

Tarrant Regional Water District Contract Audit January 2018

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City Auditor's Office

January 18, 2018

Honorable Mayor and Members of the City Council:

The City Auditor's Office has completed the Tarrant Regional Water District Contract Audit. The purpose of the audit was to review and assess contract requirements and compliance.

Management's response to our audit findings and recommendations, as well as target implementation dates and responsibility, is included following the report.

We would like to thank staff from the Water Utilities Department for their full cooperation and assistance during the audit.

Lori Brooks

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City Auditor

Attachment

c: Trey Yelverton, City Manager
Jim Parajon, Deputy City Manager
Gilbert Perales, Deputy City Manager
Jennifer Wichmann, Acting Deputy City Manager
Walter Pishkur, Water Utilities Director

**Tarrant Regional Water District Contract Audit
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Executive Summary

The City Auditor's Office has completed the Tarrant Regional Water District (TRWD) Contract audit. The performance audit was conducted in accordance with 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. The audit objective was to review and assess contract requirements and compliance.

The City Auditor's Office noted the following:

- Both the City of Arlington and TRWD are complying with contract requirements
- The Water Utilities Department is exercising due diligence in preparing annual water usage estimates
- TRWD annual and settle-up billings are calculated accurately based on the City's estimated and actual water usage and TRWD's estimated and actual expenditures

Potential opportunities for improvement include:

- Revisions to contract/local government code language and provisions
- Increasing the City's representation and oversight of TRWD financial decisions

Details of audit findings, conclusions, and recommendations are included in the following report.

Audit Scope and Methodology

The audit was conducted in accordance with generally accepted government auditing standards. The following methodology was used in completing the audit.

- Interviewed pertinent City personnel
- Reviewed and analyzed relevant documentation maintained by City personnel
- Reviewed the Tarrant County Regional Water Supply Facilities Amendatory Contract
- Performed recalculations of water usage estimates and billings
- Reviewed the City's wire process for sending monthly payments
- Ensured payments to TRWD were properly recorded in the Lawson financial system
- Reviewed TRWD's Board of Director and Advisory Committee minutes

Background

The Tarrant County Water Control and Improvement District Number One, now named Tarrant Regional Water District, entered into a “Tarrant County Regional Water Supply Facilities Contract,” dated August 29, 1979, with the Cities of Fort Worth and Mansfield (the base contract). On September 1, 1982, the TRWD and the City of Fort Worth, the City of Arlington, the City of Mansfield, and the Trinity River Authority of Texas (initial contracting parties) entered into an amendatory contract, for the purpose of providing raw water to the contracting parties. At that time, the TRWD owned the surface raw water supply facilities that included the Eagle Mountain Dam and Reservoir and the Bridgeport Dam and Reservoir on the West Fork of the Trinity River, as well as the Cedar Creek Dam and Reservoir on Cedar Creek in Henderson and Kaufman Counties. Various bonds had been issued to acquire and construct, or to refund bonds issued to acquire and construct, the Cedar Creek Dam and Reservoir and related facilities.

Because the existing system at that time was inadequate to provide known future raw water requirements to the contracting parties, it was necessary to construct additional raw water supply facilities. Each of the initial contracting parties would be required to pay their share of the cost. The TRWD proposed to acquire, construct and complete additional raw water supply facilities, including a dam and reservoir on Richland and Chambers Creeks in Navarro and Freestone Counties, and an adjacent dam and reservoir on Tehuacana Creek in Freestone County, including all pipelines, pumps and other facilities. Additional bonds were issued for these projects.

The contract will continue in force and effect until all bonds and all interest coupons pertaining thereto are paid, and will then continue in force and effect during the entire useful life of the system. It is essentially an unending contract.

The City of Arlington receives its raw water supply from two sources: Lake Arlington and the TRWD pipelines. Raw water is released into Village Creek by pipelines from Cedar Creek and/or Richland Chambers reservoirs, which then drains into Lake Arlington. All water taken by the City from Lake Arlington is District water regardless of the actual source of the water (e.g. includes rainwater). Water from Lake Arlington is pumped into the Pierce-Burch Water Treatment Plant located at 1902 Lakewood Drive in west Arlington. All maintenance costs of the facilities, including the dam,

reservoir and spillways of Lake Arlington, as well as the pump station and pipeline to the Treatment Plant, are the sole responsibility of the City. In addition, the pipelines from the Cedar Creek and Richland Chambers reservoirs run south of the City of Arlington. Raw water supply is pumped from those pipelines into the John F. Kubala Water Treatment Plant located at 7001 U.S Hwy 287. All the facilities required to pump water from the City's connection on the TRWD pipeline to the Treatment Plant were acquired, constructed, and are owned and maintained by the City.

The City of Arlington is required to provide, operate, maintain and read meters that record all water taken by the City. One of two large magnetic meters is located at the Pierce-Burch water treatment plant, while the other is at the John Kubala water treatment plant. According to the treatment plant managers, these are the most accurate meters sold in the market. There are other conventional meters that measure raw water pumped directly to the City's golf courses. These amounts are very small compared to the total amount that goes through the treatment plants. The City is required to keep accurate records of all meter measurements and provide those to the TRWD monthly. Over the past 5 years, the City of Arlington's raw water usage from the TRWD system has averaged between 19 and 21 billion gallons of water each year. The associated annual cost is about \$19-\$22 million.

The contract provides that an Advisory Committee be established. The contract states that the governing body of each of the initial contracting parties shall appoint one member from the governing body or one of its officers to serve on this committee. As such, the City of Arlington has an appointed member. The purpose of the Advisory Committee is to consult with and advise the TRWD on matters pertaining to the System, including:

- The issuance of bonds
- The operation and maintenance of the system
- Additional contracting parties and the terms and conditions of the contracts with such other parties
- Sales of water to entities that are not contracting parties and the prices, terms and conditions of such sales
- The TRWD's annual budget, prior to submission to the TRWD's board
- Review of the TRWD's annual audit
- Improvements and extensions of the System and providing for other sources of water supply
- Any other pertinent matters related to the management of the system

The Advisory Committee has access to, and may inspect, any of the physical elements of the System, as well as all records pertaining to the System. The term of membership on the Advisory Committee is twelve months beginning on March 1st of each year. A member of the committee may serve more than one term if so appointed by the governing body. All expenses of the Advisory Committee are considered operations and maintenance expenses of the System.

Audit Results

Payments by the contracting parties are the primary revenue source available to the TRWD to fund their capital and operating expenditures. As a contracting party, the City of Arlington pays its proportionate share (based on estimated total annual amount of raw water usage) directly to the TRWD in equal monthly installments. A small portion of the City's payment is a "premium" to account for the cost of system facilities existing at the time of the amendatory contract. This amount is reduced annually and will eventually be zero. The application of a premium constituted an agreed method of adjusting the equities of the initial contracting parties.

The City calculates its estimated annual water usage by identifying the prior year's actual usage, while also considering projected water sales to other cities (i.e. Dalworthington Gardens, Kennedale and Bethesda), along with any current or projected watering restrictions. The TRWD uses these estimates to determine the City's annual proportionate requirement and monthly billing. Twice per year the TRWD reviews its actual expenditures versus budgeted expenditures, while reviewing actual vs. estimated usage by the parties. Each party's proportionate share of the TRWD's costs is adjusted, accordingly.

During this audit, various reports prepared by Water Utilities staff related to water usage by the City, were reviewed and compared to determine if valid information is used to prepare estimates provided to the TRWD. No significant differences or discrepancies were noted.

The City's water usage estimates prepared for FY2016 and FY2017 were reviewed to determine reasonableness. No significant discrepancies were noted. TRWD billings and settle-ups for FY2016 and FY2017 were reviewed and re-calculated to ensure accuracy. No significant discrepancies were noted.

Internal Audit reviewed the TRWD annual budgets, its revenue requirements and the City's proportionate share, and settle-up practices. Based on review, it appears the TRWD's current budgeting process, for estimating annual expenditures and revenues in determining the contracting parties' annual obligations, is not optimally effective. For the years reviewed, TRWD overestimated expenditures and underestimated "other" revenue projections, resulting in monthly payment adjustments (credits to the City) later in the year.

Contract content, including pertinent requirements, responsibilities and rights were reviewed. Additionally, relevant state and local laws were identified and reviewed. It appears there are areas for potential improvement, which could better position the City of Arlington (and its citizens/Water Utilities customers) for more adequate representation and oversight of TRWD financial decisions and actions. These are discussed below in the detailed audit findings section.

Detailed Audit Findings

The City of Arlington has limited representation and oversight of TRWD financial decisions

Although the annual obligation to TRWD is a significant part of the Water Utilities expenditures, the City has little control over those costs. Contract specifications, State and local law, and certain financial practices contribute to this lack of control. The following was noted:

- The City of Arlington is the second largest user of water from the TRWD system, yet has no representation on the Board of Directors. The City has little to no input or control over the TRWD budget or any of its operations.
- The contract does not contain an audit clause; therefore, the City of Arlington does not have the authority to audit relevant TRWD books and records.
- The term of the contract states: "this contract shall continue in force and effect until all Bonds and all interest coupons appertaining thereto shall have been paid, and thereafter shall continue in force and effect during the entire useful life of the System." In effect, it appears this contract has no end.
- All water taken from Lake Arlington is considered part of the system, although some of the water is from rainfall and watershed from outside the district, and not from TRWD owned facilities/pipelines. The City pays for all water taken from the lake, regardless of the source.
- Lake Arlington serves as a "storage facility" for the TRWD system. TRWD may pump water into the lake at any time, yet the City is responsible for the full cost of maintaining the dam, reservoir, spillways and all other facilities.
- TRWD's current budgeting process, for estimating annual expenditures and revenues in determining the contracting parties' annual obligations, is not optimally effective. For the year-end settle-up, TRWD uses a 5-year average of water usage to calculate any amount still due/owed. For the FY2016 settle-up, the 5-year average was approximately 440M gallons more than original estimates for FY2016; however, the City received a total credit of more than \$2.5M, due to TRWD budget adjustments. See TRWD revenue fund budget history below:

	FY 2015 Budget	FY 2015 Actual	FY 2016 Budget	FY2016 Actual	FY 2017 Budget	FY2017 Projected*
Total Expenditures	\$136,125,418	\$125,331,637	\$142,640,430	\$119,969,490	\$152,844,955	\$142,603,125
Other Income	-\$7,651,206	-\$6,361,859	-\$4,485,500	-\$6,091,279	-\$5,117,700	-\$7,526,518
Net Revenue Requirement	\$128,474,212	\$118,969,778	\$138,154,930	\$113,878,211	\$147,727,255	\$135,076,607

(To be paid by Contracting Parties)

* TRWD projections as of 6-30-17

Other issues contribute, as well, to the City's lack of input and representation. For example, only citizens within the TRWD voting boundary are eligible to vote in elections of TRWD Board members. According to the TRWD Voting Boundary map prepared by TRWD (Attached – **Appendix A**), Arlington citizens are not qualified voters and cannot vote in elections of TRWD Board members.

An individual must be a Texas resident and own property subject to taxation in the District to be qualified to run for a seat on the Board. The current board does not include any Arlington citizens.

As noted earlier, the City of Arlington is represented on the TRWD Advisory Committee. The committee may bring issues or concerns to the Board, which may or may not be acted upon. Based on our review, we did not identify an effective mechanism for extensive analysis and meaningful dialog between the Water Utilities Director, Advisory Committee and the TRWD Board, regarding TRWD's budget and financial or operational decisions.

TRWD has an internal audit function. The audit reports are not currently posted on their website or provided to the public; however, they may be obtained via an open records request. As part of normal business operations, the internal audit reports are not requested and obtained by the City to gain an understanding of any potential internal process improvement reviews and recommendations.

Recommendations:

1. The City Auditor's Office recommends that the City Manager consider initiating discussions with TRWD and local State representatives to initiate possible revisions to State and local law and the TRWD contract to increase representation of the citizens of Arlington and improve their position to influence the financial decisions and management of TRWD.
 - a. The City Auditor recommends that the City Manager initiate communication/education about the lack of representation of Arlington on the TRWD Board and consider devising a plan to encourage qualified individuals to run for a seat on the Board.
 - b. The City Auditor recommends the City Manager consider initiating discussions with TRWD and/or local state representatives to make the necessary changes in the TRWD Voting Boundary that will grant Arlington citizens a right to vote in elections of TRWD Board Members.
 - c. The City Auditor recommends that the City Manager initiate contract renegotiations to include an audit clause in the contract.
2. The City Auditor recommends that the City Manager communicate the need for more information/discussion between the TRWD Board, Advisory Committee, and City management about pertinent TRWD decisions and actions affecting the City's budget and citizens' utility costs.
 - a. The City Auditor recommends that the City Manager encourage the Advisory Committee member or the Water Utilities Director to request copies of any internal audit reports prepared by the TRWD Internal Audit function.
 - b. The City Auditor recommends that the City Manager work with the City's Advisory Committee member and Water Utilities Director to encourage more examination and discussion of TRWD's budget and financial/operational decisions; and to communicate results and related concerns to the TRWD Board via the Advisory Committee.

Appendix A



<p>c. The City Auditor recommends that the City Manager initiate contract renegotiations to include an audit clause in the contract.</p>	<p>Concur</p>	<p>meeting will be scheduled in February 2018.</p>		
<p>2. The City Auditor recommends that the City Manager communicate the need for more information/discussion between the TRWD Board, Advisory Committee, and City management about pertinent TRWD decisions and actions affecting the City's budget and citizens' utility costs.</p> <p>a. The City Auditor recommends that the City Manager encourage the Advisory Committee member or the Water Utilities Director to request copies of any internal audit reports prepared by the TRWD Internal Audit function.</p> <p>b. The City Auditor recommends that the City Manager work with the City's Advisory Committee member and Water Utilities Director to encourage more examination and discussion of TRWD's budget and financial/operational decisions; and to communicate results and related concerns to the TRWD Board via the Advisory Committee.</p>	<p>Concur</p> <p>Concur</p>	<p>Concur. The City Manager has requested that the Water Utilities Director request copies of internal audits prepared by TRWD staff. Information will be attained in February 2018.</p> <p>Concur. The current City Advisory Committee Member will not be running for re-election in May 2018. Therefore, the City Manager will be meeting with the new representative and the Water Utilities Director to outline expectations for oversight and participation in the development of the District's annual budget and any other pertinent financial decisions. This meeting will be scheduled in June 2018.</p>	<p>Water Utilities Director</p> <p>City Manager</p>	<p>02/2018</p> <p>06/2018</p>