



May 23, 2008

Mr. Michael Chrisman, Secretary
Resources Agency
1416 Ninth Street, Room 1311
Sacramento, CA 95814

Dear Mr. Chrisman:

Final Report—Audit of Resources Agency's Bond Funds Propositions 12, 13, 40, & 50

Enclosed is the final audit report of the Resources Agency's (Agency) Propositions 12, 13, 40, and 50 bond funds as of June 30, 2007. The Department of Finance, Office of State Audits and Evaluations, performed this review in accordance with the Department of Finance's bond oversight responsibilities.

Our audit concludes that the Agency awarded bond funds in accordance with applicable legal requirements. However, we noted that procedures for awarding non-competitive projects, as well as overall monitoring of projects, could be improved. The Agency's response is included in the enclosed report.

In accordance with the Department of Finance's policy of increased transparency, this report will be published on our website. We appreciate the Agency's cooperation and assistance during our review. If you have any questions, please contact Diana Antony, Manager, or Evelyn Suess, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: Mr. Patrick Kemp, Assistant Secretary, Resources Agency
Mr. Bryan Cash, Deputy Assistant Secretary, Resources Agency

AN AUDIT OF BOND FUNDS

Resources Agency Propositions 12, 13, 40, and 50



Prepared By:
Office of State Audits and Evaluations
Department of Finance

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EXECUTIVE SUMMARY

In response to Department of Finance's (Finance) bond oversight responsibilities, we have audited the Resources Agency's (Agency) funding under Propositions 12, 13, 40, and 50 as of June 30, 2007. The primary objectives of this audit were to determine whether bond funds were awarded and expended in compliance with applicable legal requirements and established criteria, and to determine if the Agency had adequate project monitoring processes.

The Agency's competitive awarding process uses a detailed application process to measure an applicant's ability to complete a project; however, its non-competitive awarding process lacks key pre-award evaluation elements. Although the Agency conducts pre-award site visits to ensure program eligibility, no additional assessment is made to evaluate an applicant's organizational capacity (prior experience), project readiness (method for estimating costs), or source of additional funds. We recommend the Agency award all bond funds on a competitive basis or at minimum use pre-award evaluations to measure an applicants' ability to complete the project within the grant's budget and prescribed timelines.

While the Agency has established project monitoring procedures, they are not consistently followed, and documentation of monitoring activities is incomplete. As a result, the project's performance progress and fiscal status is incomplete, acquisition documents are untimely recorded, and grant budget modifications are not completed properly. In addition, the Agency's interagency agreements lack clearly written scopes of work and progress reporting requirements. We recommend the Agency follow its established monitoring policies and develop project monitoring tools to ensure consistent and adequate documentation. If interagency agreements are used for bond projects, clearly write the project's scopes of work and progress reporting requirements.

With added controls and documentation, the Agency can proactively identify fiscal status and project performance issues, and take action on potential problems. Management can also anticipate the need for grant and contract amendments or a need to increase site visits for at-risk projects.

BACKGROUND, SCOPE AND METHODOLOGY

BACKGROUND

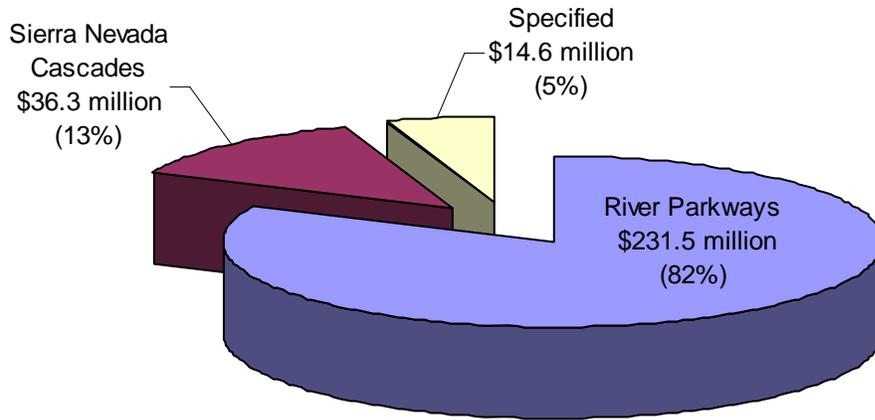
Between March 2000 and November 2002, California voters passed four bond measures totaling \$10.1 billion. The Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000 (Proposition 12) and the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act (Proposition 13) were passed on the March 2000 ballot. The California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002 (Proposition 40), and the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 (Proposition 50) were passed on the March and November 2002 ballots, respectively. These propositions authorized the sale of bonds to finance a variety of resource programs. Administered by a number of state departments, agencies, boards, and conservancies, the proceeds from these bonds support a broad range of programs that protect, preserve, and improve California's water and air quality, open space, public parks, wildlife habitats, and historical and cultural resources. Bond proceeds are expended directly by the administering departments on various capital outlay projects, and are also disbursed to federal, state, local, and non-profit entities in the form of grants, contracts, and loans.

Resources Agency

The Resources Agency (Agency) is an integral part of the Governor's cabinet. Its mission is to restore, protect and manage the state's natural, historical and cultural resources for current and future generations using creative approaches and solutions based on science, collaboration and respect for all the communities and interests involved. The Agency oversees a wide variety of departments, boards, and commissions, and has also been assigned overall lead responsibilities for the state's Proposition 12, 40, and 50 programs. Although each department is responsible for managing its individual bond programs, the Agency directly manages several of its own bond programs.

As of June 30, 2007, the Agency was allocated \$287 million in bond funds with over \$101 million expended. Bond funds have been distributed primarily between two programs: the River Parkways program and the Sierra-Nevada Cascade program. In addition, under Proposition 12, various projects were named in the bond act (known as specified projects). Figure 1 shows the Agency's bond funds by program. Although not included in Figure 1, the Agency's River Parkways program was also allocated \$72 million from the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act (Proposition 84), which was passed in November 2006. This audit does not include a review of Proposition 84 funds as no expenditures were made as of June 30, 2007.

Figure 1. Proposition Funds Allocation by Program



Source: Propositions 12, 13, 40 & 50 Bond Acts and Agency's flowchart of bond programs.

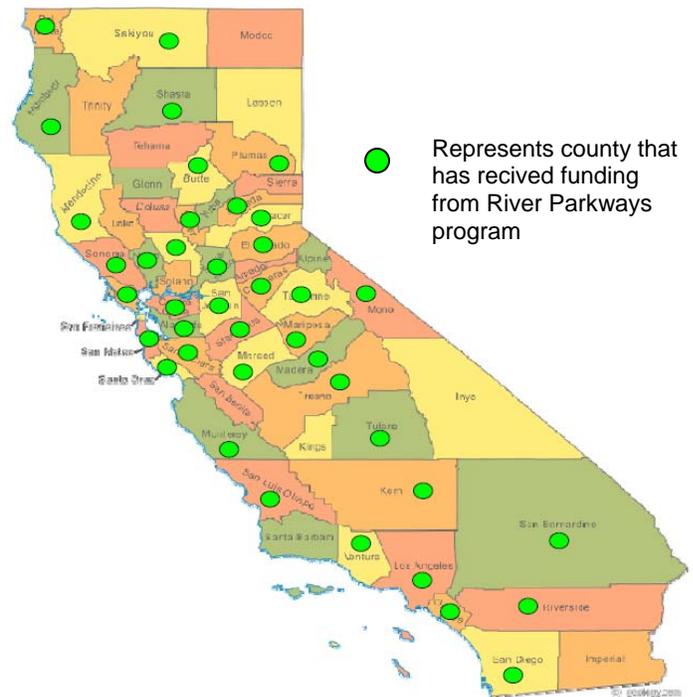
Notes: The River Parkway amount shown includes \$36.5 million in Proposition 13 funds passed through from the Department of Water Resources per Water Code section 79100(a). In addition, the total funding shown does not include \$5 million in Proposition 40 funds that was appropriated to the Agency per Public Resources Code section 5096.650(c)(1); funds were passed-through to the Department of Water Resources for expenditure in the Urban Streams program.

River Parkway Program

The Agency received \$231.5 million from the four propositions to administer projects under the River Parkway program. The funds are intended to increase recreational capacity and to improve and preserve the environment around river parkways, rivers, and streams.

The majority of funding for the River Parkway program is designated to specific geographic areas, such as the Los Angeles and San Gabriel River Watersheds, the San Joaquin River Corridor, and the San Diego River. Exhibit 1 shows the California counties that received funding under the River Parkway program. Although only the Proposition 12 funds were required to be competitively awarded per the bond act, the Agency elected to administer the majority of Proposition 13 projects and all of Proposition 50 projects on a competitive basis. Proposition 40 lacks specific legislation related to awarding; therefore, the Agency grants funds on a non-competitive basis.

Exhibit 1. River Parkway Program Project Distribution



Source: Courtesy of the Resources Agency

SCOPE

The audit was conducted to determine whether bond funds were awarded and expended in compliance with applicable legal requirements and established criteria and to determine if the Agency had adequate project monitoring processes in place.

The audit did not include an assessment of the bond authorization, issuance, and sale processes, or an examination of the efficiency or effectiveness of program operations. Further, no assessment for the reasonableness of the land acquisition costs or the conservation value of the land acquired or projects completed was performed.

METHODOLOGY

To assess whether the Agency awarded and expended bond funds in compliance with applicable legal requirements and established criteria, we reviewed the Agency's goals and objectives, grant management policies and procedures, program guidelines, and project tracking database. We also interviewed executive management and key staff directly responsible for administering bond funds. In addition, we reviewed the project tracking database to assess reliability of the data. Based on our review, we determined the data to be sufficiently reliable for audit purposes. Therefore, using data produced by the project tracking database, we judgmentally selected 29 (17 percent) out of 179 projects awarded as of June 30, 2007 for review.

The 29 projects selected for review represent projects under all three core program areas: the River Parkway program, the Sierra-Nevada Cascade program, and specified projects. Of the 29 projects, 12 (41 percent) were acquisition-related and 17 (59 percent) were development-related projects. The sample projects also represent a variety of recipients including local government, non-for-profit entities, Joint Powers Authorities, and other state agencies.

To determine whether the Agency had adequate project monitoring processes, we reviewed program guidelines in place for each proposition and the Agency's policies and procedures for project monitoring, disbursement of expenditures, and project close-out. Using the sample noted above, we reviewed the project files and interviewed the Agency's management and staff to gain a better understanding of the project monitoring process.

Recommendations were developed based on our review of documentation made available to us and interviews with the Agency's management and key staff directly responsible for administering bond funds. This review was conducted during the period September 2007 through November 2007.

The audit was performed to determine whether the Resources Agency's (Agency) awarded and expended bond funds were consistent with the applicable legal requirements and established criteria, and whether the Agency had adequate project monitoring processes. The following observations were identified:

The Agency Complied With Legal Requirements When Awarding Bond Funds

The Agency's bond funded awards and expenditures complied with applicable legal requirements and established criteria; however, the Agency's non-competitive awarding process could be improved.

The Agency uses a detailed application process for its competitive awards, which includes a pre-award site visit and an evaluation of a project's statutory conditions, statewide resource priorities, access and location, sustainability, and capacity. The Agency also reviews an applicant's:

- Organizational capacity—Does the organization have prior experience in completing this type of project or similar projects? What is planned for long-term maintenance and how will the maintenance efforts be funded?
- Project readiness—What steps will be taken immediately following the award of funds and what is the applicant's method for estimating costs (cost-effectiveness)?
- Other funding sources—What additional monetary and in-kind services (donated labor, volunteer efforts, technical expertise) are already committed to the project?

The assessments are then scored and ranked by a selection committee. The review process helps measure the applicant's ability to complete the project within the established timelines. In fact, several of these pre-award elements have been recognized as "Promising Practices" for grant accountability by the members of the Grant Accountability Project.¹

In contrast, the Agency's non-competitive awards process lacks key pre-award elements. Although site visits are conducted to verify the project's program eligibility, no additional assessment is made to evaluate an applicant's experience, project cost-effectiveness, or source of other funds. For example, the Agency awarded an \$838,000 project for trail development and restoration to a grantee that later experienced financial difficulties. The grantee notified the Agency that a cash flow problem prohibited them from completing the project, but only after requesting two advance payments and incurring \$237,000 (32 percent) in grant expenditures. The project period ended on May 1, 2007 at which time the Agency was seeking alternative proposals to complete the project.

¹ A collection of federal, state, and local audit organizations tasked by the Comptroller General of the United States' Domestic Working Group to offer suggestions for improving grant accountability.

While some projects are specifically identified in the bond act (Proposition 12 specified projects), the Agency also awards opportunity grants (Proposition 40) on a non-competitive basis. At a minimum, the Agency should evaluate an applicant's organizational capacity (prior experience) and project readiness (method for estimating costs). Any identified weaknesses can be addressed early or before a grant is awarded and the assessments can also be used to determine the level of project oversight.

While the Agency stated that it plans to award future bond funds on a competitive basis, as of June 30, 2007, 83 of 179 projects (43 percent) were non-competitively awarded and as of November 2007, \$1.5 million in opportunity grants remained unawarded.

Recommendation: Award bond funds on a competitive basis or at a minimum incorporate pre-award assessment evaluations to measure an applicants' ability to complete the project within the grant's budget and prescribed timelines.

Project Monitoring Is Inconsistently Enforced and Inadequately Documented

The Agency's established project monitoring procedures are not consistently followed and documentation of monitoring activities performed is incomplete. Based on a review of 29 project files, the following areas for improvement were observed:

- Adequately document project progress and fiscal status.
- Timely record Memorandum of Unrecorded Grant Agreements (MOUGA).

Project Progress and Fiscal Status Documentation

The Agency has monitoring procedures in place; however, the progress documentation is inconsistent and at times, incomplete. The grant agreements require grantees to provide progress information on a quarterly basis, including work completed and planned, and project challenges. The Agency also expects the seven project administrators to routinely "check-in" with grantees to obtain progress updates and document the communications. In addition to the required pre-award site visits, the Agency also recommends at least one interim site visit for each development project.

However, of 29 project files reviewed, 16 (55 percent) lacked documentation of either site visits or progress updates. Although grant agreements require grantees to provide reports upon request, the Agency rarely uses this provision to monitor and document project progress. Based on inquiries made during the audit, project administrators were able to demonstrate that site visits had been performed; however, each administrator had to search various e-mails and notes for each project. In addition, the progress information documented varied widely among each project. Complete and consistent status documentation is required for adequate project monitoring. An observation form to standardize how administrators record grantee communications and conduct site visits may be an option the Agency can adopt.

Additionally, grant agreements require formal approval of modifications to grant budgets. Yet, in 3 of 29 projects reviewed, the Agency did not document and/or follow up on budget modifications. In one instance, a grantee was reimbursed \$5,000 and \$138,000 beyond budgeted amounts. Although these amounts did not exceed the total grant amount, they equated to 50 percent and 93 percent, respectively, above the budgeted line items. In another project, the Agency reimbursed the grantee over \$14,300 (20 percent) of the "supervision"

budgeted line item. Without formal approval or documentation of budget modifications, project costs may unintentionally exceed the grant budget.

The Agency also administered projects via interagency agreements with other state agencies. Of the 29 projects reviewed, four were administered via interagency agreements. Based on a review of interagency agreements, similar areas for improvement were noted in its project progress and fiscal status documentation. In addition, we noted that the scopes of work and progress reporting requirements were not clearly written.²

For example, the Agency established a contract for \$1.9 million to construct a 9,000 square foot visitor center located on a historic site. The term of the contract was from July 1, 2002 to June 30, 2007 and stated the scope of work as “those items necessary to design, construct, and make fully operational” with minimal progress and milestone reporting requirements. In March 2007, the Agency was advised that the project was 90 percent complete. However, during a May 2007 site visit, the Agency’s project administrator found that construction was actually only 50 percent complete and would clearly not meet the June 2007 contract term. Although the Agency withheld all payments to the grantee until further progress was made, according to an October 2007 site visit, the project was only nearing completion with construction still in progress.

Internal Auditor magazine’s article, “Building Controls into Capital Construction,” noted that based on a Construction Industry Institute’s survey, about one out of every three projects is over budget or behind schedule.³ In the same article, the *Internal Auditor* concluded that “...project controls are necessary to ensure that the underlying cost and schedule data are sufficient and reliable; the on-site construction status is observed and documented; and the architects, engineers, and contractors address technical issues.” The article recommended this type of oversight even if a project management firm was retained to oversee or monitor the construction project.

In general, the Agency’s practice includes site visits, e-mail, or telephone contacts for monitoring; however, information obtained via phone or e-mail may not suffice and more frequent site visits may be required, especially for construction/development type projects. The lack of clear scope of work and progress reporting requirements can also inhibit the Agency’s monitoring effectiveness.

Recording of MOUGAs

The Agency administers land acquisitions ranging from public recreation projects to conservation projects to enhance and protect riparian habitat along the rivers. The grant contracts require MOUGA’s to be filed concurrently with escrow closing, which records a notice restricting its use (i.e. as security for any debt) and requires Agency approval prior to the sale or transfer of the property. However, in 14 acquisitions projects sampled, 3 projects (21 percent) had MOUGA’s that were recorded between 12 to 14 months following escrow closing. The significant delay in recording of the MOUGA increases the risk of improper property use.

² As of June 30, 2007, the Agency had \$17.4 million in existing interagency agreements, of which \$6.6 million (38 percent) remained unexpended. According to the Agency, it does not intend to enter into additional interagency agreements using remaining bond funds or with future bond funding such as Proposition 84.

³ *Internal Auditor*, June 2002, “Building Controls into Capitol Construction: Construction Projects Offer Fertile Ground for Internal Auditors to Provide Increased Service While Meeting the New Professional Requirements of Risk Mitigation and Control Assurance”.

With added controls and documentation, the Agency can proactively identify fiscal and project performance issues and take action on potential problems. Management can also anticipate the need for grant budget amendments or a need to increase site visits for at-risk projects.

Recommendation: Follow established monitoring policies and develop project monitoring tools to ensure consistent and adequate documentation. If interagency agreements are used for bond projects, clearly write the project's scopes of work and progress reporting requirements.

This audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS), issued by the Comptroller General of the United States.

In connection with this audit, there are certain disclosures required by GAGAS. Finance is not independent of the Agency. Both the Agency and Finance are part of the Executive Branch, which GAGAS considers an impairment to independence. Also, as required by various statutes within the California Government Code, Finance's other units are mandated to perform certain management and accounting functions. These activities impair independence. Although Finance is statutorily obligated to perform these activities, there are sufficient safeguards and divisions of responsibility in existence to enable the users to rely on the audit work performed and reported.

STAFF:

Diana Antony, CPA
Manager

Evelyn Suess
Supervisor

Kelly Wyatt
Alex Cheng
Lorena Romero
Mary Halterman



resources

AGENCY

April 23, 2008

Mr. David Botelho, Chief
Office of State Audits and Evaluations
Department of Finance
300 Capitol Mall, Suite 801
Sacramento, CA 95814

Dear Mr. Botelho:

Thank you for the opportunity to respond to the draft report pertaining to the Resources Agency's management of bond funds for Propositions 12, 13, 40, and 50.

Two observations are presented in the Audit Report: 1) a recommendation to strengthen pre-award criteria for *non-competitive* grant awards, and 2) to more consistently monitor and document projects in progress. To address these concerns, we hope the following information will better clarify our practices and demonstrate our commitment to proper management of the bond funds for which we are responsible.

Strengthening pre-award criteria for non-competitive grant awards.

As accurately stated in your report, the Resources Agency plans to award future bond funds on a competitive basis, using the processes in place that have been recognized as "Promising Practices" for grant accountability. Should this policy change, we will assess existing processes and implement changes as may be necessary to improve our pre-award criteria so that it can better measure an applicant's potential for managing a successful project.

Improving consistency in project monitoring and documentation.

Resources Agency management and staff regularly review our practices, making improvements and adjustments as necessary. Concerning some of your specific observations, please consider the following:

"... progress documentation is inconsistent and at times, incomplete."

Grant administrators monitor individual projects in a variety of ways – via phone conversations, email and written communications, and site visits. These communications are then summarized in a shared database. Project information is generally updated quarterly, with back-up communications kept separately. It should be noted that often the grant administrators are in contact with grantees on a much more frequent basis. Agency will consider additional documentation such as an "observation form" if it is deemed non duplicate to existing tracking methods. The Agency will also continue its standard practice of withholding payments to grantees until progress on projects is clearly demonstrated.

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1416 Ninth Street, Suite 1311, Sacramento, CA 95814 Ph. 916.653.5656 Fax 916.653.8102 <http://resources.ca.gov>

"...the Agency did not document and/or follow up on budget modifications."

Grant administrators regularly communicate with grantees to ensure projects are on schedule and within budget. Since project costs are reimbursed, grant administrators are able to monitor budgets in their review and approval of submitted invoices. In addition, grant administrators will now document all line-item budget modifications.

"...the scopes of work and progress reporting requirements [for interagency agency agreements] were not clearly written."

Standard Grant Agreements, which clearly identify the scope of work and project requirements, are used for all grantees, including state agencies. Interagency agreements are no longer used for projects.

"The significant delay in recording of the MOUGA increases the risk of improper property use."

No improper property use occurred. A system of checks and balances are in place to ensure proper project management. For acquisitions, in the event that a Memorandum of Unrecorded Grant Agreement (MOUGA) is not filed by close of escrow, the Agency will continue its standard practice of withholding funds to the grantee until the required MOUGA is recorded.

Additionally, we respectfully request that the word "generally" be stricken from the heading, "The Agency Generally Complied with Legal Requirements...", on page 6, of the audit report. The word weakens the main point that the Agency is in compliance with applicable legal requirements and established criteria, with no finding to the contrary.

We very much appreciate the work of your auditors and consider the audit review as an opportunity to reevaluate our practices, refine our processes, and continue to improve the overall effectiveness of our bond management responsibilities.

Should you have questions or require additional information, please contact Bryan Cash, Deputy Assistant Secretary, at (916) 653-6381.

Sincerely,

Original signed by:

Mike Chrisman
Secretary for Resources

EVALUATION OF RESPONSE

The Resources Agency's (Agency) response to the draft audit report has been reviewed and incorporated into the final report. We acknowledge the Agency's willingness to address the observations made and commend its commitment to effectively manage its bond funds.

The following evaluation is based on our review of the Agency's response for the section entitled *Project Monitoring Is Inconsistently Enforced and Inadequately Documented*:

"...progress documentation is inconsistent and at times, incomplete."

The Agency states that grant administrators summarize communications with grantees regarding progress monitoring in a shared database and other back-up communications are kept separately. However, during our review, we noted that grant administrators did not adequately and consistently document their efforts. For example, grant administrators do not provide details of what occurred during the site visits such as, what items were reviewed, the progress of the project, and if the project was on schedule. Thus, we continue to recommend that the Agency standardize how grant administrators document progress monitoring.

"...the scopes of work and progress reporting requirements [for interagency agreements] were not clearly written."

Although the Agency states that interagency agreements are no longer used for projects, we noted that as of June 30, 2007, \$6.6 million (out of \$17.4 million) in interagency agreement projects remained unexpended. Therefore, because the scope of work was not specific and progress monitoring was not expressly required in the agreements, we recommend that the Agency practice adequate monitoring, as well as consistent and adequate documentation of their efforts.

"The significant delay in recording of the MOUGA increases the risk of improper property use."

We agree that based on our review of sample projects, no improper property use occurred because of the untimely recording of Memorandum of Unrecorded Grant Agreements (MOUGA). However, we noted that for 3 out of the 14 projects' recording of MOUGA's were significantly delayed (between 12 to 14 months following escrow); consequently, increasing the potential risk for improper property use. We suggest that the Agency apply appropriate land acquisition procedures to effectively minimize the risk.

Lastly, as requested and based on our re-evaluation, we have deleted the word "generally" from the original heading "*The Agency Generally Complied with Legal Requirements When Awarding Bond Funds*" on page 6. We agree that the Agency did comply with legal requirements, but maintain that the Agency's non-competitive award process could be improved.