



October 24, 2008

Ms. Dorothy R. Rice, Executive Director
State Water Resources Control Board
P.O. Box 100
Sacramento, CA 95812

Dear Ms. Rice:

**Final Report—Audit of State Water Resources Control Board's Bond Funds,
Proposition 13, 40, and 50**

The Department of Finance, Office of State Audits and Evaluations, has completed its audit of Proposition 13, 40, and 50 bond funds for the State Water Resources Control Board (State Board) as of June 30, 2007.

Our draft report was issued on September 25, 2008. The State Board agreed with the audit finding and its response has been incorporated into this report. In accordance with Finance's policy of increased transparency, this report will be placed on our website.

We appreciate the State Board's cooperation and assistance during the audit. If you have any questions, please contact Diana Antony, Manager, or Jennifer Arbis, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

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

Enclosure

cc: Mr. Tom Howard, Chief Deputy Director, State Water Resources Control Board
Mr. Esteban Almanza, Deputy Director, Division of Administrative Services, State Water Resources Control Board
Ms. Barbara Evoy, Division of Financial Assistance Deputy Director, State Water Resources Control Board
Mr. Patrick Kemp, Assistant Secretary, Administration and Finance, Resources Agency
Mr. Bryan Cash, Deputy Assistant Secretary, Resources Agency
Ms. Julie Alvis, Deputy Assistant Secretary, Resources Agency

AN AUDIT OF BOND FUNDS

State Water Resources Control Board Propositions 13, 40, and 50



Source: Courtesy of the State Water Resources Control Board

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

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The final report is available on our website <http://www.dof.ca.gov>

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TABLE OF CONTENTS

Executive Summary	1
Background, Scope, and Methodology	2
Audit Results	6
Appendix A—Bond Funded Programs and Allocation	8
Appendix B—Sample Selection	9
Response.....	10

EXECUTIVE SUMMARY

In response to Department of Finance's bond oversight responsibilities, we have audited the State Water Resources Control Board's (State Board) funding under Propositions 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 State Board had adequate project monitoring processes.

The State Board awarded and expended funds in compliance with applicable legal requirements and established criteria and adequately tracked projects' status. However, the State Board could improve project fiscal monitoring to ensure grantees are reimbursed for allowable and eligible costs only. Although the State Board has adequate project cost monitoring procedures, the procedures are not consistently followed. Project files lacked sufficient supporting documentation to determine if claimed costs were eligible, or in instances where documentation was available, there was no indication of proper review. The State Board is accountable for the fiscal compliance of bond-funded projects; however, without an adequate evaluation of project spending, the State Board cannot ensure that project costs are eligible in accordance with applicable legal requirements and established criteria.

As an administrator of bond funds, the State Board should strengthen fiscal monitoring efforts by adhering to established fiscal monitoring procedures. Further, the State Board should provide the grant management certification training on a more frequent basis to those involved in the administration of grants.

BACKGROUND, SCOPE AND METHODOLOGY

Background

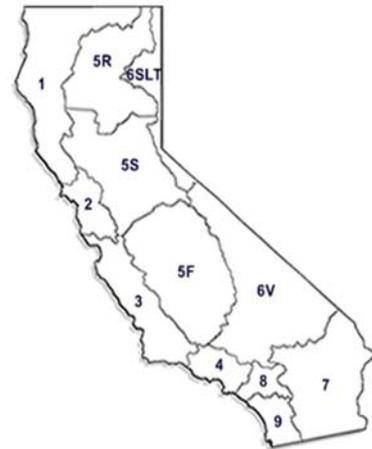
Between March 2000 and November 2002, California voters passed four bond measures totaling \$10.1 billion. The Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000 (Proposition 12) and the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection 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.

State Water Resources Control Board

The State Water Resources Control Board (State Board) and the nine Regional Water Quality Control Boards (Regional Boards) are responsible for preserving, enhancing and restoring the quality of California's water resources and ensuring proper allocation and effective use. More specifically, the State Board allocates water rights, adjudicates water right disputes, develops statewide water protection plans, establishes water quality standards, and guides the nine Regional Water Quality Control Boards. The Regional Boards are semi-autonomous and serve as the front line for state and federal water pollution control efforts. Exhibit 1 depicts the Regional Board boundaries which are based on watersheds to address the different needs of each region. The Regional Boards develop "basin plans" for their hydrologic areas, issue waste discharge requirements, take enforcement action against violators, and monitor water quality.

The State Board received a total of \$1.397 billion in Propositions 13, 40, and 50 bond funds to support 26 water quality programs. See appendix A for a list of programs that were allocated bond funds. Two divisions within the State Board administer the 26 programs—Division of Financial Assistance (DFA) and Division of Water Quality (DWQ). See Exhibit 2 for bond fund allocation by division. In addition, the Regional Boards also share program responsibilities over bond projects located within their boundaries.

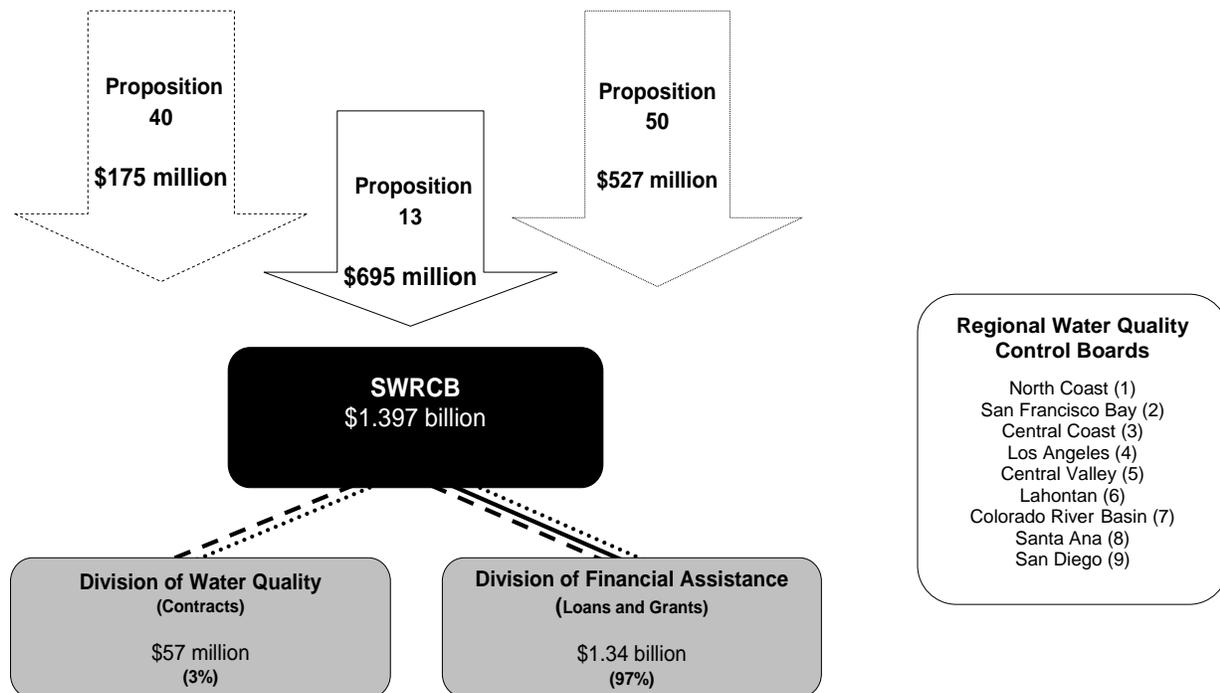
Exhibit 1. Regional Water Quality Control Board Map



Source: Courtesy of the State Water Resources Control

As of June 30, 2007, a total of 931 projects have been awarded and over \$679.3 million (49 percent of total allocation) was expended. In November 2006, voters approved an additional bond measure, the Safe Drinking Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006 (Proposition 84). This will provide the State Board with an additional \$275 million in bond funds; however, as of June 30, 2007, no Proposition 84 funds had been expended.

Exhibit 2. Proposition Funds Allocated by Division



Source: State Water Resources Control Board financial reports for fiscal years 2000-01 to 2006-07.

The Division of Financial Assistance

The Division of Financial Assistance (DFA) administers the implementation of the State Board's financial assistance programs. This includes loan and grant funding for projects, such as construction of municipal sewage and water recycling facilities, remediation for underground storage tank releases, watershed protection projects, and nonpoint source pollution control projects.

The DFA oversees 25 of the 26 bond funded programs, which constitutes 97 percent of total bond fund allocation. Although management over bond-funded projects is decentralized throughout the State Board, overall program governance resides with the DFA. The DFA has been proactive in implementing statewide monitoring guidelines and processes to promote consistency among the 25 bond-funded programs and 9 regions. The basic processes include project guideline development, project selection, and project close-out. For example, the State Board's website is used to advertise guidelines workshops and announce program funding availability. Further, the State Board uses an online application process, the Financial Assistance Application Submittal Tool (FAAST), where proponents apply for grant funding. The applications are scored and reviewed by State Board staff and stakeholders. The applications are then accepted for grant funding by selection committees consisting of engineers, technicians, geologists, and stakeholders. The FAAST application process is used by every loan and grant program administered by the DFA. Lastly, a detailed Grant Manager Training Manual is used in an effort to increase grant management consistency for all bond funded projects. The Board also tracks project status using the Grants or Contracts Administration Tracking System, a Microsoft Office Access database. In an effort to facilitate administration of bond projects and to increase transparency, the State Board plans to use an enterprise resource planning system, Loans and Grants Tracking System, which is a more sophisticated project tracking database. However, the Board does not have a set date for implementation.

The Division of Water Quality

The Division of Water Quality (Water Quality) administers 1 of the 26 bond-funded programs, the Groundwater Ambient Monitoring Assessment Program (groundwater program). The main objectives of the groundwater program are to improve statewide ambient groundwater quality monitoring and assessment and to increase the availability of information about groundwater quality to the public. Water Quality coordinates with the DFA to provide fiscal status of groundwater projects committed with bond funds.

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 Department had adequate project monitoring processes in place. Bond expenditures were audited for the period ending June 30, 2007.

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.

METHODOLOGY

To gain an understanding of key legal provisions and established criteria, we reviewed the applicable bond acts, the State Board's goals and objectives, grant management policies and procedures, and program guidelines, including legal provisions and regulations. We also interviewed executive management and key staff directly responsible for administering bond funds to determine how the established policies and procedures were implemented under the various programs. To assess whether the State Board awarded bond funds in accordance with the identified legal requirements and established criteria, we tested a sample of projects to ensure the laws and criteria were followed when the awards and expenditures were made.

The project samples were selected from the State Boards project tracking database. The State Board's project tracking process was reviewed to assess the reliability of the data. Based on our review, we determined the bond project data to be sufficiently reliable for audit purposes. We judgmentally selected 21 out of 931 projects awarded as of June 30, 2007 (see Appendix B). The 21 projects selected for review constitute 20 percent of total cumulative expenditures funded from propositions 13, 40, and 50. The projects are administered by the DFA, Water Quality, and/or the regional boards and represent projects from five of the six funding program categories (Agricultural, Groundwater Improvement & Protection, Nonpoint Source Pollution Control, Wastewater Construction, Water Recycling, and Watershed Protection). Lastly, the projects included a variety of recipients such as local and federal government, municipalities, public agencies, and nonprofit organizations.

To determine whether the State Board had adequate project monitoring processes, we reviewed and gained an understanding of the established guidelines and training developed by the DFA for overall project management and monitoring, reimbursement of expenditures, and project close-out. We also interviewed State Board management and staff to determine how the guidelines and monitoring processes were implemented. Using the sample noted above, we tested the projects to determine if they were being adequately monitored to ensure the projects stayed within scope and cost.

Recommendations were developed based on our review of documentation made available and interviews with the State Board's management and key staff directly responsible for administering bond funds. This review was conducted during the period December 2007 through April 2008.

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. The Department of Finance is not independent of the State Board, as both are part of the State of California's Executive Branch. As required by various statutes within the California Government Code, the Department of Finance performs certain management and accounting functions. These activities impair independence. However, sufficient safeguards exist for readers of this report to rely on the information contained herein.

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

The State Board Does Not Always Fiscally Monitor Bond Funded Projects to Ensure Eligibility of Project Costs

The State Board has procedures to monitor the progress of bond funded projects; however, fiscal monitoring is not consistently followed to ensure grantees are only reimbursed for allowable and eligible costs. While the State Board has taken initiative in monitoring the progress of projects (i.e. performing site visits and reviewing quarterly progress reports and work products) fiscal monitoring of claimed project costs needs improvement. The State Board uses a grant training manual and provides a grant management training and certification program, which is required once every three years for grant managers. The grant manual's invoice processing section includes a list of items required to substantiate grantee claimed costs and provides a review checklist for grant managers to document their review. However, based on our review of projects files, 16 of 21 projects (71 percent) lacked sufficient supporting documentation or had no indication that grantee claimed expenditures were reviewed prior to payment.

Without an adequate review of claimed project costs, the State Board cannot ensure project cost eligibility is in accordance with applicable legal requirements and established criteria. Since fiscal year 2000, the Department of Finance (Finance) audited 54 of the State Board's grants. In 9 instances (17 percent), the audits revealed ineligible costs submitted for reimbursement by grantees. In 13 instances (24 percent), the audits revealed a lack of supporting documentation.

During the current audit, similar administrative control issues were identified. For example, although the regional board staff monitored the progress of the Executive Partnership for Environmental Resources Training, Incorporated's (ExPERT) project, including attending events held by the grantee, the audit revealed that ExPERT invoiced the state at a rate that exceeded the hourly rate allowed by the contract. As a result, the State Board approved claimed personnel services expenditures that were ineligible. A review and comparison of the claimed costs and State Board allowable rates would have revealed the ineligible costs prior to payment.

Another example of the State Board's lack of review involved Proposition 13 and 40 bond funds from the Clean Beaches Initiative (CBI) program. For Proposition 13 grants, no requirement existed for grantees to submit supporting documentation to substantiate claimed costs. However, the CBI program demonstrated progress in project file management when additional funding was received from Proposition 40, which required the grantees to submit documents in support of claimed costs. However, according to interviews with State Board staff and based on

our observations, no review of cost eligibility was performed. Thus, CBI continues to reimburse grantees without determining the eligibility of expenditures. The State Board should ensure that established guidelines are followed, such as the use of checklists to ensure that adequate reviews of expenditures are performed prior to payment of the claimed project costs.

The Southern California Integrated Watershed Program that received \$235 million in Proposition 13 bond funds also has no requirement for grantees to submit documents to substantiate claimed costs. According to the State Board, staff performs periodic site visits to the grantee's office to review supporting fiscal documents. However, the State Board could not demonstrate that site visits were performed as there was no evidence in the project files that would indicate such review. Utilizing the grant training manual template for site visit documentation would ensure adequate evidence of the State Board's efforts in fiscal monitoring.

Conversely, the Central Coast Regional Board, for example, has been proactive in fiscal monitoring. Specifically, a grant analyst reviews all project costs for eligibility, proper documentation, and consistency with the grants budget prior to submitting the invoice to the grant manager for approval. If there is a lack of supporting documentation or the invoice includes ineligible project costs, the invoice is returned to the grantee for correction. The State Board may want to consider a similar approach in other program or regional areas.

The State Board's management should enforce fiscal project monitoring to determine project cost eligibility and to ensure that project costs do not exceed the grant or contract amount. Site visits to all bond recipients may not be feasible given the number of projects; however, the State Board can implement a risk-based approach to identify and prioritize potential at-risk bond recipients and to determine the necessity or frequency of documented site visits to review supporting documentation for claimed project expenditures.

On January 24, 2007, the Governor signed an executive order to increase accountability and transparency and to ensure bond funded projects stay within scope and cost. With over \$717.6 million (51 percent of total allocation) left to be expended, and \$275 million in Proposition 84 water quality bond funds to be received, the State Board should strengthen its fiscal monitoring of its water quality projects.

Recommendations:

- Enforce fiscal monitoring procedures to ensure proper use of bonds funds, including reviewing supporting documentation to ensure that project costs do not exceed the grant or contract amount and completing the invoice review checklist. The State Board should also consider a risk-based approach to identify and prioritize potential at-risk grantees, and determine the necessity or frequency of documented site visits to review fiscal records of bond funded activities.
- Provide grant management training on a more frequent basis to aid in enforcement of the policies and procedures.

APPENDIX A

BOND FUNDED PROGRAMS and ALLOCATION

BOND-FUNDED PROGRAMS	STATE BOARD ALLOCATION (in millions)				
	Proposition 13	Proposition 40	Proposition 50	Proposition 84 ¹	
<i>Division of Financial Assistance (DFA)</i>					
Agricultural Water Quality Grants Program		\$ 12.0	\$ 100.0	\$ 15.0	
Dairy Water Quality Grant Program					
CALFED Drinking Water Quality Program					
Small Community Wastewater Grants	\$ 34.0	15.0			
Areas of Special Biological Significance (ASBS) Grant Program				35.0	
CALFED Watershed			20.0		
California Ocean Data Observing System			80.0		
Clean Beaches Initiative Program	90.0	46.0			37.0
Coastal Nonpoint Source Pollution Control Program					
Ocean Protection					
Integrated Regional Water Management Program			200.0		
Integrated Watershed Management Program		50.0			
Lake Elsinore and San Jacinto Watershed Program	15.0				
Nonpoint Source Pollution Control Program	100.0	20.0			
Pesticide Research and Identification of Source, and Mitigation (PRISM) Grant Program					
Santa Monica Bay Restoration			20.0	18.0	
Seawater Intrusion Control	25.0				
Small Community Groundwater Grants		10.0			
Southern California Integrated Watershed Program (Santa Ana River Watershed)	235.0				
State Revolving Fund Loans	30.5			80.0	
Storm Water Program				90.0	
Urban Storm Water Grant Program		15.0			
Wastewater Construction Grants	35.5				
Water Recycling Construction & Planning Program (loans and grants)	40.0		57.0		
Watershed Protection Program	90.0				
<i>Division of Water Quality (DWQ)</i>					
Groundwater Ambient Monitoring and Assessment (GAMA) Program		7.0	50.0		
Total Allocation Per Proposition	\$ 695.0	\$ 175.0	\$ 527.0	\$ 275.0	

¹ Proposition 84 appropriations commencing fiscal year 2007-08. Source: Proposition 13, 40, 50, and 84 Bond Acts

APPENDIX B

SAMPLE SELECTION

	GRANTEE'S NAME	PROGRAM	GRANT/ CONTRACT #	AWARDED AMOUNT	EXPENDED AMOUNT
1	County of Orange	Clean Beaches Initiative	01-236-550	\$ 500,000	\$ 500,000
2	County of Orange	Clean Beaches Initiative	06-130-550	1,500,000	-
3	City of Malibu	Clean Beaches Initiative	01-219-550	4,000,000	3,491,242
4	City of Calabasas	Clean Beaches Initiative	01-231-550	495,000	391,793
5	City of Santa Monica	Clean Beaches Initiative	03-177-554	1,562,000	1,405,800
6	County of Ventura	Clean Beaches Initiative	01-080-550	705,000	500,211
7	City of Oceanside	Clean Beaches Initiative	06-315-550	5,000,000	-
8	City of Dana Point	Clean Beaches Initiative	02-217-550	4,000,000	3,980,477
9	United States Geological Survey (USGS)	Groundwater Ambient Monitoring and Assessment	03-260-250	4,030,000	3,629,744
10	United States Geological Survey (USGS)	Groundwater Ambient Monitoring and Assessment	03-235-250	6,500,000	5,227,916
11	Santa Ana Watershed Protection Authority	Southern California Integrated Watershed	01-089-250	37,000,000	37,000,000
12	Santa Ana Watershed Protection Authority	Southern California Integrated Watershed	01-093-250	22,350,000	22,350,000
13	Santa Ana Watershed Protection Authority	Southern California Integrated Watershed	01-241-250	48,000,000	48,000,000
14	City of Malibu	Santa Monica Bay Restoration	04-422-554	2,500,000	2,500,000
15	Los Angeles County Flood Control District	Santa Monica Bay Restoration	04-409-554	660,000	594,000
16	City of Los Angeles Department of Public Works	Santa Monica Bay Restoration	04-416-554	2,000,000	-
17	Resource Conservation District (RCD) of Monterey County	Agricultural Water Quality	04-326-553	1,000,000	212,786
18	Central Coast Water Quality Preservation	Agricultural Water Quality	05-105-553	999,133	457,735
19	Executive Partnership for Environmental Resources Training (ExPERT) Inc	Watershed Protection	04-092-554	754,600	207,271
20	East Niles CSD	Small Community Wastewater	SCG620-030	797,170	690,257
21	City of Placerville	Small Community Wastewater	05-197-550	2,000,000	1,798,935
				\$146,352,903	\$132,938,167



Linda S. Adams
Secretary for
Environmental Protection

State Water Resources Control Board

Executive Office

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Arnold Schwarzenegger
Governor

October 7, 2008

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

Dear Mr. Botelho:

DRAFT REPORT – AUDIT OF STATE WATER RESOURCES CONTROL BOARD'S BOND FUNDS, PROPOSITION 13, 40 AND 50

The State Water Resources Control Board (State Water Board) has received and reviewed the September 2008 draft audit report of the Bond funds for Propositions 13, 40 and 50.

The audit team determined that the \$1.4 billion dollars in awarded bond funds is being expended in compliance with applicable legal requirements and established criteria, and projects are adequately tracked. However, the audit team recommends a strengthening of fiscal monitoring efforts at the project level as identified in the State Water Board's Grant Training Manual. In addition, the audit team recommends offering additional grant manager training to reemphasize the required project-level monitoring.

The State Water Board agrees with the audit results. We are in the process of implementing your recommendations.

We appreciate the feedback on our bond programs and will continue to show due diligence in our fiscal controls and monitoring for the 894 projects awarded through Propositions 13, 40 and 50. Please contact Ms. Alice Stebbins at (916) 341-5797, if you have questions.

Sincerely,

Original signed by:

Dorothy Rice
Executive Director