



Department of Water Resources:

Its Administration of Grants Under the Flood Protection
Corridor Program Needs Improvement

November 2007 Report 2007-108



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The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the Department of Water Resources' (Water Resources) administration of the Flood Protection Corridor Program (flood protection program).

This report concludes Water Resources awarded \$57.1 million for local grants under the flood protection program based on poorly defined selection criteria and incomplete information. Most notably, it is unclear whether the most expensive grant, the acquisition of Staten Island, will result in a tangible flood protection project in return for the \$17.6 million in funds awarded. Water Resources also did not always obtain information from applicants called for in its regulations to evaluate a potential project's flood protection benefits, such as evidence that property owners are willing to sell their property at fair market value. Moreover, although Water Resources established a framework for monitoring projects that would have been effective if enforced, it has not done so. In an extreme case, Water Resources has not contacted the city of Santee since March 2004, when it disbursed \$3.65 million, despite the city's failure to submit required reports. For the other 12 projects we reviewed, Water Resources did not always obtain complete progress reports, meet its goal for conducting site visits, or adequately track costs against their budgets. Additionally, Water Resources lacks a formal process for reporting project status for the flood protection program. Finally, Water Resources neither resolved its appraisal staff's or the Department of General Services' concerns that the appraised value of Staten Island was too high, and as a result, the State potentially paid more than fair market value for the property. Correcting these deficiencies in the flood protection program is important because Water Resources will select and monitor similar projects to be funded with an additional \$330 million that California's voters approved in November 2006.

Respectfully submitted,



ELAINE M. HOWLE
State Auditor

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Summary

Results in Brief

Decisions made by the Department of Water Resources (Water Resources) to award first \$28 million and then \$29.1 million more in local grants were based on poorly defined selection criteria and incomplete information. Water Resources, which administers the Flood Protection Corridor Program (flood protection program), awarded the initial \$28 million to five projects without a scoring process to consistently compare the benefits in flood protection, agricultural land conservation, and wildlife habitat protection specified in each project proposal. Although Water Resources had developed a scoring tool for this purpose, it chose not to use the tool based on the advice of its legal counsel. Instead, Water Resources' selection process started with its providing a series of workshops to potential applicants in 2000, following the approval of the Safe Drinking Water, Clean Water, Watershed Protection and Flood Protection Bond Act (Proposition 13).

After considering the merits of 11 project proposals from various government and nonprofit organizations, the Water Resources' project selection committee (selection committee) recommended that the director of Water Resources approve funding for only five projects. However, the selection committee provided only a general sense of why it felt those projects were preferable over the six it rejected. Missing from the selection committee's recommendations were comparisons of the strengths and weaknesses of projects the committee recommended for funding and those it did not. As a result, it is unclear why the five projects Water Resources chose to fund were better investments of funds from the flood protection program than the six projects it rejected.

Most notably, the flood protection program's highest priced grant, the purchase of Staten Island at a cost of \$17.6 million, has yet to result in a tangible flood protection project. In the grant agreement for the project, Water Resources provided The Nature Conservancy (Nature Conservancy) with funds from the flood protection program to acquire Staten Island in 2001. In return the grant agreement allowed Water Resources to obtain the property rights it needed to begin a flood protection project on the island. However, during the six-year period following Nature Conservancy's acquisition of Staten Island, Water Resources has yet to implement a worthwhile flood protection project on the property. Although Water Resources contends that Staten Island has already achieved significant flood protection benefits from the standpoint of preventing future development in an area prone to flooding, its contention is questionable considering the current legal restrictions prohibiting such development.

Audit Highlights . . .

Our review of the Department of Water Resources' (Water Resources) administration of the Flood Protection Corridor Program revealed that:

- » *When Water Resources awarded \$28 million for grants in 2001, it based the decisions on a weak selection process with poorly defined selection criteria.*
- » *It is unclear whether the highest priced grant, the acquisition of Staten Island, will result in a tangible flood protection project in return for the \$17.6 million in funds awarded.*
- » *Water Resources awarded an additional \$29.1 million for grants in 2003 without the aid of key information called for in its regulations to evaluate potential projects' flood protection benefits.*
- » *Water Resources has not enforced many of the monitoring procedures it established.*
- » *Water Resources has not contacted the city of Santee since March 2004, when it disbursed the final \$3.65 million remaining on a \$4.75 million project, despite the city's failure to submit required reports.*
- » *Water Resources neither resolved its appraisal staff's concerns nor those of the Department of General Services that the appraised value of Staten Island was too high, and as a result, the State potentially paid more than fair market value for the property.*

California's voters created the flood protection program by approving Proposition 13 in March 2000. Initially funded with \$70 million, of which \$57 million was available for projects, the program aims to increase flood protection, agricultural land preservation, and wildlife habitat protection throughout the State by taking various actions, such as acquiring real property interests and setting back and strengthening existing levees. In November 2006 California's voters approved the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006 (Proposition 84) and the Disaster Preparedness and Flood Prevention Bond Act of 2006 (Proposition 1E). Together these two propositions provided Water Resources with an additional \$330 million for similar flood protection projects.

When awarding \$29.1 million in a second round of grants, Water Resources did not require applicants to submit two key types of information mandated in the flood protection program's regulations for Water Resources to evaluate the relative merits of potential projects. For example, obtaining hydrologic studies from applicants would have given Water Resources the opportunity, before approving a grant, to determine the reliability of the project's proposed flood protection benefits based on the assessment of a civil engineer. Water Resources frequently required these studies only after it had already awarded flood protection program funds.

According to the manager of the flood protection program (program manager), the regulations requiring hydrologic studies imposes a burden on grant applicants that, if enforced by Water Resources, would have limited the number of applications it considered for funding. Further, the program manager asserted that Water Resources' staff of civil engineers, who were familiar with the flood risks addressed by each proposal, evaluated the flood protection benefits of each application. Despite the program manager's assertions, however, Water Resources' project selection records do not provide a comparable quantitative analysis of a project's flood protection benefits similar to that found in a hydrologic study. Further, the program manager's assertion that Water Resources believes hydrologic studies are burdensome is inconsistent with the funding guidelines Water Resources developed under Proposition 84, which reiterate this requirement. However, Water Resources has since clarified its requirements and in the future will only require each applicant to provide an assertion letter from a civil engineer describing the flood protection benefits of the project at the time of application. Nevertheless, program regulations have the effect of law and cannot be waived by Water Resources when it is expedient. Water Resources could also improve its project selection methodology by obtaining documentation, such as letters, as evidence of property owners' willingness to sell their property for fair market prices.

The deficiencies we noted in Water Resources' project selection process calls into question the benefits the State will realize from the \$47.1 million already spent on flood protection projects. Correcting these problems will give Water Resources the detailed information it needs to select the most beneficial projects and properly distribute the more than \$3 million of flood protection program funds that remain and the \$330 million in funding from propositions 84 and 1E.

We also found that Water Resources has not adequately monitored projects, despite flood protection program regulations and grant agreements that establish a framework for its oversight of grantees. In one particularly serious case, Water Resources has not contacted the city of Santee since March 2004, when it disbursed the final \$3.65 million of a \$4.75 million project. Even though Water Resources' agreement with Santee required the city to submit semiannual progress reports detailing the project's progress and expenditures, we noted that Santee had submitted only two progress reports to Water Resources since November 2000, when a letter of agreement between them was executed. Water Resources issued a letter in March 2004 asking the city to provide an accounting of its spending, but Water Resources did not follow up or take any further action when it did not receive the requested information. Our own inquiry of Santee resulted in our obtaining expenditure records that were not always consistent with the invoices the city had previously submitted to Water Resources for payment. Because the city may be owed another \$250,000 in grant funds, Water Resources should ensure that Santee has properly spent the money it already received.

For many other projects funded by the flood protection program, Water Resources did not obtain complete progress reports. Specifically, the progress reports for nine projects we reviewed did not meet the flood protection program's regulations. These deficient reports did not discuss the status of the projects in terms of schedules and budgets, and many of the reports failed to provide records of project expenditures that went beyond the grantee's assertion of incurred costs and did not report on any key issues affecting timely project completion. This lack of critical information has compromised Water Resources' ability to effectively monitor projects funded by the flood protection program.

Further undermining its knowledge of project status was Water Resources' inability to meet its goal of regularly visiting project sites to monitor progress. It also did not consistently maintain project activity logs to satisfactorily describe both the occurrence and the results of staff visits to project sites and to document important communications with grantees. Water Resources claims that staff turnover, staff redirection, vacancies caused by the hiring freeze,

and travel restrictions due to budget restrictions contribute to these monitoring weaknesses, but its lack of formal procedures to guide staff also likely contributed to its inconsistent monitoring approach.

Another factor hampering Water Resources' ability to effectively monitor projects and ensure project completion is its practice of not withholding a percentage of each progress payment to grantees. Water Resources contends that such a withholding would not be effective because other factors have delayed projects. However, in the case of the \$4.75 million project with the city of Santee, Water Resources may have lost its leverage to obtain progress reports and effectively monitor the project after disbursing almost the entire amount allocated. In response to its March 2004 request that the city provide an accounting of expenditures, Water Resources never received the information, did no further follow up, and did not obtain an audit report on the project as required under the letter of agreement.

Water Resources lacks an adequate internal reporting process on project status for the flood protection program. Because the flood protection program will administer additional grants and projects with funds from propositions 84 and 1E, Water Resources will need to develop processes to report to the Legislature and the Department of Finance to comply with the State General Obligation Bond Law and a January 2007 executive order from the governor that directs agencies to exhibit greater accountability over expenditures financed by bonds.

Recommendations

To provide consistency in its project selection process and to better justify its decisions on selecting future projects, Water Resources should do the following:

- When awarding grants, use a process, such as a consistent scoring system, that enables it to justify the rankings of projects it selects.
- Adhere to the regulations of the flood protection program requiring a hydrologic study as part of the grant application. If Water Resources believes hydrologic studies are too costly for some grant applicants, it should consider establishing a process to obtain this information or substantial other evidence supporting its decisions before awarding grants. For example, Water Resources could use funds from the flood protection program to pay for a study after preliminary selection, before deciding whether to fund the entire project.

- For proposed projects involving land acquisitions, adhere to the regulations of the flood protection program requiring grant applicants to submit evidence of willing sellers.

Water Resources should follow up with Santee to determine how the city spent its allocated funds. Additionally, Water Resources should release the unspent portion of allocated funds to the city only after Santee demonstrates it can use the funds for flood protection purposes, provides an audit report with an accounting of how the city used the \$4.75 million previously disbursed, and submits a final inspection report by a registered civil engineer as the letter of agreement with Santee requires.

To effectively monitor projects, Water Resources should develop policies and procedures to ensure that it does the following:

- Receives sufficiently detailed and complete progress reports from grantees with supporting records of expenditures.
- Communicates to staff its expectations for conducting and documenting site visits and for documenting important communications with grantees.
- Withholds a percentage of payments to a grantee when appropriate and releases those funds only after it is satisfied that the project is reasonably complete.

To comply with reporting requirements for projects it funds with propositions 84 and 1E, and to ensure that its management is kept apprised of key issues, Water Resources should develop a process for reporting project status. This process should include regular reporting of each project's budget and costs, progress in meeting the goals and time schedules of the grant agreement, and any key events affecting the project.

Agency Comments

Water Resources agrees with the need for our recommendations and indicates it is working towards their implementation. However, in its response, Water Resources disputes some of the conclusions presented in the audit report.

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Introduction

Background

The mission of the Department of Water Resources (Water Resources), created in 1956, is to manage the water resources of California in cooperation with other agencies and to protect, restore, and enhance the natural and human environments. It also works to prevent and minimize flood damage, ensure the safety of dams, and educate the public about the importance of water and its proper use. For fiscal year 2006–07, the Legislature authorized Water Resources to spend \$1.5 billion in pursuit of its mission and approved funding for roughly 2,800 positions.¹

A Bond Measure Approved in 2000 Provided \$70 Million to Water Resources for the Flood Protection Corridor Program

In March 2000 voters approved the Safe Drinking Water, Clean Water, Watershed Protection and Flood Protection Bond Act (Proposition 13), authorizing the State to sell \$1.97 billion of general obligation bonds for various water quality and flood protection programs. Proposition 13 added provisions to the Water Code and gave Water Resources \$70 million to establish the Flood Protection Corridor Program (flood protection program). The purpose of the flood protection program is to support flood control projects for the purpose of preserving agricultural land, flood control, and habitat conservation. The text box lists the allowable uses of these funds to achieve the purposes specified in Proposition 13.

Figure 1 on the following page illustrates how Proposition 13 allocated portions of the flood protection program's total initial funding for administration, educational efforts, one designated flood protection project, and flood protection projects that Water Resources could select. Proposition 13 allowed Water Resources to use up to 5 percent, or \$3.5 million, for administering the flood protection program, and Water Resources set aside another 5 percent (\$3.5 million) to pay bond issuance and

Allowable Uses of Program Funds

Water Resources shall use program funds for the protection, creation, and enhancement of flood protection corridors through all of the following actions:

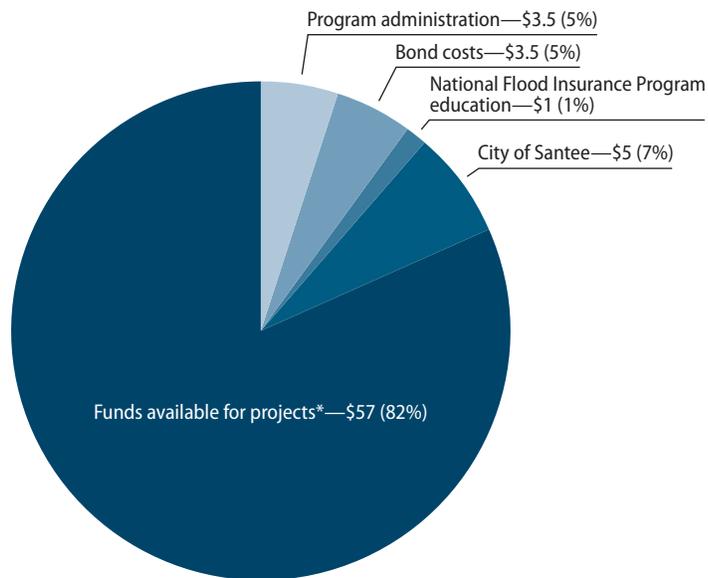
- Acquiring easements and other interests in real property from willing sellers to protect or enhance flood protection corridors and floodplains while preserving or enhancing the agricultural use of the real property.
- Setting back existing flood control levees and strengthening or modifying existing levees.
- Acquiring interests in real property from willing sellers located in a floodplain that cannot reasonably be made safe from future flooding.
- Acquiring easements and other interests in real property from willing sellers to protect or enhance flood protection corridors while preserving or enhancing the wildlife value of the real property.

Source: Water Code, Section 79037.

¹ This amount excludes \$5.8 billion budgeted for the Electric Power Fund, which manages long-term energy contracts and associated bond debt.

audit costs.² Further, Proposition 13 specifies that Water Resources allocate \$1 million to educate and provide technical assistance to cities and counties regarding the National Flood Insurance Program. Additionally, Proposition 13 directed that Water Resources allocate \$5 million to the city of Santee for flood protection of its streets and highways. The remaining \$57 million is available for flood protection projects that Water Resources manages and grants to local governments and nonprofit organizations.

Figure 1
Initial Funding Allocation for the Flood Protection Corridor Program
(Dollars in Millions)



Sources: The Safe Drinking Water, Clean Water, Watershed Protection and Flood Protection Bond Act and Department of Water Resources' (Water Resources) Flood Protection Corridor Program files.

* As shown in Figure 2 on page 10, Water Resources made internal decisions that allowed it to award \$28 million in direct-expenditure grants and \$29.1 million in competitive grants, for a total of \$57.1 million.

² The State General Obligation Bond Law allows bond funds to be used to pay for costs of a state agency with responsibility for administering the bond program (including those costs incurred by the State Treasurer's Office, the State Controller's Office, and the Department of Finance) associated with issuing and administering bonds. As of August 14, 2007, Water Resources estimated that it will charge only about \$20,000 against this amount, leaving a balance of \$3.48 million for future flood protection projects.

Water Resources Has Gradually Developed a Process for Managing the Flood Protection Program

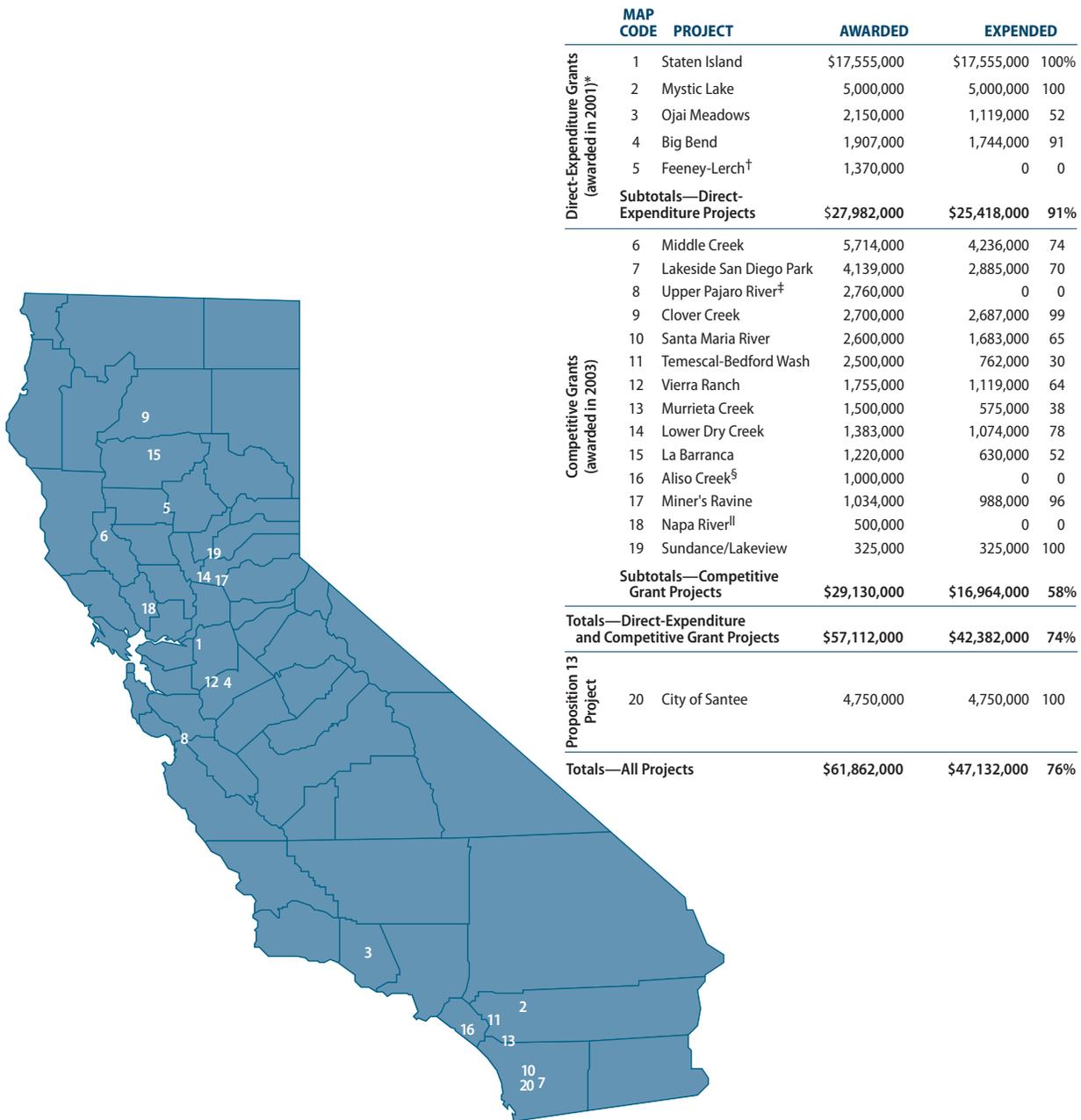
Water Resources' Division of Flood Management (division) manages the flood protection program. According to the manager of the flood protection program (program manager), the program has had one manager since fiscal year 2000–01, as well as two or three staff positions that have not always been filled. Initially, staff were responsible for developing regulations, soliciting and reviewing grant applications, and making funding recommendations to the director of Water Resources (director). Currently, staff review and approve grantee payment requests, track project costs and budgets, and monitor grantees' progress in fulfilling their agreements.

Water Resources awarded most of the flood protection program's available funding to 19 projects across California, as shown in Figure 2 on the following page. It awarded grants in two rounds. Through an informal solicitation, the first round of grants occurred in the summer of 2001, following the recommendations of an 11-member project selection committee (selection committee) composed of Water Resources' staff and representatives from the Department of Fish and Game, the Department of Conservation, the Governor's Office of Emergency Services, and the California Bay-Delta Authority (CALFED). CALFED is a collaboration among 25 state and federal agencies that came together with a mission to improve water supplies in California and the health of the San Francisco Bay/Sacramento–San Joaquin River Delta region (Bay-Delta region). Using this process, Water Resources awarded five grants that, with subsequent amendments, amount to \$28 million, or 49 percent of the flood protection program's total \$57 million in available funding. Water Resources calls these initial grants direct-expenditure grants, as opposed to competitive grants, because of the manner in which it selected them (an issue we discuss further in Chapter 1).

Using its experience awarding direct-expenditure grants, Water Resources developed flood protection program regulations, which became effective in August 2003. These regulations outlined the competitive grant selection process, including the information grant applicants had to submit and how Water Resources would consider and rank applications. The regulations also required certain monitoring provisions in grant agreements, such as periodic reporting of progress by grantees and Water Resources' right to inspect projects and, at its discretion, withhold all or part of grant payments to ensure that grantees are making appropriate progress.

The regulations also state that within the geographic scope of CALFED, Water Resources shall use flood protection program funds for projects that, to the greatest extent possible, are consistent with CALFED's long-term plan. In 2000 CALFED drafted a 30-year plan

Figure 2
Flood Protection Corridor Program Grants and Expenditures as of June 30, 2007



Source: The Department of Water Resources (Water Resources) Flood Protection Corridor Program files and accounting records.

* Water Resources is planning to fund an additional direct-expenditure project for \$30,000; however, it is not expecting to have an agreement executed until 2008.

† Although funds were awarded in 2001, no agreement has been executed because of title issues with the property.

‡ As discussed in Chapter 1, funds have not been disbursed to this project because of negotiation issues with property owners.

§ Although funds were awarded in 2003, the terms of the grant agreement involving the project's scope are still being negotiated with the grantee. Water Resources anticipates this agreement will be finalized by the end of 2007.

|| Water Resources indicates that the grantee could not find an acceptable easement holder for the purchased property until August 2007 and is now requesting reimbursement under the grant agreement.

for the Bay-Delta region, which describes a strategy to implement the plan and identifies complementary actions that CALFED agencies—including Water Resources—will also pursue.

Water Resources began its selection process for the second round of grant funding in November 2002 when it issued a request for project proposals. Although its regulations were not finalized, Water Resources sent out guidelines along with its request for proposals that mirrored its draft regulations. By February 2003 Water Resources had received 45 grant applications and formed another selection committee to review the project proposals. As before, the selection committee was composed of representatives of various state entities and CALFED. In August 2003 the selection committee made its funding recommendations to the former director, and Water Resources awarded most of the grant agreements throughout the remainder of that year. Overall, the selection committee recommended 14 projects that, with amendments, were funded at a total of \$29.1 million.

In addition to showing the locations of the 20 projects funded by the flood protection program, including Santee, Figure 2 shows that Water Resources disbursed \$47.1 million, or 76 percent of the funds awarded, through fiscal year 2006–07. More than half of the disbursements were for the three projects to which it awarded the largest grants: Staten Island, Mystic Lake, and Middle Creek. Additionally, the figure shows that nearly four years after Water Resources awarded the funds, it has not yet issued payments to four of the projects it selected.

Two Other Recent Bond Measures Give Water Resources More Funding for Flood Protection Projects

In November 2006 voters approved two bond measures that provide Water Resources with \$330 million in additional funds for flood protection projects. The Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006 (Proposition 84) provides Water Resources with an additional \$40 million for the flood protection program. The Disaster Preparedness and Flood Prevention Bond Act of 2006 (Proposition 1E) provides Water Resources with \$290 million for the protection, creation, and enhancement of flood protection corridors and bypasses. Water Resources indicated that, along with new staff, the staff managing the flood protection program will also award and oversee projects funded under propositions 84 and 1E.

After voter approval of several bond measures in November 2006, the governor issued an executive order in January 2007 that requires state agencies administering bond funds to institute a three-part accountability structure for the funds received from the

new bonds. Each agency is required to create a strategic plan that includes performance standards for bond-funded projects and to document its monitoring plan for ensuring that bond-funded projects stay within scope and budget. The executive order also requires agencies to report semiannually to the Department of Finance (Finance) regarding whether bond-funded projects are being executed in a timely fashion and are achieving their intended purposes. Lastly, the executive order requires agencies to contract with Finance to audit bond expenditures to determine whether claimed expenditures are consistent with legal requirements, are in line with the strategic plan, and achieved the intended outcomes. According to the program manager, Water Resources is developing procedures to comply with these requirements, which we discuss further in Chapter 2.

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review Water Resources' administration of the flood protection program. Specifically, the audit committee asked us to review and evaluate Water Resources' processes for initiating, reviewing, approving, and funding projects under the flood protection program to ensure that they are reasonable and comply with applicable laws and regulations. We were also asked to assess Water Resources' policies and procedures for monitoring projects to determine if they are on course and whether Water Resources has fiscal controls to ensure that payments are made only for allowable purposes, duplicate payments are detected and avoided, and project expenditures do not exceed budgets. In addition, the audit committee asked us to assess how Water Resources holds grantees accountable to the terms of their grant agreements, to evaluate its policies regarding any allowed subprojects, and to determine whether it has properly reported on project status.

We obtained an understanding of Water Resources' process for initiating, reviewing, and selecting grant proposals by reviewing project selection files and conducting interviews with staff serving on the project selection committees. We reviewed communications from selection committee meetings, obtained and reviewed the selection committees' project-scoring criteria for direct-expenditure and competitive grants, and assessed the selection committees' justifications for the projects they recommended to the director.

We chose projects for which Water Resources had awarded funds of at least \$1.5 million, resulting in a sample size of 12 projects that represented \$50.3 million. Given the significant size of the funding mandated for the city of Santee in the flood protection program's

implementing legislation, we included that project in our sample as well. As a result, our sample included 13 projects representing \$55 million. Aside from the city of Santee, our sample included four direct-expenditure projects and eight projects Water Resources chose through its competitive grant process in 2003.

We also assessed whether Water Resources obtained the application materials from grant applicants required under flood protection program regulations and guidelines before making its funding decisions. Among the materials we looked for were a work plan from the grant applicant that contains a task breakdown and timetable of the proposed project and a hydrologic study from a civil engineer or professional hydrologist for the project site. Water Resources placed this requirement into the program's regulations to assist in assessing the feasibility of proposed projects and the likelihood of achieving the stated flood protection benefits. Because Water Resources did not have regulations or other materials to guide its evaluation of proposed direct-expenditure projects, we reviewed documents available in its files to understand how it selected those projects.

Many of the projects we reviewed involve property acquisitions. The Public Works Board and the Department of General Services (General Services) serve as the control agencies for the State's property acquisitions, reviewing real estate transactions and ensuring that enough due diligence was performed to protect the State's interests. However, Water Resources is statutorily exempt from Public Works Board approval when it acquires real property. Despite this exemption, Water Resources is required to follow similar procedures to those used by the Public Works Board when it acquires real property. Water Resources is, however, required to obtain approval from General Services when it enters into a contract to acquire an interest in real property valued at more than \$150,000. As a matter of practice, Water Resources sometimes submitted real estate contracts to General Services for review even when Water Resources was not the entity that would ultimately take title to the property. Although General Services' approval was not required in these instances, we looked to see whether Water Resources appropriately addressed any concerns General Services raised when it performed these reviews.

To evaluate the effectiveness of Water Resources' monitoring of projects, we identified the monitoring activities outlined in the flood protection program's regulations and in its agreements with grantees. We present our assessment, along with the specific criteria we used, in the Appendix. We also interviewed staff with the flood protection program and reviewed fiscal controls for tracking payments for each project to ensure that the payments did not exceed the budget approved in the grant agreements.

Specifically, we reviewed up to 10 payments for each of the 13 projects in our sample. We assessed whether Water Resources accurately recorded the payments into its budget-tracking sheets, a tool used to track project expenditures by budgeted task, and its accounting system. We also reconciled total flood protection program expenditures recorded in Water Resources' accounting system to the records of the State Controller's Office. Based on these procedures, we determined that the data on the flood protection program expenditures recorded in Water Resources' accounting system was sufficiently reliable for the purposes of our audit. Our review of up to 10 payments for each project was also intended to test for duplicate payments. Although we noted no such payments, we found weaknesses in the supporting progress reports, which are intended to describe and justify project expenditures. We discuss these weaknesses on page 37 of the audit report.

To determine Water Resources' policies for subprojects, we interviewed its staff and reviewed the files for the 13 projects in our sample in an attempt to identify subprojects. We noted that grantees sometimes hired subcontractors to perform project-related tasks. Water Resources includes in its grant agreements standard clauses making grantees responsible for their subcontractors' work. Under flood protection program regulations, grantees report project performance through periodic progress reports, which would also report the progress of work performed by subcontractors. Thus, as part of our monitoring review, we assessed how Water Resources used progress reports to monitor grantees' efforts. However, we found that the projects in our sample did not have subprojects, and as a result we did not pursue this matter further.

To determine what steps Water Resources takes when projects deviate from the approved scope and budget, we interviewed its staff and considered the results of our review of the 13 projects in our sample. Our testing noted instances when the sample projects had changing scope items or performance timelines. In these situations we determined whether Water Resources had formally approved the changes through amendments to its grant agreements. Finally, we evaluated Water Resources' reporting requirements under Proposition 13.

Chapter 1

THE DEPARTMENT OF WATER RESOURCES SELECTED PROJECTS USING POORLY DEFINED CRITERIA AND MADE FUNDING DECISIONS BASED ON INCOMPLETE INFORMATION

Chapter Summary

When the Department of Water Resources (Water Resources) awarded \$28 million in grants under the Flood Protection Corridor Program (flood protection program), it based its decisions on a weak selection process using poorly defined criteria. Of particular concern, we noted that Water Resources made these decisions without using a scoring tool it had developed that would have allowed Water Resources to assess the relative merits of the 11 direct-expenditure projects under consideration in 2001.

Although Water Resources had developed a scoring tool to use in comparing the flood protection, agricultural land conservation, and wildlife habitat protection benefits of the project proposals, it decided not to use the tool based on the advice of its legal counsel. Specifically, because it had not yet issued formal regulations for the flood protection program, Water Resources was concerned that the scoring tool might be construed as “underground” regulations that would not be legally permissible. Further, Water Resources believed that issuing regulations would be time consuming and would unnecessarily delay funding projects.

We question Water Resources using a project selection approach that does not enable it to demonstrate that funding the five direct-expenditure projects it approved was a better investment of public funds than funding the six projects it rejected. Most uncertain is why Water Resources concluded that its most expensive grant, Staten Island, would ever result in a tangible flood protection project. Before Water Resources assembled a project selection committee (selection committee) to consider possible projects, its former director committed one-quarter of the flood protection program’s funds to the Staten Island grant.

When awarding the remaining \$29.1 million for local competitive grants in 2003, Water Resources did not always obtain from applicants two key types of information called for in the regulations and guidelines it had developed by then to evaluate the relative merits of potential projects. For example, rather than requiring applicants to submit hydrologic studies that would assist it in assessing the feasibility of proposed projects and the likelihood of achieving their stated flood protection benefits, Water Resources obtained most hydrologic studies after approving projects. The

information in the studies would have improved Water Resources' evaluation of potential projects' feasibility and flood protection benefits and mitigated its risk of approving projects with unrealizable or overstated flood protection benefits.

Finally, for projects involving property acquisitions, Water Resources did not always obtain evidence that property owners in the respective project areas were willing to sell their property at fair market values. If Water Resources had included this step in its selection process, it might have avoided awarding funds to a grantee who has since been unable to negotiate purchase agreements with property owners.

It is essential that Water Resources establish well-defined selection criteria and take steps to ensure that it obtains all project application materials before deciding how to spend the remaining \$3.48 million in flood protection program funds and the additional \$330 million made available by recently approved bond measures. By doing so, Water Resources will be in a stronger position to judiciously distribute flood protection program funds to projects that promise to benefit the State.

Water Resources Awarded \$28 Million in Direct-Expenditure Grants Without Clearly Documenting Rationales for Its Funding Decisions

The Safe Drinking Water, Clean Water, Watershed Protection and Flood Protection Bond Act (Proposition 13) allows Water Resources to spend flood protection program funds for projects through its direct expenditure or by awarding grants to local public agencies and nonprofit organizations. In August 2001 a selection committee formed by Water Resources and composed of members of its staff and those of other state agencies recommended that the former director of Water Resources (former director) approve funding for five direct-expenditure projects totaling \$28 million. The former director approved the selection committee's recommendations and began formally awarding funding later that year.

Unfortunately, the documentation of the selection committee's decision process lacked evidence of clear rationales to support its funding recommendations. Although the selection committee ranked each of the 11 projects it considered, its basis for those rankings is not clear because, on advice from its legal counsel, it decided against using the scoring tool it had developed. Instead, the selection committee's recommendations describe only the benefits of each project, not why the five projects it chose were preferable over the others. Further, Proposition 13 requires that Water Resources give the highest funding priority to projects supported by certain state agencies; however, lacking documentation of the reasons behind its funding decisions, Water Resources cannot

demonstrate that its project selections complied with these priorities and were the best possible use of flood protection program funds.

Water Resources' files provide scant information on how it solicited the 11 project proposals that the selection committee considered in August 2001. According to the manager of the flood protection program (program manager), who was a member of the selection committee, Water Resources' staff contacted potential applicants about the available funds for direct-expenditure project proposals during 2000 after the voters approved Proposition 13. Notes from an August 2001 selection committee meeting also generally discuss a series of prior workshops and informational sessions attended by Water Resources' staff to inform potential applicants about the flood protection program. Although Water Resources considered the 11 proposals that resulted from their solicitation efforts as potential direct-expenditure projects, they were in effect grants because the 11 applicants were government agencies and nonprofit organizations. As such, we expected Water Resources to have documents demonstrating its solicitation efforts, such as formal notices of a competitive grant opportunity under the flood protection program, to ensure that its selection committee was in a position to pick projects from the widest possible pool. With no evidence of competitive grant solicitations in its files, it is uncertain whether the selection committee could have chosen other projects better suited for the flood protection program.

Water Resources appears to have rationalized its lack of a competitive grant process in 2001 by calling its initial selection process a pilot project for the subsequent competitive process it would use to award grants in 2003. Notes from the selection committee's August 2001 meeting indicate that Water Resources intended to choose good direct-expenditure projects while it developed the flood protection program's regulations and grant selection process. One item that the selection committee did develop was a set of scoring criteria that would ensure a consistent evaluation of the relative merits of each direct-expenditure project. However, the program manager told us that Water Resources decided against using scoring criteria to evaluate projects based on the advice of its legal counsel.

The unused scoring criteria generally seemed to be a well-developed tool that would have allowed the selection committee to better document its rationale for the 11 projects it ranked in 2001. The maximum score was 2,700 points, with the first 2,100 points allotted for flood protection, wildlife habitat protection, and agricultural land conservation benefits, at a maximum score of 700 points each. The remaining 600 points were based on, among other things, cost-effectiveness, water supply and quality benefits, social benefits,

Lacking documentation of the reasons behind its funding decisions, Water Resources cannot demonstrate that its project selections complied with statutory priorities and were the best use of flood protection program funds.

To evaluate potential projects in 2001, Water Resources' legal counsel advised against using scoring criteria because they could be construed as "underground" regulations.

and administrative elements. The program manager, who was on the selection committee, indicated that Water Resources' legal counsel advised against using the scoring criteria because, given that the Office of Administrative Law had not previously approved them, the criteria could be construed as "underground" regulations. Further, the program manager stated that obtaining the Office of Administrative Law's approval would be time consuming and delay the funding of direct-expenditure projects. As a result, according to the program manager, the selection committee selected direct-expenditure projects based on whether members believed the proposed projects fulfilled the State's interest and complied with the criteria outlined in Proposition 13.

However, lacking a scoring tool or other comparable approach, it is unclear to us how the selection committee reached the funding recommendations it made in August 2001. In its recommendations to fund five direct-expenditure project proposals, the selection committee described the benefits of all 11 proposed projects and their links to the State's interests, but did not indicate why it rejected the six projects it was not recommending. With the exception of the Staten Island grant, for which the former director of Water Resources and the former secretary of the California Resources Agency had previously committed to funding, Water Resources' decision to fund the other four direct-expenditure projects provided only a general sense for why the selection committee felt they were preferable over the six projects not selected.

One project the selection committee rejected proposed spending \$3 million to acquire up to 9,000 acres of land within a floodplain located near a national park. Water Resources indicated that this land was under considerable development pressure and that acquiring the property would preclude development within a floodplain. Further, Water Resources contended that the project would benefit local wildlife and augment other state efforts led by the Department of Fish and Game. According to Proposition 13, projects deemed important by state agencies, such as the Department of Fish and Game, should receive the highest priority. Given Water Resources' description of this project and the absence of a rationale for denying funding, we found no reason why investing in this project would not have been as good a use of flood protection program funds as the projects ultimately funded.

The Staten Island Acquisition Focuses on Wildlife Conservation and May Not Result in a Tangible Flood Protection Project

The selection committee's recommendation to fund five direct-expenditure projects in August 2001 included funding the flood protection program's most expensive project, the acquisition of Staten Island. At a total cost of \$35.1 million, The Nature Conservancy (Nature Conservancy) originally proposed to acquire Staten Island with state funds available under a program administered by the California Bay-Delta Authority (CALFED). In its grant proposal under CALFED's Ecosystem Restoration Program (restoration program), Nature Conservancy stressed the project's benefits to wildlife habitat protection and agricultural land conservation. However, the grant proposal did not indicate a specific flood protection project on the island. Being supportive of the grant proposal, CALFED committed to funding half of the acquisition, and the former director agreed to fund the remaining \$17.6 million under the flood protection program. We noted that the former director chose to commit these funds in April 2001, nearly four months before the selection committee presented its funding recommendations in August 2001, suggesting that the selection committee's decision to fund Staten Island was a formality. Six years after Nature Conservancy acquired Staten Island, Water Resources has yet to implement a flood protection project on the island, and it is unclear whether the acquisition will ultimately result in a tangible flood protection project.

Six years after Nature Conservancy acquired Staten Island, Water Resources has yet to implement a flood protection project on the island.

Initially Proposed Under Another State Program, the Staten Island Project Focused on Ecosystem Restoration

The Staten Island grant, sponsored by Nature Conservancy, involved acquiring a 9,200-acre island in the Sacramento–San Joaquin River Delta for agricultural land conservation and to protect the habitat of waterfowl, especially the sandhill crane. In May 2000 Nature Conservancy sought full funding of the \$35.1 million needed to acquire and provide stewardship on Staten Island from CALFED's restoration program plan. In its application for the restoration program grant, Nature Conservancy stated its objectives were to protect critical agricultural wetlands, promote restoration and protection of habitat, and facilitate expansion of species like the sandhill crane. Focusing almost entirely on these conservation activities, Nature Conservancy stated only that the "project is designed to be consistent with flood control and water management activities in the [Delta] as well," which suggests that a flood protection project was not the original focus of the Staten Island acquisition.

Water Resources' former director agreed to provide half of the \$35.1 million cost to acquire Staten Island from flood protection program funds before Water Resources formed a project selection committee.

According to the minutes of its December 2000 meeting, the CALFED Policy Group subsequently decided that the project should not be solely financed with restoration program funds. As noted previously, the former director committed Water Resources to provide half of the \$35.1 million cost from flood protection program funds. However, this commitment was made in April 2001, four months before the selection committee made its funding recommendation.

The Staten Island Grant May Not Result in a Tangible Flood Protection Project

Water Resources contends that the value of the Staten Island grant is based on the cost avoidance achieved by preventing residential and commercial development on the island and providing a large area for transitory floodwater storage to relieve pressure on nearby levees and thus avoiding flood damage. As an additional flood protection benefit, Water Resources states that it plans to implement a flood protection project on the island once it identifies one that is suitable. However, legal restrictions governing the property's use make it unlikely that development would ever occur on Staten Island, and flood protection projects on the island may not be cost-effective. Therefore, it is questionable whether the flood protection program's most expensive grant would ever result in a tangible flood protection project.

In September 2001 Water Resources and Nature Conservancy finalized a \$17.6 million grant agreement for the Staten Island project. The agreement included a conservation easement to Water Resources that gave it the right to take various actions to protect the island's natural, ecological, environmental, and wildlife features. Under the terms of the easement, Nature Conservancy agreed to grant Water Resources access to Staten Island to ensure that the environmental and wildlife aspects of the island are preserved and protected, but retained the right to conduct agricultural practices that were not inconsistent with land preservation.

In addition to granting the conservation easement, Water Resources required Nature Conservancy to participate in the North Delta Improvement Program (delta improvement program), which is part of the CALFED Bay-Delta Program, for a period of 10 years ending in November 2011. Under the participation agreement, Nature Conservancy acknowledged that the delta improvement program might recommend a flood protection project or activity that includes Staten Island as part of its efforts to address flood management, ecosystem restoration, and water supply reliability issues in the north Sacramento–San Joaquin River Delta region. In

that event Nature Conservancy would convey to Water Resources, at no cost, the property interests needed to execute the as yet unidentified project or activity.

During the six months immediately following the conclusion of the 10-year period specified in the participation agreement, Water Resources has the right to designate property interests on Staten Island necessary for implementing a flood protection project or activity. Nature Conservancy and Water Resources also negotiated a restriction that flooding would be permitted on average no more frequently than once every 10 years, and they agreed that any floodwater would be removed from Staten Island at the State's expense as quickly as necessary to limit damage to the agricultural land conservation and wildlife habitat values of the island.

Although the agreement between Nature Conservancy and Water Resources allows for the possibility of a flood protection project on Staten Island, such a project may not be feasible. According to a Water Resources branch chief who was the CALFED senior engineer responsible for identifying potential flood protection projects for Staten Island at the time the grant was awarded, the flood protection benefits were conceptual only, and the benefits and costs had not yet been quantified. The branch chief told us that, based on a rough cost-benefit analysis that Water Resources prepared in August 2005, the costs to implement a flood protection project on land that includes Staten Island greatly outweigh the benefits to be obtained. She stated that preventing future development on the island is the only current flood protection benefit obtained that pertains to the flood protection program's goals, and that the property represented a unique purchase opportunity because it was a large island owned by one property owner.

The 10-year period for negotiating a flood protection project using Staten Island ends in November 2011, and we found limited evidence of any progress. Nevertheless, six years after acquisition of the land, the program manager indicated to us that Water Resources is still considering various proposals and hopes to select a suitable project sometime in fiscal year 2007–08. If Water Resources determines that a flood protection project on Staten Island is not cost-effective, it is possible that the only flood protection benefit derived from the State's \$17.6 million grant is the cost-avoidance of flood damage to commercial and residential property that might have occurred had development taken place on Staten Island.

However, a December 2000 appraisal of Staten Island showed that development there is unlikely in the foreseeable future. The appraisal noted that the then-current zoning dictated that Staten Island's "highest and best" use—defined as the probable and legal

Based on a rough cost-benefit analysis that Water Resources prepared in August 2005, the costs to implement a flood protection project on land that includes Staten Island greatly outweigh the benefits to be obtained.

use that is physically possible, appropriately supported, and financially feasible and results in the highest value—is either farming and speculation uses or farming and/or habitat and environmental uses. The appraisal also indicated that zoning laws would allow Staten Island to be divided into 40-acre residential tracts, which would provide for as many as 226 residential units, but division of that kind was unlikely to occur for 20 years because of restrictions imposed by state law. Moreover, the appraisal stated that changing Staten Island’s zoning was unlikely for the “foreseeable future.” Therefore, at the time of the appraisal, the likelihood of future commercial and residential development was low. As of September 2007, Staten Island’s zoning remained the same.

When Awarding \$29.1 Million in Competitive Grants, Water Resources Did Not Obtain All Required Documentation or Use Selection Criteria Consistently

In our review of eight competitive grants, we found that Water Resources did not always obtain two key types of required information from applicants before making grant award decisions. Using its experiences in administering direct-expenditure projects, Water Resources developed regulations in August 2003 that defined the project selection process for local grants funded with the remaining \$29.1 million. These regulations described the supporting documentation that applicants needed to submit for Water Resources to evaluate before awarding grants. The regulations also defined how Water Resources would balance the proposed benefits of flood protection with wildlife habitat protection and agricultural land conservation.

Although its scoring of grant applications correctly balanced flood protection benefits with the other goals of the flood protection program, we noted that Water Resources made funding decisions without the benefit of hydrologic studies or, in many cases that involved property acquisitions, without evidence that property owners were willing to sell their property at fair market values. Although Water Resources now contends that hydrologic studies are a burdensome requirement, potentially limiting the number of applications it receives, it nevertheless included this requirement in the flood protection program’s regulations in August 2003 when it was considering competitive grant applications. Further, the value Water Resources appears to see in these studies is evidenced by its attempts to get them after issuing grant awards. Without obtaining hydrologic studies and evidence that property owners were willing to sell at the time it was evaluating project proposals, it is unclear how Water Resources could adequately evaluate the potential benefits of land acquired for flood protection projects or whether

It is unclear how Water Resources could adequately evaluate the potential benefits of land acquired for flood protection projects when it did not obtain hydrologic studies or evidence that property owners were willing to sell their property at fair market values.

the land could even be acquired from a willing seller at fair market prices. Additionally, Water Resources was inconsistent when deciding whether to approve funding requests for structural and recreational enhancements, like pedestrian bridges and bike trails.

Water Resources Did Not Always Obtain Hydrologic Studies From Grant Applicants

The regulations of the flood protection program require every grant applicant to provide Water Resources with a hydrologic study prepared by a qualified civil engineer or professional hydrologist. According to the program manager, Water Resources inserted this requirement into the regulations to assist it in assessing the feasibility of proposed projects and the likelihood they will achieve their stated flood protection benefits. The intent was to use the studies to help reduce the risk of funding projects with uncertain flood protection benefits.

However, for the eight competitive grants we reviewed, Water Resources obtained complete hydrologic studies for just three of the eight projects it approved and offered varying reasons for awarding funds without obtaining these studies for the other five projects. For example, Water Resources provided its engineers' scoring sheets for evaluating the potential flood protection benefits of the eight projects we reviewed, asserting that its engineers were familiar with the flood risks being addressed by each project proposal. Although the scoring sheets indicate an engineer reviewed the flood protection benefits described in each application, they do not provide a comparable quantitative analysis of a project's flood protection benefits similar to those found in the few hydrologic studies Water Resources did obtain. The program manager also asserted that in some cases Water Resources waived the hydrologic study requirement when the grantee was under time constraints to acquire land. The program manager stated that the studies are time consuming and prohibitively expensive for some grant applicants, adding that requiring a hydrologic study with each application might have limited the number of projects submitted. As a result, he decided not to require a study with each application.

Finally, the program manager asserted that grant applicants were required to secure letters from civil engineers attesting to the proposed projects' approaches to securing flood protection benefits, although Water Resources states that it has not always obtained those letters at the time projects were approved for funding. In fact, we found only one such letter among the five projects approved without hydrologic studies that we reviewed.

For the eight competitive grants we reviewed, Water Resources obtained complete hydrologic studies for just three projects when it approved the applications.

Regardless of Water Resources' rationale, the flood protection program regulations have the effect of law and cannot be waived by Water Resources when it is expedient to do so. A reasonable explanation Water Resources might offer for not securing these studies is that it already had access to this information from other sources; however, the fact that Water Resources later required five of the grantees to provide such studies indicates that is not the case. Moreover, in the only letter Water Resources received from a civil engineer attesting to the benefits of one of the eight grants we reviewed, the civil engineer acknowledged the limitation of the opinions he provided as follows:

Please understand that the above opinions are based on a preliminary review of the available information. Validation of these opinions will require the completion of appropriate hydrologic, hydraulic and sediment-transport studies. Barring any unforeseen findings in those studies, I believe the project concept that you have proposed will serve the purpose of reducing flood damage and enhancing river functions and habitat values.

Water Resources' reliance on such a letter to help it assess the flood protection benefits of a proposed project seems counter to the intent of the flood protection program regulations that funding decisions be based on solid information.

After it approved five of the eight projects we reviewed without obtaining the required studies, Water Resources later received hydrologic studies for four projects. However, the practice of disbursing funds to projects before obtaining the studies is problematic. For example, Water Resources received a hydrologic study supporting the Santa Maria River project in June 2006, after it had provided the grantee roughly \$1.7 million. The validity of the study is uncertain, however. Water Resources told us it had several questions regarding the study's conclusions and that the scope needed to be expanded to cover all the properties the grantee will acquire. Thus, Water Resources has referred the study back to the grantee. Water Resources further stated that, to the extent that hydrologic studies—provided by the grantees after flood protection program funding is provided—discredit proposed flood protection benefits, its grant agreements allow it to terminate the grants, although previously disbursed funds are not recoverable. Thus, if Water Resources ultimately rejects the hydrologic study and terminates the Santa Maria River project, it cannot recover the \$1.7 million it already disbursed.

Water Resources stated that, to the extent that a hydrologic study received after a project is funded discredits proposed flood protection benefits, previously disbursed funds are not recoverable.

The program manager asserts that, as part of its selection process, Water Resources will require each applicant for funding provided by the recently approved bond measures to submit, at a minimum, an engineer's or hydrologist's opinion of the flood protection

benefits of the proposed project. Further, each grantee will have to submit a complete hydrologic study early in the project work scope to determine whether Water Resources should fund the balance of the project. However, current regulations and flood protection program application guidelines for the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006 (Proposition 84), which provides \$40 million for projects, still require applicants to submit hydrologic studies before they can receive funding. Water Resources' clarifying instructions to applicants indicate that they must provide either hydrologic studies or opinion letters from civil engineers if hydrologic studies are not available.

Evidence of Willing Sellers Was Lacking for Most Grants Involving Land Acquisitions

Another weakness in the process of selecting flood protection program grants is that Water Resources did not always obtain evidence from applicants that the land they planned to acquire was available from willing sellers. Proposition 13 states that land acquired with flood protection program funds shall be from willing sellers, and the flood protection program's regulations require applicants to provide evidence that affected property owners are willing participants in any proposed real property transactions. In practice this evidence is typically a letter from property owners—termed a willing-seller letter. Obtaining a willing-seller letter does not guarantee a grantee will be successful in acquiring property. For example, although Water Resources obtained willing-seller letters for the Santa Maria River project, the grantee was unable to acquire one of the properties because the seller sold the property to a third party for twice the appraised value. However, requiring such a document provides Water Resources with assurance—beyond that offered by the applicant's assertion—that the land can be acquired at a fair market value. By meeting the requirements of Proposition 13 and its own regulations, Water Resources could reduce the risk of awarding flood protection program funds to grantees that cannot use the funds because property owners have no desire to sell their properties at fair market values.

Although six of the eight competitive grant applications reviewed in our sample contemplated land acquisitions, only the applicants for the Santa Maria River and Lakeside San Diego Park projects provided willing-seller letters for some of the properties they proposed to acquire. For one of the six projects, we noted that the willing-seller letter would have provided particularly helpful evidence to Water Resources because the project has experienced problems negotiating purchases with the property owners.

Water Resources could reduce the risk of awarding flood protection program funds to grantees that cannot use the funds by obtaining evidence that property owners are willing to sell their property at fair market values.

A secondary benefit of ensuring that grant applicants include evidence of willing sellers in their applications is that Water Resources could better insulate itself from significant scope changes to projects once grantees discover they cannot acquire properties.

Specifically, the Upper Pajaro River project has been unable to use the \$3.3 million Water Resources awarded it four years ago because the property owners are purportedly unwilling to sell their property at fair market value. Despite this delay, in March 2007 Water Resources extended the funding agreement to October 2008 without first obtaining a willing-seller letter because the grantee believes that it can reach a purchase agreement with one of the property owners for a larger amount of land. Relying solely on the grantee's assertion that this property owner wants to sell more property, Water Resources did not obtain a willing-seller letter from the grantee until August 2007, five months after extending the funding agreement. According to Water Resources, the grantee has not purchased the property as of September 2007. Because unused funds do not benefit the flood protection program's ultimate goals, it is possible that Water Resources could have selected other projects with property owners willing to negotiate the sale of their property for fair market prices.

A secondary benefit of ensuring that grant applicants include evidence of willing sellers in their applications is that Water Resources could better insulate itself from significant scope changes to projects once grantees discover they cannot acquire properties. We noted two cases in which a grantee informed Water Resources that it could not purchase the properties initially identified in its grant application and requested the authority to substitute other properties.

For example, because of stalled land negotiations in the Upper Pajaro River project, the grantee requested in August 2006 to change the scope of the original agreement to increase the amount of land purchased from one property owner, while eliminating the proposed land to be purchased from property owners unwilling to sell at fair market value. We expected Water Resources to have evaluated the substituted property to determine its flood protection benefits, which could significantly impact the original scope of the project. However, in this case Water Resources accepted the grantee's request without rescoring the project to determine the effect of the property substitution. The program manager believed this was sufficient because Water Resources reviewed the characteristics of the original property, compared them with the characteristics of the property to be substituted, and concluded that the changes were minor and had no effect on the project's rank. Although the program manager asserts this review took place, when we asked for documentation of the review, he could not provide it. By rescoring the project using a documented procedure, Water Resources would have been in a stronger position to justify the changes made to the scope of the project.

In reviewing the Santa Maria River project, which is administered by the same grantee as the Upper Pajaro River project, we found that Water Resources appropriately rejected two scope change requests to acquire property interests outside the project's defined area. Water Resources rejected one of these requests because the land in question was already protected by an open-space easement, and at least half of the proposed property was located outside a federally designated floodplain. We believe Water Resources correctly exercised its oversight authority in this case because the requested scope change did not offer additional flood protection, agricultural land conservation, or wildlife habitat protection benefits. Nevertheless, Water Resources could be more consistent if it had procedures to recognize when scope changes significantly alter the benefits of a project that warrant the project's reevaluation against other projects that have not received funding from the flood protection program.

Water Resources Was Inconsistent When Considering Whether to Fund Structural and Recreational Enhancements

Our review also revealed instances when Water Resources was inconsistent in finalizing its awards to grantees. It considered funding requests for structural and recreational enhancements, such as pedestrian bridges and bike trails, on four projects we reviewed at Temescal-Bedford Wash, Napa River, Clover Creek, and Murrieta Creek. Although Water Resources eventually rejected the funding requests for the Temescal-Bedford Wash and Napa River projects, it approved a total of roughly \$623,000 in structural and recreational enhancements for the Clover Creek and Murrieta Creek projects.

The program manager stated that Water Resources believes that these enhancements add allowable public benefits because Proposition 13 does not specifically prohibit such activities. Water Resources stated that it considers several factors when making funding adjustments, including whether the proposed enhancements are within the scope of the flood protection program and represent a sufficiently small portion of the project, and whether the grantee had access to alternative sources of funding. In the case of the Murrieta Creek project, Water Resources' approval of \$14,000 in recreational enhancements appears acceptable because the funds represent a sufficiently small portion of the \$1.5 million grant. However, Water Resources' rationale appears to be inconsistent with its decision to fund the structural and recreational enhancements for the Clover Creek project. The grantee for that project used 20 percent of the grant funds—roughly \$609,000—for such enhancements and received more

By not having a consistent rationale for funding structural and recreational improvements, Water Resources is open to criticism that it is not administering the flood protection program in a fair and equitable manner.

than \$8 million in additional funding from other sources. We do not believe that 20 percent of the total grant meets the definition of a sufficiently small portion of the project.

By not having a consistent rationale for funding structural and recreational improvements, Water Resources leaves itself open to criticism that it is not administering the flood protection program in a fair and equitable manner. Although funding structural and recreational enhancements is allowable under the flood protection program, we question whether a better use of the funds would have been for activities that directly achieve the goals of the flood protection program.

A Better Project Selection Process Is Needed Now Because Water Resources Will Soon Award Up to \$330 Million in Additional Grants

Water Resources must address concerns about its project selection process before it awards the \$330 million of funding it will soon receive for similar projects under Proposition 84 and the Disaster Preparedness and Flood Prevention Bond Act of 2006 (Proposition 1E), and allocates the remaining \$3.48 million of Proposition 13 flood protection program funds. Water Resources has requested competitive grant applications for funds available under Proposition 84, due in November 2007, which it will evaluate in the same way it did competitive grants funded by Proposition 13. For Proposition 1E, it plans to develop procedures and processes and to solicit projects for funding consideration in the spring of 2008, as well as in subsequent years as additional funds become available.

The \$330 million from propositions 84 and 1E can profoundly benefit the State's flood protection efforts. However, as noted earlier, Water Resources has made project selection decisions under the flood protection program using poorly defined criteria and without the benefit of key documents. To maximize the benefits derived from future bond-funded projects and justify its future funding decisions, Water Resources needs to improve its grant-awarding process.

Recommendations

To provide consistency in its project selection process and to better justify its decisions on selecting future projects, Water Resources should do the following:

- When awarding direct-expenditure grants, select projects in a manner that allows it to justify its project rankings. One way Water Resources could achieve this would be to develop and use a consistent scoring process and use the scores as a basis for making funding decisions.
- Adhere to the regulations of the flood protection program requiring a hydrologic study as part of the grant application. If Water Resources believes hydrologic studies are too costly for some grant applicants, it should consider establishing a process to obtain this information or substantial other evidence supporting its decisions before awarding grants. For example, Water Resources could use funds from the flood protection program to pay for a study after preliminary selection, before deciding whether to fund the entire project.
- For proposed projects involving land acquisitions, adhere to the regulations of the flood protection program requiring grant applicants to submit evidence of willing sellers.
- Develop a rationale for determining whether scope changes are significant enough to warrant another review of a project's merits or whether an unfunded project might be a better alternative.
- Develop policies and procedures to consistently evaluate whether proposed structural and recreational enhancements conform to the goals of the flood protection program and are the most effective use of funds.

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Chapter 2

ERRORS AND INCONSISTENCIES HAMPER THE DEPARTMENT OF WATER RESOURCES' OVERSIGHT OF THE FLOOD PROTECTION CORRIDOR PROGRAM

Chapter Summary

As noted earlier, the Department of Water Resources (Water Resources) has awarded \$57.1 million under the Flood Protection Corridor Program (flood protection program) to 19 grantees as well as \$4.75 million to the city of Santee. Our review found that although Water Resources has established a monitoring approach that would be effective if enforced, it did not always follow good monitoring practices. In the case of the \$4.75 million Santee project, Water Resources did not obtain required status reports or follow up with the city on its use of funds for three years after the city had received the money. In cases involving other grantees, we noted that Water Resources frequently accepted progress reports that lack the necessary detail, did not regularly conduct site visits or adequately document communications with grantees, and did not retain a percentage of payments to ensure that grantees remained on schedule. The manager of the flood protection program (program manager) indicated that high staff turnover, staff redirection, vacancies caused by the hiring freeze, and travel restrictions due to budget restrictions contributed to Water Resources' monitoring lapses; however, its responsibilities to effectively monitor the flood protection program dictate that it planned for such contingencies.

Water Resources is not legally required to obtain the advice of the Department of General Services (General Services) on appraisals for land acquisitions unless it is taking title to property valued at \$150,000 or more. Nevertheless, on several occasions Water Resources did seek General Services' advice but did not always heed it, potentially resulting in overpaying for land. In the case of the acquisition of Staten Island, Water Resources neither resolved the concerns noted by its staff or General Services that the appraised value of the land was too high.

Water Resources Has Established Project-Monitoring Practices

The flood protection program's regulations and grant agreements establish the framework of an approach for Water Resources to effectively monitor projects. This approach requires each grantee to provide a work plan with the project's specific schedule and components. For each project we reviewed, the grantee submitted such a work plan. Further, when grantees request payments, Water

Required Elements of Progress Reports

- Records of expenditures.
- Description of project activities since the previous report.
- Status of the project relative to the schedule.
- Key issues that must be resolved.

Source: California Code of Regulations, Title 23, Section 497.10(a).

Resources' monitoring approach requires them to submit progress reports that contain the elements shown in the text box. A progress report tells Water Resources what costs it should reimburse when approving the payment request, whether the project is on schedule, and whether any key issues need to be resolved. By requiring this information, Water Resources places itself in a stronger position to understand a project's status and any obstacles to reaching a successful and timely completion.

Water Resources' grant agreements also specify its right to inspect project sites to assess a grantee's compliance with the work plan. Another benefit of conducting a site visit is the opportunity it gives Water Resources to validate the progress reports the grantee submits with payment requests. Although neither regulations nor grant agreements specify the frequency of site visits, the program manager stated that his expectation is that two visits are conducted annually for each active project.

Other important aspects of Water Resources' monitoring process include documenting the dates and content of telephone and e-mail communications with grantees, tracking reimbursed costs to guard against exceeding project budgets, withholding portions of progress payments to ensure project completion or entire payments if it is not satisfied with project progress, and obtaining evidence that demonstrates that the grantee acquired the correct land with flood protection program funds.

Water Resources' monitoring approach would, if followed, provide the information required to adequately assess the status of projects and determine whether grantees are using funds appropriately. However, Water Resources does not always follow the procedures it has established.

Water Resources Failed to Adequately Monitor the \$5 Million Project With the City of Santee

Water Resources' monitoring of the Santee project demonstrates its weak practices in an extreme case. The Safe Drinking Water, Clean Water, Watershed Protection and Flood Protection Bond Act (Proposition 13) specifically earmarked \$5 million to Santee, located in San Diego County, for flood protection of its streets and highways. Water Resources entered into a letter of agreement in November 2000 specifying that Santee would receive \$4.75 million to enact flood protection measures in the flood corridor of

Forester Creek, which flows through the city. Water Resources retained the remaining \$250,000 for administrative, overhead, and bond processing costs.

Santee intended to use its funds to increase water flow capacity by excavating the nearby water channel and obtain land to expand the channel through the corridor. Under the letter of agreement, Santee agreed to provide Water Resources with semiannual progress reports. Each report would detail the activities for the reporting period, the amount of funds spent, and the purpose of each expenditure. Moreover, Santee stated it would complete the project no later than October 2003 and agreed to provide a final inspection report by a registered civil engineer to attest that the project was completed in accordance with the final plans and specifications.

For its part Water Resources specified in the letter of agreement that Santee would receive funds on a “just-in-time” basis to meet the city’s obligations and expenditure requirements. Specifically, Water Resources stated that it would disburse four payments, one for each major project task; withhold 10 percent of each payment request until Santee provided evidence that the task was complete; and withhold 10 percent of the last payment until Santee submitted an acceptable audit report on the project.

Even though Water Resources executed what appears to be a strong letter of agreement, its efforts to enforce the fiscal and reporting provisions were minimal. Between November 2000 and March 2004, when it received the balance of its award, Santee submitted only two semiannual progress reports, one in May 2001 and the other in November 2003. Water Resources sent a letter to Santee in October 2003 to express concern that the letter of agreement specified that the project should have been completed already. In its letter Water Resources wrote, “It is apparent that the schedule has been delayed, but no formal notification of this delay has been given to [Water Resources]. Although it is not a requirement of the letter agreement,” Water Resources asked Santee to submit “a brief report on the status of the project.”³ Water Resources also asked the city to “provide updated versions of the project description, schedule, and budget as well as an updated funding schedule.” In response the city indicated that it had “experienced delays in the project’s execution due to redesign and funding issues,” and it submitted the November 2003 progress report.

Water Resources executed what appears to be a strong letter of agreement with the city of Santee, but its efforts to enforce the fiscal and reporting provisions were minimal.

³ Water Resources’ letter is incorrect; as noted earlier, its letter of agreement with Santee required semiannual progress reports.

Water Resources has not followed up with Santee to obtain delinquent information in the three years since it was requested.

During this three-year period, Santee also submitted three payment requests: one in April 2002 and two in February 2004. However, Water Resources' records indicate that Santee did not include updated information to support the requests. The April 2002 invoice referenced the May 2001 progress report, yet Water Resources subsequently approved it for payment and withheld 10 percent of the amount. For the February 2004 invoices, Water Resources realized it had insufficient information on claimed costs. Although it indicated to Santee in a March 2004 letter that it would pay the invoices totaling roughly \$3.65 million, Water Resources went on to say that "within 60 days of completion of the proposed acquisitions" of property, it should "receive an accounting of the funds showing exactly how the grant funds were used." However, the manager monitoring the project acknowledged that Water Resources never received that information and, in the three years since the March 2004 letter, he has not followed up with Santee to obtain it. Moreover, even though the letter stated that Water Resources would withhold 10 percent of the new costs claimed (roughly \$350,000) from the February 2004 payment until Santee submitted an acceptable audit report on the project, Water Resources failed to do so. As a result of its lapse in monitoring the Santee project, Water Resources lost a powerful incentive to obtain the delinquent reports.

In response to our inquiries, Santee provided a record of how it spent the \$4.75 million disbursed to it, but that record was not always consistent with information the city had previously submitted to Water Resources. For example, in its two payment requests in February 2004, Santee stated to Water Resources that it had used the first \$1.2 million in funds it received for property acquisitions and claimed that it would use the remaining funds to pay for additional property acquisitions, including three invoices for property the Department of Transportation purchased for the Santee project. However, in response to our request for an accounting of how it used these funds, Santee supplied a list of expenditures that showed that it used the first \$1.2 million for project design and the remaining roughly \$3.5 million for property acquisitions. Although most of these properties were listed on invoices that Santee had previously sent to Water Resources, the list did not include three invoices for properties the Department of Transportation acquired for it. Because Water Resources is responsible for appropriately monitoring the Santee project, it should follow up to determine how the city spent the flood protection program funds.

Water Resources may still retain some leverage to help it properly monitor the Santee project. Specifically, Santee may still be due nearly \$250,000 in flood protection program funds from Water Resources. As noted in the Introduction, Water Resources estimates it will spend only \$20,000 of the \$3.5 million it set aside for

bond administration and the \$250,000 it retained from Santee's allocation for administrative, overhead, and bond processing costs. If Santee can demonstrate that it can use the funds for flood protection purposes, Water Resources should release the unspent portion of allocated funds to the city. However, it should do so only after Santee provides an audit report with an accounting of how the city used the \$4.75 million previously disbursed and a final inspection report by a registered civil engineer, as the letter of agreement requires.

Water Resources Has Not Adequately Monitored Other Projects

We observed that when monitoring 12 other projects, Water Resources did not always perform the following steps:

- Obtain all the required information from grantees that submitted progress reports.
- Regularly conduct site visits.
- Adequately document communications and visits with grantees.
- Adequately track project expenditures against their budgets.
- Exercise its ability to retain a percentage of each progress payment for noncapital costs until work is complete.
- Obtain evidence that grantees successfully acquired property with program funds.

We discuss each of these lapses in Water Resources' monitoring practices in detail in the subsections that follow.

The table on the following page summarizes our evaluation of Water Resources' monitoring efforts based on our assessment of its actions related to 12 projects in our sample (we did not include the Santee project, which was discussed in the previous section). Detailed evaluations of its monitoring of all the projects we reviewed appear in the Appendix. We applied three "grades" when evaluating Water Resources' monitoring efforts. As shown in the table, a "Yes" grade (✓) indicates that Water Resources' monitoring of the project always met the criteria, a "No" grade (✗) means that its monitoring efforts met the criteria for less than 50 percent of the items tested, and a "Marginal" grade (■) reflects our determination that Water Resources did not always meet the monitoring criteria but did so at least 50 percent of the time. Table A.1 in the Appendix contains more information on the criteria we used to evaluate Water Resources' monitoring efforts.

If Santee can demonstrate that it can use the funds for flood protection purposes, Water Resources should release the unspent portion of allocated funds to the city, but only after Santee provides an audit report with an accounting of how the city used the \$4.75 million previously disbursed and a final inspection report by a registered civil engineer.

Table
Summary of Grades for the Department of Water Resources' Monitoring of Sampled Projects

	DIRECT-EXPENDITURE PROJECTS					COMPETITIVE GRANT PROJECTS						
	STATEN ISLAND*	MYSTIC LAKE*	OJAI MEADOWS	BIG BEND	MIDDLE CREEK	LAKESIDE SAN DIEGO PARK	UPPER PAJARO RIVER*	CLOVER CREEK	SANTA MARIA RIVER	TEMESCAL-BEDFORD WASH	VIERRA RANCH	MURRIETA CREEK
Work Plan												
Specific schedule and components of projects (task/schedule breakdown)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Progress Reports												
Records of expenditures	NA	NA	✗	✗	✓	✓	NA	✓	■	■	✗	✗
Description of project activities since prior report	NA	NA	✗	✓	✗	✓	NA	✓	✓	✓	✗	✓
Description of overall status from a budgetary perspective	NA	NA	✗	✗	✗	✗	NA	✗	✗	✗	✗	✗
Description of whether project is ahead of, on, or behind schedule	NA	NA	■	✗	✗	✗	NA	✗	✗	✗	✗	✓
Key issues to resolve to ensure timely project completion	NA	NA	✗	✗	✗	✗	NA	✗	✗	✗	✗	✗
Site Visits												
Frequency of site visits	NA	NA	✗	✗	NA	✗	NA	■	✗	✗	✗	NA
Description of site visit activities	NA	NA	✗	✓	NA	✗	NA	✗	✗	✗	✓	NA
Communication With Grantees												
Frequency of documented communication	NA	NA	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗
Documentation of communication	NA	NA	✓	✓	✓	✗	✓	✗	✓	✗	✓	✗
Fiscal Controls												
Budget-tracking sheet consistent with latest amendments	NA	NA	✗	✗	✗	✓	✗	✗	✗	✗	✓	✓
Withheld 10 percent from payments	NA	NA	✗	✗	✗	✗	NA	✗	✗	✗	✗	✗
Contract Deliverables												
Deeds, closing statements, easements, and other real estate documents	✓	✗	NA	✓	■	✓	NA	NA	✓	NA	NA	NA

Source: Bureau of State Audits' review of the Department of Water Resources' Flood Protection Corridor Program project files.

Note: Rationales for the grades of ✓, ■ and ✗, as well as inapplicable items marked NA, are provided in the project-specific report cards, tables A.2 through A.14, in the Appendix.

NA = Not applicable.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

■ = Marginal. Water Resources did not always meet the monitoring criteria, but did so at least 50 percent of the time.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

* Three of the 12 projects did not involve ongoing activities. The Staten Island and Mystic Lake projects each only involved the acquisition of one property. Additionally, as discussed in Chapter 1, the Upper Pajaro River project is stalled.

Water Resources Did Not Consistently Obtain Acceptable Progress Reports From Grantees

Before disbursing flood protection program funds for requested progress payments, Water Resources did not obtain acceptable progress reports for nine of the projects we reviewed that needed progress reports.⁴ Regulations of the flood protection program require that a progress report include records of expenditures, descriptions of project activities, status of the project relative to the schedule, and key issues to resolve. Four projects did not provide records of expenditures in their progress reports to demonstrate that the projects properly used the funds claimed. Further, Water Resources approved payments to three projects after receiving progress reports with inadequate descriptions of activities since the prior progress report.

For example, in consecutive progress reports for June 2003, June 2004, and April 2005, the grantee for the Ojai Meadows project described the work performed for one task by basically restating the task name, without providing an explanation of what it had accomplished since the prior report, which would assure Water Resources that the grantee was not making payment requests for the same work. To verify that grantees are claiming allowable costs, Water Resources needs to obtain simple supporting documents, like subcontractor invoices and receipts. Water Resources indicated that it only began requiring grantees to submit such records of expenditures during the course of this audit.

Because the flood protection program regulations do not specify how grantees should discuss project status relative to schedules and key issues to resolve, we defined what we considered to be reasonable expectations for progress report content based on best practices and our experience. We expected progress reports to describe whether the project is on track from a budgetary perspective; to state whether the project is ahead of, on, or behind schedule; and to expressly address the presence or absence of key issues to resolve for the successful and timely completion of the project. Progress reports for all nine projects that needed them failed to adequately describe projects' fiscal status and key issues requiring resolution. Moreover, although most of the projects we reviewed have been delayed, we found that only the progress reports for the Ojai Meadows and Murrieta Creek projects indicated whether they were ahead of, on, or behind schedule.

Four of nine projects reviewed did not provide records of expenditures in their progress reports to demonstrate that the projects properly used the funds claimed.

⁴ We did not expect progress reports for three of the 12 projects we reviewed. The Staten Island and Mystic Lake projects each involved the acquisition of one property in one transaction with no further progress that would require tracking. Additionally, as discussed in Chapter 1, the Upper Pajaro River project is stalled and has not received any funds.

Because Water Resources did not regularly visit project sites, it could not compensate for the missing or incomplete information contained in the grantees' progress reports.

By defining and requiring such reasonable information, Water Resources can make better informed management decisions and maintain a stronger understanding of project status.

Water Resources Did Not Meet Its Goal for Conducting Regular Site Visits, and It Poorly Documented the Results of Site Visits It Did Perform

Although the regulations of the flood protection program do not require site visits, Water Resources has an informal goal to conduct them; however, it did not meet its goal. Therefore, because it did not regularly visit project sites, it could not compensate for the missing or incomplete information contained in the grantees' progress reports. According to the program manager, Water Resources set an informal goal to visit each active project site twice annually. However, in reviewing the activity logs that its staff maintain to document their visits and communications with grantees, we determined that Water Resources did not meet this expectation for six of the seven projects it should have visited.⁵ For example, Water Resources' files indicate that it visited the Big Bend project site only three times since its first payment to the grantee in June 2002.

Water Resources also did not record several site visits in its activity logs. Rather, it documented staff visits by keeping travel expense claims, which merely record a staff person's travel costs. Moreover, when we requested a list of the site visits it had made, Water Resources provided us with a list it asserts was based on travel records, date stamps on digital photographs, and day planners; however, it did not include evidence to substantiate the list. Visiting each site on a regular basis can provide Water Resources assurance that progress reports accurately and fairly reflect project status, particularly since Water Resources received progress reports that lacked key pieces of information, as described in the previous section.

For the site visits it did record, Water Resources did not ensure that staff adequately described the activities they performed for five projects we reviewed. For example, for a visit to the Temescal-Bedford Wash project site, a staff person recorded only one activity, "planting slopes," and for two other site visits, the staff person mentioned conversations with grantee staff but did not discuss how the project was progressing. In contrast, the entries in the Vierra Ranch activity log provided a summary of the visit, discussed the grantee's progress and issues to resolve by task, and explicitly stated that the work completed in the field appeared to match the progress the grantee reported. The program manager

⁵ The Staten Island and Mystic Lake projects each involved the acquisition of one property, the Middle Creek project is mostly land acquisition, and the Upper Pajaro River and Murrieta Creek projects are stalled; therefore, we did not expect Water Resources to visit them.

acknowledged that Water Resources did not maintain activity logs during busy periods or meet its goal for site visits because of staff turnover. As a result of this audit, the program manager told us Water Resources has developed an observation form to standardize how it conducts and records site visits.

Water Resources Did Not Consistently Record or Prioritize Noteworthy Communications With Grantees

As part of its monitoring process, Water Resources uses activity logs to document its communications with grantees. These activity logs are accessible by all staff within the flood protection program and are intended to assist them in their monitoring efforts by providing a record of important communications, which might include updates on project status or key issues grantees need to resolve. When the flood protection program experiences staff turnover, activity logs are particularly useful in helping a new employee become familiar with a project's history.

Although Water Resources has not established policies or procedures dictating how often communication should occur, we believe contacting a grantee at least once every three months to follow up on the project's progress and documenting the results of the discussion in the activity log would constitute sound proactive monitoring. However, our review of 10 projects where we expected ongoing communication revealed that all had activity logs showing gaps in documented communications exceeding three months.⁶

According to the project manager, to mitigate gaps in the project activity logs, Water Resources retains its e-mail communications with grantees, and he provided lists of e-mails with the grantee for the Lakeside San Diego Park project and others as examples. The lists referenced hundreds of e-mails but do not prioritize noteworthy communications or present new staff with key information on project status, which is the intent of keeping an activity log. Further, the program manager indicated that staff had regular telephone contacts with grantees that were not documented in the activity logs. Our review also found that four of the 10 projects had activity logs, which indicated that Water Resources had communicated with grantees, but did not document the context of those communications. Without a summary of the topics covered in conversations, the value of the activity log as an effective monitoring tool is diminished.

Our review of 10 projects that we expected ongoing communication with grantees revealed that all had project activity logs showing gaps in documented communications exceeding three months.

⁶ Because the Staten Island and Mystic Lake projects each involved the acquisition of one property, which occurred shortly after the grant was awarded, we did not expect Water Resources to maintain activity logs for them.

During one 13-month period Water Resources disbursed more than \$102,000 to a grantee but did not document any communication in the project's activity log.

The activity log for the Temescal-Bedford Wash project is an example of the limited documentation of noteworthy communications between Water Resources and a grantee. In July 2004 Water Resources entered into an agreement with the grantee, awarding \$2.5 million in flood protection program funds for the acquisition of property. In September 2004 Water Resources began disbursing flood protection program funds and has since disbursed a total of more than \$762,000. Water Resources' activity log for this project begins in August 2004, which is around the time of the first payment; however, we did not see a subsequent entry in the activity log until September 2005, or nearly 13 months after the previous entry. During the 13-month period Water Resources had disbursed more than \$102,000 but did not document any communication in the activity log. The last entry that we observed in the activity log was made in November 2006.

Further, Water Resources' activity log for the Temescal-Bedford Wash project demonstrated the limited descriptions of communications with grantees. For example, Water Resources' staff noted that they sent the grantee a request for a "budget design clarification." However, it is unclear from the activity log what aspect of the project's budget needed clarification and why, because the entry did not describe the clarification requested, and no subsequent entries addressed this request. As a result of long gaps between entries and vague descriptions, activity logs have limited value as tools for keeping staff apprised of important communications with grantees.

With Its Inadequate Tracking of Expenditures, Water Resources Has Weakened Its Fiscal Control Over Projects

Although Water Resources has a process to track payments, it did not adequately track expenditures against the budgets for seven of 10 projects we reviewed to which Water Resources made ongoing payments or expected to make future payments.⁷ Specifically, Water Resources did not update its budget-tracking sheets to reflect amendments in the budgets for the Middle Creek, Upper Pajaro River, Santa Maria River, and Temescal-Bedford Wash projects, inaccurately recorded expenses for the Ojai Meadows project, and did not properly record the budget for the Big Bend project on the budget-tracking spreadsheet. These errors limit Water Resources' ability to hold the projects accountable to approved budgets.

⁷ The Staten Island and Mystic Lake projects each received one payment, which only required simple tracking.

Moreover, they indicate a basic weakness in a key fiscal control that could result in Water Resources paying for activities not included in approved budgets.

Further, for the Clover Creek and Temescal-Bedford Wash projects, Water Resources approved payment requests that exceeded the projects' then-currently approved budgets for certain tasks. For example, Water Resources approved a May 2005 payment request for \$1.1 million to the Clover Creek project that exceeded the approved budget for two tasks by more than \$300,000. At the time Water Resources was processing a budget amendment to reallocate funds among tasks, but the amendment was not approved before Water Resources made the payment. According to the program manager, if the invoice had not been paid before June 30, the grantee would have had to wait until the fiscal year 2005–06 budget was approved and the funds were available, which he believed could cause a delay of four to five months. Subsequently, Water Resources approved budget amendments to reallocate the existing grant funds among tasks.

The grantee's situation notwithstanding, Water Resources has a fiduciary responsibility to safeguard funds and follow state administrative procedures. Although its administrative missteps did not lead to improper payments, they increase Water Resources' risk of inappropriately approving unallowable payment requests or rejecting allowable ones. Tracking expenditures against budgets is a key fiscal control to ensure that projects stay within budget and can provide a tool to guard against duplicate payments.

Water Resources Chose Not to Withhold a Percentage From Payments to Ensure Project Completion

The flood protection program's regulations and grant agreements allow Water Resources to retain up to 10 percent from each payment for costs other than land acquisition. The regulations also allow Water Resources to withhold any payment if it does not believe that a project is making adequate progress. However, it did not use this authority for any of the projects receiving payments for costs other than land acquisition that we reviewed. According to the program manager, Water Resources has not withheld funds because many grantees are small local agencies and nonprofit organizations that do not have the financial reserves to continue working on their projects if they do not receive their entire payments.

Not withholding funds from projects may have actually contributed to the slow progress that many projects have made over the past few years. Of the 12 project work plans we reviewed, 10 required the grantees to complete their work by the end of 2006, and the

Tracking expenditures against budgets is a key fiscal control to ensure that projects stay within budget and can provide a tool to guard against duplicate payments.

Had Water Resources retained 10 percent of the \$4.75 million it disbursed to the city of Santee, it would have had more leverage to encourage the city to finish its project and submit the required reports promptly.

remaining two were to be completed by the end of October 2007. Yet Water Resources considers only three of the 10 projects complete. Among the completed projects are the Staten Island and Mystic Lake projects, which were solely land acquisitions and involved only one payment each to purchase land. Water Resources accepted the final completion report from the third project, Clover Creek, in 2007. The program manager and the legal counsel for the flood protection program both believe Water Resources has not encountered situations where withholding a percentage of payments would have affected progress. Instead, they assert that other factors delayed these projects. However, as discussed previously, the Santee project has experienced significant delays, and also failed to submit required reports. Had Water Resources retained 10 percent of the \$4.75 million already disbursed to the city of Santee, it would have had more leverage to encourage the city to finish its project and submit the required reports promptly.

Water Resources Did Not Always Obtain Required Documents on Land Acquisition or Property Interest

Water Resources' grant agreements requires grantees to submit evidence that the correct land or interest in land was acquired with flood protection program funds within 60 days of acquisition. The evidence can be a legal document, such as a grant deed, showing the grantee as the new property owner. However, Water Resources has not obtained a required easement for the Mystic Lake project and did not obtain required deeds for two properties purchased for the Middle Creek project.

As part of its Mystic Lake grant agreement, Water Resources required the grantee, the Wildlife Conservation Board, to deliver a final recorded easement allowing Water Resources to implement a flood protection project or flood control easement. Although Water Resources disbursed \$5 million to help purchase the property in March 2002, according to the program manager, it has not yet obtained a signed, recorded easement. Because Water Resources does not yet have the conservation easement, it cannot record the easement, which would serve as a way of demonstrating its rights under the easement. According to the legal counsel for the flood protection program, the Wildlife Conservation Board's review and approval can be time consuming. Nevertheless, it is Water Resources' responsibility to obtain the easement for which the flood protection program paid.

Moreover, although Water Resources received acceptable evidence for properties that four grantees purchased, it did not receive such evidence for two of the seven properties purchased under the Middle Creek project. When we asked staff at Water Resources

to locate the missing documents, they contacted the grantee and received the documents a few days later. However, Water Resources' failure to obtain the conservation easement and other evidence when the property acquisition occurred increases the risk that it will not realize the proposed flood protection benefits of the project and others like it.

Water Resources Needs to Develop a Process for Reporting Future Costs of the Flood Protection Program

In 2003 the Legislature amended the State General Obligation Bond Law (bond law) to require agencies that administer bond funds to report to the Legislature and the Department of Finance (Finance) on the status of bond-funded projects at least once a year. Because Proposition 13 predates the bond law's effective date, Water Resources did not fall under the reporting requirements for the flood protection program. However, with the continuation of the flood protection program through the \$40 million provided by the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006 (Proposition 84) and the \$290 million from the Disaster Preparedness and Flood Prevention Bond Act of 2006 (Proposition 1E), Water Resources will be required to report regularly to the Legislature and Finance on the status of projects funded by these bonds. The text box details the reporting requirements for propositions 84 and 1E.

Bond Law Reporting Requirements for Bonds Approved After January 1, 2004

A state agency administering bond proceeds must report at least once a year to the Legislature and the Department of Finance the following information:

- A list of all funded, required, or authorized projects and their geographical location.
- The amount of funds allocated on each project.
- The status of any project required or authorized to be funded.

Source: California Government Code, Section 16724.4.

Additionally, a January 2007 executive order issued by the governor on bond accountability requires state agencies like Water Resources to make semiannual reports to Finance about the ongoing actions taken to ensure that projects and activities funded from bond proceeds are being executed in a timely fashion and are achieving their intended purposes.

Although it has informally reported project status in the past, Water Resources needs to develop regular reporting procedures in compliance with the bond law and the governor's executive order for the Proposition 84 and Proposition 1E funds that the flood protection program will administer. According to the program manager, Water Resources informally reported project status to the Legislature even though it was not required to do so. Additionally, the chief of the division of flood management (chief) explained that Water Resources' management learns of project status through conversations with flood protection program staff, contract amendment requests, and the program manager's annual appraisals.

The chief of the division of flood management told us that a more formal reporting process was not created because of a shortage of staff and because the informal reporting did not indicate significant problems that would necessitate more structured information.

The chief further stated that Water Resources occasionally provides a written update on projects in its monthly activity report to the Reclamation Board, and that Finance requires an annual high-level report on bond expenditure status. Water Resources provided us with examples of these reports, however, they lacked the information needed to comply with the reporting requirements of the bond law and the governor's executive order.

The chief told us that a more formal reporting process was not created because of a shortage of staff and because the informal reporting did not indicate significant problems that would necessitate more structured information. However, the chief agreed that Water Resources may gain some benefits from implementing a more formal internal process for reporting the status of the flood protection program and that such reporting may help it follow up on projects that have stalled.

The program manager stated that to comply with its new requirements, Water Resources intends to purchase a software package that will expedite and simplify the process of reporting project status. Water Resources plans to use the software when reviewing grant applications for Proposition 84.

Although It Is Not Legally Required to Do So, Water Resources Has Voluntarily Chosen to Seek General Services' Advice on Some Land Acquisition Grants

Although it is not legally required to obtain the advice of either the Public Works Board or General Services, Water Resources has at times decided that doing so would be beneficial.⁸ For example, Water Resources asked General Services to provide an opinion on the appraisal for the flood protection program's largest expenditure, the acquisition of Staten Island. In its grant agreements for nine projects that have included land acquisitions, Water Resources inserted clauses stating that General Services would review land appraisals before disbursements of flood protection program funds occurred. Nevertheless, our audit found that Water Resources' use of General Services, in practice, has been limited. General Services was solely responsible for reviewing the appraisal report for only three of the nine projects that have acquired land, with Water Resources' land agents solely reviewing

⁸ As discussed in the Scope and Methodology section of the Introduction, Water Resources is statutorily exempt from oversight of the Public Works Board. It is, however, required to obtain approval from General Services when it enters into a contract wherein it acquires an interest in real property valued at more than \$150,000.

the five other appraisal reports. For the last project that acquired land—the Staten Island project—both General Services and Water Resources reviewed the appraisal report.

According to the program manager, before 2004 Water Resources primarily requested General Services to review appraisal reports and real estate documents. In 2004 Water Resources began primarily using its land agents and continued seeking General Services' help only on an exception basis.

Water Resources' decision to submit four grants to General Services for review seemed to be valuable because General Services noted concerns with the appraised value of land in two instances. For the Mystic Lake grant, General Services rejected the appraisal, which, according to General Services' appraisal reviewer, resulted in the property owner lowering the sale price to an acceptable level. In the case of Staten Island, General Services reviewed the appraisal and the proposed conservation easement to be obtained by the State and concluded that the appraised value of the land was "at the high end of the value range, but the analysis, opinions, and conclusions are not unreasonable to the point that the [appraisal] report is rejected." (We discuss this review further in the next section.)

In its review documents approving the conservation easement, General Services noted "certain limiting conditions" on its review, stating that it "was done on draft or photocopy documents" provided by Water Resources and that it received certain key documents, including the draft escrow instructions and the signed easement and grant agreement just one day prior for review. Citing "extreme pressure to finish our processing and approve the documents as drafted," General Services noted that it could not perform "a page by page comparison to confirm that the reviewed drafts and signed documents are the same, or that Escrow Instructions are accurate."

Ultimately, General Services approved the appraisal and conservation easement. Nevertheless, we would have expected Water Resources to use the information provided in General Services' review documents to attempt to negotiate a lower purchase price and to ensure that General Services felt comfortable with the conservation easement and closing documents; however, this did not happen. Moreover, as discussed in the next section, Water Resources did not share with General Services its concerns about the Staten Island appraisal.

In addition, Water Resources asked that General Services review an appraisal report for the Napa River project, which is in the process of acquiring land. General Services conditionally approved the value of

Water Resources' decision to submit four grants to General Services for review seemed to be valuable because General Services noted concerns with the appraised value of land in two instances.

Water Resources is withholding payment for one property until the issues raised by General Services concerning the appraisal are resolved.

the land for “at least \$500,000,” contingent on adequate access to the property for its highest and best use, which General Services’ appraisal review indicates is outside storage. General Services expressed concern that the value of the land would be significantly less than \$500,000 in the absence of adequate access to the property because it could not be used for storage purposes. The program manager indicated that he and legal counsel for the flood protection program concluded that the \$500,000 value was appropriate without requiring road improvements to the property because doing so would be counter to the grantee’s intended uses—open space, floodplain, and habitat. The General Services’ appraisal reviewer stated that General Services does not track whether contingencies are resolved when its role is limited to providing advice on an appraisal report, and in this case he had no further contact on the project after completing the review. Although the legal counsel for the flood protection program had concluded that the \$500,000 value was appropriate, in September 2007 he stated that Water Resources is withholding payment until the issues concerning the appraisal are resolved.

Unresolved Concerns With the Appraisal for Staten Island May Have Resulted in Water Resources Overpaying for the Land

Recognizing that the grant to The Nature Conservancy (Nature Conservancy) for the purchase of Staten Island was the flood protection program’s largest grant, in August 2001 Water Resources asked General Services for its advice on whether the island’s appraised value was reasonable. Although General Services and the appraisal staff at Water Resources expressed concerns that the appraised value of Staten Island was too high, Water Resources made no effort to address those concerns.

Nature Conservancy provided Water Resources with a December 2000 appraisal of Staten Island’s value: a total value of \$31.5 million, with real property valued at \$29.5 million (including \$2 million for farm improvements) and \$2 million for machinery and equipment. After an initial review of the appraisal, officials with Water Resources were concerned that the appraised value of \$29.5 million for the property was too high. Minutes of a meeting held on August 21, 2001, among representatives of Water Resources, General Services, and the Attorney General’s Office indicate that attendees discussed the potential transaction and decided it would be prudent for Water Resources and General Services to do a joint review of the appraisal.

Both Water Resources and General Services Reviewed the Appraisal

In a review drafted on August 27, 2001, Water Resources' appraisal staff concluded that the appraiser's value of \$29.5 million was overstated by \$7.9 million. In explaining the lower valuation, Water Resources' appraisal staff took issue with several elements of the Staten Island appraisal, including the appraiser's depiction of market conditions. In the review, Water Resources' appraisal staff stated, "In general, while I agree that values have increased slightly over the past 4 or 5 years, I believe a 40 percent change in value is unrealistic and unrepresentative of the market." Water Resources' appraisal staff also took issue with the comparable property sales the appraiser used when reaching a valuation for the island, stating that "a number of the sales should be removed from final consideration because of the conditions of the sales, their distance from the subject or difference in location influences, and their potential for development."

Water Resources' review of the appraisal concluded that only four of the 13 property sales the appraiser cited were truly comparable to the Staten Island property. Based on these findings and others, Water Resources appraisal staff concluded that the value of the real property associated with Staten Island was \$21.6 million, rather than the \$29.5 million listed in the appraiser's report.

On September 4, 2001, General Services completed its review of the appraiser's report and valued the island at \$27.5 million for the land only, excluding land improvements because of a lack of data. General Services pointed out several areas that could be a basis for negotiating a lower price. For example, General Services indicated that the appraiser's annual rate of appreciation of 10 percent for prior sales was potentially too high and that comparable land sales of less than 1,000 acres should not be used in appraising Staten Island, which comprises 9,200 acres. However, General Services' conclusion was not as critical as Water Resources'; it stated the following:

The overall impression of this report is that the appraiser has done a relatively conscientious job in attempting to quantify [valuation] . . . but his conclusions generally favor the subject. However, bearing in mind that the appraiser does get to have an opinion, there is no fatal flaw that would cause the report to be rejected. It is merely a matter of the appraiser being at the absolute upper end of the value range. Still there are several areas that could be the basis for negotiating a lower overall value for the ownership.

Water Resources appraisal staff concluded that the value of the real property associated with Staten Island was \$21.6 million, rather than the \$29.5 million listed in the appraiser's report.

Our interview with a Water Resources' appraisal staff person confirmed that she was directed by her manager to refrain from sharing her concerns about the appraisal for Staten Island with General Services' staff.

Water Resources Failed to Resolve the Issue of Staten Island's True Value

Despite their concerns with the Staten Island appraisal, Water Resources' appraisal staff declined to share any of their opinions during a meeting between General Services and Water Resources staff held on August 29, 2001. In an entry in his project diary, the real estate officer with General Services who reviewed the appraisal suggested that Water Resources' appraisal staff were told not to express their opinions regarding the Staten Island appraisal. Our interview with a Water Resources' appraisal staff person confirmed that she was directed by her manager to refrain from sharing her concerns about the appraisal with General Services' staff. The appraisal staff person indicated that "the normal process when you review an appraisal is that you work together with [General Services] and the appraisal firm to resolve any concerns you or others have." That kind of collaboration in this case might have effectively resolved concerns regarding Staten Island's value, ensuring that the State's interests were adequately protected.

Questions about Staten Island's appraised value appear to have been well founded, because a subsequent appraisal conducted on neighboring properties in September 2004 considered, but decided not to use, the Staten Island transaction as a comparable sale. The appraisal reported, "It is the consensus of local brokers and appraisers that the price paid [for Staten Island] was well above market." This appraisal indicated Staten Island's sale price was \$3,349 per acre. The sale price of the second most expensive potentially comparable property was quoted at \$2,791 per acre, and the average among the comparable sales excluding Staten Island was \$2,416 per acre. The September 2004 appraisal was for four neighboring properties totaling more than 20,000 acres south of Staten Island. The appraisal was performed for Water Resources while it was considering purchasing the properties for a water storage project. On average, the four properties were appraised at \$2,311 per acre.

Despite General Services' conclusion that Staten Island's appraisal value was at the "absolute upper end of the value range" and its own internal reviewer's concerns about the appraisal, Water Resources proceeded to enter into a grant agreement with Nature Conservancy on September 27, 2001. Water Resources agreed to provide \$17.6 million from flood protection program funds for half of the purchase price, with the remaining funds coming from the CALFED Bay-Delta Ecosystem Restoration Program. Nature Conservancy and the seller agreed on a purchase price of \$30 million for Staten Island. The grant agreements and closing documents specify that the \$17.6 million from the flood protection program are for the property acquisition only, while the restoration program funds are for the remainder of the property

acquisition costs (\$12.4 million) and to fund Nature Conservancy's ongoing stewardship of the island (roughly \$5.1 million), making a total of \$35.1 million for the Staten Island acquisition.

Recommendations

Water Resources should follow up with Santee to determine how the city spent its funds. Additionally, Water Resources should release the unspent portion of allocated funds to the city but only after Santee demonstrates it can use the funds for flood protection purposes, provides an audit report with an accounting of how the city used the \$4.75 million previously disbursed, and submits a final inspection report by a registered civil engineer, as the letter of agreement with Santee requires.

To effectively monitor projects, Water Resources should develop policies and procedures to ensure that it does the following:

- Receives sufficiently detailed and complete progress reports from grantees, with supporting records of expenditures, descriptions of project activities, status of budget and schedule, and key issues to resolve.
- Communicates to staff its expectations for conducting and documenting site visits.
- Establishes expectations for how often staff should communicate with grantees and develops a process to record communications consistently.
- Regularly updates its project budget-tracking sheets to adjust for contract amendments and changes in budgeted tasks and to accurately track funds disbursed to grantees.
- Withholds a percentage of payments to a grantee when appropriate and releases the funds only after it is satisfied that the project is reasonably complete.

To comply with reporting requirements for projects it funds under propositions 84 and 1E, and to ensure that its management is kept apprised of key issues, Water Resources should develop a process for reporting project status. This process should include regular reporting of each project's budget and cost status, progress in meeting the goals and time schedules specified in the grant agreement, and any key events affecting the project.

To avoid paying more than fair market value for properties, Water Resources should, before disbursing funds, take steps to ensure that it resolves concerns about the quality of appraisals raised by its staff and General Services, when its advice is sought.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of the report.

Respectfully submitted,



ELAINE M. HOWLE
State Auditor

Date: November 1, 2007

Staff: John Baier, CPA, Audit Principal
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Appendix

REPORT CARDS OF THE DEPARTMENT OF WATER RESOURCES' MONITORING OF 13 PROJECTS FUNDED BY THE FLOOD PROTECTION CORRIDOR PROGRAM

As discussed in the Introduction, we graded the Department of Water Resources (Water Resources) on its monitoring of 13 projects that received funding through the Flood Protection Corridor Program (flood protection program), including the project in the city of Santee. We based our evaluation of Water Resources' performance on its flood protection program regulations, grant agreements, and informal policies, as shown in Table A.1 on the following page. In the absence of established criteria, we used reasonable expectations for several monitoring activities, including documentation of communications with grantees, based on best practices and our past experience.

We summarize the results of our grading of Water Resources' monitoring efforts in the Table in Chapter 2 on page 36 and explain our conclusions for each of the 13 selected projects separately in tables A.2 through A.14 beginning on page 54.

Table A.1
Criteria for Evaluating the Department of Water Resources' Monitoring of Sampled Projects

	CRITERIA	PASSING CRITERIA*
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	Title 23, California Code of Regulations (CCR), sections 497.7(e) and 497.9(a)—The specific schedule and components of the project should be defined, such as a project timetable and task breakdown.	All grant agreements contain a work plan that provides a description of each major task, along with that task's budget and scheduled completion date.
Progress Reports		
Records of expenditures	Title 23, CCR, Section 497.10(a)(1); Reasonable Person [†] —When claimed work referenced subcontractors, grantees provided copies of subcontractor invoices to support the claimed amount. The grantee's "record of expenditures" went beyond its assertion of incurred eligible costs.	All sampled progress reports covering noncapital costs (other than land acquisition activity) include records of expenditures that support the payment request (or invoice) from the grantee. Records of expenditures include subcontractor invoices and other evidence of costs incurred.
Description of project activities since prior report	Title 23, CCR, Section 497.10(a)(2); Reasonable Person—In describing the work performed, the grantee's description was specific enough to explain to the lay reader why claimed costs would be reimbursed with program funds.	All sampled progress reports contain descriptions of activities claimed in associated invoices. The descriptions are discrete/unique enough to identify distinguishable project progress.
Description of overall status from a budgetary perspective	Title 23, CCR, Section 497.10(a)(3) and (a)(4); Reasonable Person—As the administering state agency, the Department of Water Resources (Water Resources) should be getting regular reports comparing the project's budget to its estimated final expenditures.	All sampled progress reports describe whether the project is or is not on track from a fiscal perspective.
Description of whether project is ahead of, on, or behind schedule	Title 23, CCR, Section 497.10(a)(3) and (a)(4); Reasonable Person—As the administering state agency, Water Resources should be getting regular reports regarding the project's completion schedule.	All sampled progress reports indicate whether the project is ahead of schedule, on schedule, or behind schedule.
Key issues to resolve to ensure timely project completion	Title 23, CCR, Section 497.10(a)(3) and (a)(4); Reasonable Person—As the administering state agency, Water Resources should be getting information on potential roadblocks to the successful and timely completion of projects.	All sampled progress reports state whether any key issues still need to be resolved for the successful and timely completion of the project.
Site Visits		
Frequency of site visits	Department's internal goal for the program and its plans to monitor future grants—Water Resources intends to conduct site visits of each active project twice over a 12-month period.	All project sites were visited twice or more within a 12-month period. (Does not apply to projects that involve only land acquisition or that Water Resources knew were already stalled.)
Description of site visit activities	Reasonable Person—The results of site visit should be documented in project activity logs to improve monitoring and verify the accuracy and completeness of submitted progress reports.	All site visit descriptions we reviewed contain: (1) assessment of the grantee's progress on the project (based on observation), and (2) identification or follow up on key issues that could adversely impact project progress and/or completion.
Communication With Grantees		
Frequency of documented communication	Reasonable Person—Communication should be frequent enough to ensure the department stays current on the grantee's progress. Water Resources should communicate with a grantee at least once every three months.	All entries on a project's activity log demonstrate that some form of communication took place (such as references to phone calls, e-mails, or letters) within a 3-month period.
Documentation of communication	Water Resources' expectations; Reasonable Person—Important communication with grantees should be adequately documented in project activity logs to promote effective monitoring. Examples of important communication include updates on project status or key issues grantees need to resolve.	All communication referenced in a project's activity log describe the topics of conversations and why they are relevant or important to the project. (Entries that simply state "follow-up e-mail" or "spoke with grantee" are insufficient documentation of conversations.)

CRITERIA		PASSING CRITERIA*
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	Water Resources has a budget-tracking sheet for each project that defines the fiscal budget for each major project task and is used to monitor expenditures against these budgets.	All expenditures for projects that have multiple project tasks are tracked with budget-tracking sheets, on which staff have accurately recorded both the budgets and expenditures to-date (by task).
Withheld 10 percent from payments	Title 23, CCR, sections 497.3(n) and 497.9(i); Grant Agreements; Reasonable Person—Grantees have more incentive to finish projects and meet milestones in a timely manner when a portion of payment is withheld until project completion. Therefore, Water Resources should withhold a percentage of its progress payments.	At least one payment had a 10 percent withholding. We applied this criteria only to those claimed costs where land was not being acquired (such as construction costs).
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	Grant Agreements; Reasonable Person—When interest in real property is to be acquired with program funds, Water Resources should obtain evidence that such interests were actually acquired through grant deeds and other closing documentation.	All properties purchased by grantees for projects in our sample have copies of grant deeds and/or similar documents indicating that the targeted land was acquired.

Sources: Title 23, California Code of Regulations, Chapter 2.7.1, grant agreements, and Department of Water Resources' (Water Resources) procedures.

* A *Yes* grade means that Water Resources' monitoring always met the criteria. A *No* grade means that Water Resources met the monitoring criteria less than 50 percent of the time. A *Marginal* grade means that Water Resources did not always meet the monitoring criteria, but did so at least 50 percent of the time.

† In the absence of established monitoring criteria, we defined what we considered to be reasonable expectations based on best practices and our past experience.

Table A.2
Monitoring Report Card for City of Santee

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports*		
Records of expenditures	✗	Department of Water Resources (Water Resources) approved payments without requiring subcontractor invoices to verify the city's assertion of incurred eligible costs.
Description of project activities since prior report	✗	Although the city provided good descriptions of project activities, Water Resources allowed a 2-year gap between progress reports. This gap erodes the value of the described activities in the project's progress reports.
Description of overall status from a budgetary perspective	✗	The 2 progress reports did not indicate whether the project was underbudget, on budget, overbudget, or compare expenditures to the budget.
Description of whether project is ahead of, on, or behind schedule	■	One of 2 progress reports addressed whether the project remained on schedule.
Key issues to resolve to ensure timely project completion	✗	The 2 progress reports did not indicate whether there were any key issues that needed to be resolved to ensure timely project completion.
Site Visits		
Frequency of site visits	✗	We found evidence of only 1 site visit in the 5 years following Water Resources' first payment for the project in May 2002. The site visit occurred in March 2004.
Description of site visit activities	✗	The site visit was not recorded in the project file; rather we confirmed it through an interview and a review of a travel expense claim. Therefore, no documentation of the results of the site visit exists.
Communication With Grantees		
Frequency of documented communication	✗	We found evidence of only 3 instances of communication since Water Resources' first payment in May 2002.
Documentation of communication	✓	
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	✗	Water Resources did not develop a budget-tracking sheet.
Withheld 10 percent from payments	✗	The letter of agreement specified that Water Resources shall withhold 10 percent of each approved payment until the project is complete, and the city has submitted an audit report and an engineer's report. Water Resources withheld a portion of the first payment but did not withhold a portion of the other 2 payments. It subsequently released the funds previously withheld. However, as of September 2007, it has not received either report required by the agreement.
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	✗†	In March 2004 Water Resources requested the city to provide an accounting of the costs associated with each acquired land parcel. As of June 2007 Water Resources still had not obtained this information.

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

■ = Marginal. Water Resources did not always meet the monitoring criteria, but did so at least 50 percent of the time.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

* Water Resources obtained only two progress reports, which were two years apart. Its letter of agreement required the city to submit progress reports semiannually.

† Although Water Resources' letter of agreement did not specifically require the city to submit copies of grant deeds, we believe its inability to get an accounting of acquisition costs is problematic.

Table A.3
Monitoring Report Card for Staten Island

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	NA	Our tests focused on progress reports that were submitted with reimbursement requests. Because the entire grant was advanced in 1 payment to acquire Staten Island, we did not expect to see a progress report.
Description of project activities since prior report	NA	
Description of overall status from a budgetary perspective	NA	
Description of whether the project is ahead of, on, or behind schedule	NA	
Key issues to resolve to ensure timely project completion	NA	
Site Visits		
Frequency of site visits	NA	Because the project was substantially complete after the grantee acquired Staten Island, we did not expect the Department of Water Resources (Water Resources) to conduct a site visit of the property.
Description of site visit activities	NA	
Communication With Grantees		
Frequency of documented communication	NA	Because the entire grant was expended to acquire Staten Island, we did not expect to see communication between Water Resources and the grantee after the land was acquired.
Documentation of communication	NA	
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	NA	Because the grant was fully disbursed in 1 payment and was for 1 task (land acquisition), we did not expect to see a budget-tracking sheet for the project, nor did we expect Water Resources to withhold a percentage from the payment.
Withheld 10 percent from payments	NA	
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	✓	

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

NA = Not applicable.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

Table A.4
Monitoring Report Card for Mystic Lake

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	NA	Our tests focused on progress reports that were submitted with reimbursement requests. Because the entire grant was advanced in 1 payment to acquire the Agri-Empire Ranch, we did not expect to see a progress report.
Description of project activities since prior report	NA	
Description of overall status from a budgetary perspective	NA	
Description of whether the project is ahead of, on, or behind schedule	NA	
Key issues to resolve to ensure timely project completion	NA	
Site Visits		
Frequency of site visits	NA	Because the project was substantially complete after the grantee acquired the Agri-Empire Ranch, we did not expect the Department of Water Resources (Water Resources) to conduct a site visit of the property.
Description of site visit activities	NA	
Communication With Grantees		
Frequency of documented communication	NA	Because the entire grant was expended to acquire the Agri-Empire Ranch, we did not expect to see communication between Water Resources and the grantee after the land was acquired.
Documentation of communication	NA	
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	NA	Because the grant was fully disbursed in 1 payment and was for 1 task (land acquisition), we did not expect to see a budget-tracking sheet for the project, nor did we expect Water Resources to withhold a percentage from the payment.
Withheld 10 percent from payments	NA	
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	✗	Water Resources was to obtain a conservation easement from the grantee within 60 days following the transaction in March 2002. We noted that Water Resources asked for the easement in early 2005 and as of September 2007 still had not obtained the easement.

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

NA = Not applicable.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

Table A.5
Monitoring Report Card for Ojai Meadows

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	✗	We reviewed 4 progress reports that contain invoices from the grantee. However, we noted no subcontractor invoices or other evidence supporting the grantee's claimed costs.
Description of project activities since prior report	✗	Three of the 4 progress reports fail to describe the grantee's specific accomplishments or progress on the project.
Description of overall status from a budgetary perspective	✗	All 4 progress reports fail to indicate whether the project was on budget.
Description of whether the project is ahead of, on, or behind schedule	■	One of the 4 progress reports fails to indicate whether the project remained on schedule.
Key issues to resolve to ensure timely project completion	✗	All 4 progress reports fail to indicate whether there were any key issues that needed to be resolved to ensure timely project completion.
Site Visits		
Frequency of site visits	✗	We noted evidence of only 2 site visits in the project's activity log since the Department of Water Resources (Water Resources) made its first payment under the project in June 2003.
Description of site visit activities	✗	Both site visits noted in the project's activity log do not discuss the status of the project. Only 1 of the 2 entries discussed key issues that needed to be resolved for timely project completion.
Communication With Grantees		
Frequency of documented communication	✗	Our review of the project's activity log noted 2 gaps in communication that exceeded 3 months.
Documentation of communication	✓	
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	✗	Although Water Resources developed a budget-tracking sheet for this project, it did not schedule project expenditures against the specific budgets for subtasks established in the grant agreement. Further, Water Resources accepted payment requests that did not provide this level of information.
Withheld 10 percent from payments	✗	Water Resources has made 4 payments for this project. Each payment was for project costs other than land acquisition. None of the 4 payments we reviewed indicate that Water Resources withheld a percentage from the payment until project completion.
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	NA	This project has not yet acquired any land with program funds. As a result, we did not expect to see grant deeds or similar documents.

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

NA = Not applicable.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

■ = Marginal. Water Resources did not always meet the monitoring criteria, but did so at least 50 percent of the time.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

Table A.6
Monitoring Report Card for Big Bend

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	✗	None of the 10 progress reports reviewed contain evidence of project cost beyond the grantee's assertion. We saw no copies of subcontractor invoices or other records supporting the grantee's payment request.
Description of project activities since prior report	✓	
Description of overall status from a budgetary perspective	✗	All 10 progress reports reviewed fail to indicate whether the project remained on budget.
Description of whether the project is ahead of, on, or behind schedule	✗	All 10 progress reports reviewed fail to indicate whether the project remained on schedule.
Key issues to resolve to ensure timely project completion	✗	All 10 progress reports fail to indicate whether there were any key issues that needed to be resolved to ensure timely project completion.
Site Visits		
Frequency of site visits	✗	We noted evidence of only 3 site visits in the project's activity log since the Department of Water Resources (Water Resources) made its first payment under the project in June 2002. The first site visit took place in June 2005, 3 years after the first payment.
Description of site visit activities	✓	
Communication With Grantees		
Frequency of documented communication	✗	We noted 2 gaps in communication that exceeded 3 months in length.
Documentation of communication	✓	
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	✗	Water Resources' budget-tracking sheet does not agree with its grant agreement.
Withheld 10 percent from payments	✗	Water Resources did not withhold any percentage from the payments we reviewed.
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	✓	

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

Table A.7
Monitoring Report Card for Middle Creek

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	✓	
Description of project activities since prior report	✗	Of the 10 payments we reviewed, 9 were payments to escrow for land acquisitions. Because progress reports are only required when the grantee makes a reimbursement request, we expected to see only 1 progress report. However, for this single progress report, the grantee did not describe project progress, budget or schedule status, and key issues to resolve when seeking \$112,000 in reimbursement, electing to provide only invoices supporting costs incurred.
Description of overall status from a budgetary perspective	✗	
Description of whether the project is ahead of, on, or behind schedule	✗	
Key issues to resolve to ensure timely project completion	✗	
Site Visits		
Frequency of site visits	NA	Because the majority of claimed costs were for land acquisition, we did not expect the Department of Water Resources (Water Resources) to conduct a site visit of the project.
Description of site visit activities	NA	
Communication With Grantees		
Frequency of documented communication	✗	We noted 2 gaps in communication that exceeded 3 months in length.
Documentation of communication	✓	
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	✗	Water Resources' budget-tracking sheet was not updated to include the budget amendment. Additionally, project expenditures were not always posted to the correct tasks.
Withheld 10 percent from payments	✗	For the 1 payment made for activities other than land acquisition, Water Resources did not withhold a percentage from this payment until project completion.
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	■	We expected Water Resources to be able to show us grant deeds or escrow closing statements for 7 land acquisitions, proving that land was acquired as intended. However, it was only able to provide these documents for 5 acquisitions. In the 2 cases it did not have this information, Water Resources had to contact the grantee to obtain these documents in response to our request.

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

NA = Not applicable.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

■ = Marginal. Water Resources did not always meet the monitoring criteria, but did so at least 50 percent of the time.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

Table A.8
Monitoring Report Card for Lakeside San Diego Park

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	✓	
Description of project activities since prior report	✓	
Description of overall status from a budgetary perspective	✗	The 3 progress reports we reviewed did not indicate whether the project was on budget.
Description of whether the project is ahead of, on, or behind schedule	✗	Only 1 of the 3 progress reports indicated whether the project was on schedule.
Key issues to resolve to ensure timely project completion	✗	The 3 progress reports did not address whether there were key issues that needed to be resolved to ensure timely project completion.
Site Visits		
Frequency of site visits	✗	The Department of Water Resources (Water Resources) has conducted only 3 site visits since its first payment to the grantee in December 2003.
Description of site visit activities	✗	Water Resources did not have an activity log for this project; instead it provided us with copies of travel expense claims that document the 3 site visits. We found no documentation regarding the results of the site visits in the project file.
Communication With Grantees		
Frequency of documented communication	✗	Water Resources did not maintain an activity log for this project. Staff relied on saved e-mails that were not documented in the project file.
Documentation of communication	✗	
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	✓	
Withheld 10 percent from payments	✗	We noted 8 payments for activities other than land acquisition (such as construction). Water Resources did not withhold any percentage from these payments.
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	✓	

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

Table A.9
Monitoring Report Card for Upper Pajaro River

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	NA	No expenditures on project because of stalled negotiations between grantee and property owners. Given the lack of progress, we did not expect to see progress reports.
Description of project activities since prior report	NA	
Description of overall status from a budgetary perspective	NA	
Description of whether the project is ahead of, on, or behind schedule	NA	
Key issues to resolve to ensure timely project completion	NA	
Site Visits		
Frequency of site visits	NA	No expenditures on project because of stalled negotiations between grantee and property owners. Given the lack of progress, we did not expect to see evidence of site visits.
Description of site visit activities	NA	
Communication With Grantees		
Frequency of documented communication	✗	We noted 3 gaps in communication that exceeded 3 months in length.
Documentation of communication	✓	
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	✗	The Department of Water Resources developed a budget-tracking sheet but has not updated it to reflect a March 2007 budget amendment.
Withheld 10 percent from payments	NA	No expenditures on project because of stalled negotiations between grantee and property owners. Given the lack of program payments, we did not test for withholdings.
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	NA	No expenditures on project because of stalled negotiations between grantee and property owners. Given the lack of progress, we did not expect to see contract deliverables.

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

NA = Not applicable.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

Table A.10
Monitoring Report Card for Clover Creek

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	✓	
Description of project activities since prior report	✓	
Description of overall status from a budgetary perspective	✗	Three of the 5 progress reports we reviewed did not indicate whether the project was on budget.
Description of whether the project is ahead of, on, or behind schedule	✗	Four of the 5 progress reports we reviewed did not indicate whether the project was on schedule for completion.
Key issues to resolve to ensure timely project completion	✗	None of the 5 progress reports we reviewed indicate whether there were any key issues that needed to be resolved.
Site Visits		
Frequency of site visits	■	Although we noted only 2 site visits within 12 months of the first payment, we did not see evidence of any additional site visits over the subsequent 2 years.
Description of site visit activities	✗	Of the 2 site visits documented in the project's activity log, 1 does not discuss the project's progress, and neither indicates whether there were any key issues that would prevent timely project completion.
Communication With Grantees		
Frequency of documented communication	✗	We noted 4 gaps in communication that exceeded 3 months in length.
Documentation of communication	✗	The project's activity log is not always clear regarding the specific topics of communication with the grantee.
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	✗	Even though the Department of Water Resources (Water Resources) correctly scheduled task budgets and associated expenditures, it approved a payment for tasks in excess of budgeted amounts before contract amendments were approved to adjust the budget. Thus, Water Resources is not using the budget-tracking sheet as a fiscal control against overpayment.
Withheld 10 percent from payments	✗	We noted 5 payments for costs other than land acquisition (such as construction). Water Resources did not withhold any percentage from these payments until project completion.
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	NA	No land has been acquired on this project; therefore we did not test for this requirement.

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

NA = Not applicable.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

■ = Marginal. Water Resources did not always meet the monitoring criteria, but did so at least 50 percent of the time.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

Table A.11
Monitoring Report Card for Santa Maria River

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	■	We reviewed 4 progress reports, of which 2 provide records of expenditures (such as invoices from subcontractors) as evidence of incurred costs.
Description of project activities since prior report	✓	
Description of status overall from a budgetary perspective	✗	All 4 progress reports fail to indicate whether the project remained on budget.
Description of whether the project is ahead of, on, or behind schedule	✗	Only 1 of the 4 progress reports indicates whether the project remained on schedule for completion.
Key issues to resolve to ensure timely project completion	✗	All 4 progress reports fail to indicate whether there were any key issues that needed to be resolved to ensure timely completion.
Site Visits		
Frequency of site visits	✗	We noted only 2 site visits since the Department of Water Resources (Water Resources) made its first payment in June 2004.
Description of site visit activities	✗	Neither of the 2 site visits recorded on the project's activity log discusses project status. Only 1 discusses key issues that needed to be resolved.
Communication With Grantees		
Frequency of documented communication	✗	We noted 2 gaps in communication that exceeded 3 months.
Documentation of communication	✓	
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	✗	Water Resources' budget-tracking sheet does not reflect the most recent contract amendment, which adjusts the budget by task, although it posted expenditures to the correct task items.
Withheld 10 percent from payments	✗	We noted 6 payments for costs other than land acquisition (such as construction costs). Water Resources did not withhold any percentage from these payments until project completion.
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	✓	

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

- ✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.
- = Marginal. Water Resources did not always meet the monitoring criteria, but did so at least 50 percent of the time.
- ✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

Table A.12
Monitoring Report Card for Temescal-Bedford Wash

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	■	We reviewed 10 progress reports. Although 9 provide records of expenditures (such as subcontractor invoices), 1 progress report does not provide this level of documentation.
Description of project activities since prior report	✓	
Description of overall status from a budgetary perspective	✗	None of the 10 progress reports discuss whether the project remained on budget.
Description of whether the project is ahead of, on or behind schedule	✗	None of the 10 progress reports discuss whether the project remained on schedule.
Key issues to resolve to ensure timely project completion	✗	None of the 10 progress reports indicate whether there were any key issues that needed to be resolved to ensure timely project completion.
Site Visits		
Frequency of site visits	✗	We noted only 3 site visits since the Department of Water Resources (Water Resources) made its first payment in September 2004.
Description of site visit activities	✗	None of the 3 site visits recorded in the project's activity log discuss the project's status, and only 2 identify key issues that needed to be resolved on the project.
Communication With Grantees		
Frequency of documented communication	✗	We noted 2 gaps in communication with the grantee that exceeded 3 months.
Documentation of communication	✗	The project's activity log is not always clear regarding the specific topics of conversation with the grantee.
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	✗	Budgets for all tasks on the budget-tracking sheet did not agree with the amended budget. Further, Water Resources approved a payment that exceeded the established budget for a task.
Withheld 10 percent from payments	✗	We reviewed 10 payments for activities other than land acquisition (such as construction). Water Resources did not withhold a percentage from any of these payments until project completion.
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	NA	No land acquisitions are involved in the project yet; therefore we did not test for this requirement.

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

NA = Not applicable.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

■ = Marginal. Water Resources did not always meet the monitoring criteria, but did so at least 50 percent of the time.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

Table A.13
Monitoring Report Card for Vierra Ranch

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	✗	We reviewed 10 progress reports. None of the 10 provides records of expenditures (such as subcontractor invoices) to support the grantee's payment request.
Description of project activities since prior report	✗	None of the 10 progress reports provides a discrete description of project activities since the prior report.
Description of overall status from a budgetary perspective	✗	None of the 10 progress reports indicate whether the project was on budget.
Description of whether the project is ahead of, on, or behind schedule	✗	Only 1 of the 10 progress reports indicate whether the project was on schedule.
Key issues to resolve to ensure timely project completion	✗	None of the 10 progress reports indicate whether there were any key issues that needed to be resolved to ensure timely project completion.
Site Visits		
Frequency of site visits	✗	We noted only 2 site visits since the Department of Water Resources (Water Resources) made its first payment in January 2005. There was a gap of over 12 months between the 2 site visits.
Description of site visit activities	✓	
Communication With Grantees		
Frequency of documented communication	✗	We noted 3 gaps in communication with the grantee that exceeded 3 months.
Documentation of communication	✓	
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	✓	
Withheld 10 percent from payments	✗	We reviewed 10 payments for activities other than land acquisition (such as construction). Water Resources did not withhold a percentage from any of these payments until project completion.
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	NA	No land acquisitions were involved in this project; therefore, we did not test for this requirement.

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

NA = Not applicable.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

Table A.14
Monitoring Report Card for Murrieta Creek

	EXPECTATION MET	COMMENTS
Work Plan		
Specific schedule and components of project (task/schedule breakdown)	✓	
Progress Reports		
Records of expenditures	✗	We tested the only progress report and it does not provide copies of subcontractor invoices to support incurred project costs.
Description of project activities since prior report	✓	
Description of overall status from a budgetary perspective	✗	The progress report did not indicate whether the project was on budget.
Description of whether the project is ahead of, on, or behind schedule	✓	
Key issues to resolve to ensure timely project completion	✗	The progress report did not indicate whether there were any key issues that needed to be resolved to ensure timely project completion.
Site Visits		
Frequency of site visits	NA	The Department of Water Resources (Water Resources) is aware that this project stalled due to the loss of another funding source. We did not expect it to conduct site visits for this project.
Description of site visit activities	NA	
Communication With Grantees		
Frequency of documented communication	✗	We noted 2 gaps in communication with the grantee that exceeded 3 months.
Documentation of communication	✗	The project's activity log is not always clear regarding the specific topics of communication with the grantee.
Fiscal Controls		
Budget-tracking sheet consistent with latest amendments	✓	
Withheld 10 percent from payments	✗	For the only payment for costs other than land acquisition (such as construction costs), Water Resources did not withhold any percentage from this payment until project completion.
Contract Deliverables		
Deeds, closing statements, easements, and other real estate documents	NA	This project has not yet involved land acquisitions; therefore, we did not test for this requirement.

Source: Bureau of State Audits' review of Department of Water Resources' (Water Resources) project files.

NA = Not applicable.

✓ = Yes. Water Resources' monitoring of the project always met the criteria described in Table A.1 of the Appendix.

✗ = No. Water Resources met the monitoring criteria less than 50 percent of the time.

(Agency response provided as text only.)

Date: October 12, 2007

To: Elaine M. Howle, State Auditor*
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

From: Department of Water Resources

Subject: Formal Response to Audit

Thank you for the opportunity to review the draft copy of your report entitled "Department of Water Resources: Its Administration of Grants Under the Flood Protection Corridor Program Needs Improvement". Enclosed is the Department of Water Resources' formal response to the draft report which was received by the Resources Agency on October 3, 2007.

DWR appreciates the efforts of your audit team to improve processes and procedures for the administration of the Flood Protection Corridor Program. DWR has already begun to implement many of the types of process improvements that the audit recommends as part of our effort to administer the Program under Propositions 84 and 1E. DWR agrees with and will incorporate your recommendations as it moves forward to administer the new bond funds.

Please contact me or have your staff contact David Gutierrez, DWR's Acting Director of FloodSAFE California, at (916) 653-6055.

(Signed by: Lester Snow)

Lester A. Snow
Director
(916) 653-7007

* California State Auditor's comments begin on page 79.

**California Department of Water Resources Response to
California Bureau of State Audits Report Entitled:
"Department of Water Resources: Its Administration of Grants Under the
Flood Protection Corridor Program Needs Improvement"**

The Department of Water Resources' (DWR) responses to the draft audit report are set forth below. The headings for each response are intended to correlate with the headings contained in the draft report, with the main headings in bold, the subheadings underlined, and the recommendations italicized.

Report Summary

DWR is appreciative of all of the considerable time and effort the California Bureau of State Audits (BSA) invested in their audit of the Flood Protection Corridor Program (Program). In the few instances where changes to address BSA concerns have not already taken place, DWR is working diligently to incorporate all applicable recommendations. While the department acknowledges the results of the audit as generally fair and balanced in nature, DWR has reservations with the characterizations in the summary and believes that the summary does not fully reflect the findings contained within the main report. A reader's review of the full report provides a more thorough and contextual evaluation of the program.

①

The Flood Protection Corridor Program has earned a reputation for being a solid, effective team effort which selected quality projects with input from flood, wildlife, and agricultural experts from a variety of government agencies. As a result of the projects funded through the program that are completed or are nearing completion, the program has achieved non-structural flood risk reduction from each project, conserved more than 9,500 acres of agricultural land, and conserved and enhanced approximately 2,500 acres of wildlife habitat, most of which was at risk of loss due to urbanization.

②

Report Introduction

DWR concurs with the information contained in the report's introductory section.

Chapter 1

③

Water resources awarded \$28 million for direct-expenditure grants without clearly documenting the rationale for its funding decisions

This heading and the text contained below characterize the direct expenditures as grants. DWR believes that they are direct expenditure projects specifically allowed by Water Code Section 79037(a), as opposed to competitive grants, because of the project characteristics (i.e., State benefit) and because of the manner in which they were selected.

④

The report correctly points out that the selection committee had developed a scoring tool to be used for ranking the 11 proposed projects, and that it was not used upon advice of counsel. DWR counsel was concerned that any tool or criteria developed prior to formally issuing regulations could be construed as an underground regulation and the direct expenditure decisions could be challenged based upon those grounds. A successful challenge could result in an invalidation of the direct expenditure decisions which

would then force DWR to cancel the expenditures and begin the process over. With that concern in mind, DWR used the criteria provided for in the statute itself, which is set forth in Water Code Section 79037, and calls for funding of projects that provide flood benefits along with agricultural and/or wildlife benefits.

It should be noted that the voters, in approving Proposition 13, allowed for direct expenditures, and that there is no requirement in the statute that direct expenditures be awarded on a competitive basis. By using the criteria set forth in Section 79037 for the selection of direct expenditure projects, DWR fully complied with the requirements set forth in the law. (5)

In its discussion of the direct expenditure decisions, BSA states that DWR's decision to fund the direct expenditure projects provided only a general sense of why the committee felt they were preferable. BSA also states that with regard to a particular proposal discussed in the report, it is unclear why investing in that project would not have been a better use of flood protection funds compared to other funded projects. DWR did, in fact, have clear reasons as to why each of the other projects were not funded, and this information was provided to BSA prior to this response. DWR provided BSA with a copy of a briefing book which was provided to the Director of DWR after the projects were selected and sent to him for final approval. The briefing book provides a ranking of the 11 projects reviewed by the selection committee and includes an explanation as to why six of the 11 projects were not chosen. Those projects, and the reason for not selecting them, are listed in the briefing book as follows: (6)

- Rock Creek Owens Ranch: Army Corps of Engineers had not committed matching funds to the project
- Rock Creek Sunshine Bend: Army Corps of Engineers had not committed matching funds to the project
- Sutter Basin: Other projects had greater flood protection benefits
- Indio Hills/Joshua Tree National Park: Other projects had greater flood protection benefits
- Mission Creek: Other projects had greater flood protection benefits
- Sand Source: Other projects had greater flood protection benefits

The Staten Island Project is primarily focused on wildlife conservation and may not result in tangible flood benefits

Water Code Section 79307 states that Program funds may be used by DWR for direct expenditure for the purposes of flood control protection, agricultural land preservation, and wildlife habitat protection. Specifically, funds may be used for acquiring easements from willing sellers to protect or enhance floodplains while preserving or enhancing the agricultural use of real property. The Staten Island project clearly meets the statutory criteria for the Program. (9)

The Report states that it is unclear whether the project will ultimately yield tangible flood protection benefits. As noted in the report, one of the benefits of the project is based upon the fact that it prevents development on the island. According to FEMA Flood Insurance Maps, Staten Island is located with the 100-year flood plain. In fact, Staten Island is located near the confluence of the Cosumnes and Mokelumne (10)

Rivers. Moreover, the Mokelumne splits at the eastern end into the North Fork of the Mokelumne Rivers and South Fork of the Mokelumne Rivers. The potential for flooding at this location is very high, and preventing future development on such land provides a real flood protection benefit.

Further, the purchase of Staten Island provides an alternative for flood control plans for the North Delta. As a condition to providing funding to the Nature Conservancy (TNC) for the acquisition of Staten Island, DWR required TNC, pursuant to the North Delta Improvement Program Flood Protection Planning Participation Agreement, to participate in the planning process for flood improvements in the North Delta. The ultimate goal of that planning process is to develop and implement a final plan that will address the objectives of flood management, ecosystem restoration and water supply reliability in the North Delta region. In addition,

⑪ TNC is required to cooperate with the design and implementation of any flood management project or activity on or involving Staten Island, including the potential for flooding of portions of Staten Island and conveying interests in real property for implementation of the project. TNC has fulfilled its responsibilities to date under this agreement. DWR is in the process of preparing a Draft Environmental Impact Report for the North Delta Improvement Program, which identified alternatives that may directly affect Staten Island. It is unclear at this time what project will eventually be selected for implementation but alternatives involving additional flood control facilities on Staten Island as part of the flood risk reduction efforts for the northern part of the Delta have not been ruled out. Although a solution involving Staten Island by itself does not look

⑫ as promising as it did at the time of the purchase, alternatives with flood control facilities on multiple islands, including Staten Island, are continuing to be analyzed and refined.

Water Resources awarded competitive grants without all necessary documentation and without consistently considering criteria

Water Resources did not always obtain hydrologic studies for projects we reviewed

The report correctly indicates that DWR did not enforce this regulation because it could have limited the number of applicants to the Program. It should be noted that the regulation was promulgated by DWR in order to assist with its decision making process. As DWR moved forward with the application process, however, it became clear that only those grantees who had previously prepared such studies prior to applying for grants would be able to comply with this requirement. The reason is that the time period necessary to develop required bathymetric, hydrologic and hydraulic data is longer than the project proposal solicitation period. Further, most grantees are unwilling to invest the tens of thousands of dollars needed to prepare such studies when there is no guarantee they would be selected for grant funding. As a result, otherwise worthwhile projects would have been precluded from applying. Therefore, DWR made the decision to not enforce this requirement in order to allow for the greatest number of entities to apply

⑬ for grants.

DWR did not abandon this requirement altogether. If a decision was made to award funding to a project that had not submitted a hydrologic study with the application, preparation of a hydrologic study was included in the scope of work for the project unless it was obvious there would be no hydrologic impacts, and in such cases an engineer's or hydrologist letter expressing this conclusion was still required. If the full study did not support the anticipated benefits of the project, the grant would be terminated.

DWR will change the Program guidelines and not require hydrologic studies at the time of application, however, an engineer's or hydrologists opinion as to the flood benefits of the project in will still be required at the time of application. After a preliminary decision to award the project has been made, a full hydrologic study will be funded. If the full study does not support the anticipated benefits of the project, the grant will be terminated.

⑭

⑮

Evidence of willing sellers was lacking for most grants involving land acquisitions

The report correctly points out that a willing seller letter does not always guarantee that a grantee will be successful in acquiring property, as a willing seller letter is not a binding commitment. DWR agrees with the report's recommendation to require willing seller letters or equivalent evidence in all future applications and will do so as the Program moves forward.

Finding discussed on pages 37 through 38 regarding scope changes and the subsequent recommendation to develop a rationale for determining when project scope changes are significant enough to warrant another review of the project's merits

③

In the past, when a grantee proposed a scope change, Program staff examined the proposed change to determine if allowing the change would cause any change in the project's benefits, specifically in the areas of flood benefits, wildlife benefits, or agricultural benefits. If the changes were found to be sufficiently small so that the project ranking score would not change or the change would not be sufficient to alter the project's rank in relation to the other projects ranked in the same competitive funding cycle, the "no effect" conclusion was then explained in a memorandum and presented to management who had the responsibility to approve or deny the scope change. In the future, these evaluations will be more thoroughly documented and criteria will be developed for determining when the proposed scope change must be re-submitted to the project selection team for re-evaluation.

⑯

Water Resources was inconsistent when considering whether recreational enhancements would be funded

The Program has consistently given evaluation points to projects that show multiple use objectives in addition to flood risk reduction. There is no threshold provided for in either statute or regulations as to what portion of a project can or should be "structural," though we generally tried to keep the portion below 20% of the costs. Because of the unique needs of individual projects, some of which require structural elements to enable the non-structural elements to function (for example, a structural weir may be necessary to spill floodwaters into the floodplain at a predetermined flood stage), the percentage can vary from zero to 50%.

DWR plans to implement the BSA report's recommendation to provide a consistent rationale for funding recreation projects, and will develop criteria for the types of structural elements that can be properly funded as part of Program projects. Using these criteria, DWR will continue to evaluate the merits of the total project, and ensure that any structural elements fit the criteria and have a valid reason for being included as an eligible part of the project.

Because Water Resources will soon award up to \$330 million of additional grants, improving the project selection process is needed

- ⑰ The report acknowledges that DWR has well-defined selection processes for both direct expenditure projects and for the evaluation and ranking of competitive proposals, although based upon advice of legal counsel DWR chose not to use the numerical ranking tool for the early direct expenditure projects before regulations were adopted. In the future, a scoring tool similar to the one used for competitive project evaluation will be used to ensure that direct expenditure projects, while not legally required to be selected competitively, will meet a pre-determined score to demonstrate that the benefits from the project justify project costs.

Recommendations

When awarding direct expenditure grants, select projects in a manner that allows DWR to justify its project rankings

DWR plans to implement this recommendation through the provision of better documentation of its direct expenditure project evaluations, and will develop and apply criteria similar to those used for competitive grants for future decisions regarding direct expenditures. Since direct expenditure projects are not competitively ranked, projects will be required to meet a minimum threshold score indicating sufficient benefits to justify investing State funds in the project.

Adhere to the flood protection program regulations that require hydrologic studies as part of the grant application

DWR will change the Program guidelines and not require hydrologic studies at the time of application, however, an engineer's or hydrologist's opinion as to the flood benefits of the project will still be required at the time of application. After a preliminary decision to award the project has been made, a full hydrologic study will be funded. If the full study does not support the anticipated benefits of the project, the grant will be terminated

Adhere to program regulations requiring grant applicants to provide evidence of willing sellers

DWR will implement this recommendation and will require that applicants who propose property acquisition as part of their project provide willing seller letters or equivalent evidence, such as an executed purchase agreement, in their application.

Develop a rationale for determining when scope changes are significant enough to warrant another review of the project's merits, or whether other unfunded projects might be a more attractive alternative

As mentioned earlier, when a grantee proposed a scope change, Program staff examined the proposed change to determine if allowing this change would cause any change in the benefits resulting from the project. In the future, these evaluations will be more thoroughly documented and criteria will be developed for determining when the proposed scope change must be re-submitted to the project selection team for re-evaluation.

Develop policies and procedures to evaluate whether proposed structural activities conform to the goals of the program and are the most effective use of funds

DWR will implement this recommendation and will develop criteria for the types of structural elements that can be properly funded as part of Program projects. Using these criteria, DWR will continue to evaluate the merits of the total project, and ensure that any structural elements fit the criteria and have a valid reason for being included as an eligible part of the project.

Chapter 2

Water Resources has established project monitoring practices

DWR has no comments with regard to this finding.

Water Resources failed to adequately monitor its \$5 million grant to the City of Santee

The terms of the funding agreement with Santee are now being enforced, and DWR will release the unspent funds after Santee provides an audit report with an accounting of how it has used the previously disbursed funds. Project monitoring will occur until the project is completed and a full report is received by DWR.

Water Resources has not adequately monitored other grant projects

Water Resources did not consistently obtain acceptable progress reports from grantees

The BSA report correctly points out that Program regulations do not specify standards for progress reports. DWR appreciates the BSA's recommendations regarding reasonable expectations for progress report contents and will incorporate them into future administration of the program.

Water Resources did not meet its goal for conducting regular site visits, and the results of such visits were poorly documented

As the report points out, at the outset of the Program, the Program Manager set an internal, informal goal of conducting two site visits per year for each project. DWR did not meet this goal due to staff shortages and budgetary restrictions imposed upon it as a result of the budget crisis which began in mid-2001, as well as gaps in staff availability. This staffing shortage caused a need to prioritize department-wide activities, which unfortunately resulted in an inability to meet our own informal program goal.

However, it should be noted that Program staff have been able to visit each site at least once per year, with some sites being visited more often. BSA was provided with evidence of these visits during the audit. When the site visits were conducted, Program staff found satisfactory evidence that the projects were progressing as the grantees had informed them. Going forward, with additional funding and staff as a result of Proposition 84, two site visits per year is an achievable goal, depending on the number warranted for a particular project. As a result of this audit, site visit reporting forms have been developed to formalize the reporting findings and observations during site visits, and these forms will be used by Program staff in the future.

Water Resources did not consistently record or prioritize noteworthy communications with grantees

- (19) The report places great emphasis on the fact that Program staff did not consistently document communications with grantees in its activity logs. Despite the lack of this particular form of documentation, DWR Program staff regularly communicated with grantees via phone and email contacts, and has provided BSA with evidence of this fact.

DWR will continue to foster frequent and meaningful communication with its grantees on a regular basis in order to ensure that project results are achieved efficiently and in a timely manner. Additionally, copies of all project-related e-mails are being organized by project on a shared computer storage drive accessible to Program staff.

Better tracking of project expenditures is needed

Program project expenditures are tracked by using the internal DWR accounting system, the Program's project tracking spreadsheets, and each grantee's project accounting system. Having triple redundancy allows Program staff to compare the numbers in the three systems, and, in the event a discrepancy is found, research the cause and resolve the discrepancy.

- (20) The budget tracking sheets are substantially complete and accurate with the exception of the small number of cases that are the focus of the report. Staff turnover resulted in behind-schedule updating of some of the Program tracking sheets, and the Program has hired new staff to update these records, as well as additional project management staff. As a result, budget tracking will improve tremendously, and DWR plans to maintain an adequate level of support staff for the Program.

Water Resources chose not to withhold a percentage from payments to ensure project completion

- (21) The title in this subheading presupposes that withholding a percentage from payments ensures project completion. DWR made the determination that, within the scope of its projects, a 10 percent withholding would not have resulted in improved project progress. In its discussion of this finding, the report concludes that the practice of not withholding 10 percent from each payment may have inhibited the rate of progress that many projects have made over the years. The report correctly points out that this is a discretionary action provided for in Program regulations.

Water Resources did not always obtain required land acquisition or property interest documents

DWR acknowledges its responsibility to obtain such easements and will make greater efforts to obtain such easements in a timely manner.

Water Resources needs to develop a reporting process for future flood protection program costs

As a result of Executive Order S-02-07, DWR is accountable for ensuring that bond expenditures related to Propositions 1E and 84 contribute to long-lasting, meaningful improvements to critical infrastructure, and provide the public with readily accessible information about how the bonds are being spent.

In order to meet the new requirements related to bond accountability, DWR has initiated the following activities:

1. DWR is establishing a Bond Accountability and Management (BAM) Office, in addition to, providing the necessary public outreach related to bond accountability.

Some of the responsibilities of the BAM Office will be tracking bond expenditures and metrics data for projects/programs, developing internal tools and process for budget planning and expenditure tracking, coordinating and developing legislatively mandated reports, and responding to questions from external sources such as the Legislature, Governor's Office, Department of Finance, etc.

2. DWR is engaged in the development of a consistent cost collecting structure for all bond funded activities so that expenditure data can easily be reported at the program, activity and task levels.
3. DWR has solicited consulting services (October 2007) to implement a Grant Management technology system and reengineer key organizational business processes.
4. DWR has documented the current process and timeline required for the development, review and approval of legislatively mandated reports.

The activities listed above will enable DWR to effectively and efficiently manage programs and projects funded with general obligation bonds. In addition, these improvements to DWR's business operations will allow it to institute the three-part accountability structure of Front-End, In-Progress and Follow-Up Accountability as required by the Executive Order and implemented through the Department of Finance's bond accountability website.

Although it is not legally required to do so, Water Resources has at times chosen to seek General Services' advice on land acquisition grants

BSA correctly notes that DWR is exempt from DGS review where it is providing grants for land acquisitions. As explained during the course of the audit, DWR obtains qualified reviews of every appraisal of land to be acquired. DWR obtains DGS approval when the State itself is acquiring property for over \$150,000. For cases where property is being acquired through a grant, DWR relies upon its own qualified real estate appraisers.

Unresolved concerns with the appraisal for Staten Island may have resulted in Water Resources overpaying for the land

These concerns were resolved by the approval of the appraisal by both the Chief of DWR's Real Estate Branch and DGS' Senior Real Estate Officer. In addition, DWR's former Director approved the funding agreement with TNC based on all available information.

②

- ②3 The BSA report cites to DGS' conclusion that the appraisal was at the absolute upper end of the value range. However, the upper end of the value range is considered fair market value, as set forth in Section 1263.320 of the Code of Civil Procedure.¹

Water Resources and General Services failed to resolve the issue of Staten Island's true value

See above comments.

Recommendations

Water Resources should follow-up with Santee to determine how funds were spent

- ②4 DWR will implement this recommendation. It should be noted that DWR is statutorily required to provide Santee with the full \$5 million, and does not have the authority to withhold the funds in order to determine whether Santee can use the funds for flood protection purposes. It must be assumed that the Legislature and the people of the State of California (via passage of Proposition 13) decided Santee could use the full amount for flood protection purposes. That being said, the terms of the funding agreement with Santee are now being enforced, and DWR will release the unspent funds after Santee provides an audit report with an accounting of how it has used the previously disbursed funds. Project monitoring will occur until the project is completed and a full report is received by DWR.

Water Resources should develop policies and procedures to ensure that it receives sufficiently detailed and complete progress reports

DWR agrees with this recommendation and will implement it.

Water Resources should develop policies and procedures to communicate to staff expectations for conducting site visits and how they document them

DWR agrees with this recommendation. As a result of this audit, DWR has developed site visit reporting forms to formalize the reporting findings and observations during site visits, and these forms will be used by Program staff in the future.

Water Resources should develop policies and procedures to establish expectations for how often staff should communicate with grantees and develop a process to records these communications in a consistent manner

- ②5 DWR will continue to communicate with its grantees on a regular basis in order to ensure that desired project results are achieved. Telephone and e-mail will likely continue to be the primary means of communication, with the most significant communications noted in the project activity logs. E-mails will continue to be saved and organized by project on a computer hard drive accessible to Program staff and management.

¹ Section 1263.320 of the Code of Civil Procedure states:

(a) The fair market value of the property taken is the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.

(b) The fair market value of property taken for which there is no relevant, comparable market is its value on the date of valuation as determined by any method of valuation that is just and equitable.

Water Resources should develop policies and procedures to consistently update project budget tracking sheets to adjust for contract amendments and changes in budgeted tasks, and to accurately track funds disbursed to grantees

DWR agrees with this recommendation. DWR takes its responsibility to account for Program expenditures seriously. DWR will continue to rely on its three-pronged system to accurately track funds disbursed to grantees. Additionally, DWR is planning to implement a new software project tracking system that will automate many of the accounting functions currently done by spreadsheet, and automate the ability to generate frequent reports to management. As noted previously, DWR has obtained dedicated Program staff and has filled new project manager positions in order to improve budget tracking significantly. DWR will endeavor to maintain an adequate level of support staff for the Program.

Water Resources should develop policies and procedures to, where appropriate, withhold a percentage of payments to grantees and release these funds only after it is satisfied that the project is reasonably complete

DWR agrees with this recommendation, and DWR will continue to use the 10 percent withholding at its discretion when it believes that doing so will result in improving compliance on the part of the grantee.

To comply with reporting requirements for projects it funds with Propositions 84 and 1E, and to ensure that its management is kept apprised of key issues, Water Resources should develop a project status reporting process

DWR agrees with this recommendation, and had begun the process of complying with Executive Order S-02-07 prior to this audit. In order to meet the new requirements related to bond accountability, DWR has initiated the following activities:

1. DWR is establishing a Bond Accountability and Management (BAM) Office, in addition to, providing the necessary public outreach related to bond accountability.

Some of the responsibilities of the BAM Office will be tracking bond expenditures and metrics data for projects/programs, developing internal tools and process for budget planning and expenditure tracking, coordinating and developing legislatively mandated reports, and responding to questions from external sources such as the Legislature, Governor's Office, Department of Finance, etc.

2. Developed a consistent cost collecting structure for all bond funded activities so that expenditure data can easily be reported at the program, activity and task levels.
3. Solicited consulting services in October 2007 to implement a Grant Management technology system and reengineer key organizational business processes.
4. Documented the current process and timeline required for the development, review and approval of legislatively mandated reports.

The activities listed above will enable DWR to effectively and efficiently manage programs and projects funded with general obligation bonds. In addition, these improvements to DWR's business operations will allow it to institute the three-part accountability structure of Front-End, In-Progress and Follow-Up Accountability as required by the Executive Order and implemented through the Department of Finance's bond accountability website.

To avoid the potential of paying more than fair market value for property, Water Resources should take steps to ensure that its staff's concerns regarding the quality of appraisals, as well as those raised by the Department of General Services when its advice is sought, are resolved prior to disbursing funds.

- ②6 DWR will continue to review and approve all appraisals for acquisitions under the Program. When required by law, DWR will obtain DGS approval of appraisals and acquisitions. In other cases DWR may request DGS to review appraisals if appropriate.

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE DEPARTMENT OF WATER RESOURCES

To provide clarity and perspective, we are commenting on the response to our audit report from the Department of Water Resources (Water Resources). The numbers below correspond with the numbers we have placed in the margin of Water Resources' response.

Water Resources takes issue with the way that we structure our audit reports, implying that the summary is not reflective of the findings in the report. We disagree. Our reports include a "Results in Brief" section that presents a high-level summary of our findings and recommendations. This summary section is not meant to include every aspect of the issues more fully discussed in the report, as doing so would defeat the purpose of including a summary.

①

Water Resources' description of the Flood Protection Corridor Program's (flood protection program) benefits may be overstated and requires clarification. Specifically, we question Water Resources' assertion that each project has achieved nonstructural flood reduction because, as Figure 2 demonstrates on page 10 of the audit report, four of the 20 projects it selected have yet to receive program funding, even though their funding was awarded more than four years ago. Further, as we state on pages 19 through 22 of the audit report, the flood protection program's largest grant project—the acquisition of Staten Island at a cost of \$17.6 million—may not result in a tangible flood protection project because of the prohibitive cost of such a project involving the property. Finally, although Water Resources did not disclose how it calculated the 9,500 acres of agricultural land conserved, we note that the Staten Island acquisition, which was roughly 9,200 acres, was likely a significant portion of the total.

②

Throughout its response Water Resources references chapter, section, and subsection titles, and specific page numbers from the draft copy of the audit report we provided for its official comment. We informed Water Resources that the draft was subject to final editorial review and that these items could change as a result of that review. We have not attempted to reconcile the titles and page numbers Water Resources cited in its response to the audit report.

③

The audit report characterizes Water Resources' direct-expenditure projects as grants because \$28 million was awarded to government agencies and nonprofit organizations to further the goals of the flood protection program. Characterizing these awards as grants rather than direct expenditures is consistent with the commonly

④

understood meaning of the terms grant and direct expenditure and is consistent with how these terms are used elsewhere in the Water Code.⁹ In its own internal documentation, Water Resources referred to these projects as “grants.” Moreover, Water Resources is incorrect in suggesting that our report characterizes these expenditures as “competitive grants.” In fact, on pages 16 through 18 of the audit report we discuss Water Resources’ decision to not use its project-scoring criteria when evaluating direct-expenditure projects. The use of such scoring criteria is a common practice when awarding grants.

- ⑤ Water Resources appears to misunderstand our conclusions regarding its selection process for direct-expenditure projects. We do not contend that the Safe Drinking Water, Clean Water, Watershed Protection and Flood Protection Bond Act required Water Resources to award direct-expenditure projects on a competitive basis. The point of our critique, as we state on page 16 of the audit report, is that Water Resources cannot demonstrate it had a clear rationale for ranking the 11 direct-expenditure projects it considered and how it arrived at the decision to fund five of these projects. We believe that Water Resources should award funding using a fair and open process to clearly demonstrate why projects were or were not selected.
- ⑥ Water Resources’ suggestion that we ignored the briefing book cited in its response is inaccurate and misleading. Our conclusions are chiefly based on our assessment of the briefing book Water Resources refers to in its response because limited evidence existed of other analyses for these projects. As we describe on page 18 of the audit report, the selection committee’s funding recommendations contained in the briefing book provided only a general sense of why they were preferable over the projects not selected. Absent other documentation to justify the funding decisions, it is unclear how Water Resources arrived at the project rankings in the briefing book.
- ⑦ Water Resources is incorrect in asserting that its briefing book stated that the Army Corps of Engineers had not committed matching funds to the Rock Creek Owens Ranch and Rock Creek Sunshine Bend projects. To the contrary, the briefing book states that the Army Corps of Engineers will provide funding up to 75 percent of each project’s total cost. Nevertheless, even if the briefing book had stated funding from the Army Corps of Engineers was not committed, it still would be unclear how

⁹ See, for example, Section 12929.41 of the Water Code, which defines a direct expenditure as one where funds are expended by the department and a grant as one where grants are made to local agencies. It is a well-accepted principle of law that a phrase or expression may be interpreted in accordance with its use in other related statutes (*Frediani v. Ota* (1963) 215 Cal. App. 2d 127, 133).

such circumstances would have made funding these projects less attractive because Water Resources did not use a methodology to consistently quantify the impact of matching funds.

Water Resources simply restates the evidence it provided us during the audit for why it did not select the Sutter Basin, Indio Hills/Joshua Tree National Park, Mission Creek, and Sand Source projects. The briefing book merely included the statements “other projects competing for direct expenditure funds had greater flood benefits” as the reason for not funding these projects without providing additional information or analysis to demonstrate the differences. Because Water Resources lacked additional information and analysis, we were unable to determine why it chose not to fund these projects.

⑧

Water Resources’ response misconstrues our audit report’s discussion of the Staten Island project. The audit report does not question whether spending funds on Staten Island met the flood protection program’s criteria. Similarly, the audit report does not question the wildlife habitat protection or agricultural land conservation benefits of the transaction. Rather, the audit report questions whether Staten Island will result in a tangible flood protection project. As we note on page 21 of the audit report, a cost-benefit analysis that Water Resources prepared in August 2005 concluded the cost to implement a flood protection project on land that included Staten Island outweighed the benefits to be obtained. Further, Water Resources’ inability to implement a flood protection project on the island since its purchase in 2001 raises doubt if flood protection benefits from such a project will ever be realized.

⑨

Water Resources misrepresents our audit report’s conclusions. The assertion that the Staten Island acquisition will limit future development on the island is Water Resources’ belief and not our conclusion. To the contrary, as we note on page 22 of the audit report, the December 2000 appraisal of Staten Island stated that the likelihood of future development on the property was low given zoning and state legal restrictions. Further, as of September 2007, Staten Island’s zoning remains the same.

⑩

Water Resources overstates The Nature Conservancy’s (Nature Conservancy) obligations by indicating that it “is required to cooperate with the design and implementation” of a flood protection project on Staten Island. Rather, under the grant agreement, Nature Conservancy is only required to “participate” in this process, and should the North Delta Improvement Program pursue a flood protection project on Staten Island, Nature Conservancy would then negotiate the specific property rights it

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would convey to allow such a project to proceed. Moreover, Water Resources fails to mention Nature Conservancy's participation is limited to 10 years, ending in November 2011.

- ⑫ We are unsure how Water Resources can conclude that the prospect for a flood control project involving Staten Island does not look as promising as it did at the time of purchase. As we note on page 21 of the audit report, according to Water Resources' branch chief who was the California Bay-Delta Authority senior engineer responsible for identifying potential flood protection projects to implement on Staten Island at the time the grant was awarded, the flood protection benefits of a project on the island were conceptual only, and the benefits and costs had not yet been quantified.
- ⑬ Water Resources' statement that it decided to not enforce the regulatory requirement that grant applicants submit hydrologic studies is puzzling. As we discuss on page 24 of the audit report, regulations have the effect of law and cannot be waived by Water Resources. Even though Water Resources now contends its regulations are burdensome and would potentially limit the number of applicants, Water Resources has had four years to modify the regulations since they were approved in 2003, but has not done so. Further, as we note on page 25, the requirement to submit hydrologic studies remains in its guidelines for future flood protection program funding under the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006.
- ⑭ Water Resources' reliance on an engineer's or hydrologist's letter is not an adequate substitute for obtaining hydrologic studies since the conclusions expressed in such letters do not appear to be as definitive as those found in hydrologic studies. We discuss an example of such a letter on page 24 of the audit report. In the letter, the civil engineer indicates that a full hydrologic study would be necessary to validate his opinion regarding the project's flood protection benefits. Because many of the grants under the flood protection program exceed \$1 million, it would seem prudent to obtain greater assurance of a proposed project's flood protection benefits before committing such a significant level of funding. Finally, Water Resources' assertion that it required these letters if applicants did not provide a hydrologic study is inaccurate since we saw only one such letter for the five projects we reviewed where it had not obtained hydrologic studies during the application period.
- ⑮ Water Resources' claim that it will terminate a grant if a hydrologic study does not support the anticipated benefits of a project obscures its questionable practice of disbursing grant funds prior to receiving such studies. On page 24 of the audit report, we provide Water Resources' perspective that it cannot recover previously

disbursed funds if it terminates a grant because a hydrologic study has discredited the proposed flood protection benefits. Thus, Water Resources' disbursement of \$1.7 million to the Santa Maria River project, which has not yet submitted an acceptable hydrologic study, places a significant amount of flood protection program funds in jeopardy.

Water Resources asserts that when flood protection program staff evaluated project scope changes and determined such changes would not alter a project's ranking, they would send a memorandum to management concluding that such scope changes had no effect. However, as we state on page 26 of the audit report, Water Resources was unable to provide documentation demonstrating that flood protection program staff evaluated the merits of scope change requests.

⑩

Water Resources is mistaken in concluding that the audit report acknowledges that it has a well-defined selection process for direct-expenditure projects. To the contrary, on page 17 of the audit report, we acknowledge only that the scoring criteria that Water Resources had developed, but did not use on the advice of counsel, would have allowed the selection committee to better document its rationale for ranking the 11 projects it evaluated in 2001. As we discuss in Chapter 1, in the absence of documentation explaining its rationale for its project rankings, it is unclear to us how the selection committee reached the funding recommendations it made in August 2001.

⑪

Water Resources misunderstands the point of our critique. As we illustrate in the Table on page 36 of the audit report, Water Resources has not met its goal of conducting site visits twice annually and frequently did not document the results of these visits. The table shows that Water Resources failed to meet its goal of visiting projects twice a year for six of the seven projects we reviewed. Additionally, it shows that Water Resources failed to adequately document the results of its site visits for five of the seven projects we reviewed. Moreover, the evidence of site visits that Water Resources' refers to were travel expense claims and a site visit list it created based on travel records, date stamps on digital photographs, and day planners, which fail to document the results of site visits.

⑫

Water Resources does not appear to appreciate the value of documenting important communication with grantees and attempts to excuse its lack of documentation by noting that it regularly communicates with grantees via telephone calls and e-mail. To reiterate our point, documenting noteworthy and important communication with grantees is intended to assist staff in their monitoring efforts and is particularly useful in helping a new employee become familiar with a project's history. However, other than entries

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in the activity logs—which we found had gaps exceeding three months and were vague in some cases—Water Resources did not provide evidence of its telephone calls with grantees. Further, the e-mail lists Water Resources provided us included hundreds of e-mails that were simply organized by date rather than by key activities or issues. Moreover, these e-mail lists, which are retained on a shared computer storage drive accessible to staff, showed gaps in communication of up to six months in some instances, e-mails that were apparently unread, and some e-mails that appear unrelated to Water Resources’ monitoring efforts.

- ⑳ As we depict in the Table on page 36 of the audit report, we found errors in seven of the 10 budget-tracking sheets that we reviewed; contrary to Water Resources’ assertion, we do not consider these circumstances to be indicative of “substantially complete and accurate” budget-tracking sheets.
- ㉑ Water Resources correctly notes that we believe withholding a percentage from payments can help ensure project completion. However, Water Resources’ response fails to acknowledge that, as we note on page 42 of the audit report, it considers only three of the 12 projects we reviewed to be complete. We do not dispute that other factors may have contributed to these delays, but withholding a percentage of payments is an accepted and frequently used best practice for ensuring that other parties complete their efforts in a timely manner. For example, Water Resources also does not mention that it neglected to withhold 10 percent (roughly \$350,000) from a February 2004 payment to the city of Santee—one of the flood protection program’s largest projects—even though its letter of agreement with Santee required it to do so. Water Resources has also failed to obtain required project reports from Santee after it requested these items three years ago in March 2004. Had Water Resources retained a percentage of the payments to Santee, it would have had more leverage to encourage the city to finish the project and submit the required reports promptly.
- ㉒ Water Resources’ statement mischaracterizes its actions in resolving concerns regarding Staten Island’s appraised value, which were raised by its own appraisal staff and those of the Department of General Services (General Services). We did not see evidence that these concerns were resolved, and, in fact, as we state on page 48 of the audit report, Water Resources’ appraisal staff were directed to not discuss their concerns about the Staten Island appraisal with representatives from General Services. Although the Water Resources’ former director ultimately signed the grant agreement for Staten Island, such approval does not infer that the appraisal issues noted on pages 46 through 48 of the audit report were ever resolved.

Water Resources misses our point and is attempting to justify the potential overpayment for Staten Island by citing the legal definition of fair market value. Our concern is that Water Resources failed to resolve concerns that its appraisal staff and General Services raised over the island's true value, and that if it had addressed those concerns, it might have negotiated a lower price for the acquisition. While it may be correct that Water Resources could lawfully accept the valuation of the property at the high end of the range, this certainly did not preclude it from following the good business practice of attempting to negotiate a lower purchase price, particularly in light of concerns that had been noted throughout the appraisal review process. Moreover, as we note on page 48 of the audit report, the concern that Staten Island was overpriced appears to have been well-founded, as a September 2004 appraisal performed for Water Resources on neighboring properties indicated "It is the consensus of local brokers and appraisers that the price paid [for Staten Island] was well above market."

②3

Water Resources seems to suggest that it is required to give Santee the full \$5 million regardless of whether it provides information on how it spent the funds previously received. Our recommendation only suggests that Water Resources assure itself that Santee complies with the reporting requirements in the "letter of agreement" both parties signed before it disburses the remaining flood protection program funds.

②4

In its response, Water Resources' use of the term "continue" inaccurately implies that it regularly had communicated with grantees and documented noteworthy and important communication in its project activity logs. As we note in the Table on page 36 of the audit report, Water Resources could not demonstrate that it had frequent communication with grant recipients for 10 projects we reviewed. Further, the table shows that Water Resources did not adequately document its communications for four of these projects.

②5

Water Resources' response does not state whether it will resolve concerns regarding the quality of appraisals raised by its staff and General Services, when General Services' advice is sought. As we mention on page 45 of the audit report, Water Resources' decision to submit some appraisals to General Services for review seemed valuable because General Services, on occasion, has noted concerns with the appraised value of land. Thus, we firmly believe that Water Resources' actions to implement our recommendation should include appropriately resolving its appraisal staff's concerns, and those that General Services raises when asked for advice, before disbursing funds.

②6

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press