



THE METROPOLITAN WATER DISTRICT  
OF SOUTHERN CALIFORNIA

## **Report**

### **Office of General Auditor**

## **Internal Audit Report for September 2022**

### **Summary**

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One report was completed:

#### **1. Observations and Recommendations to the General Manager and Audit & Ethics Committee**

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### **Observations and Recommendations**

Metropolitan is facing unprecedented challenges. After two and a half years, we are still dealing with the effects of the pandemic; it affected the global supply chain and dramatically altered how we work. Climate change has significantly impacted our water resources and increased the cost of sustaining our operations. Over the past year, Metropolitan experienced significant changes to our organizational structure and key personnel; change of this magnitude is fraught with risk and would stress any organization's internal control environment. Successfully navigating these challenges will require us to be focused, flexible, and swift.

### **Risk Assessment**

Effective planning demands a realistic view of risk. Executive management should develop a comprehensive risk assessment incorporating every aspect of our operations. Each risk identified should include an analysis of its likelihood to occur, the exposure or impact it would have should it be realized, and the velocity or speed with which the impact would affect us. Doing so will require the full participation of executive and senior management. The result should represent Metropolitan's shared understanding of the risks we face and the priority we assign to them.

### **Refining Our Strategic Plan**

It is impossible to eliminate all risks, but we can mitigate those that pose the greatest threat. Management should use the Risk Assessment to identify the risks that require mitigation and agree upon the necessary steps. By doing so, we would create a prioritized strategic plan that represents management's shared understanding.

The General Manager should present the Risk Assessment and the Strategic Plan to the Board for discussion and approval.

### **Budget**

Effective budgets should be realistic and fund Metropolitan's priorities. They should also serve as tools to monitor performance and adapt to changing circumstances; this is especially critical in the volatile environment we find ourselves in presently.

Metropolitan employs a two-year budget used primarily to calculate rates. Many senior-level executives and managers have no input in its development; consequently, there is a lack of ownership and accountability.

The District has little or no control over some of its more significant expenditures (e.g., power, chemicals, etc.); climate change and supply chain disruptions created a degree of volatility that didn't exist in the past. For example, higher energy prices, higher pumping demand, and reduced hydroelectric generation substantially increased Metropolitan's payments to the California Independent System Operator (CAISO). Metropolitan pays CAISO weekly. Until January this year, the District had \$1 million on deposit with CASIO as collateral. In February, Metropolitan had to increase that deposit by \$2.8 million. During September, Metropolitan's collateral deposit increased to \$10.8 million, and on September 27, CAISO invoiced the District an additional \$2.4 million.

Our circumstances make it essential to monitor the budget closely and make adjustments as necessary. Management should consider implementing a one-year, "zero-based" budget. Each management team member should be responsible for developing budgets for their areas of responsibility; each should be accountable for their budget. The General Manager should review and approve the entire budget and submit it to the Board for discussion and approval.

Monthly, each executive should receive a report of their expenditures to compare with budgeted amounts; they should report significant variances and explain why they occurred. If necessary, budgets should be revised and approved.

### **Board Governance**

Metropolitan's Administrative Code requires the Board to govern with an emphasis on outward vision, encouragement of diversity in viewpoints, and strategic leadership more than administrative detail. Given the size and diversity of our Board, that task would be challenging under the best circumstances. It is more challenging at Metropolitan because we flood our Board members with difficult-to-digest details. For example, at the September 13 Board meeting alone, members received more than 450 pages of material. This situation makes it difficult, if not impossible, for them to be strategic and focus on the most critical issues.

The Board should consider relying more on monitoring the progress of a well-defined strategic plan and budget and less on the details of day-to-day operations. Such a change will require considerable discussion and debate, perhaps with the assistance of a knowledgeable facilitator.

### **Board Member Orientation**

Metropolitan is immensely complex, and the make-up of our Board has changed dramatically over the past few years. New Board members need time to understand the nature of our mission, our operations, and their responsibility as members to make good decisions; at present, they don't get much help. The District should reestablish a formal orientation program for new members.

### **Accountability and Performance Management**

Accountability is essential to good governance; effective oversight and performance management are meaningless without it. The California State Audit confirmed that Metropolitan does not perform well in this area. A significant contributing factor is our inability or unwillingness to hold employees at all levels accountable for poor performance and bad behavior. One only needs to look at a summary of our performance evaluation process to see the evidence. With more than 1,800 employees, only a handful receive performance ratings less than "Meets Expectations." Metropolitan has a competent and devoted workforce, but it defies logic that so few would at least need to improve.

Management should evaluate the performance rating process. The District should train supervisors to evaluate performance effectively, and management should provide them with their support. The District should incentivize and reward good performers, coach and develop those who require improvement and hold those who do not improve or exhibit inappropriate behavior accountable.