.

*The District concurs with this recommendation and is currently revising its policy to limit the use of contract amendments under the authority of the General Manager to time extensions only and will rebid any contracts that significantly change the scope of work or the nature of services or work product. The District will implement these changes prior to June 2016.*

5. To ensure its contract amendments reflect the authorization of the board, the district should revise its administrative code to require the general manager to submit a

quarterly report to the district's board detailing all its contracts, contract amendments, and contract and amendment dollar amounts.

*In recognition of this recommendation, the District will expand on its current practice of reporting on contracts entered into under the General Manager's authority. Future reports will include all contracts and amendments disclosing dollar amounts. The District will implement these changes prior to June 2016.*

6. To ensure it receives the best value from its contracts, the district should do the following by June 2016:
  - Adopt and implement a policy requiring that it include in all its contracts' scopes of work specific, well-defined deliverables; measurable results; timelines and progress reports; and evaluations of the contractors once they complete the work.
  - Ensure project managers verify services were rendered before approving invoices for payment.
  - Create processes for project manager to organize and retain contract files that include important documents such as vendor performance and deliverable verification and acceptance.

*The District agrees with this recommendation and is currently revising its procurement policy and contracting procedures to provide greater contract management controls as outlined in the Auditor's recommendations. The District is currently in the process of adopting these revisions immediately.*

7. To ensure its employees are able to properly administer contracts, the district should, by September 2016, follow through with its plan to require its staff responsible for project management to attend training by a reputable trainer on contract management.

*To further ensure that contracts are properly administered, the District agrees with this recommendation and will provide contract management training for all project managers. This process will commence in December 2015 and will be completed by June 2016.*

8. To minimize its risk when contracting with vendors, the district should adhere to its administrative code and execute all contracts after approval by its general counsel. Further, the district should amend its administrative code to prohibit engaging in a verbal contract. Finally, the district should continue to report to its finance committee all sole-source contracts and contracts entered under the general manager's authority.

*The District agrees with this recommendation. We are committed to the integrity of our contracting procedures. To limit potential risk, greater oversight is exercised through legal review of all contracts prior to execution. Procurement policy revisions will explicitly prohibit verbal contracts. As previously stated, the District will continue and plans to expand our practice of reporting to the Finance and Audit Committee all sole-sourced contracts and contracts entered under the General*

*Manager's authority. The District will implement these changes no later than June 2016.*

9. To ensure its expenditures do not constitute a gift of public funds, the district should do the following:
  - Immediately eliminate its allocation of funds to individual Board Members for community outreach.
  - Develop policies to specify limitations on the types of activities it will sponsor in the future to ensure that it funds only those organizations whose activities have a direct link to its authorized purposes. For example, it should eliminate its purchase of holiday turkeys.
  - Revise the administrative code by June 2016 to include more specific guidance as to what constitutes a reasonable and necessary use of public funds. The guidance should establish restrictions on the amount spent for board member installation ceremonies. It should also include a process for the district to ensure that expenses are reasonable and necessary before it pays them.

*The District agrees with these recommendation and plans to immediately eliminate its allocation of funds to individual Board Members for community outreach. The District will also refine its policies to specify limitations on sponsorship activities. Further, the District has eliminated the sponsorship for turkey donations.*

*Additionally, the District will revise its Administrative Code to limit and specify the types of expenditures and activities it sponsors; this will include restrictions in funding of Board Member installations. These items will be addressed in the District's Administrative Code prior to June 2016.*

## Chapter 3 Recommendations and District Response

*The District continues to improve its operations through the establishment and enforcement of strong policies and procedures. The following will provide additional clarification and actions taken by the District in the past few years to improve its handling of hiring, compensation of its board and employees, and appropriateness of its expenditures.*

1. To ensure it considers the most qualified candidates for the positions, the district should follow its established hiring policies. Specifically, it should use a competitive hiring process and ensure that its board first formally approves of all positions for which the district recruits. Further, the district should only consider for employment individuals who meet the established minimum qualifications for the positions for which they have applied. If the district believes certain qualifications are not necessary for the position, it should indicate in the position description that such qualifications are desirable but not required.

*The District agrees with these recommendations. By way of background and as stated in the report, the District has policies and procedures for recruitment and hiring of staff. During the five-year audit period, a total of 24 job openings were filled with a competitive recruitment process. The recruitment of the four positions that were not in compliance with district policy, occurred in 2011 and 2012. Since 2013, the District has ensured that it follows a competitive recruitment process. Examples of the District's compliance includes the recruitment and hiring of the former general manager and finance director in 2013, and the recent recruitment and hiring of the general manager and finance director in 2015, in addition to all other lower level positions filled since 2013.*

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*Since 2013, the District has ensured that all candidates meet the minimum qualifications of their current positions. As noted in the report, current senior managers meet the qualifications required for their positions. In addition, the remaining non-senior manager staff also meet the minimum qualifications of their current positions.*

*As noted in the report, the District maintains job descriptions that detail the minimum qualifications of staff. The District will continue to maintain appropriate job descriptions to meet the operations needs of the District.*

*In July 2015, the Board approved recent policy that further enforces that the Board will abstain from participating in any aspect of employment and personnel matters with the exception of matters pertaining to the General Manager. The Board also approved recent policy that the Board will approve employee classifications and positions before a competitive process is commenced. Since 2013, the District has followed these policies as a matter of practice; however, additional enforcement will be provided by the development of a human resources procedures manual to ensure compliance with its recruitment and hiring policies.*

2. To ensure that it does not inappropriately grant merit raises to its staff, the district should follow its policy to provide annual performance evaluations to all employees.

*As noted in the report, the District has a policy and procedure for performance evaluations. Moving forward, the District will ensure that all performance evaluations for all staff are completed on an annual basis by the end of the fiscal year.*

3. To ensure it is efficiently using its resources, the District should do the following:
  - Eliminate its board members' automobile allowances and instead reimburse them based on mileage or transit use.
  - Periodically analyze and beginning in June 2016, report to the board whether all elements of its board member compensation, including health and related benefits, are appropriate and reflect the common practices of special districts.



- Adopt a policy that its general managers will participate in benefits at the same level as District staff and that the board will negotiate the general managers' contracts on the basis of salary and not other benefits such as retirement.

*The District recognizes the need for improved policies to efficiently use its resources with regards to automobile allowances and compensation for the board and employment contracts for general managers. With regard to board members per diem and benefits, the District's board policy states that board member benefits in no event shall exceed the benefit contributions of employees. The District will continue to follow state law and ensure that its benefits for directors and employees are comparable with other benefits provided by similar water districts. In early 2013, the board froze its per diem amount for four years. In addition, the district has maintained the same communication allowance of \$200 since before 2006. The District plans to provide an annual analysis during the budget review period of all of the benefits provided to board members to ensure that benefits are reasonable and comparable to other benefits provided by other water districts.*

*As it relates to board members' automobile allowance, the District plans to continue to build upon best practices, efficiencies, and cost savings measures already implemented. Specifically and as noted in the report, the District recently revised its policies to ensure board members demonstrate they have a valid driver's license, automobile insurance, and an acceptable driving record as a condition for receipt of the automobile allowance and for mileage reimbursement expenses. The automobile allowance will be reviewed by the board by June 30, 2016 as part of the annual analysis of benefits for board members. Further, the District will complete a report by June 2016 or sooner on all board member benefits, including health.*

*With regard to staff compensation and benefits, the District plans to conduct a total compensation survey that would include salary and benefits by the end of 2016. With regard to compensation and benefits for the general manager, the District will strengthen its policies and enforce language that general managers will have the same benefits as staff and will negotiate total compensation on the basis of salary only. As noted in the report, the employment contract with the current general manager offers the same benefits as other employees.*

4. To ensure it complies with state law and its own administrative code, the district should require board members to report back to the board on meetings and conferences they attend at the district's expense. The district should record these reports in meeting minutes or document them in expense files before it reimburses the board members for their travel expense claims.

*As it relates to requiring board members to report back to the board on meetings and conferences they attend at the District's expense; in previous years the District has left the reporting of external meetings and conferences to individual board members. The District acknowledges the need for reporting and, moving forward,*

*the District will provide stronger enforcement of this reporting requirement by establishing procedures including a board agenda listing of board of director's report of meetings and conferences.*

5. To ensure that its travel expenses are reasonable and necessary, the district should take steps, such as issuing a clarifying memorandum or providing additional training, to ensure all board members and staff, especially those who process reimbursement claims, are aware of what it considers to be proper expenses incurred while traveling, including the following:
  - Air travel that is coach or an equivalent class.
  - Meetings and conferences that have a direct connection to water policy or the district's mission. It should update its list of such preapproved meetings accordingly.

*The District agrees with these recommendations and adopted revisions, in July 2015, to Part 3 of the Administrative Code that addresses the concerns presented in the report. Prior to the recent change, in February of 2013, the District approved a resolution to revise the Administrative Code to allow for a maximum of \$5,000 budget per fiscal year for each Board Director to attend conferences or seminars. Moreover, the District will continue to implement recent changes to its policies and will further develop procedures to ensure compliance of these policies specifically addressing the authorization of rental vehicles, travel expenses, lodging, and meals.*

*With regard to rental vehicles, as stated in the report, the District adopted a policy in July 2015 requiring that vehicles be rented only to board members or employees for eligible reimbursement. In addition, language was added to the policy with specific requirements and guidelines of the authorization and use of rental vehicles for eligible reimbursement. With regard to forms of travel other than automobile travel, the District will strengthen its procedures to ensure that travel expenses are reasonable and necessary. The District will review its current procedures in processing claims by designated staff and will provide additional training to all employees on the criteria and steps to process reimbursements. These steps will include the substantiation that air travel is of coach or equivalent class, substantiation that meeting expenses and conferences have a direct connection to the District's mission, and substantiation that lodging expenses reflect a group or government rate. These recommendations will be completed by June 2016.*

6. To ensure it only reimburses reasonable and necessary meal expense, the district should take steps such as issuing a clarifying memorandum or providing additional training, to ensure all board members and staff, especially those who process reimbursement claims, are familiar with its meal reimbursement limits.

The district should revise its administrative code by June 2016 to prohibit paying for reimbursing meals that occur within the local area that involve meetings either

between only district representatives or between district representatives and the district's contractors.

The district should revise its administrative code by June 2016 to prohibit providing the costs of meals to third parties.

*For further refinement of its policies for meal expense reimbursements, as stated in the report, the District will revise the Administrative Code to prohibit paying or reimbursing meals in the local area that involve meetings between any District representatives or District representatives and contractors by June 2016. The District will also revise its Administrative Code to prohibit providing cost of meals for third parties.*

*Additionally, in relation to this report, the District recently adopted meal costs limits that are comparable to the IRS's established rates. Staff has received training on the new meal expense reimbursement limits and will receive additional training as the policies and procedures are strengthened to include the recommendations on meal reimbursement restrictions that are recommended in this report.*



## Comments

### CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE CENTRAL BASIN MUNICIPAL WATER DISTRICT

To provide clarity and perspective, we are commenting on the response to our audit report from the Central Basin Municipal Water District (district). The numbers below correspond to the numbers we placed in the margin of the district's response.

During the district's official review of our draft report in late October 2015, the board of directors (board) adopted a plan to implement a hotline for reporting potential ethics violations and to contract with a law firm to conduct an independent review of those alleged violations, which we describe on page 28. As a result of the board's action, we added text to our recommendation on page 42 to clarify that the district should implement changes to its ethics policy by June 2016.

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At the outset, it is helpful to point out that, unlike most municipal water districts in this state that directly provide water to residents, this district is a limited-purpose agency whose primary responsibility during most of the 63 years of its history is to wholesale water from the Metropolitan Water District of Southern California (Metropolitan) to be resold to water distributors who directly provide water to residents of their respective communities. Whatever governance structure is put in place, this function remains the primary responsibility of the district. Therefore, a change in governance would not deny "2 million citizens the right to direct representation on major water policy issues" because the district's role does not require broad policy making. Further, our recommendation to the Legislature on page 42 would not result in the loss of representation, or disenfranchisement, of the residents within the district's jurisdiction. The district's eligible voters currently have the power to elect the public officials of the public agencies that constitute the district's customer base. If the Legislature implemented our recommendation, these public agencies would then have the power to appoint the board. Thus, the district's residents would retain ultimate authority over the district's board through representative democracy. This would be analogous to the way in which the representatives of Metropolitan and the San Diego County Water Authority are appointed, as we describe on page 41. Moreover, any subsequent governing body would continue to operate in an open and transparent manner under the Ralph M. Brown Act and would allow for public participation in the decision-making process.

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- ③ As stated in our report on pages 39 through 41, because of the recent positive changes made by the district, we believe the options available under the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (Reorganization Act) are premature at this time. However, as stated on page 39, we remain skeptical of the board's ability to consistently ensure the district's stability and provide it with effective, ongoing leadership. Thus, the intent of our recommendation is for the Legislature to consider options, such as the one we propose, that are less extreme than those permitted under the Reorganization Act, but that create greater accountability between the district and its direct customers so that the district remains encouraged to continue the positive changes it recently made. We also note that while the Reorganization Act is locally administered, the Legislature may revise the statutes it enacted to authorize the district if it deems such revisions are necessary to meet changing conditions.
- ④ The district's statement that our report fails to reflect the district's operational improvements over time ignores the numerous instances in our report where we point out the district's improvement in certain areas. For instance, we note the district's recent progress related to addressing potential ethical violations on pages 27 and 28 and adopting a new strategic plan on page 29. Further, we acknowledge actions it has recently taken to address the issues we found related to the district paying for inappropriate and questionable meal expenses on page 80. In addition, the district's statement that many of the individuals who were involved in the questionable circumstances described in our report are no longer with the district overlooks the fact that the district's policies and controls were weak or lacking in many areas throughout our audit period, regardless of the individuals involved. For instance, the district still has no formal debt management policy, as we describe on page 35; its management of its contracts did not follow best practices and sometimes circumvented its own policies regarding contracts throughout our audit period, as we point out beginning on page 49; and several of the travel and meal expense issues we identified in Tables 10 and 11 on pages 77 and 79, respectively, occurred within the past two fiscal years.
- ⑤ Our contract selection included four contracts the district entered into in each of the five fiscal years in our audit period. The district is correct that 11 of the 13 contracts we identified as sole-source contracts on page 50 were executed prior to fiscal year 2013–14. However, we describe additional contracting issues that occurred throughout our audit period in Chapter 2 on pages 56 through 60. For example, on page 57 we describe that 19 of the 20 contracts we reviewed had scopes of work that did not include one or more of the following elements: measurable results, timelines or progress reports, or an evaluation component. Further, on pages 62 and 63

we recommend changes to the district's contracting policies and processes to ensure that it not only receives the best value from its contracts, but also strengthens its control environment and ensures it has adequate contracting practices.

We do not recommend a specific structure for or size of the board. In the recommendation to the Legislature on page 42, we offer the example of a board appointed by the district's customers to better reflect the fact that the district's customers are generally water retailers and not the residents of the district. We can envision multiple ways that can happen that may include, among other possibilities, a hybrid board of elected and appointed officials or a board of limited size elected by the retailers from a slate of individuals nominated by those retailers. Ultimately the decision of whether or how to change the governance structure resides with the Legislature.

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Consistent with the audit objectives, we reviewed the qualifications of the district's senior managers. In reviewing the qualifications of specific former managers, we identified additional concerns with the district's hiring process, including its failure to consistently follow established policies requiring it to use a competitive hiring process, and discuss those concerns on pages 66 through 69. Although we note on page 24 that the process the district used to hire the current general manager included interviews of top candidates, we did not review the competitiveness of the process the district used for its other current hires and therefore cannot conclude that it did or did not follow a competitive process for all individuals hired since 2013. Nevertheless, we stand by our recommendation on page 80 that the district follow its hiring policies by using a competitive hiring process.

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