Report to Management

AUDIT OF THE AGRICULTURAL WATER CONSERVATION DEMONSTRATION INITIATIVES

July 13, 2011

Texas Water Development Board

Internal Audit

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KEY POINTS OF INTEREST

Overall Conclusion

The Demonstration Initiative contracts were properly solicited and awarded. Contracting and Purchasing personnel work with contract managers to ensure the contracts are monitored and contract deliverable requirements are met. Invoice documentation appears sufficient to support the payments made.

Key Facts and Observations

Contract managers are familiar with the terms and conditions of the contract agreements. The contract managers review the contractors' reports, participate (when possible) in contractor meetings, and are in constant contact with the contractors' personnel.

Based upon testing of sample invoices from both contracts, the quarterly billings appeared to have sufficient supporting documentation for justification of expenses. The testing also indicated that Contracting and Purchasing staff and contract managers reviewed the billings and progress reports.

Contracts were solicited, awarded, reviewed and finalized in accordance with appropriate laws and regulations. Contracts are properly monitored by the Contracting and Purchasing section and individual contract managers. The contract managers receive timely reports and information from the contractors in accordance with contract deliverable requirements.

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A. Management Summary

1. Purpose

The purpose of this report is to present the conclusion and observations from an audit of the Agricultural Water Conservation Demonstration Initiatives. This audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* and Generally Accepted Government Auditing Standards.

The government standards require the audit to be planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for observations and conclusions based on the selected audit objectives. The evidence obtained provides a reasonable basis for the observations and conclusions based on these objectives.

2. Background

The Texas Water Development Board's agricultural water conservation programs were originally implemented from a trust fund set up from general revenue funds in FY 1985 by the Texas Legislature. Interest derived from the trust fund investments was returned to the fund and appropriated by the Legislature to four agencies: TWDB, the State Soil and Water Conservation Board, Texas AgriLife Extension Service, and Texas AgriLife Research.

In the 2003 legislative session, the trust fund (which held approximately $15 million at that time) was changed to a "dedicated fund." Management of the fund was assigned to TWDB and appropriations to other agencies ceased.

In FY 2004, TWDB implemented a long-term agriculture demonstration program to be paid from the dedicated fund. Seven applications were received in response to the Request for Applications. The applications went through a normal evaluation process, which resulted in recommendations to the Board to approve two applications. The Agricultural Water Conservation Demonstration Initiatives (hereinafter referred to as "contracts" or "demonstration initiatives") are essentially a multi-year program funded for a total of $10 million from the Agricultural Conservation Water Fund. The two demonstration initiatives are:

(1) Lower Rio Grande Valley (LRGV) —Contractor: Harlingen Irrigation District. Sub-contractors are Texas AgriLife Research and AgriLife Extension Service. The joint project between the contractor and sub-contractors has been named Agriculture Demonstration Initiative (ADI).

This is a 10-year demonstration. Funding from the state grant is $3.8 million; local/federal matching funds are $2.3 million. The project demonstrates technologies on a scale that is larger than previous research projects. Working with 30 different field sites, it examines the various types of irrigation systems being used in the Lower Rio Grande Valley via the use of surface water through a canal system. The program includes a focus on the efficient use of

water (i.e., more production with the same amount of water) in times of adequate water supply and water conservation (limited irrigation) when surface water supplies are limited by drought.

(2) Texas Southern High-Plains (High Plains)—Contractor: Texas Tech University. Sub-contractors are Texas AgriLife Research, Texas AgriLife Extension Service, and High Plains Underground Water Conservation District. The joint project between the contractor and sub-contractors has been named the Texas Alliance for Water Conservation (TAWC).

This is an 8-year demonstration program. The program consists of a $6.2 million state grant from the fund with an approximate $1.8 million local match.

The project includes a broad-based look at not only irrigated crops, but also livestock management at approximately 30 different sites. It measures water use from the Ogallala Aquifer and is geared toward water conservation. This is all groundwater-supplied irrigation. The focus of this program is water conservation (use less water to grow the same amount of crops or livestock production) since the amount of water available is steadily declining.

Both projects meter rainfall, soil moisture, wells (High Plains), canal systems (LRGV) and other physical data to determine water usage. The Texas AgriLife Extension Service collects and analyzes financial data (costs for seed, tillage, and equipment), as well as water data, to evaluate the economic impact of the system being demonstrated. The water and economic data are presented to the public via field days and workshops. Both programs also maintain this information on their specific websites.

3. Scope and Objectives

The scope of this audit encompassed the examination and evaluation of the adequacy and effectiveness of the internal controls and quality of performance in carrying out assigned responsibilities in relation to the demonstration initiatives. The scope included specific program steps designed to assess:

- Effectiveness and efficiency of operations;
- Reliability and integrity of information; and
- Compliance with laws, rules, and regulations.

The objectives included procedures designed to determine if:

- Contracts for the demonstration initiatives are properly administered;
- Contract managers receive timely reports and information from the contractors in accordance with contract requirements;
- Contract supporting information in the agency's Contract Administration System provides sufficient and relevant information to assist contract managers in monitoring their contracts;
- Contracts were solicited, awarded, reviewed and concluded in accordance with appropriate laws and regulations;

- Contracts are properly monitored by the Contracting and Purchasing section and individual contract managers; and
- Procedures for invoicing, paying, approving, monitoring, etc. contracts adequately ensure proper payment of funds.

4. Conclusion

The Demonstration Initiative contracts were properly solicited and awarded. Contracting and Purchasing personnel work with contract managers to ensure the contracts are monitored and contract deliverable requirements are met. Invoice documentation appears sufficient to support the payments made.

5. Action Plans

None required.

B. Detailed Observations

1. Contracts for Demonstration Initiatives Were Properly Solicited and Administered

TWDB Contracting Policies and Procedures state in part:

> *Contract managers must ensure their contracts contain a clear scope of work that defines performance and deliverable requirements. Contract managers must also manage and document ongoing day-to-day contract issues and monitor the progress of the work performed by a contractor*.

Seven applicants submitted pre-proposals in response to the Board's Request for Applications. After review, two of the applicants, Texas Tech University and the Harlingen Irrigation District, were requested to develop and provide "fully comprehensive proposals," and were subsequently awarded contracts. Both of the applications were properly reviewed in accordance with procedures. The contracts were approved by the Board on September 22, 2004.

The contract manager is the designated contact and lead for each of the demonstration initiatives. For each contract, review and approval of the contract was required from Contracting and Purchasing, the Conservation Division Director, the pertinent budget officer, Legal Services, Accounting, and the Deputy Executive Administrator for Water Science and Conservation.

Invoices are submitted quarterly in conjunction with the quarterly contractor progress reports. Testing of invoices revealed that the deliverables (quarterly reports) met contract specifications, the payment requests (invoices) were reviewed and approved by the contract manager, and payments were made timely

to the contractors and properly updated in the agency's Sage MIP Fund Accounting System and Uniform Statewide Accounting System.

Based on review of the contracts, observation of the process, and testing of data, the contracts were properly solicited, reviewed and awarded and appear to be properly administered.

Recommended Action Plan 1: None required.

2. Contractor Data is Sufficient and Timely; Contracts are Properly Monitored

The contract documents and contractors' quarterly billings are filed in the agency's Contract Administration System (CAS), which is located within TxWISE. Because of the recent upgrades to CAS and the large volume of documentation, contractors' progress reports had not been scanned into CAS at the beginning of audit fieldwork, although they were available in hard copy. This was resolved by the end of fieldwork, and CAS now contains all FY 2010 and FY 2011 progress reports. The progress reports were part of the required deliverables dictated by the contracts.

Deliverables included data from studies detailed within quarterly progress reports and annual reports. The deliverables and invoices were examined by Contracting and Purchasing staff before they were forwarded to the appropriate contract managers for review. Both Contracting and Purchasing management and the contract managers stated that contract requirements are being met.

Interviews with the contract managers revealed that they are familiar with the terms and conditions of the contract agreements. The contract managers review the contractors' reports, participate (when possible) in contractor meetings, and are in constant contact with the contractors' personnel.

Based upon a test of sample invoices from both the High Plains and LRGV contracts, the quarterly billings appeared to have sufficient supporting documentation for justification of expenses. The testing also noted that Contracting and Purchasing staff and contract managers reviewed the billings and progress reports.

Recommended Action Plan 2: None required.

3. Contracts Comply With Regulatory Requirements; However the "Asset Ownership" Clause Required Clarification

Contracts were solicited, awarded, reviewed and finalized in accordance with appropriate laws and regulations. The contracts are properly monitored by the Contracting and Purchasing section and individual contract managers. The contract managers receive timely reports and information from the contractors in accordance with contract deliverable requirements.

Review of both the LRGV and High Plains contracts revealed each contract contained an "ownership" clause in accordance with the *TWDB-Contracting Policies and Procedures*. Paragraph 4 of the clause states in part:

> *Any equipment that is purchased by the CONTRACTOR or its subcontractors and the expense reimbursed by the BOARD shall be the property of the BOARD for the duration of this CONTRACT.*

The contracts are still active; however, no assets purchased by the contractors (LRGV and High Plains) have been recorded in the State Property Accounting System (SPA). Assets include a $286,000 Flow Meter Calibration and Demonstration facility constructed under the LRGV contract as well as various expensive meters, gauges, probes, etc. for both contracts.

The ownership clause was reviewed by TWDB's Deputy General Counsel, who stated the original intent was not to have TWDB own the assets. Rather, the intent of the "ownership" clause was to provide TWDB with the right to reclaim the assets to finish the project with another contractor if so desired. Nevertheless, the clause required clarification.

As a result, the contract language for the ownership clause was modified, and management took immediate action to amend the contracts (note that the full text of the original and amended clauses can be found in the Exhibit to this audit report). In addition, the Deputy General Counsel recommended the contract templates for research contracts be revised to include the corrected language. Management implemented this recommendation and revised the clauses within the contract templates for research contracts.

Recommended Action Plan 3: None required.

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C. Exhibit to the Audit Report

Asset Ownership Clause: Original and Revised Text

Section II, Article V, Paragraph 4 of the Demonstration Initiative contracts originally stated:

Any equipment that is purchased by the CONTRACTOR or its subcontractors and the expense reimbursed by the BOARD shall be the property of the BOARD for the duration of this CONTRACT. The CONTRACTOR or its subcontractors shall be responsible for the regular maintenance and upkeep of the equipment and will be financially responsible for any damages to the equipment caused by negligence or deliberate misuse. Upon acceptance by the EXECUTIVE ADMINISTRATOR of the final report, the equipment ownership is transferred to the CONTRACTOR. If this CONTRACT is terminated before the FINAL REPORT DEADLINE, the equipment must be shipped to the BOARD unless the EXECUTIVE ADMINISTRATOR, in his sole discretion, determines to transfer ownership to the CONTRACTOR.

Section II, Article V, Paragraph 4 is revised as follows:

Equipment: The CONTRACTOR is entitled to purchase equipment with funds made available under this Contract. The CONTRACTOR shall maintain inventory records of such equipment and shall use such equipment only for its intended purpose and in conformance with any warranty or guarantee included with the purchase of the equipment. The CONTRACTOR shall keep and maintain records relating to the necessity for and the use of the equipment to further the purposes of this CONTRACT. CONTRACTOR shall be solely liable for any damage to and loss of such equipment if such damage or loss is due to CONTRACTOR's negligence or deliberate misuse.

If this CONTRACT is terminated for any reason prior to satisfactory performance of CONTRATOR's work or the completion of the Demonstration project, then the BOARD may require the return of purchased equipment to the BOARD or may allow the CONTRATOR to reimburse the BOARD and maintain ownership of the equipment.

If the BOARD accepts the FINAL REPORT under this CONTRACT, then the CONTRACTOR may maintain ownership of the equipment or may dispose of the equipment in any manner authorized by applicable law relating to surplus or salvage property.