



County of Monterey

Item No.

Board Report

Board of Supervisors
Chambers
168 W. Alisal St., 1st Floor
Salinas, CA 93901

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Consider receiving the July 22, 2024, GPP Analytics Water Recycling Agreement Expense Audit (Audit).

RECOMMENDATION:

It is recommended that the Monterey County Water Resources Agency Board of Directors:

Receive the July 22, 2024, GPP Analytics Water Recycling Agreement Expense Audit (Audit).

SUMMARY/DISCUSSION:

At the request of the Monterey County Water Resources Agency ("Agency"), the County of Monterey Auditor-Controller's Office ("ACO") engaged GPP Analytics, Inc. ("GPP") to conduct a financial audit to assess the accuracy and compliance of expenses reported by Monterey One Water ("M1W") reported over four fiscal years (FY 2018-19 to FY 2021-22), the audit period, in accordance with the Amended and Restated Water Recycling Agreement Between Monterey Regional Water Pollution Control Agency [now M1W] and Monterey County Water Resources Agency (the "Agreement"). The Agreement was entered into by the Agency and M1W on November 3, 2015, to incorporate and restate agreements that had been developed over the years since the establishment of the Castroville Seawater Intrusion Project ("CSIP"), the Salinas Valley Reclamation Project ("SVRP"), and the Salinas River Diversion Facility ("SRDF"). Subsequently, there have been three minor amendments to the Agreement related to the New Source Water Facilities.

The Audit's objectives were to evaluate M1W's expenses for compliance with the provisions of the Agreement. This work was completed through verifying if expenses for the SVRP, CSIP, and the SRDF were reasonably incurred, verifying direct and indirect costs were accurately documented, and assessing financial systems and internal controls. The Audit aimed to verify proper record keeping, accurate reporting, accurate reconciliations, and compliance with the Agreement overall.

During the audit, starting from the entrance conference on August 24, 2023, to the exit interview on April 8, 2024, staff from GPP, M1W, the Agency and the ACO met regularly to review the process, data, findings, and recommendations for accuracy and completeness.

The Audit resulted in seven findings listed below, including overallocation of an estimated \$1,110,117 of indirect costs during the audit period. The Audit report contains detailed recommendations by GPP to address the seven findings, which follow:

Finding 1: Noncompliant Indirect Cost Methodology. GPP identified a difference in M1W's

calculation of indirect costs compared to the methods outlined in the Agreement. This resulted in an estimated \$1,110,117.41 overcharge to the WRA in total for the four audit years. It is recommended that M1W and the WRA revise and finalize its indirect cost plan to align with the requirements of the Agreement and return the overcharged amount to the WRA.

Finding 2: Inconsistent Time Records. M1W did not use a consistent method for recording and tracking time billed to the WRA. Moreover, GPP identified discrepancies between time recorded in the payroll system with independent entries into the work order system. While the work order system is not intended to replicate the payroll system in all instances, some of the discrepancies identified indicate that the payroll system cannot be assumed accurate. Because the information in the two systems was so discrepant, GPP could not determine if M1W over or under-billed the WRA for employee time. It is recommended that M1W enforce internal controls for verifying time records for each payroll period and that it furnish detailed records to the WRA monthly.

Finding 3: Noncompliance With Required Monthly Reporting. GPP's analysis of monthly reports from M1W to the WRA, as required in the Agreement, ceased for a ten-month period. This was a breach of the Agreement and undermines the ability of WRA to monitor M1W's spending and use of the WRA's program resources. It is recommended that M1W adopt a formal procedure for monthly reporting, assign it to a staff member, and develop a backup/succession plan for key deliverables due to the WRA to ensure long-term adherence to the Agreement.

Finding 4: Accounting Practices and Limited Transparency. GPP observed accounting practices that do not comply with the Agreement, and lack of transparency in M1W's handling of WRA's finances, leading to inconsistent financial reporting and questionable account balances reported by M1W. Disparities in cash balances indicate that M1W's accounting does not meet the requirements for segregating and tracking funds. The misalignment between reported financial data provided to the WRA and M1W's annual audits exacerbates this lack of clarity. Recommendations by GPP include amending the Agreement for clear procedures, segregating WRA funds into distinct enterprise funds, and performing a separate annual financial audit of the WRA funds managed by M1W.

Finding 5: Percent Overcharged. Based on Finding 1, indirect cost methodology, GPP reports M1W overcharged the WRA by a total of \$1,110,117.41 for the four-year audit period. During each of the four years this was \$64,226.76 or 1.5% of FY 2018-19 expenses, \$175,362.29 or 3.7% in FY 2019-20, \$343,192.18 or 6.3% in FY 2020-21, and \$527,336.19 or 8.6% in FY 2021-22. We recommend that, per the Agreement, M1W reimburse the WRA for the total amount overcharged.

Finding 6: Weak Control Environment. Based on Findings 1-4, GPP does not believe M1W possesses an appropriate financial system and internal controls to effectively record, monitor, and allocate operational and maintenance costs in accordance with the Agreement. It is recommended that M1W implement the recommendations detailed in those findings.

Finding 7: Breaches of the Agreement. Based on Findings 1-4, GPP believes M1W specifically breached several areas of the Agreement. It is recommended both parties seek an update to the Agreement that will hold both parties more accountable and bring awareness of any problems managing the Agreement to both party's board of directors promptly.

The Audit was conducted in accordance with the Institute of Internal Auditors Professional Practices Framework and the U.S. Government Accountability Office's Generally Accepted Government Auditing Standards ("GAGAS"), which requires sufficient and appropriate evidence be obtained to provide a reasonable basis for its findings and conclusions based on its audit objectives. GPP indicated that the evidence obtained provides a reasonable basis for the Audit findings and conclusions based on the Audit objectives.

As recommended by GPP, the Agency requested and M1W has agreed that there will be a separate annual audit of its CSIP, SVRP and SRDF funds performed by an external auditor. The Agency will reimburse M1W the audit expenses on those funds, unless, per the Agreement, the audit shows that M1W has overcharged annual costs to Agency by more than five percent, in which case M1W shall promptly reimburse the Agency for the cost of the audit.

M1W has begun to address its internal controls and systems issues, and M1W's General Manager and the Agency's General Manager have agreed to establish a working group of Agency and M1W staff and leadership to begin addressing the remaining issues.

On August 13, 2024, the Agency Board of Supervisors took action related to this item and provided additional direction for staff to bring back regular updates regarding the resolution of the Audit findings and recommendations as well as discussions regarding updates to the Agreement.

OTHER AGENCY INVOLVEMENT:

The Agency has worked with M1W and the Auditor-Controller's office throughout the audit phases.

FINANCING:

Section 8.05 of the Agreement states that "If the audit shows that PCA [now M1W] has overcharged annual costs to WRA by more than five percent, PCA shall promptly, on demand by WRA, reimburse WRA for the cost of the audit."

Section 8.06 of the Agreement states that, "If any audit shows that an undercharge or an overcharge has occurred, each agency will have 90 days to comply with the audit findings." GPP identified an overallocation of \$1,110,117.41 during the audit period of indirect cost between M1W's calculations compared to the method outlined in the Agreement and recommends the Agency seek refund of the difference. The refund would be credited to Funds 131 (CSIP), 132 (SVRP) and 134 (SRDF) upon receipt from M1W.

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Attachments:

1. Water Recycling Agreement Expense Audit Report Packet
2. Amended and Restated Water Recycling Agreement and Amendments

