



June 18, 2010

Ms. Belinda Faustinos, Executive Officer
San Gabriel and Lower Los Angeles
Rivers and Mountains Conservancy
Watershed Conservation Authority
100 N. Old San Gabriel Canyon Road
Azusa, CA 91702

Dear Ms. Faustinos:

Final Report—Audit of San Gabriel and Lower Los Angeles Rivers and Mountains Conservancy's Propositions 40 and 50 Bond Funds

The Department of Finance, Office of State Audits and Evaluations, has completed its audit of the San Gabriel and Lower Los Angeles Rivers and Mountains Conservancy's (Conservancy) Propositions 40 and 50 bond funds for the period ending June 30, 2008.

The Conservancy's response to the report findings is incorporated into this final report. We acknowledge receipt of the Conservancy's corrective action plan dated May 28, 2010 and we are currently working with the Conservancy to ensure all audit findings are addressed.

In accordance with Finance's policy of increased transparency, this report will be placed on our website. Additionally, pursuant to Executive Order S-20-09, please post this report in its entirety to the Reporting Government Transparency website at <http://www.reportingtransparency.ca.gov> within five working days of this transmittal.

We appreciate the assistance and cooperation of the Conservancy. If you have any questions regarding this report, 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: On following page

cc: Mr. Frank Colonna, Governing Board Chair, San Gabriel and Lower Los Angeles Rivers
and Mountains Conservancy
Mr. Patrick Kemp, Assistant Secretary for Administration and Finance, California
Natural Resources Agency
Mr. Bryan Cash, Deputy Assistant Secretary, Natural Resources Agency
Ms. Julie Alvis, Deputy Assistant Secretary, Natural Resource Agency

AUDIT OF BOND FUNDS

San Gabriel and Lower Los Angeles Rivers and Mountains Conservancy Propositions 40 and 50



Watershed Conservation Authority, Azusa River Wilderness Park Project
Source: El Encanto Azusa Wilderness Park Master Plan

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

093825063

October 2009

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Final reports are available on our website at <http://www.dof.ca.gov>

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In accordance with the Department of Finance's (Finance) bond oversight responsibilities, we have audited the San Gabriel and Lower Los Angeles Rivers and Mountains Conservancy's (Conservancy) funding under Propositions 40 and 50 as of June 30, 2008. The audit objectives were to determine whether bond funds were awarded and expended in compliance with applicable legal requirements and established criteria, and to determine if the Conservancy had adequate monitoring processes in place. Additionally, we followed-up on prior audit findings included in our November 2006 audit report. We identified a number of control and accountability issues requiring corrective action.

The Conservancy Has Not Exercised Adequate Fiduciary Oversight of Bond Funds

The audit identified a significant number of recurring audit findings from 2006 related to the Conservancy and its joint powers entity, the Watershed Conservation Authority (Authority). We also found instances of questionable practices and expenditures at the Authority. Collectively, these issues demonstrate the Conservancy's inadequate fiduciary oversight of bond funds. The following issues from the 2006 audit remain uncorrected:

- Although formed as separate legal entities, the Conservancy's and the Authority's staff are the same individuals, functioning as both grantor and grantee. This lack of arms-length separation compromises the state's oversight of bond funds.
- Grant funds continue to be advanced before immediate cash need, including 13 advances totaling \$2.4 million to the Authority.
- The Conservancy failed to collect the Authority's unused advance balances and related interest.
- The funding mechanism (bond grants) used by the Conservancy to compensate for the lack of support staff is highly questionable and may be prohibited by the Budget Act, Bond Act, and General Obligation Bond Law. In some cases, the Conservancy inappropriately used existing capital outlay appropriations to subcontract support activities in violation of the Budget Act.
- Grant contracts continue to need improvement—project scopes and budgets are vague. Additionally, the lack of project monitoring resulted in ineligible bond expenditures and incomplete projects.
- The Conservancy's project tracking system used for external reporting purposes is incomplete and inaccurate.

The current audit determined the Authority commingled bond funds with general operating funds, and inappropriately used these funds for ineligible costs; and the Authority has not completed annual financial audits.

The recommendations in this report are intended to assist management in improving operations and accountability for bond funds.

BACKGROUND, SCOPE AND METHODOLOGY

BACKGROUND

Between March 2000 and November 2002, California voters passed the following four bond measures totaling \$10.1 billion:

- Proposition 12—The Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000
- Proposition 13—The Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act
- Proposition 40—The California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002
- Proposition 50—The Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002

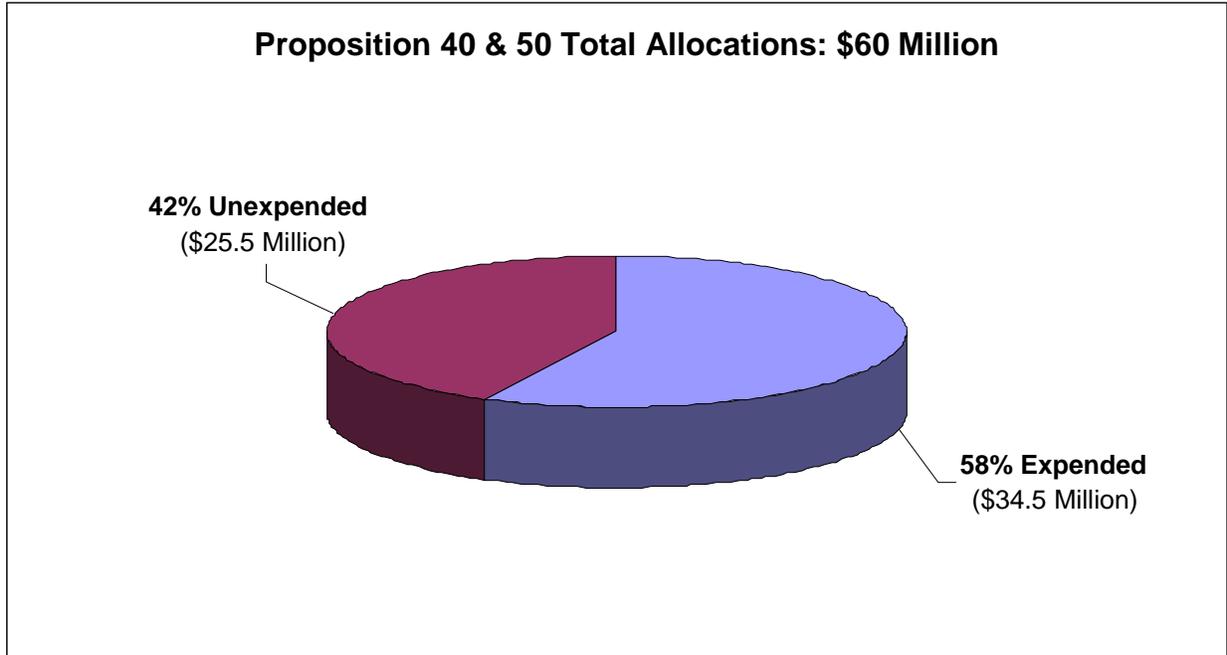
These propositions authorized the sale of bonds to finance a variety of resource programs. Administered by a number of state departments, agencies, boards, and conservancies, the proceeds from these bonds support a broad range of programs that protect, preserve, and improve California's water and air 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 nonprofit entities in the form of grants, contracts, and loans.

San Gabriel and Lower Los Angeles Rivers and Mountains Conservancy

Created in 1999, the Conservancy is a department within the California Natural Resources Agency. The Conservancy's mission is to preserve urban open space and habitats for the enjoyment of present and future generations. The Conservancy undertakes projects that improve watershed within its jurisdiction, provide for low-impact recreation and educational uses, and restore and protect wildlife and habitat. Its territory covers eastern Los Angeles County and western Orange County. This vast and varied area includes mountains, valleys, rivers, coastal plain, and coastline. The Conservancy's Governing Board (Board) includes 13 voting and 7 non-voting members who are appointed or are designated by virtue of the local, state, and federal office they hold.

A significant amount of the Conservancy's funding is from bond funds. As of June 30, 2008, \$34.5 million of Propositions 40 and 50 was expended from the total \$60 million allocated to the Conservancy (refer to Figure 1). Additionally, in November 2006, the Conservancy was allocated an additional \$51 million from the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act (Proposition 84) to carry out the Conservancy's enabling statute and for the protection of the Santa Monica Bay and its watersheds. This present audit does not include a review of Proposition 84 funds. These funds will be included in a subsequent audit.

Figure 1. Proposition 40 and 50 Funds Allocated and Expended as of June 30, 2008



Source: The Conservancy's certified financial statements as of June 30, 2008

The Conservancy administers bond funded projects to local agencies, nonprofit organizations, and joint powers authorities for the acquisition, development, restoration, and protection of land and water resources. The grant funds are applied to three geographic program areas as follows:

1. Urban Lands: All land within the developed, urban core of the Conservancy territory. The primary intent of the urban lands program is to create new accessible urban passive open space and recreational opportunities.
2. River/Tributary Parkways: Land falling within one-quarter mile on either side of the centerline of a river or tributary within the Conservancy territory. The primary intent is to provide for a revitalized accessible river parkway along the main stems of the San Gabriel and Lower Los Angeles Rivers and their tributaries, increase riparian corridors, and enhance recreational opportunities.
3. Mountains, Hills, and Foothills: Land lying within the area of a named system of mountains, hills, and foothills. The primary intent of this program is watershed, habitat, wildlife corridor protection, trails, and public access as appropriate to the site.

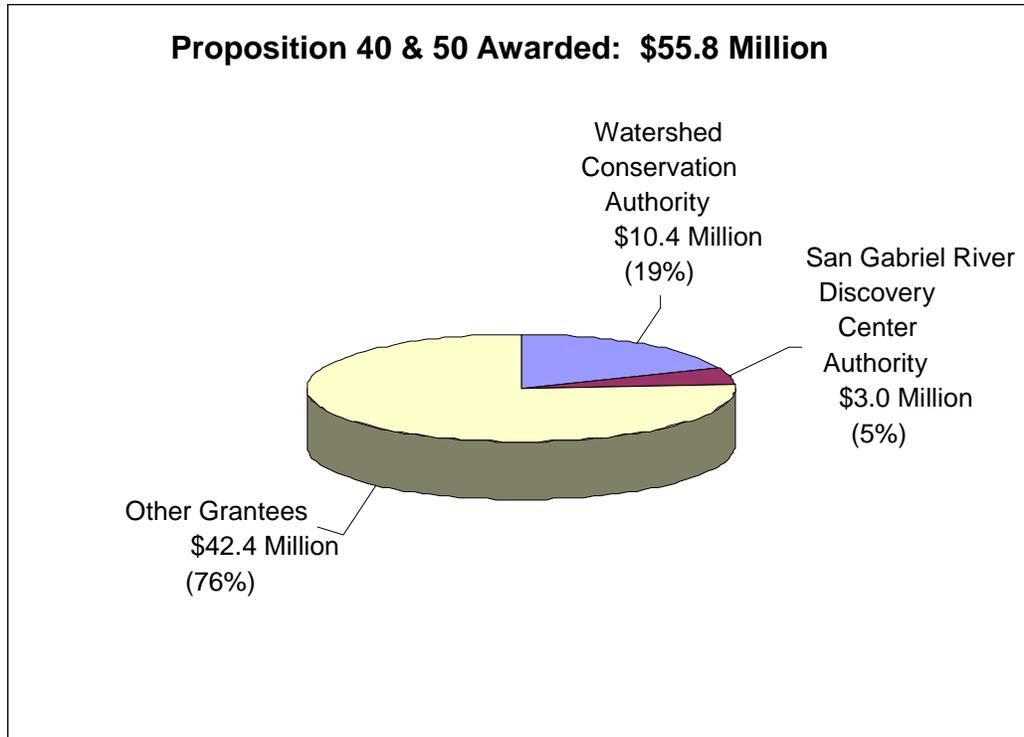
Partnering with Other Public Agencies as Joint Powers Authorities

The Conservancy has entered into three joint powers authorities pursuant to the provisions of Government Code Sections 6500, et seq. (Refer to Appendix A for the three joint powers authorities and their purposes). These provisions allow two or more public agencies, by agreement, to jointly exercise any power common to the partnering agencies. Each of these agreements creates a separate legal entity from its contracting members. Government Code Section 6500, et seq., also allows for the mutual exchange of services, contributions of public

funds, and the loaning of agency personnel by the contracting parties in order to accomplish the purposes as set forth in these agreements. Currently, the Conservancy's staff administers the programs at each of the individual joint powers authorities.

As of June 30, 2008, the Conservancy awarded to its joint powers authorities \$13.4 million (or 24 percent) of the \$55.8 million in total bond funds awarded. Of the \$13.4 million, the Watershed Conservation Authority and San Gabriel River Discovery Center Authority were awarded \$10.4 million and \$3 million, respectively, as illustrated in Figure 2 below.

Figure 2. Grant Awards by Recipient as of June 30, 2008



Source: The Conservancy's Propositions 40 and 50 Grant Program Report as of June 30, 2008

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 Conservancy had adequate project monitoring processes in place.

Due to the magnitude of bond funds disbursed to the Watershed Conservation Authority (Authority), the audit also included a limited review of the Authority's bond projects and related controls.

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 was performed on the reasonableness of the land acquisition costs or the conservation value of acquired land or projects completed.

METHODOLOGY

To determine whether bond funds were awarded and expended in compliance with applicable legal requirements and established criteria, and whether the Conservancy and the Authority had adequate monitoring processes, we performed the following procedures:

- Reviewed applicable bond acts and grant management policies, procedures, and program guidelines, including legal provisions and regulations.
- Interviewed key personnel responsible for administering bond funds to obtain an understanding of how the Conservancy and Authority oversee various project stages: pre-award, award, interim monitoring, closeout, and post-close monitoring.
- Conducted a follow-up on the Department of Finance's prior audit report issued in November 2006.
- Examined a sample of project files to determine if the projects stayed within scope and cost, and site visits were documented.
- Identified and assessed the project tracking methods to determine their adequacy for monitoring projects.
- Reviewed a sample of expenditures to verify accuracy of recorded and reported financial information.
- Reviewed the reasonableness of the Conservancy's administrative expenditures charged to bond funds.

We held multiple discussions with the Conservancy and Authority throughout our audit fieldwork to discuss and provide specific project review details. Recommendations were developed based on review of documentation made available to us and interviews with Conservancy management and key staff directly responsible for administering bond funds. This audit was conducted during the period December 2008 through October 2009.

Except as noted, this audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. In connection with this audit, there are certain disclosures required by *Government Auditing Standards*. The Department of Finance is not independent of the Conservancy, 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 identified a significant number of uncorrected prior audit findings pertaining to the San Gabriel and Lower Los Angeles Rivers and Mountains Conservancy (Conservancy) and the Watershed Conservation Authority (Authority). Our report dated November 9, 2006 identified significant and material deficiencies in fiscal activities that collectively raised questions about the Conservancy’s ability to meet its fiduciary responsibilities over bond funds. The table below summarizes the current status of these deficiencies:

Table A. Uncorrected 2006 Prior Audit Findings

2006 Prior Audit Finding	Corrected	2009 Current Status	Reference
Lack of Operational Independence	No	Conservancy’s and Authority’s roles as grantor and grantee continue to compromise oversight of bond funds.	Finding 1
Grant Funds Advanced Before Immediate Cash Need	No	Issued over 35 separate advances, including 13 to the Authority. Conservancy failed to collect the Authority’s unused advances and related earned interest. The Authority used these funds for ineligible support costs, including lobbying services.	Finding 2 Finding 5
Grants May Not Be Consistent With Bond Acts	No	Grants are awarded to administer the Conservancy’s and Authority’s support programs using capital outlay funds. This process circumvents the state’s budget and contracting process.	Finding 3
Grant Contracting Improvements Needed	No	Contract scopes and budgets are vague. Lack of project monitoring resulted in ineligible bond fund expenditures, as well as projects not completed within scope	Finding 4

Finding 1: The Conservancy’s and Authority’s Roles as Grantor and Grantee Continue to Compromise Oversight of Bond Funds

Although formed as separate legal entities, the lack of operational independence between the Conservancy and Authority continues to compromise bond fiscal oversight. Despite added oversight by internal and external parties, our audit found inadequate management and fiscal controls as noted below.

The day-to-day operations are the responsibility of the Conservancy’s Executive Director and staff; however, the Conservancy’s and the Authority’s staff are the same individuals. As a result, the Executive Director and staff are ultimately responsible for contract performance as both the grantor and grantee. The lack of prior corrective actions and additional fiscal weaknesses found during this audit questions the Conservancy’s commitment to implement appropriate day-to-day fiscal controls.

In addition, as noted in Findings 2 and 5, the Authority (grantee) failed to return unused advances and earned interest and instead used the funds inconsistent with the bond acts. It also failed to conduct the required annual financial audit since its inception in 2003. Under these circumstances, most grantors would strongly reconsider awarding additional funds to a grantee with these audit findings. However, the Conservancy continues to issue significant bond grants to the Authority (over \$10.4 million as of June 2008).

Government Code Section 13402 specifies state agency heads are responsible for the establishment and maintenance of systems of internal accounting and administrative control within their agencies. The elements of a satisfactory system of internal controls include, but are not limited to, a system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures; and an effective system of internal review.

Recommendation:

The Conservancy and the Natural Resources Agency, along with legal counsel, should evaluate the current organizational structure to establish alternative controls to help mitigate fiscal and grant management weaknesses. This may include amending the Joint Powers Agreement to clarify roles and responsibilities, increase management and fiscal oversight, require periodic status reports to the Board, and more active Board oversight.

Finding 2: The Conservancy Continues To Advance Funds without Immediate Cash Need, and Does Not Monitor Advances Consistent with its Internal Policies

Since the 2006 audit, over 35 advances totaling \$9.8 million were issued to various grantees, including 13 advances, or \$2.4 million, to the Authority. Our current audit found the Conservancy continues to:

- Issue advances without immediate cash need. In some cases, advances remained outstanding for over one year before the grantee's first reimbursement request.
- Inadequately monitor advanced funds and issue additional advances when previous advance balances remain unused.
- Allow grantees to keep unused advance balances and earned interest – in some cases for over two years.

For example, under the RMC 3248 grant awarded to the Authority, the Conservancy advanced \$250,000 in October 2003 with a second advance of \$176,000 in April 2007, even though the initial advance remained unspent. In August 2009, 13 months after the project was closed, an unexpended balance of \$83,620 (including \$23,503 in earned interest) remained in the Authority's account. As detailed in Finding 5, the Authority commingled unused bond advances and earned interest in its general operating account and subsequently used the funds for ineligible support costs.

The Conservancy's internal policies require advances only in the case of immediate cash need with few exceptions, such as project completion would be jeopardized without an advance. Additionally, the policy requires outstanding advances be reviewed on a quarterly basis to confirm continued need (not to exceed 90 days), interest earnings be reported quarterly, and upon project completion, all remaining advance funds and accrued interest be deposited in the fund of origin. Based on the findings noted above, the Conservancy is not implementing its established policies.

Lastly, in the 2006 audit, concerns were raised over the effect on federal tax laws applicable to the use of bond funds. Specifically, it was noted the organizations' interdependence could result in a conclusion that the advances made by the Conservancy to the Authority do not constitute an expenditure for purposes of the federal tax law governing the tax exempt status of interest earned on general obligation bonds. In a similar arrangement involving another state conservancy, the State Treasurer's Office (STO) was unable to conclude the funds would be treated as spent for purposes of federal tax law, and cautioned that the interest earned may be subject to Internal Revenue Service rules on arbitrage.

Recommendations:

- A. Do not advance funds prior to verification of grantee's immediate cash need.
- B. To remove any potential questions regarding the tax exempt treatment of grants to the Authority, the Conservancy should refrain from advancing any bond funds to the Authority.
- C. Require all grantees to return unexpended bond advances not required for immediate expenditure, and any interest earned thereon.
- D. Within 30 days from the date of this report, submit a corrective action plan indicating the total advances and earned interest due to and collected by the Conservancy. Maintain supporting documentation for these amounts.

Finding 3: Questionable Administrative Services Grants

Similar to the 2006 audit finding, the Conservancy continues to subcontract its project administration via grants to the Mountains Recreation and Conservation Authority (MRCA)¹. Since the 2006 audit, the Conservancy awarded over \$1.3 million of these grants, as shown in Table B below. The grants are not for specific resource conservation projects, acquisitions, or capital expenditures; rather, the project tasks are for program delivery and administrative functions. The grant scopes are broad and include identification of additional or alternate funding sources, addressing and creating correspondence, maintaining project files, contract management, etc. (see Appendix B for example).

Table B. Program/Project Administration Grants

Grant Number	Project Description	Grant Amount
RMC 3590	Project Management	\$ 62,932
RMC 3600	Project Management	79,864
RMC 3601	Project Management	353,538
RMC 3612	Technical Assistance	67,559
RMC 3613	Project Management	761,695
Total		\$1,325,588

For example, during fiscal year 2007-08 grants RMC 3612 and RMC 3613 totaling \$829,254 funded over 13,000 personnel hours which is equivalent to approximately six full-time positions.

¹ The MRCA is a joint powers authority comprised of Santa Monica Mountains Conservancy, Conejo Recreation Park District, and Rancho Simi Recreation and Park District.

The grants awarded to MRCA are questionable because:

- *In effect, the grants subcontract state agency functions in circumvention of the state's oversight and budgetary controls.* The Conservancy did not request additional support appropriations via the state's budget change proposal process. According to the Conservancy², outsourcing project (grant) management functions to a joint powers authority or a private entity would "not be reasonable since the state can not relinquish its responsibility to administer the grants." In some cases, the Conservancy inappropriately used existing capital outlay appropriations to subcontract support activities in violation of the Budget Act. Capital outlay appropriations are only authorized for acquisition of land or other real property, major construction, improvements, equipment, designs, working plans, repairs, and equipment necessary in connection with construction or improvement of projects.
- *The grants also circumvent the state's contracting policies.* As noted, these are non-civil service employees performing support and program management functions for the Conservancy. The State Constitution generally requires contracting to be limited to those services that cannot be performed by civil service employees, except as provided for in Government Code Section 19130. Exceptions include contracting when it achieves cost savings without having a detrimental effect on the civil service system or services are not available within civil service or are of such highly specialized or technical nature unavailable in civil service.
- *The grants do not comply with the intent of the general obligation bond law.* Government Code Section 16727 allows bond funds to be used for a state agency's bond program or grant administrative costs. In this case, the grantee is doing things that the Conservancy would have otherwise had to do itself; however, because the funds are disbursed via capital outlay grants, there is no accountability over actual support and administrative costs charged to bond funds. Many bond acts limit the amount of bond proceeds used towards administrative expenses. Therefore, administrative costs charged to bond proceeds should be reasonable and demonstrable.

In addition, as noted in Finding 4 below, the terms of the grant agreements, including project management, reimbursement reviews, and project close-outs, are not being met. Yet, as noted below, the Conservancy granted an additional \$926,400 to MRCA for the same project management services.

Although outside the scope of this audit, it was noted that the Conservancy has issued a \$926,400 Proposition 84 grant to MRCA for additional positions in fiscal year 2008-09. Per Public Resource Code Section 75070.5 not more than 5 percent of Proposition 84 may be used for program administration. Under the Conservancy's current practice, it is unable to account for total administrative costs charged to bond funds.

We recognize the Conservancy is a small organization with few staff; however, the funding mechanisms (grants) it used to compensate for the lack of staff is highly questionable and may be prohibited by the Budget Act, Bond Act, and General Obligation Bond Law.

² Statement from approved August 16, 2006 budget change proposal for support appropriations.

Recommendations:

- A. Discontinue awarding grants for administrative and management functions. The Natural Resources Agency should, with the assistance of counsel, determine the appropriate disposition (recovery, refund, or other settlement) of all expended bond funds used for these purposes.
- B. Request and obtain approval for support and/or administrative funding from the Department of Finance. Refrain from using capital outlay funding for these purposes.
- C. Separately account for all administrative costs charged to bond funds.

Finding 4: The Conservancy Does Not Adequately Monitor Bond Funded Projects

As referenced in the 2006 audit, the Conservancy continues to lack adequate contracting and monitoring procedures. Based on a review of 17 projects, the following issues were noted:

- *Grant agreements lack a clear project scope, tasks, and budget detail.* Without clearly defined scopes and budgets the Conservancy is unable to adequately monitor project progress and costs.
- *Required quarterly progress reports are not consistently submitted or reviewed.* Of those submitted, most lacked detail including tasks accomplished, milestones achieved, and problems encountered. Further, there was insufficient justification for time and budget amendments and insufficient documentation to support project costs. Without expenditure documentation, the Conservancy cannot ensure reimbursed costs are eligible.
- *Projects are not completed as specified in the grant agreement.* The Conservancy failed to conduct final inspections prior to final payment. For example, the Graham Elementary School Improvement project was closed-out as completed in June 2007; however, based on our May 2009 site visit, the required trees were never planted and the ceramic tiles were never installed, yet the grantee was reimbursed the entire grant amount.
- *Post-close monitoring is not performed and projects are not maintained as required in the grant agreement.* Once a project is closed, the post-monitoring requirement is intended to ensure the project is adequately maintained as specified in the grant agreement. For example, the Maywood Bike Access project required the grantee to provide long-term maintenance of the project; however, during our May 2009 site visit, the interpretive sign was covered with graffiti, planted foliage was overwhelmed with weeds, and the site was littered with trash.
- *The project tracking system is inaccurate and unreliable.* The Conservancy's database lacks accurate and complete information such as number of bond grants awarded, award amount or balance, project type or description, and performance period. A comparison of accounting records with the project database indicated a difference of over \$800,000 in project expenditures.

Recommendations:

- A. Require all grant contracts to include specific and clear project scopes and detailed expenditure budgets outlining the approved project tasks and costs.

- B. Monitor projects to ensure they stay within scope and cost, document monitoring activities, and establish a payment review process to ensure invoices are checked for reasonableness and accuracy.
- C. Develop and implement final site visit documentation for completed projects to ensure all grant components are completed prior to final payment.
- D. Develop, implement, and document post-closure monitoring procedures to ensure projects are maintained as specified in the grant agreement.
- E. At year-end, reconcile project database information to the Conservancy's accounting records to ensure all bond projects are accurately recorded.

Finding 5: The Watershed Conservation Authority Lacks Bond Fiscal Oversight

The following observations were noted during the review of the Authority's bond grants:

- *The Authority has not conducted the required annual fund audits.* Since its inception in 2003, the Authority failed to conduct the annual audit as required by the joint powers agreement and Government Code Section 6505. The Authority recognizes the oversight and is arranging for the audit. Until an independent audit is performed, its financial statements and controls may not be reliable. The Conservancy should consider this risk before awarding Authority grants and document steps taken to mitigate risk.
- *Bond funds are commingled with general operating funds³ and include ineligible costs.* Based on a sample of transactions during fiscal years 2006-07 through 2007-08, this audit questioned \$67,310 of ineligible or non-project specific expenditures charged to bonds (see Table C below). Of this amount, \$47,873 was paid from the general operating account and \$19,437 was charged to specific bond grants. According to the Authority's financial statements, bond funds represent 96 percent⁴ of general operating account revenues.

Table C. Ineligible Bond Costs

Description	Amount Questioned
Lobbying Services	\$55,750
Office Facility Repairs	8,687
Insurance Premium, Mailbox Rental, etc.	2,873
Total	\$67,310

Office repairs, insurance premiums, and mailbox rentals are considered indirect costs. None of these costs were specifically identifiable to grants advanced to the Authority. In

³ Consistent with the Joint Exercise of Powers Agreement, the Los Angeles County Public Works Department (County) performs fiscal accounting for the Authority. The Authority's revenues and expenditures are accounted for in the County's accounting system.

⁴ Based on the Authority's quarterly Statement of Revenues and Disbursements prepared by the County Auditor-Controller.

accordance with Office of Management and Budget (OMB) Circular A-87, such costs should be equitably allocated to all programs through an approved indirect cost allocation plan.

Government Code Section 54964 and OMB Circular A-87 prohibit lobbying costs to be funded from public funds.

The Conservancy's grant provisions require advanced funds be deposited in a separate interest bearing account and interest earned used solely on the state approved project. The Authority agrees it should segregate bond grant funds from its general operating transactions and plans to implement accounting system changes.

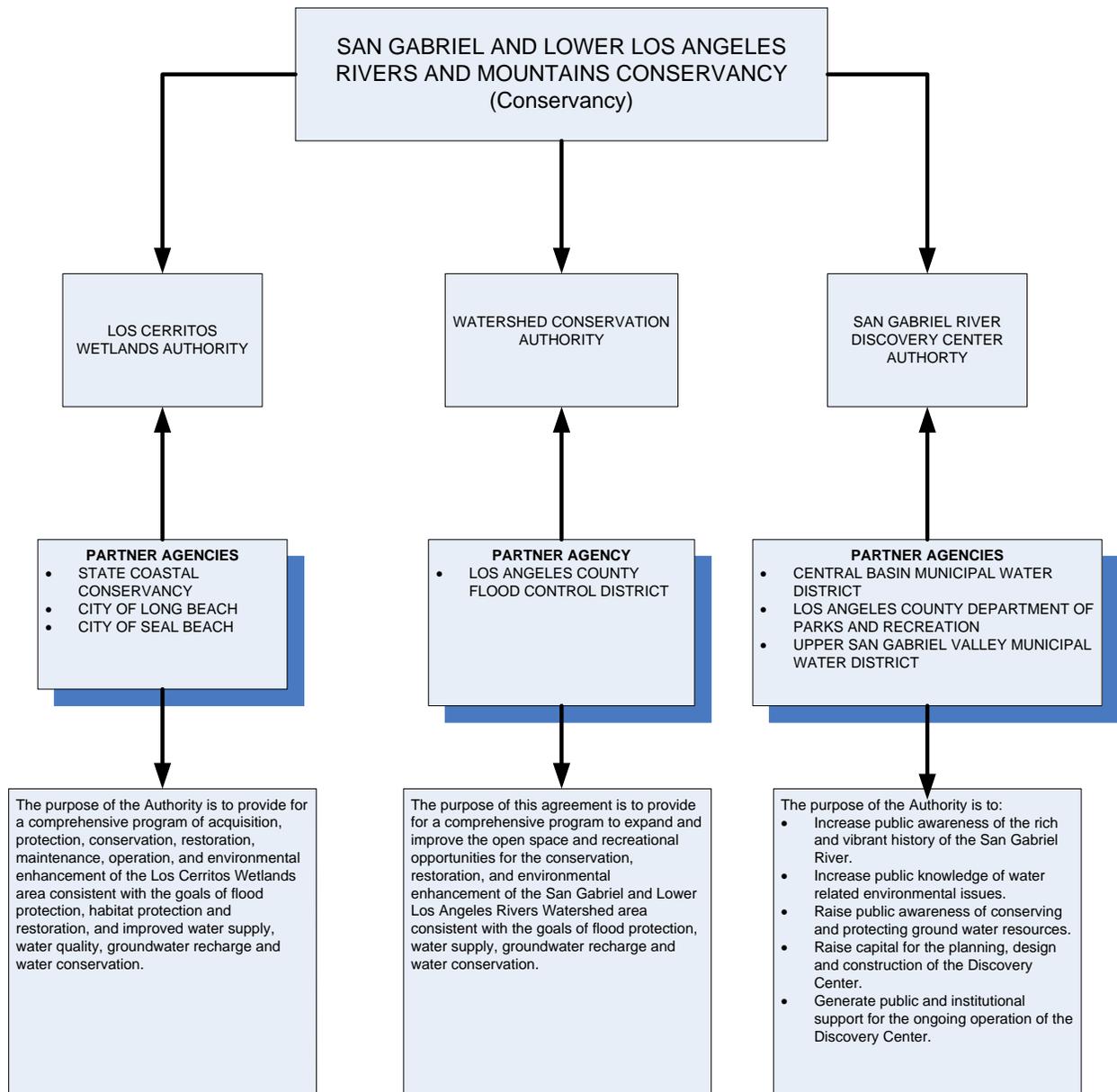
- *The Conservancy does not track contributions made towards the Authority.* The joint powers agreement limits annual contributions⁵ from the Conservancy to \$35,000; however, the Conservancy was unable to account for its total annual contribution to the Authority. The Authority does not employ any of its own staff and relies solely on Conservancy staff, supplies, and equipment for operations. We question how the Conservancy can ensure it does not exceed the prescribed annual contribution limits and how it effectively uses state resources.

Recommendations:

- A. The Authority should ensure an annual audit of its accounts and records is conducted consistent with the requirements of its joint powers agreement and Government Code Section 6505.
- B. The Authority should review all expenditures from the general operating account and verify that only eligible costs were paid with bond funds. Return any ineligible costs to the Conservancy.
- C. The Authority should maintain separate accountability for each grant at a level that permits the tracing of receipts and disbursements.
- D. The Conservancy should track all contributions made towards the Authority, and provide an annual report to its Board verifying compliance with contribution limits.

⁵ Per the Authority's joint powers agreement, contributions are defined as monetary contributions, if any, and the reasonable value of the services of any Conservancy employees loaned to the Authority.

The Conservancy's Joint Powers Authorities



Example Project Management Services Grant

Grantee: Mountains Recreation and Conservation Authority (MRCA)

Grant Amount: \$761,695

Performance Period: July 1, 2007 through June 30, 2008

At the direction of the Conservancy Executive Officer, MRCA will provide Project Management and Technical Assistance for projects on the Conservancy Workprogram [master list of projects]. The scope of work shall include, but is not limited to:

- *Project identification and evaluation*—This task includes work to assist individual stakeholders in the development of a project, with the intent to add it to the Conservancy Workprogram. Types of tasks should include, but are not limited to, reviewing submitted project identification forms, reviewing project applications, applicant meetings, and completing project evaluation forms.
- *Technical support*—This task includes work to assist individual stakeholders to create plans and develop projects with the intent to add it to the Workprogram. Types of tasks should include, but are not limited to acquisition services, landscape architecture, habitat restoration, Geographic Information Systems (GIS), trail development, cultural/historical, and water quality.
- *Identification of additional or alternative funding sources*—This task includes work to identify funding sources, to supplement Proposition 40 State bond funds, for approved and proposed projects on the Conservancy Workprogram. Types of tasks should include, but are not limited to, researching funding leads, evaluating funding sources, and meetings.
- *Project preparation*—This task includes work required to prepare the project file for a Conservancy Board action. Types of tasks include, but are not limited to, completion of the Conservancy Board Staff report and shape file.
- *Project monitoring*—This task includes work required to administer the approved grant. Types of tasks should include, but are not limited to, addressing and creating correspondence, reviewing quarterly reports, attending meetings, and maintaining project files.
- *Reimbursements*—This task includes work required to process reimbursement requests. Types of tasks should include, but are not limited to, reviewing reimbursement requests, reviewing reimbursement back-up material, and working with grantee discrepancies.
- *Contract management*—This task includes work required to prepare and manage the contract and contract revisions. Types of tasks should include, but are not limited to, execution of initial contract, execution of contract revisions, and contract compliance.
- *Closeout*—This task includes work required to closeout the approved grant. Types of tasks should include, but are not limited to, reviewing final reimbursement request, reviewing closeout documentation, and closing out project.

Source: Grant Agreement RMC 3613



San Gabriel & Lower Los Angeles RIVERS AND MOUNTAINS CONSERVANCY

CALIFORNIA RESOURCES AGENCY

Governing Board of the Conservancy

Frank Colonna, Chair
Environmental Public Member

Dan Arrighi, Vice Chair
Central Basin Water Association

Linda Adams
California Environmental Protection
Agency

Denis Bertone
San Gabriel Valley Council of
Governments

Barbara Carrera
San Gabriel Valley Water Association

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Orange County Division of the League of
California Cities

Margaret Clark
San Gabriel Valley Council of
Governments

Gloria Molina
Los Angeles County Board of
Supervisors

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Ruth Coleman
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John Donnelly
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Thomas M. Stetson
San Gabriel River Water Master

Bernie Weingardt
Angeles National Forest
US Forest Service

Gail Farber
Los Angeles County Department of
Public Works

Executive Officer

Belinda Faustinos

May 14, 2010

David Botelho, Chief
Office of State Audits and Evaluations
915 L Street
Sacramento, CA 95814

Dear Mr. Botelho:

RE: Draft Report-Audit of San Gabriel and Lower Los Angeles
Rivers and Mountains Conservancy's (RMC) Proposition 40 and 50
Bond Funds

This letter serves as our written response to the draft report audit
received in our office on April 15, 2010.

Finding 1: The Conservancy's and Authority's roles as Grantor and Grantee Continue to Compromise Oversight of Bond Funds

Following the 2006-07 Audit, the RMC took action to address the
separation of duties issues raised in that audit. With regard to
Board membership the following actions have been or are being
taken:

- 1) The Watershed Conservation Authority (WCA) joint powers
agreement is being amended to reduce the number of board
members representing the RMC to three; thereby
establishing a majority for the members representing the Los
Angeles County Flood Control District.
- 2) The Watershed Conservation Authority joint powers
agreement is being amended to require that all WCA fiscal
matters will be handled by WCA personnel reporting directly
to the Director of the Los Angeles County Flood Control
District.

The WCA has been established as an employer entity as of
February 1, 2010. The WCA now employs a deputy executive
officer, two project managers and a fiscal manager who works
directly on all WCA projects, including those funded by the RMC.
The RMC monitors these grants consistent with the practices and
policies for all grantees.

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This action was reviewed by our deputy attorney general and approved by the RMC Board. Periodic status reports to the RMC and WCA boards will continue to be provided on a regular basis.

The WCA has pressed the Los Angeles County Auditor-Controller to complete the audits in a timely manner. Attached as Exhibit A is the current timeline for completion of all audits for the WCA.

Finding 2: The Conservancy continues to advance funds without immediate cash need and does not monitor advances consistent with its internal policies

RMC has carefully reviewed advances made to grantees over the last three years and has noted several cases where payments were made from grant funds and characterized as advances when they should in fact be reimbursements. These have included grants submitted as advance requests with documentation of actual expenditures (versus projected expenditures), and payments to escrow accounts for acquisition projects. Going forward, RMC is now accurately characterizing these types of payments in keeping with established internal controls.

As to those grants where funds were outstanding for more than 90 days, including RMC 3248, RMC has not and will no longer advance funds to grantees or the WCA before the funds are needed. Action has been taken to ensure that advances will not be granted for more than 30 days. This change in policy has been implemented and will be affirmed by the RMC board on May 24, 2010.

The RMC has taken steps to require more specific documentation of immediate cash need. We are documenting these requests now with specific information about vendors/contractors and payment conditions. RMC now requires all grantees to return unused advance funds and interest earned on the funds unless they are approved by the RMC Board to be applied to purposes consistent with the original intent of the grant. RMC will submit a corrective action plan within 30 days from the date of this report as requested.

Lastly, as to the issues related to the effect on federal tax laws applicable to the use of bond funds, we have been advised by state bond counsel that once the WCA joint powers agreement is amended to have a majority of non-state members this matter will no longer be of concern.

Finding 3: Inappropriate Use of Bond Funds

RMC strongly disagrees with this finding and requests that it be stricken from the audit report.

As stated in the 2006 audit, all grants for project management to the Mountains Recreation and Conservation Authority are for specific resource conservation projects, acquisitions, or other related capital expenditures. Information supporting the fact that MRCA staff had specific projects assigned to each staff member including the name of each project and the hours spent on each was provided to the audit team. The RMC statute (Section PRC

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32604(a) specifically provides that planning is a critical element in the execution of our projects.

Further, making a grant to the MRCA for these services is legitimate and is not a violation of GC 19130, as no state civil service employees are impacted. Further, the Department of Finance specifically states that GC section 16727 allows bond funds to be used for bond program or grant administrative costs, therefore the comment about noncompliance with bond law is irrelevant. Finally, the Attorney General approves all resolutions adopted by the RMC, including all grants and contracts. The RMC is in the process of scheduling a meeting with the Deputy Attorney General and Natural Resources Agency to review this matter. However, it is RMC's position, since both the Deputy Attorney General and Natural Resources Agency were present as members of the RMC Board when all of the questioned grants were approved, that the funds were allocated and expended consistent with all applicable statutes.

RMC will continue to request support and administrative funding as appropriate through the budget process. Administrative funds will continue to be properly tracked in our support account 3825-001-001. RMC contracts with Department of General Services, Contracted Fiscal Services for all accounting functions.

Finding 4: The Conservancy does not adequately monitor bond funded projects

This finding is also repetitive of the findings in our 2006 audit. As with the prior audit the RMC finds the conclusion that the "grant agreements lack a clear project scope, tasks and budget detail" does not accurately reflect the level of detail RMC requires from grantees in developing the scope of work, tasklist and budget as specified in our grant agreement templates. With respect to the quarterly reports, current open grant contracts have much more comprehensive information than reports in the past.

The generalized finding that projects are not completed as specified in the grant agreement is as far reaching as it is unsubstantiated. RMC is developing a consistent format for this element of our project management requirements

Lastly, RMC is currently working with Contracted Fiscal System to insure consistency in our posting of expenditures. We are taking steps to move to a true accounting system to insure that there are no reporting inconsistencies between our internal project tracking system and what is reported through the CalStars system.

Finding 5: The Watershed Conservation Authority Lacks Bond Fiscal Oversight

WCA believes that the fiscal statements and controls of the Los Angeles County Auditor-Controller are acceptable and sound. As shown in Exhibit A, the Auditor Controller has submitted a plan of action for completion of all audits and we will closely track progress for each milestone.

Regarding funds used to by the Los Angeles County Flood Control district for lobbying services, we provided substantial information to the audit team demonstrating that such expenses are permitted with their funds.

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Based on the audit team's recommendation (which was not made in 2006, although these expenses were clearly occurring at that time), we are establishing separate accounts for each grant from the RMC to the WCA with the Auditor-Controller. The other two categories of ineligible grant costs for a total of \$11,560 were posting errors and have been corrected by the Auditor-Controller and posted to the correct fund.

WCA staff is now initiating a process in accordance with Office Management and Budget (OMB) Circular A-87 to ensure that all future indirect costs are allocated through an approved cost allocation plan. As indicated above the new accounts, which were recommended by the field auditors were established and interest is now allocated directly to each grant in their accounting system known as ECaps.

Finally we take exception with the characterization that the *Conservancy does not track contributions made toward the Authority*. All grants and payments made from our support budget are clearly posted in WCA's accounts. The minor amounts for copying and supplies that the RMC contributes to the WCA are in the range of \$5,000-\$7,000 annually, well within our annual \$35,000 contribution limitation.

Thank you for the opportunity to respond to the draft audit report. Please contact me with any additional questions or concerns.

Sincerely,

Original signed by:

Belinda V. Faustinos
Executive Officer

Attachment: Exhibit A – WCA Audit Schedule

cc: Bryan Cash, Deputy Assistant Secretary, Natural Resources Agency
Julie Alvis, Deputy Assistant Secretary, Natural Resources Agency
Patrick Kemp, Assistant Secretary for Administration and Finance, Natural Resources Agency
Terry Fujimoto, Deputy Attorney General

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Exhibit A – WCA Audit Schedule and Milestones

From: Hartnett, John M. [JHARTNETT@auditor.lacounty.gov]
Sent: Wednesday, April 28, 2010 3:21 PM
To: Belinda Faustinos
Cc: Rosario, Rachelene R.; Anema, Rachelle
Subject: FW: Expected Delay for WO 7-75A?

Belinda,

I have spoken with our Administrative Services Division and below is the proposed timeline for the financial audit of the Watershed Conservation Authority. The beginning and final-deliverable dates are in a wide range to allow give the prospective audit firms some flexibility and possibly result in a better price for the JPA. This raises the question of how you plan to pay for the audit. If you have any questions or concerns, feel free to contact me.

05/03 Draft Audit Work Order Request for FY2003-04 through FY2009-10 (plus two one-year optional renewals)
05/17 Issue Work Order Request to Master Agreement Firms
05/25 Written Questions Due
06/02 Proposers' Conference
06/25 Proposals Due
07/15 Evaluation Committee meeting
07/23 Evaluation Committee Selection
08/15---09/15 Beginning Date
12/31 Final Deliverable Due Date

John

John M. Hartnett CPA, Principal Accountant
Auditor-Controller, Accounting Division
500 West Temple Street Room 603
Los Angeles, CA 90012
(213) 974-8327
jhartnett@auditor.lacounty.gov

We have reviewed the Conservancy's response and provide the following comments:

Finding 1

The Authority's planned procedural and organizational changes appear to enhance both organizations' independence. However, inherent risks continue to exist because both entities' daily operations are directed by the same person; the Conservancy's Executive Director is also the Authority's Executive Officer. Report findings 2 and 5 reflect the lack of controls or the failure to implement established controls. Therefore, we recommend the Conservancy's Board address proper segregation of duties and clearly define roles of the Conservancy's Executive Director from that of the Authority's Executive Officer. Based on the Authority's response, the Authority's Board should also clearly define the roles and responsibilities of its Executive Officer and Deputy Executive Officer.

Finding 2

We acknowledge the Conservancy's efforts to ensure accuracy of its reported advances and revise its internal policies. The Conservancy Board had previously established advance policies; however, as noted in the report, the Conservancy did not implement those policies. Specifically, based on a sample reviewed, advances remained outstanding for over a year. The Conservancy did not adequately monitor the advances and issued additional advances when previously issued advances were unused. In addition, the Conservancy allowed grantees to keep unused advance balances and interest earned—in some cases, for over two years.

Lastly, Finance is currently seeking the State Treasurer Office's advice to determine if there are any potential federal tax implications caused by the Conservancy's practice of advancing bond funds to the Authority.

Finding 3

The grants were questioned because the scope of work included both project planning and administrative tasks as outlined in Appendix B. Using grants to procure administrative services circumvents budgetary controls and contracting policies. Administrative services should be procured via a contract using support appropriations, not a grant using capital outlay appropriations. Additionally, although administrative services are allowable bond expenditures, they must be accounted for separately, as many bond acts limit the amount of bond proceeds used towards administrative expenses.

The Conservancy should discontinue its practices of awarding grants that combine both capital project planning and administrative tasks. If capital planning grants are to be issued, the Conservancy should clearly identify each project's planning tasks and the related budgets. The observation remains as is; however, for clarification purposes, the finding title has been revised.

Finding 4

As noted in the Scope section of the report, one of the audit objectives was to determine if the Conservancy has adequate project monitoring processes in place. Conditions noted in the finding were based on a sample of 17 projects reviewed. Implementing the recommended monitoring procedures will improve the Conservancy's project oversight for bond funded projects.

Finding 5

As stated in the report, the Authority's general operating account was commingled with its grant funds. Based on a sample of expenditures reviewed, we questioned \$47,873 in expenditures because the Authority could not demonstrate that grant funds were not used to pay for ineligible expenditures such as lobbying services and maintenance costs. We also questioned \$19,437 in ineligible expenses charged directly to bond grants.

Regarding tracking of the Conservancy's contributions, contributions such as salaries for staff working on Authority projects are not tracked. Accordingly, the Conservancy should take the recommended steps to correct the conditions noted.