

General Obligation Bonds

The Departments of Water Resources and Finance Should Do More to Improve Their Oversight of Bond Expenditures

May 2011 Report 2010-117



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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 California State Auditor presents this audit report concerning the Department of Water Resources (Water Resources) and the Department of Finance's (Finance) administration and oversight of general obligation bonds.

This report concludes that Water Resources demonstrated effective oversight of general obligation bonds, but it could improve in certain areas. During our review of a sample of 10 projects, we noted that Water Resources made appropriate decisions when awarding bond funds and making payments for project activities. However, for two of the 10 projects, Water Resources could not demonstrate that it performed site visits or took other steps to ensure the projects achieved their expected outcomes. We also found that Water Resources lacks a documented review process to ensure information posted to the Bond Accountability Web site is correct. Our review of the Web site revealed instances where Water Resources posted inaccurate award information for certain projects and in some cases did not post any information at all.

We also found that Finance should do more to ensure transparency and accountability for bond spending related to the general obligation bonds approved by voters in November 2006 to fund the State's Strategic Growth Plan. The former governor's executive order from January 2007 required Finance to establish a Bond Accountability Web site that was to include information on the amounts spent on each bond-funded project. However, Finance's approach to establishing the Web site required departments to post information on the amounts awarded and not the amounts spent. By not providing the public with periodic information on the amounts spent for each project—to then compare against amounts awarded—the public lacks a way to measure each project's progress towards completion. In addition, Finance lacks a tracking process to ensure that state departments update the Bond Accountability Web site and describe the expected or realized benefits of bond-funded projects in terms the public can readily understand. Finally, we noted that the executive order requires state agencies to either contract with Finance for audits of bond expenditures or make alternative arrangements for audits with Finance's approval. However, as of late April 2011, Finance had issued audit reports on only three of the state agencies administering the general obligation bonds that support the State's Strategic Growth Plan, and none were of Water Resources.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

Because it will spend significant amounts of funds from general obligation bonds in the coming years, the Department of Water Resources (Water Resources) must position itself to administer this spending effectively. We reviewed its management of a sample of 10 projects that received funding from various general obligation bonds issued by the State, and found that Water Resources generally demonstrated effective oversight of these projects. Nonetheless, Water Resources could take steps to better ensure that its spending achieves expected outcomes and to comply with certain public transparency and accountability requirements.

With a proposed budget of \$3.96 billion for fiscal year 2011–12 and more than 3,000 employees, Water Resources' activities include evaluating existing water supplies; forecasting future water needs; and exploring potential solutions to meet the needs of the State's citizens, industry, and wildlife. Water Resources also works to prevent and minimize flood damage, ensure the safety of dams, and educate the public about the importance of water and its efficient use.

A portion of Water Resources' annual budget is supported by general obligation bonds—funds obtained by the State through long-term borrowing authorized by the voters—which accounted for \$345 million, or roughly 9 percent, of the \$3.96 billion in proposed spending outlined in the 2011–12 Governor's Budget. From July 2005 through June 2010, Water Resources spent \$2.3 billion from 13 different general obligation bonds. Water Resources will likely continue to spend significant amounts from general obligation bonds in the future. With the passage of propositions 84 and 1E by voters in November 2006, the State's electorate authorized nearly \$9.5 billion in general obligation bonds, of which the two bond acts allocated more than \$5.9 billion to Water Resources for various flood control and water management efforts. Through fiscal year 2009–10, Water Resources had spent \$1.6 billion from these two propositions.

In evaluating whether Water Resources effectively managed the 10 projects under review, we found that Water Resources made appropriate decisions when awarding general obligation bond funds and when paying grant recipients for projects. Specifically, for projects selected on a competitive basis, Water Resources developed thorough guidelines and procedures for selecting projects, and it documented its rationale for its funding decisions. In cases in which Water Resources awarded projects by using its discretion to determine whether the project was eligible for bond funding, the projects selected were consistent with the

Audit Highlights . . .

Our review of the Department of Water Resources' (Water Resources) administration of bond funds revealed the following:

- » *It generally made appropriate decisions when awarding the general obligation bond funds and when paying recipients.*
- » *Although it generally demonstrated effective oversight of projects, we noted some weaknesses for two of the 10 projects we reviewed.*
 - *It did not always obtain quarterly progress reports or the progress reports received were late or incomplete for one project.*
 - *It could not demonstrate that it performed an adequate site visit for one project or that it had obtained a civil engineer's certification that the project was built as planned, and for another project no site visits were conducted.*
- » *It could improve its transparency and accountability requirements—Water Resources has posted inaccurate or incomplete information on the Bond Accountability Web site for some of the projects we reviewed, and would benefit from developing a formal review process.*

In assessing the Department of Finance's oversight, we found that:

- » *It has not required state agencies—such as Water Resources—to post the amount of bond funds actually spent for specific projects, and doing so would enhance public transparency.*

continued on next page . . .

- » *It lacks procedures to ensure agencies update their information on the Bond Accountability Web site.*
- » *It has completed relatively few audits of state agencies that administer Strategic Growth Plan general obligation bonds and none of Water Resources.*

requirements established in the general obligation bond acts. Water Resources has also implemented various procedures to ensure that payments were consistent with relevant grant agreements. In all of the projects we reviewed, Water Resources required grant recipients to submit reasonably detailed and itemized invoices for the work performed. Moreover, Water Resources frequently limited the amounts of funds that it advanced or reimbursed grant recipients to ensure that not all of the funds were disbursed until the project was complete.

Water Resources also generally demonstrated effective oversight of projects by implementing procedures to monitor the projects' progress and to ensure that the State ultimately obtains required *deliverables*—tangible structures, or other outcomes that Water Resources expects the grantee to produce in exchange for the bond funds received—such as project completion reports from grant recipients and certifications from civil engineers verifying the adequacy of construction activities. However, we did note some weaknesses in this area for two of the 10 projects we reviewed. We attempted to evaluate a sample of 10 quarterly progress reports on the \$16.2 million Pajaro Valley Groundwater Storage Project, but found that Water Resources did not obtain two of these reports while others were submitted by the grant recipient late or lacked important information, such as indicating whether there were obstacles to the timely completion of the project or discussing the status of the budget. By not obtaining these reports, Water Resources was not always in a position to know whether this project was on track to achieve its intended results.

Water Resources also could not demonstrate that it performed an adequate site visit for this same project. Although Water Resources asserted that it performed multiple visits, it could not demonstrate what aspects of the project it reviewed during these visits and what conclusions, if any, were reached. We had expected Water Resources to be able to provide documentation of its visits, such as a checklist or report demonstrating that important aspects of the project were reviewed during each visit. The lack of adequately documented site visits for this project was particularly problematic since Water Resources also could not demonstrate that it had obtained final deliverables, such as a final construction report from the grant recipient and certification from an independent civil engineer indicating that the project was built correctly. By not enforcing its requirements for project deliverables, Water Resources cannot be certain that the project was completed in accordance with the grant agreement and that water users are receiving the intended benefits of the project. For another project, Water Resources did not perform any site visits of the \$15.2 million canal expansion related to its Water Quality Exchange Program project, stating it lacked funding to do so.

Although Water Resources generally demonstrated effective oversight for the projects we reviewed, it could improve its practices for complying with the public transparency and accountability requirements associated with certain general obligation bonds. The former governor's executive order issued in January 2007 required that the public have readily accessible information on the projects being funded by general obligation bonds supporting the State's Strategic Growth Plan¹ and the amount spent for each project. Water Resources was to provide this information on a public Web site. However, our review found that Water Resources has posted inaccurate or incomplete information for some of the projects we reviewed, such as reporting incorrect amounts awarded for certain projects. The lack of a formalized process to review and report information to the public seems to be a contributing factor to Water Resources' difficulties in this area.

Water Resources has been trying to address some of these issues with its new Bond Management System; however, we found that the key functionality that would allow it to report project status to the public has not been implemented, even though the contractor, who committed to providing this functionality at a cost of \$1.5 million, has completed its work. According to the deputy assistant of its Bond Accountability Division (deputy), Water Resources did not obtain the reporting functionality expected because the contractor had difficulty understanding Water Resources' accounting system and there was not enough collaboration between the contractor and Water Resources' Division of Technology Services. The deputy further explained that Water Resources plans to develop this reporting capability with its own staff and has established a goal of having this functionality operational by August 2011.

In addition to Water Resources' administration of general obligation bonds, we assessed the role of the Department of Finance (Finance) to determine whether it was providing adequate guidance to and oversight of Water Resources regarding an executive order issued by the former governor in 2007. Our review found that Finance should do more to ensure accountability and transparency for bond spending, as required by the executive order. Specifically, we found that Finance has not required state agencies—such as Water Resources—to post the amount of bond funds actually spent for specific projects. Instead, it has allowed agencies to

¹ In 2006 the State initiated the first phase of its comprehensive Strategic Growth Plan to address the State's critical infrastructure needs over the next 20 years. During the November 2006 General Election, 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), which provided funding to partially address the requirements outlined in the State's Strategic Growth Plan.

report the amounts *committed* to projects, or the amounts that are expected to be spent in the future. Although Finance asserted that this approach meets the requirements of the executive order, we believe the information on the Web site would be more beneficial to the public if Finance required administering agencies to also report the actual amounts of bond funds spent. Doing so would provide the public with a way to measure the progress of the projects in their communities, such as by comparing the amounts awarded to the amounts spent.

Our review also found that Finance lacks procedures to ensure that agencies update their information on the Bond Accountability Web site.² We noted that Water Resources was not posting all project information, and was omitting projects under certain bond programs. We also found that Finance has completed relatively few audits of state agencies that administer general obligation bonds. The 2007 executive order requires state agencies to either contract with Finance for these audits or make alternate arrangements for audits with Finance's approval. However, as of late April 2011, Finance had issued audit reports on only three state entities administering the general obligation bonds approved by voters in November 2006 to support the State's Strategic Growth Plan, and none were of Water Resources.

Recommendations

To ensure that its expenditures of bond funds achieve the intended purposes, Water Resources needs to strengthen its monitoring of project deliverables. For example, it should review the policies and practices of its various divisions, ensuring that periodic progress reports are obtained from grant recipients and that final site visits document the results of the reviews performed.

To provide the public with accurate and complete information on the bond-funded projects it administers, Water Resources should develop and consistently use a formalized, documented review process that will provide greater assurance that project information posted to the Bond Accountability Web site is regularly updated and contains accurate information.

² In this audit report we refer to the Web site created by Finance in response to the January 2007 executive order as the Bond Accountability Web site. This Web site links to other Web sites administered by various state agencies for specific project information.

To enhance transparency and accountability regarding the State's use of general obligation bond funds, the governor should require administering agencies to report actual amounts spent on bond-funded projects and update the expenditure information at least semiannually.

To enhance the value of the Bond Accountability Web site, Finance should do the following:

- Require administering agencies to provide information about the actual amounts of bond funds spent on posted projects at least semiannually.
- Develop a tracking and review process to periodically assess the completeness of the project information posted to the Bond Accountability Web site.

To ensure that expenditures were consistent with bond laws and that projects achieve the intended benefits or outcomes agreed to when the projects were originally awarded, Finance should conduct audits of, or approve and assure that Water Resources and other agencies obtain audits of, Strategic Growth Plan bond expenditures.

Agency Comments

Water Resources agreed with our recommendations. However, Finance disagreed with our conclusions and recommendations, stating that providing amounts spent on the Bond Accountability Web site would not enhance transparency and accountability. It also disagreed with our conclusion that it has performed few audits of Strategic Growth Plan bonds.

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Introduction

Background

General obligation bonds are a form of long-term borrowing in which the State issues municipal securities and pledges its full faith and credit to repay bondholders. This borrowing finances large investments in the State's infrastructure, such as paying for roads, water delivery systems, and public school construction. The California Constitution requires that general obligation bonds be submitted to voters for approval, and the bonds must be approved by a majority vote. Once voters approve the bonds, the State Treasurer's Office (Treasurer) is authorized to sell the bonds in the financial marketplace, and the State then uses the proceeds from the sales to support the projects or activities authorized by the bond acts. According to the Treasurer, most of the State's debt as of June 30, 2010, was in the form of general obligation bonds, accounting for \$68.8 billion of the nearly \$90 billion outstanding.

The Department of Water Resources Is Responsible for Spending a Significant Amount of Funds Derived From General Obligation Bonds

With a proposed budget of around \$3.96 billion for fiscal year 2011–12 and more than 3,000 employees, the Department of Water Resources (Water Resources) is charged with managing the State's water resources and with ensuring that the water needs of the State's citizens and industries are satisfied while also considering the needs of wildlife. A portion of Water Resources' annual budget is supported by general obligation bonds. Of its 2011–12 proposed budget of \$3.96 billion, roughly 9 percent—or \$345 million—is planned to come from these bonds. Because of the passage of 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), Water Resources will spend increasing amounts from general obligation bond proceeds in the future. The voters' approval of these propositions authorized the State to sell nearly \$9.5 billion in general obligation bonds, and the language in the bond acts enacted by these propositions allocated to Water Resources roughly \$5.9 billion of the funds from the bonds. Through fiscal year 2009–10, Water Resources had spent roughly \$1.6 billion in funds from these two bond acts, leaving billions to be spent in the future.

Water Resources has also spent funds from the sale of other general obligation bonds. During the period that we reviewed—from July 2005 through June 2010—Water Resources spent funds

from the sale of 13 different general obligation bonds. Table 1 lists these bonds and provides information on the bond amounts authorized by voters, the resulting funds allocated to Water Resources, and the bonds issued by the Treasurer. The table also provides information on the amount of principal and interest the State paid on these bonds during the period that we audited.

Table 1
Amounts Authorized, Issued, and Paid for Select General Obligation Bonds Through June 30, 2010
(In Thousands)

PROPOSITION	BOND ACT	DATE APPROVED BY VOTERS	TOTAL AUTHORIZED BY BOND ACT	TOTAL ADMINISTERED BY WATER RESOURCES*	TOTAL BONDS ISSUED	TOTAL PRINCIPAL PAID ON BONDS ISSUED	PRINCIPAL PAID (LAST FIVE YEARS)†	INTEREST PAID (LAST FIVE YEARS)†
Prop 3	California Safe Drinking Water Bond Law of 1976	June 8, 1976	\$175,000	\$175,000	\$172,500	\$162,200	\$18,240	\$6,203
Prop 25	Clean Water Bond Law of 1984	November 6, 1984	325,000	10,000	325,000	302,805	40,605	14,050
Prop 28	California Safe Drinking Water Bond Law of 1984	November 6, 1984	75,000	75,000	75,000	69,785	13,275	4,159
Prop 44	Water Conservation and Water Quality Bond Law of 1986	June 3, 1986	150,000	75,000	134,465	84,235	22,790	15,481
Prop 55	California Safe Drinking Water Bond Law of 1986	November 4, 1986	100,000	100,000	100,000	65,240	17,720	12,612
Prop 70	California Wildlife, Coastal, and Park Land Conservation Act of 1988	June 7, 1988	776,000	5,000	768,670	568,905	154,320	82,486
Prop 81	California Safe Drinking Water Bond Law of 1988	November 8, 1988	75,000	75,000	74,420	34,725	13,170	9,996
Prop 82	Water Conservation Bond Law of 1988	November 8, 1988	60,000	60,000	54,765	23,185	10,260	8,378
Prop 204	Safe, Clean, Reliable Water Supply Act	November 5, 1996	995,000	281,000	893,180	159,675	119,490	160,339
Prop 13	Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bond Act	March 7, 2000	1,970,000	1,052,000	1,692,810	192,630	164,965	259,878
Prop 50	Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002	November 5, 2002	3,440,000	370,000	2,596,255	83,845	79,750	286,162
Prop 84	Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006	November 7, 2006	5,388,000	2,103,000	2,039,860	920	920	71,497
Prop 1E	Disaster Preparedness and Flood Prevention Bond Act of 2006	November 7, 2006	4,090,000	3,800,000	1,577,940	470	470	49,034
Totals			\$17,619,000	\$8,181,000	\$10,504,865	\$1,748,620	\$655,975	\$980,275

Sources: State Treasurer's Office (Treasurer), applicable voter information guide, and applicable bond acts.

* Total amounts allocated to Department of Water Resources (Water Resources) are based on text contained in each bond act and, in some instances, include amounts where the bond acts specified sums for Water Resources and other departments without further specifying how much for each. Water Resources also may ultimately spend more than the amounts allocated by the bond acts based on subsequent spending authority granted by the Legislature. For example, Proposition 1E includes \$290 million for various flood control projects without specifying a particular state department and agency responsible for this spending. Therefore, this \$290 million is not included in our table as an allocation to Water Resources, even though the Bond Accountability Web site suggests that Water Resources expects to receive authority from the Legislature to spend some of these funds.

† Reflects bond payment activity during our audit period of July 1, 2005, through June 30, 2010, according to the Treasurer.

As Table 1 indicates, \$8.2 billion of the total \$17.6 billion authorized under these 13 general obligation bonds was allocated to Water Resources by the bond acts, and most of this \$8.2 billion came from the last four general obligation bonds approved by voters, namely propositions 13, 50, 84, and 1E. From July 2005 through June 2010, the State's payment of principal and interest on these 13 general obligation bonds amounted to \$1.6 billion.

Under the various acts authorizing general obligation bonds, Water Resources received the allocations listed in Table 1, but it generally could not spend funds from the sale of the bonds until it received the Legislature's approval to do so through an appropriation, such as through the spending authority granted in the annual budget act or through a continuous appropriation specified in law. From July 2005 through June 2010, Water Resources spent nearly \$2.3 billion—or approximately 27.5 percent of its total allocation—related to the 13 bond acts. More than 90 percent of this \$2.3 billion came from the same four bond acts providing the bulk of the allocated funds—propositions 13, 50, 84, and 1E—as mentioned in the previous paragraph. Table 2 provides information on the Legislature's appropriations to Water Resources from these four bond acts and on Water Resources' related spending activity.

Table 2
Department of Water Resources' Appropriations and Expenditures From Propositions 13, 50, 84, and 1E
(In Thousands)

	FISCAL YEARS				
	2005-06	2006-07	2007-08	2008-09	2009-10
Appropriations*					
Prop 13	\$66,369	\$77,518	\$26,790	\$34,664	\$55,791
Prop 50	130,948	95,105	152,701	39,970	43,578
Prop 84		305,000	227,479	593,295	290,006
Prop 1E			420,014	930,361	801,833
Total Appropriations	\$197,317	\$477,623	\$826,984	\$1,598,290	\$1,191,208
Expenditures					
Prop 13	\$37,835	\$20,108	\$24,774	\$7,610	\$14,107
Prop 50	91,666	129,444	69,517	146,712	3,053
Prop 84			274,004	117,618	162,604
Prop 1E			282,984	407,323	347,245
Total Expenditures†	\$129,501	\$149,552	\$651,279	\$679,263	\$527,009
Total Disbursed	\$175,396	\$197,857	\$359,119	\$312,105	\$456,375

Source: State Controller's Office year-end accounting records for fiscal years 2005-06 through 2009-10.

* Amounts shown under *total appropriations* do not include re-appropriations or the balance of spending authority from previous fiscal years.

† The amounts shown under *total expenditures* include amounts accrued. The amounts shown under *total disbursed* are presented on a cash basis and represent payments made during the fiscal year. As a result of timing differences between when expenses are recognized and payments are made, the amounts between the two rows for a single fiscal year will not agree.

As Table 2 shows, the Legislature dramatically increased Water Resources' authority to spend general obligation bond funds beginning in fiscal year 2006–07, after voters approved propositions 84 and 1E. For example, the Legislature appropriated roughly \$197 million from propositions 13 and 50 during fiscal year 2005–06. However, by fiscal year 2009–10, the Legislature had provided to Water Resources nearly \$1.2 billion in spending authority from the four bond acts, of which approximately \$1.1 billion came from propositions 84 and 1E. Not surprisingly, Water Resources' annual expenditures of funds from propositions 13, 50, 84, and 1E have increased collectively. As shown in Table 2, during fiscal year 2005–06 Water Resources spent \$129.5 million of the funds from these four bonds, and this amount increased to \$527 million for fiscal year 2009–10.

Water Resources' level of responsibility for performing certain functions—such as awarding bond funds to projects or monitoring projects' ongoing progress—varies according to the nature of the funded activity. For example, in some cases, the bond acts allow Water Resources to exercise discretion in selecting which specific projects receive funding. Proposition 1E allocated \$3 billion to Water Resources for various flood control projects, such as those that evaluate, repair, or replace levees. However, the text of Proposition 1E does not specify how Water Resources is to select these projects for funding. As a result, Water Resources may choose to decide administratively which projects receive funding—as long as the projects selected are consistent with the types of projects, or purposes, described in the bond act—or it can impose a competitive selection process in which grant applicants submit project proposals that Water Resources scores and ranks. In this particular case, Water Resources decided to award a portion of the \$3 billion on a competitive basis under its Early Implementation Program—a competitive local grant program that focuses on providing funding to local agencies with flood control projects that can be ready for implementation in the fiscal year that the Legislature authorizes the funds.

In other instances, the bond acts may specify certain projects and locations to receive funding. For example, Proposition 50 allocated \$20 million to Water Resources for grants for canal lining and related projects necessary to reduce the use of water from the Colorado River. Similarly, Proposition 84 allocated \$36 million to Water Resources for water conservation projects related to the Colorado River.

Aside from the varying levels of specificity the bond acts provide to Water Resources when awarding funds, the nature of the projects or activities funded can also influence how closely Water Resources monitors a project's ongoing progress. For example, portions of propositions 84 and 1E allocated funding to Water Resources to

simply pay local entities, such as city or county water district, for their share of costs associated with flood control projects being built by the federal government. Since the federal government is building the flood control projects in these circumstances, and the local entity and the State are simply providing funding for a portion of the costs incurred by the federal government and are not directly involved with managing the project's construction, we would not expect Water Resources to conduct site visits of the construction site or require periodic progress reports from the local entities receiving bond funds. Propositions 84 and 1E allocated \$180 million and \$500 million, respectively, for these types of projects.

Government Accountability, Transparency, and the Department of Finance's Role in Providing Effective Oversight for the State's Expenditures of General Obligation Bonds

Propositions 84 and 1E allocated nearly \$9.5 billion to various state agencies and represents a significant long-term investment by the State's taxpayers. These two propositions were a part of a larger group of bond acts that were passed by voters in the November 2006 general election that are collectively referred to as Strategic Growth Plan bonds because of their alignment with the State's plan to improve its infrastructure over the next several years. Recognizing the importance of building and maintaining the public's confidence by showing voters that the state government must account for how it spends funds from Strategic Growth Plan bonds, and that such expenditures will result in meaningful and long-lasting improvements to critical infrastructure, the former governor issued an executive order in January 2007. The executive order requires state agencies—under the direction of the Department of Finance (Finance)—to provide the public with information on the projects and activities funded by the proceeds from Strategic Growth Plan bonds, including those issued under propositions 84 and 1E.

Additionally, the executive order requires state agencies to develop three-part bond accountability plans (accountability plans) that describe how each department charged with administering these bonds will make decisions about what projects or activities to fund with Strategic Growth Plan bonds, how it will ensure that infrastructure projects or other activities stay within the scope and cost that it identified when deciding to provide funding for the project or activity, and how it will ensure that audits are performed on bond expenditures. Further, the executive order requires agencies to have their accountability plans approved by Finance before spending bond funds.³

³ Finance may authorize an agency to spend funds for up to four months prior to the approval of its accountability plan in extraordinary cases for an established program for which bond proceeds are continuously appropriated by the terms of a bond measure.

Required Information for the State's Bond Accountability Web Site

- Each agency's three-part accountability plan.
- A list of projects or other activities funded under each general obligation bond act and a description and the amount spent for each project or activity.
- The ongoing "in-progress" actions taken to ensure that each bond-funded project and activity remains within its scope and cost.
- The results of completed projects, programs, or other authorized activities funded by general obligation bonds.

Source: California Executive Order S-02-07, January 2007.

Beyond requiring the approval of accountability plans, the executive order requires Finance to fulfill other key responsibilities to ensure that the public transparency and accountability requirements are achieved. For example, a central component of the executive order is the requirement that Finance establish a public Web site⁴ that will provide readily accessible information on how the State is using the proceeds of general obligation bonds associated with the State's Strategic Growth Plan. According to the executive order, the information required to be posted on the Bond Accountability Web site includes, among other items, each agency's accountability plan, a list of the projects or activities to be funded, and the amounts spent on each one. The text box describes in more detail the required contents of the Web site as contained in the executive order.

In order for Finance to meet its responsibilities, the 2007 executive order requires state agencies to provide any information Finance determines is necessary to support the Bond Accountability Web site. The executive order also requires that agencies report to Finance at least twice a year, submitting semiannual reports that describe the actions being taken to ensure that the projects and activities funded from bond proceeds are being executed in a timely fashion and are achieving their intended purposes.

Beyond the requirements that it approve accountability plans and establish a Bond Accountability Web site, the other key responsibility placed on Finance by the executive order is the requirement that it ensure that Strategic Growth Plan bond expenditures are audited. To make sure that all such bond expenditures are subject to audit, the executive order requires state agencies to either contract with Finance for the performance of these audits or to make alternative arrangements subject to Finance's approval. As one of the State's fiscal control agencies, with responsibility for preparing the governor's annual budget, Finance has its own audit division called the Office of State Audits and Evaluations (OSAE). In addition to performing audits of bond expenditures, OSAE engages in audits of state agencies and local entities receiving state funds, to ensure that they adhere to state requirements.

⁴ In this audit report we refer to the Web site created by Finance in response to the January 2007 executive order as the Bond Accountability Web site. This Web site links to other Web sites administered by various state agencies for specific project information.

In addition to the public transparency and accountability requirements outlined in the executive order for propositions 84 and 1E, Water Resources' expenditures of bond funds authorized under Proposition 50 are subject to certain accountability requirements. Specifically, the text of Proposition 50 requires that, no later than January 1 of each year, each state agency spending Proposition 50 funds shall report to the Legislature on certain aspects of the projects and activities funded. Specifically, state agencies are required to report on the amount of funds awarded during the previous fiscal year for each recipient, providing this information by project. In addition, state agencies are required to provide other information on each project, such as its geographic location and the intended public benefit that each award provides. Finally, state agencies are required to provide information on the balance of funds remaining and available for future expenditures and grants. To comply with this requirement, the Natural Resources Agency, the state agency that has oversight for Water Resources, has developed a Proposition 50 Web site. Water Resources' staff are responsible for providing information on its Proposition 50 awards to the Web site.

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to audit Water Resources' management of general obligation bond funds to assess whether it has demonstrated the ability to manage the current volume of bond funds it has received and to evaluate its plans to manage future bond spending. Specifically, the audit committee asked the bureau to determine the amount of bond funds received, obligated, and spent by Water Resources between July 2005 and June 2010. Further, the audit committee asked the bureau to determine the amount of debt service the State has incurred related to Water Resources' general obligation bonds. The audit committee also asked the bureau to determine how Water Resources ensures that bond funds are used for the purposes for which they are approved and to review and evaluate the current oversight and accountability structure external to Water Resources. In addition, the audit committee asked the bureau to determine how much bond funds have been spent on projects or programs that otherwise would be funded by State Water Project revenues and General Fund appropriations. Specifically, it asked the bureau to determine whether Water Resources tracks bond proceeds and expenditures separately from expenditures of the State Water Project revenues and General Fund appropriations, and whether the tracking methods provide for the accurate accounting and management of the bond funds. Further, the audit committee asked the bureau to identify the extent to which Water Resources has shifted bond funds between projects and programs.

To determine the amount of bond funds received, obligated, and spent by Water Resources between July 2005 and June 2010, we reviewed the Legislature's appropriations to Water Resources and obtained accounting records from the State Controller's Office (Controller) and Water Resources to identify spending activity, including accrued encumbrances. To determine the amount of debt service the State has incurred related to Water Resources' general obligation bonds, we reviewed debt service payment information—by general obligation bond—maintained by the Treasurer.

To determine how Water Resources ensures that bond funds are used for the purposes for which they are approved, we selected a sample of 10 projects or activities funded with general obligation bond proceeds during our audit period of July 1, 2005, through June 30, 2010. In order to select our sample of projects—and to determine how much was spent from general obligation bonds during our audit period—we reviewed records from the Controller to identify total general obligation bond expenditures during the audit period. After obtaining these expenditure records, we compared them to other accounting records maintained by Water Resources to ensure that we selected projects for review from a reasonably complete universe of expenditure activity. After categorizing Water Resources' expenditures, by general obligation bond and fiscal year, we identified the fiscal years and general obligation bonds that had significant expenditure activity to further focus our sample selection. Since expenditures from propositions 13, 50, 84, and 1E accounted for more than 90 percent of all bond expenditures during our audit period, we limited our sample selection efforts to these four propositions' bonds. We then identified general obligation bonds and fiscal years that had significant expenditure activity and identified claim schedules from Water Resources' accounting system that supported the activity. When reviewing claim schedules, we generally selected the largest invoice paid from the claim schedules we reviewed, using this invoice to identify the contract or other encumbering document that defined the project or activity we would review. We include more detailed information concerning the 10 projects we reviewed in Appendix A.

Once we selected a project for review, we assessed Water Resources' internal controls and assessed the effectiveness of its oversight in five general areas. Specifically, we evaluated whether Water Resources demonstrated effective oversight when awarding bond funds to grant recipients, making payments, monitoring the ongoing status of the project, ensuring that it obtained key interim or final deliverables, and complying with applicable public accountability and transparency requirements. We performed this analysis by interviewing Water Resources' staff, testing certain payments made under the contracts sampled, reviewing progress

reports and deliverables, and assessing whether the contents of the Bond Accountability Web site, if applicable, were consistent with the status of each project in our sample.

To evaluate the current oversight structure external to Water Resources, we reviewed the roles and responsibilities of various state entities, including the Controller, the Treasurer, and Finance. Our review concluded that Finance was the only external entity that had a significant oversight function related to Water Resources' administration and management of general obligation bonds. To determine the extent of Finance's oversight responsibilities, we examined the requirements of the January 2007 executive order that imposed bond accountability oversight requirements on Finance. We then interviewed Finance staff within its budget office and within its audits division to determine how it had implemented the requirements of the executive order. We also reviewed documentation to the extent available that demonstrated Finance's level of involvement when implementing the executive order. To determine the extent to which Finance has audited Water Resources' bond expenditures as well as the bond expenditures of other state agencies, we interviewed staff and reviewed the audit reports produced by Finance and also reviewed its audit programs to evaluate and understand the nature of Finance's audits and reviews.

To determine how much bond funds have been spent on projects or programs that otherwise would have been funded by State Water Project revenues and General Fund appropriations, our legal counsel reviewed the allowable activities described in the general obligation bonds allocated to Water Resources and the activities of the State Water Project. Our legal counsel concluded that in some limited circumstances, the general obligation bonds we reviewed benefit the State Water Project. We include an expanded discussion of the State Water Project in Appendix B.

To determine whether Water Resources tracks bond proceeds and expenditures separately from the State Water Project revenues and expenditures and whether bond funds have been spent on projects or programs that otherwise would have been funded by the State Water Project and General Fund appropriations, we interviewed Water Resources' accounting staff to learn how they record expenditures and revenues associated with the State Water Project. We determined that Water Resources accounts for State Water Project activity as an enterprise fund, and that these funds are separate and distinct from state funds established by other voter-approved general obligation bonds. Further, we determined that an independent, external certified public accounting firm audits the financial statements of the State Water Project annually. We reviewed the independent auditor's report and evaluated

the extent to which the State Water Project's operating revenues exceeded operating expenditures during our audit period. We also reviewed reports prepared by the Controller to determine the extent to which significant operating transfers into and out of the funds comprising the State Water Project occurred during our audit period. In addition, we made inquiries of Water Resources staff and reviewed supporting documentation for a sample of transfers to understand the nature of the transfers noted during our review. Finally, to determine whether Water Resources shifted bond funds between projects and programs, we reviewed a sample of 10 accounting adjustments—referred to as *plans of financial adjustments*—during our audit period to determine whether Water Resources had transferred expenditures between different general obligation bonds or had inappropriately transferred expenditures between general obligation bonds and the State Water Project. Our review of these accounting adjustments did not reveal any areas of concern.

Audit Results

Although It Generally Demonstrated Effective Oversight of Its Bond Spending, the Department of Water Resources Can Improve in Certain Areas

The Department of Water Resources (Water Resources) demonstrated effective stewardship of bond funds when it decided to award grants and issue payments to grant recipients under propositions 13, 50, 84, and 1E;⁵ however, Water Resources exhibited weaknesses in other areas. We evaluated Water Resources' administration of a sample of 10 projects that received funding from these four propositions, focusing on whether it demonstrated effective oversight when awarding bond funds to grant recipients, approving payments, monitoring the ongoing execution of the project or activity, obtaining deliverables such as key reports and certifications of project completion, and adhering to external accountability and public transparency requirements. Table 3 on the following page summarizes the results of our review. More detailed information for each project is included in Appendix A of this report. Although Water Resources generally demonstrated effective oversight for these 10 projects, it could improve in certain areas, such as monitoring the ongoing execution of projects and obtaining project completion reports. We noted problems in these areas for two of the 10 projects we reviewed. Beyond these areas for improvement, we also noted that Water Resources should do more to ensure that it complies with public transparency and accountability requirements for bond spending. Specifically, we noted that Water Resources often lacked documented procedures for ensuring that it provides the public with complete and accurate information on its bond-funded projects, and at times some of the information it posted to the Bond Accountability Web site⁶ was inaccurate or incomplete. Water Resources is in the process of implementing a new computer system, called the Bond Management System (system), to help it meet public accountability and transparency requirements, and it expects to begin using the system to report project information in August 2011.

⁵ These four enacted propositions are the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bond Act (Proposition 13); the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 (Proposition 50); 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).

⁶ In this audit report we refer to the Web site created by Finance in response to the January 2007 executive order as the Bond Accountability Web site. This Web site links to other Web sites administered by various state agencies for specific project information.

Table 3
Evaluation of the Department of Water Resources' Oversight for a Sample of 10 Projects Funded by Various General Obligation Bonds

DEPARTMENT OF WATER RESOURCES (WATER RESOURCES) UNIT/DIVISION	PROJECT NAME	FUNDING SOURCE	AWARD AMOUNT (IN MILLIONS)	COMPONENTS OF EFFECTIVE OVERSIGHT				
				WATER RESOURCES' DECISION TO AWARD FUNDS WAS CONSISTENT WITH THE APPLICABLE BOND ACT	WATER RESOURCES ENSURED PAYMENTS WERE CONSISTENT WITH GRANT ACTIVITY	WATER RESOURCES DEMONSTRATED CONSISTENT MONITORING OF PROJECT PERFORMANCE	WATER RESOURCES OBTAINED KEY PROJECT DELIVERABLES	WATER RESOURCES COMPLIED WITH APPLICABLE TRANSPARENCY REQUIREMENTS
Bay-Delta Office	Delta Regional Salmon Outmigration and Salinity Intrusion Study	Prop 13, Prop 50, State Water Project	\$5.1	✓	✓	✓	✓	✗
Division of Planning and Local Assistance*	All-American Canal Lining Project	Colorado River Management Account, Prop 50, Prop 84, General Fund	170.4	✓	✓	✓	✓	✗
	Water Quality Exchange Partnership Program	Prop 13	20.0	✓	✓	■	✓	†
	Pajaro Valley Groundwater Storage Project	Prop 13	16.3	✓	✓	✗	■	†
	Whittier Narrows Project	Prop 50	2.0	✓	✓	✓	✓	■
Engineering	Rock Stockpile Project	Prop 1E	4.3	✓	✓	✓	✓	✗‡
Flood Division	Feather River Levee Improvement Project	Prop 1E	154.8	✓	✓	✓	✓	✗
	Natomas Levee Improvement Project	Prop 1E	193.3	✓	✓	✓	✓	■
	Santa Ana River Mainstem Project	Prop 84, General Fund	§	✓	✓			■
State Water Project Analysis Office	Long-Term Purchase of Water From Yuba County Water Agency	Prop 50	30.9	✓	✓	✓	✓	✗

Sources: Bureau of State Audits' review of project files and discussions with Water Resources' staff.

Note: The assessments shown in the table are based on the information presented in Appendix A. Refer to tables A.1 through A.10 for further detail on project-specific conclusions.

✓ = Yes: Generally indicates that Water Resources had both (1) policies and procedures to ensure that it exercised effective oversight and (2) demonstrated compliance with the oversight component shown. We also concluded "yes" for certain projects when we determined that Water Resources did not need policies and procedures, or when we concluded that evaluating certain oversight components would be inappropriate, given the nature or status of the project at the time of our review.

■ = Partial: Indicates that Water Resources had either (1) policies and procedures to ensure that it exercised effective oversight or (2) demonstrated compliance with the oversight component shown.

✗ = No: Indicates that Water Resources had neither (1) policies and procedures to ensure that it exercised effective oversight nor (2) demonstrated compliance with the oversight component shown.

* The Division of Planning and Local Assistance was reorganized in 2009 and is now called the Integrated Regional Water Management Division.

† The transparency component did not apply to the project because projects funded by Proposition 13 do not have public transparency and accountability requirements.

‡ The Flood Division was responsible for identifying funds and for external accountability requirements, while the Division of Engineering supervised rock deliveries.

§ This project receives funding under the Flood Control Subventions Program, which provides funding to local entities participating in federal flood control projects. Water Resources does not enter into grant agreements under this program and funding is limited by appropriation.

|| Water Resources was not responsible for monitoring or obtaining deliverables for this project. For more details, refer to Table A.9 in Appendix A.

Water Resources Exhibited Effective Oversight When Deciding to Award General Obligation Bond Funds and Disburse Payments

Water Resources' level of involvement when awarding and paying bond funds to grant recipients can vary significantly. In some cases, Water Resources' financial responsibilities are limited to simply paying bond funds for the State's share of costs associated with construction projects being performed by federal agencies, such as the Army Corps of Engineers. In other cases, Water Resources is much more heavily involved, such as with competitive grant programs in which prospective grant recipients have their proposals evaluated and ranked based on established guidelines or criteria. For the 10 bond-funded projects we reviewed, Water Resources demonstrated effective oversight over its decision to award bond funds and issue payments. Specifically, we found that Water Resources had appropriate policies and procedures in place to make awarding decisions, and that the purposes of these awards were consistent with the allowable uses specified in the bond acts. Further, we found that Water Resources had adequate and reasonable processes to ensure that it obtained supporting documentation for the costs claimed by grant recipients, and that such documentation was reviewed and approved by Water Resources' staff before payment.

The text of general obligation bond acts varies in the specificity with which it directs spending. Bond funds may, by law, only be used for the purposes authorized in the bond act, as approved by the voters. Some of the bond acts we reviewed require that bond funds be used for specific projects or in specific locations. In other cases, the bond acts we reviewed were less specific in terms of which particular projects should be funded or which particular locations should benefit. For three of the 10 projects we reviewed—the All-American Canal Lining Project, the Santa Ana River Mainstem Project, and the Long-Term Purchase of Water from the Yuba County Water Agency (Lower Yuba River Accord Project)—the bond acts were relatively specific in their requirements. For example, Water Resources awarded Imperial Irrigation District—a community-owned utility providing water in Southern California—nearly \$170.4 million for the All-American Canal Lining Project. The funding Water Resources awarded for this project came from a variety of sources, including amounts from Proposition 50, Proposition 84, and the State's General Fund. The scope of this project entailed building a 23-mile concrete-lined canal parallel to the existing All-American Canal. By lining the canal with concrete, the State expects to reduce water loss through seepage into the ground and thereby allow the State to more effectively use the water that it is allocated from the Colorado River under an agreement with other nearby states. A section of Proposition 50's text, codified in Section 79567 of the California Water Code, specifically allocates \$20 million in funding

The text of general obligation bond acts varies in the specificity with which it directs spending—some require bond funds to be used for specific projects in specific locations, while others had no requirements.

to Water Resources to support canal-lining projects along the Colorado River. Proposition 84 provides similar language in its bond act. Section 75050 of the Public Resources Code allocates \$36 million to Water Resources for projects related to the Colorado River.

In some cases, general obligation bonds specify that Water Resources is to spend bond funds on preexisting programs. One such bond program is the Flood Control Subventions Program, through which Water Resources provides financial assistance to local agencies to help them meet their share of construction costs when the federal government is making the improvements. Under this program, the Legislature authorizes Water Resources to provide payments to local entities, such as counties or local districts, after certain conditions have been met. These conditions include the requirements that Congress must have previously authorized the project and that the local entity must have entered into a cost-sharing arrangement with the federal government. Once these conditions have been met, the Legislature authorizes particular projects to receive funding under this program. One of the projects we selected in our sample was the Santa Ana River Mainstem Project, which was authorized by Congress in 1986 and received authorization for state funding from the Legislature. Under this project, Water Resources provided bond funding to Orange County to help satisfy its share of the costs of the federal project. Water Resources provided most of the funding for the Santa Ana River Mainstem Project under Proposition 84. Proposition 84 allocated funding to pay for the nonfederal share of costs for projects under the flood control subventions program.

While in some cases general obligation bonds specify that Water Resources is to spend bond funds on preexisting programs, in other cases, it is more involved with the award decision-making process.

In other cases, Water Resources is more involved with the award decision-making process and develops guidelines and criteria for evaluating project proposals submitted under competitive grant programs. This was the case for three of the 10 projects we reviewed, namely the Pajaro Valley Groundwater Storage Project, the Whittier Narrows Project, and the Feather River Levee Improvement Project (Feather River Levee Project). Our review of Water Resources' guidelines for the competitive grant programs included in our sample found that they were reasonably detailed and that expectations were clearly communicated to prospective applicants. For example, Water Resources' Division of Flood Management (Flood Division) established guidelines in 2008 to outline the application and selection process for programs funded under its Early Implementation Program, such as the Feather River Levee Project. The guidelines provide background on Water Resources' interpretation of the authorizing statutes under propositions 84 and 1E and also discuss which entities can apply for funding and what aspects of potential projects are eligible and ineligible for funding. Overall, we found that these guidelines provide for a clearly defined application process.

We also found that Water Resources applied scoring criteria and had justifications for the scores it assigned to projects. For instance, for the Groundwater Storage Project, Water Resources' Division of Planning and Local Assistance (Planning Division) developed a tool for scoring project proposals and a multilevel review process to select projects for funding. Its scoring tool assessed project proposals on such criteria as the need for the project, the applicant's readiness to proceed, and any environmental benefits anticipated. Moreover, the scoring criteria clearly stated the types of information that would result in a high or low score on each scored category of the proposal. For example, applicants that were ready to begin construction within six months received a maximum score of five points when Water Resources evaluated how quickly a project could get started. Conversely, for project proposals that could not be started until 15 months following the grant award, Water Resources provided one point. The Groundwater Storage Project received one of the highest scores, ranking second out of 43 projects evaluated. By objectively scoring projects based on the merits of the potential projects, Water Resources is more likely to select projects from which the public will receive the most benefit.

For the remaining four projects in our sample, Water Resources decided how much to award and which specific projects to fund because the bond acts neither specified particular projects for funding nor required Water Resources to follow a competitive selection process. In each of the remaining four projects we reviewed—the Delta Regional Salmon Outmigration and Salinity Intrusion Study (Delta Salmon Migration Study), the Rock Stockpile Project, the Natomas Levee Improvement Project, and the Water Quality Exchange Partnership Program (Water Exchange Program)—we found that Water Resources' decision to award these funds was consistent with the bond acts that provided the funding.

For example, Water Resources appropriately awarded \$4.3 million from Proposition 1E for a project to purchase and stockpile rock at strategic locations in the Sacramento–San Joaquin Delta (Delta) so that it would be available to repair damaged levees in the event of a catastrophic flood. In July 2007 the former governor issued immediate directives for Water Resources to improve the State's ability to respond to Delta emergencies. One of the directives was to stockpile materials to repair damaged levees. In response, Water Resources proposed to purchase and stockpile more than 200,000 tons of large durable rock at three locations to repair levees in a future flood emergency. In August 2007 Water Resources notified the Department of Finance (Finance) of its intent to use Proposition 1E funds for the Rock Stockpile Project. In October 2007, through the Department of General Services' (General Services) competitive bidding process, Water Resources solicited potential contractors to furnish, deliver, and stockpile the rock.

For four projects we reviewed, Water Resources decided how much to award and which specific projects to fund because the bond acts neither specified particular projects for funding nor required it to follow a competitive selection process.

Water Resources demonstrated effective oversight by receiving detailed invoices for many of its projects

The purchase order for \$4.3 million was issued in November 2007, and by December of the same year the contractor began delivering the rock for use in repairing damaged levees in response to a Delta emergency.

In addition to making award decisions that were consistent with the requirements of applicable bond acts, Water Resources demonstrated effective oversight by receiving detailed invoices for many of its projects. These invoices frequently itemized claimed project costs and related them back to tasks or deliverables specified in the grant agreements. According to our review of a sample of payments made for the 10 projects we reviewed, Water Resources had reasonable, sufficient information to make payment decisions and to ensure that the work performed was consistent with the scope of work outlined in the contract or grant agreement. For example, for the All-American Canal Lining Project, Water Resources required the grant recipient to submit monthly invoices and supporting documents, such as the contractor's paid invoices, payroll entries, or bills of materials. Our review of five invoices found that the invoices were often very detailed and sometimes exceeded 100 pages, including subcontractor invoices showing details about specific work accomplished during the month. We also found that the Planning Division staff used a two-step process to review the invoices and supporting documents against criteria for allowable payments specified in the project contract and as defined by state law. Following an initial review by Water Resources' staff, Water Resources' project manager would finalize the approved and nonapproved payment requests.

Water Resources Did Not Consistently Monitor the Status of Some Projects and Could Better Ensure That It Receives Expected Outcomes

Although it actively monitored the progress of most of the bond-funded projects we reviewed, Water Resources did not always maintain adequate oversight for some projects funded by general obligation bonds, limiting its ability to ensure that these projects were moving forward as scheduled and achieving their intended purposes. Table 3 on page 18 shows that Water Resources demonstrated effective monitoring processes for seven of the 10 projects we reviewed by using effective controls, such as requiring periodic progress reports, assigning a full-time staff member to monitor daily activities, or conducting site visits. For one project we reviewed—the Santa Ana River Mainstem Project—Water Resources was not responsible for monitoring or obtaining any deliverables. However, Table 3 also shows that for two of the 10 projects we reviewed—the Pajaro Valley Groundwater Storage Project and the Water Exchange Program—Water Resources'

Planning Division did not take steps to sufficiently monitor project status or ensure that it received intended project deliverables. For example, the Planning Division did not perform any on-site inspections during construction of a canal expansion as part of the Water Exchange Program, and it could not demonstrate that it performed on-site inspections during the construction of the Pajaro Valley Groundwater Storage Project. Further, although the Pajaro Valley Groundwater Storage Project was completed nearly three years ago, Water Resources has yet to receive final deliverables, such as a certification from a civil engineer that the project was built as planned. By not enforcing its monitoring requirements, Water Resources limits its ability to adequately assess project status and identify risks that could impede project progress and receipt of deliverables.

Water Resources' Planning Division Did Not Adequately Monitor Two of the Projects Under Review

For the Pajaro Valley Groundwater Storage Project, the Planning Division did not consistently enforce its requirement for the grant recipient to submit periodic progress reports that would allow it to assess project status and identify any key issues that need to be resolved. Water Resources' agreement with the grant recipient required the recipient to submit quarterly progress reports on the status of the Pajaro Valley Groundwater Storage Project. The grant agreement required that the progress reports summarize the work completed during the reporting period, including a statement of construction progress compared to the project's schedule, and provide a comparison of costs to date compared to the approved scope of work and project budget. During our review we attempted to evaluate a sample of 10 quarterly progress reports and ascertain whether Water Resources was staying well-informed on the project's progress. Our review found that Water Resources did not obtain two of the expected quarterly progress reports in our sample, and some of the eight reports it did receive were submitted late or did not provide all of the information called for in the grant agreement. As a result, it seems questionable as to whether Water Resources was consistently monitoring the project's progress.

Even though the Pajaro Valley Groundwater Storage Project grant agreement required that the recipient submit progress reports on a quarterly basis and provide project information, this frequently did not take place for the eight progress reports we reviewed. Specifically, three of the eight progress reports we reviewed reported project activity that was outdated. One progress report dated in October 2005 reported activity that took place between March 2000 and December 2004. Similarly, another progress report dated in late January 2008 covered project activity from mid-June 2003 through

For two of the 10 projects we reviewed, Water Resources did not take steps to sufficiently monitor project status or ensure that it received intended project deliverables.

March 2005. Since the grant agreement specified that Water Resources would not pay grant funds until it received statements of project costs and timely progress reports, it appears that the grant recipient submitted progress reports only when it requested grant funds, as opposed to submitting them on a quarterly basis. For example, the grant recipient requested its sixth payment in January 2008, at the same time that it submitted its progress report.

When we inquired about the late progress reports for this project, Water Resources acknowledged that the grant recipient did not submit the required documents on a timely basis. A Water Resources' manager with responsibility for the Pajaro Valley Groundwater Storage Project explained that the progress reports are helpful to Water Resources in determining whether the project is on schedule and would be the basis for any informal or formal action Water Resources might take with regard to project completion issues. In explaining why Water Resources accepted the late progress reports, the manager indicated that Water Resources' main focus in oversight for grant projects is to ensure the funded work is undertaken and that eligible costs are reimbursed. As long as Water Resources' staff are satisfied—through their email and phone communications—that the grant recipient is moving forward in a reasonable manner to complete the project, the manager explained that Water Resources may exercise some discretion regarding the timing, content, or format for the required progress reports.

As outside observers reviewing Water Resources' documentation for this project, we could not identify how Water Resources knew that the grant recipient was moving forward in a reasonable manner. In addition to the grant recipient submitting certain progress reports late, the activities covered in the progress reports for this project did not always cover all information required in the grant agreement. Specifically, five of the eight progress reports we reviewed had limited or missing information on whether the Pajaro Valley Groundwater Storage Project remained within budget, was on schedule, or faced any obstacles to the timely completion of the project. The first three progress reports we reviewed generally met all three of these expectations outlined in Water Resources' grant agreement. We noted that these first three progress reports were produced on a template that mirrored guidance that Water Resources had provided to other grant recipients under this particular bond program. The progress report template that Water Resources developed, which is also referenced in the grant agreement, requires grant recipients to provide information on the project's status—such as describing the work performed during the quarter, major accomplishments, and a description of any issues that could affect the schedule and budget. Water Resources'

Five of the eight progress reports we reviewed had limited or missing information on whether the Pajaro Valley Groundwater Storage Project remained within budget, was on schedule, or faced any obstacles.

template also required grant recipients to provide information on project cost and schedule, comparing the current status to information in the project's approved work plan.

However, beginning with the fourth progress report we reviewed, the grant recipient stopped using the template and began providing more limited information to Water Resources. For example, the fourth progress report was a compilation of monthly progress reports from a subcontractor managing the project on behalf of the grant recipient. The information presented in these monthly reports did not discuss obstacles to the timely completion of the project and provided limited information on the project's budget, discussing the value of various contracts and contingency amounts but not whether the project was over or under budget relative to Water Resources' grant award. The information provided in subsequent progress reports we reviewed was even more limited. The seventh progress report we examined, dated in late March 2008, provides only a bulleted list of the activities performed and does not discuss the project's schedule, budget, or obstacles to completion. Because of the lack of detail in the progress reports we reviewed, it is difficult to evaluate how informed Water Resources was regarding the Pajaro Valley Groundwater Storage Project's deployment. The lack of adequate progress reports is also problematic because it likely limits how effective a subsequent project manager at Water Resources could be in administering the grant. According to a manager at Water Resources with responsibility for this project, eight grant analysts and technical staff members have been assigned to work on this project at different times.

In addition to not always obtaining adequate progress reports, the Planning Division could not demonstrate that it performed site visits for the Pajaro Valley Groundwater Storage Project. Although Water Resources asserted that it performed multiple visits, it could not demonstrate what aspects of the project it reviewed during these visits and what conclusions, if any, were reached. Instead, the primary documentation Water Resources was able to provide of its site visits were maps and images, dating back to as early as 2000. However, these stale documents were merely planning documents that do not demonstrate that the project was on track or achieving its intended benefits. When performing our review, we had expected to see more explicit documentation of Water Resources' site visits, such as an inspection report or checklist demonstrating what Water Resources was evaluating during its visits and what conclusions were reached. A project manager explained that during the time of this project, Water Resources followed an informal approach to performing site inspections, explaining that the types of documentation generally included in the project file would consist of inspection agendas and maps provided by the grant recipient.

Water Resources could not demonstrate that it performed site visits for the Pajaro Valley Groundwater Storage Project—the primary documents regarding site visits were stale and were merely planning documents that do not demonstrate the project was on track or achieving its intended benefits.

Water Resources could have placed stronger financial incentives on the grant recipient to submit required documentation.

Moreover, Water Resources did not enforce its project completion requirements for the Groundwater Storage Project. The grant recipient informed Water Resources that construction on the project was complete in August 2008. Under the terms of the grant agreement, Water Resources was to receive a certification from a registered civil engineer that the project had been completed in accordance with the project's plans. Further, the grant recipient was required to provide Water Resources with a final progress report on project construction and expenditures for review and comment. According to a Water Resources' manager with responsibility for the project, the grant recipient has not submitted these final documents. When we asked why it had not received these items, Water Resources explained that the grant recipient was involved with various lawsuits through 2010, which challenged their financial stability. As a result, Water Resources explained that the grant recipient was not focused on providing these final items during this period of time. Water Resources also indicated that the grant recipient had significant turnover in 2008 of key agency staff. Ultimately, Water Resources indicated that it expects to obtain the certification from the civil engineer and final progress report from the grant recipient, and noted that it has not fully disbursed the bond funds committed to the project. Nevertheless, it seems that Water Resources could have placed stronger financial incentives on the grant recipient to submit this required documentation. The grant agreement allows Water Resources to withhold all or any portion of the grant award and take other action as necessary to protect the State's interests. Since the grant recipient informed Water Resources of the project's completion in August 2008, Water Resources' accounting records indicate that it had disbursed more than \$500,000 to the grant recipient.

We also found that the Planning Division did not perform any on-site inspections of the \$15.2 million canal expansion that was a part of the Water Exchange Program. Such inspections would be prudent, given the State's financial commitment to this project. In March 2001 Water Resources entered into a grant agreement with the Metropolitan Water District (MWD) of Southern California. The grant agreement awarded \$20 million in Proposition 13 bond funds to MWD to support its Water Exchange Program. MWD intended to use the grant award to explore opportunities to collaborate with other local water agencies to improve water quality and supply for all these entities. Among the collaborative efforts that this grant funded between MWD and other local agencies was a study of the water conveyance capacity associated with the Arvin-Edison South Canal. Ultimately, MWD informed Water Resources that it would spend most of its remaining Proposition 13 funds on expanding the canal, since construction costs were higher than originally anticipated and it lacked progress towards addressing the water rights necessary to implement the other water

exchange projects under review. In June 2009 MWD submitted its final report to Water Resources and confirmed that construction of the canal project was completed in early March 2009. Because most of the \$20 million award ultimately went toward construction on a canal, we had expected to see evidence that Water Resources had conducted a site visit to verify that the \$15.2 million was spent to expand the canal successfully or that Water Resources had obtained other evidence, such as certification from a civil engineer of the *as-built drawings* showing how the canal was actually expanded. According to Water Resources' staff, they did not perform a site visit of the project at completion because Water Resources lacked administrative funding under Proposition 13 to perform such an activity. However, this explanation seems questionable given that during fiscal year 2008–09, the year the project was completed, Water Resources had a support budget of more than \$1.1 billion from various funding sources. While not all of this \$1.1 billion was allocated for administrative costs, such as performing site visits, it seems unlikely that Water Resources could not have found funding for a site visit or, if costs were really a concern, arranged to obtain independent verification of the project's successful completion. Although Water Resources did have an independent Certified Public Accountant (CPA) firm audit the spending associated with the grant, it is unlikely that the CPA firm would have the expertise to know whether the construction was ultimately accomplished as planned. As a result, Water Resources cannot be sure that the construction to expand the canal, on which it spent \$15.2 million, took place or that the costs charged for construction were reasonable given the work performed.

Water Resources Effectively Monitored Most of the Bond-Funded Projects We Reviewed

As Table 3 on page 18 shows, for seven of the nine projects for which Water Resources was responsible for managing project activities, Water Resources demonstrated effective monitoring and implemented controls to monitor project status and ensure project completion. Four of these were construction projects for which Water Resources effectively used various monitoring tools, such as assigning dedicated staff to manage the grant award, requiring the submission of periodic progress reports, and performing on-site inspections or other activities to ensure that the project was completed properly. For the remaining three projects that did not involve construction, we found that Water Resources used similar controls to ensure that the grant recipients achieved project goals. By actively monitoring its projects, Water Resources is in a better position to understand a project's status and any obstacles to achieving the intended benefits.

Water Resources cannot be sure that the construction to expand a canal, on which it spent \$15.2 million, took place or that the costs charged for construction were reasonable given the work performed.

For two of the four construction projects—the Feather River Levee Improvement Project and the Natomas Levee Improvement Project—we found that the Flood Division effectively managed the projects by assigning dedicated staff to manage the project and placing inspectors at construction sites to ensure that the project remained within its original scope, schedule, and budget and achieved intended outcomes. For example, the Flood Division assigned an engineer to manage each project. The job duties for these engineers included providing technical and financial oversight for the projects and monitoring expenditures. The engineers were also responsible for reviewing and approving project deliverables, including levee evaluations, final plans, and specifications.

The Flood Division also used inspectors at the project sites to observe construction activities. The Flood Division required the inspectors to prepare and submit daily inspection and weekly progress reports to inform management of project progress

and status. We reviewed a sample of the daily inspection and weekly progress reports for the Feather River Levee Improvement Project and daily inspection reports for the Natomas Levee Improvement Project. Our review found that the reports provided sufficient information to the Flood Division managers on the activities performed by contractors at the construction site. Specifically, the reports provided detailed information on daily construction activities, site visitors, work progress, and safety issues, which allowed management to keep abreast of project progress and any potential issues that may have impeded timely completion.

Additionally, for both of these projects, the Flood Division required the grant recipients to submit quarterly work plans and progress reports to help it ensure that Water Resources remained adequately informed. Required information to be included in these quarterly work plans is detailed in the text box. We reviewed five quarterly work plans for each project and found that they provided Water Resources with sufficient information on the projects' progress.

The Flood Division also required the grant recipients for both projects to submit quarterly progress reports that described the work it completed in the previous quarter, including a statement of construction progress compared to the project schedule and a comparison of

Elements That the Flood Division Generally Requires in Grant Recipients' Quarterly Work Plans

Project Information

- Engineering and construction matters.
- Environmental matters.
- Status of permits, easements, rights-of-way, and approvals as may be required by other state, federal, or local agencies.
- Major accomplishments planned for the quarter (such as tasks to be completed, milestones to be met, and meetings to be held or attended).

Cost Information

- List of anticipated project costs for the period covered by the quarterly work plan.
- Comparison of projected costs to overall budget plan.
- Amount of advance funds sought from the State.

Schedule Information

- Schedule of activities during the period covered by the quarterly work plan.
- Comparison of projected schedule to original or last reported schedule.
- A list of any changes anticipated.

Sources: Department of Water Resources' funding agreements for the Feather River Levee Improvement Project and the Natomas Levee Improvement Project.

the actual costs to date against the project budget. Our review of a sample of quarterly progress reports for both projects found that the reports contained reasonably detailed information that would allow the Flood Division to monitor the project's status and progress. By actively monitoring its bond-funded projects, the Flood Division places itself in a stronger position to ensure that projects are progressing according to the time frames set in the original agreement, and are achieving the intended purposes.

For the two remaining construction projects—the Whittier Narrows Project and the All-American Canal Lining Project—Water Resources used similar controls to effectively monitor project status and scope. Specifically, for both of these projects, Water Resources required the grant recipient to submit monthly or quarterly progress reports, but it relied upon independent verifications of project completion, rather than performing its own on-site inspections, which seems to be a reasonable practice.

Before disbursing any funds for the Whittier Narrows Project, which is still under construction, Water Resources required the grant recipient to submit detailed construction plans and specifications certified by a California registered civil engineer, along with a written statement that all necessary permits and approvals had been obtained. During the construction, Water Resources requires the grant recipient to submit quarterly progress reports containing certain information to help it monitor the project status relative to the scope. For example, Water Resources requires these reports include information regarding project status, a comparison of actual progress to the set schedule, and a comparison of actual costs to the original budget.

Our review of a sample of five progress reports for each of the two projects found that Water Resources was obtaining adequate information to stay abreast of project status and progress and to be aware of any potential risks of the project falling behind schedule. Once the projects are complete, Water Resources requires that the grant recipients submit various closeout documents. For example, the grant recipient for the Whittier Narrows Project will be required to submit a project completion report within 90 days of completion of all tasks. This report must be certified by a registered civil engineer and include a description of the actual work done, a final schedule showing actual progress versus planned progress, and copies of any final documents or reports. Once obtained, the project completion report should assure Water Resources that the project was completed as designed and that it achieved its intended goals.

For these two construction projects, Water Resources was obtaining information to stay abreast of project status and progress and to be aware of any potential risk of the project falling behind schedule.

For the All-American Canal Lining Project, Water Resources also used periodic progress reports to monitor project status and progress effectively. To ensure that the project proceeded as planned and that the State spent its funds for allowable costs, Water Resources required the grant recipient to submit monthly progress reports and detailed invoices. Similar to those for the Whittier Narrows Project, the progress reports contained information about project status, a comparison of the actual schedule to the planned schedule, and photographs of the project. Before considering the project complete, Water Resources also required the grant recipient to obtain final acceptance and approval of the project from the U.S. Bureau of Reclamation. By requiring submission of work plans and progress reports, Water Resources is able to track the status of projects and better ensure that expected outcomes are achieved. Water Resources did not release the final retention payment until March 2011, after the U.S. Bureau of Reclamation had approved the completion of various final items.

For each of these projects that did not involve construction, Water Resources had adequate processes for monitoring project operations.

The remaining three of the seven projects with effective monitoring controls—the Delta Salmon Migration Study, the Rock Stockpile Project, and the Lower Yuba River Accord Project—did not involve construction. For each of these projects Water Resources had adequate processes for monitoring project operations to ensure that the projects remained within scope and achieved the intended outcomes. The Delta Salmon Migration Study, which was investigating salmon movement and salinity intrusion in the Delta, required the contractor to establish multiple receiver stations to track the movements of tagged fish. For this project, Water Resources' Bay-Delta Office assigned a staff member who was responsible for coordinating and monitoring project activities. According to the program manager, this staff member routinely went to various project sites to confirm that the contractor was performing work as described in the project plan. For example, he went to a hatchery to observe the fish being raised for the study, and he later went to the fish release site to verify that the contractor had implanted the fish with tracking tags and to observe the fish release process. Water Resources indicated that the project halted prematurely due to the bond freeze.⁷ Despite ending fieldwork early, the consistent involvement enabled the Bay-Delta Office to ensure that the project remained on track until that point and allowed Water Resources to obtain necessary interim deliverables, such as reports on a pilot study and a final study plan.

Similarly, though the Rock Stockpile Project was not a construction project, Water Resources' Engineering Division placed a staff person on site to monitor and report on-site issues and project progress.

⁷ In December 2008 the State initiated a bond freeze—ordering departments to cease authorizing any new projects, and to suspend most existing projects. By taking this action, the State intended to limit its prior practice of providing interim financing to bond projects, and to preserve financial resources for the State's day-to-day operational needs.

The purpose of this project was to purchase and stockpile more than 200,000 tons of rock in the Delta to repair damaged levees during an emergency. The Engineering Division, which was responsible for oversight of the daily rock deliveries, assigned a construction inspector to monitor each rock delivery, verify the weight of the rock, and report on project progress and any issues at the delivery site. We reviewed five of the construction inspector's daily reports and found that they contain sufficient information, including date and times of deliveries, amounts of delivered materials, names of the equipment operators and site visitors, and descriptions of the daily work. These daily reports allowed Water Resources to stay abreast of the project status and to ensure that intended deliverables were received.

Finally, Water Resources also effectively monitored its Lower Yuba River Accord Project. As part of its involvement in the Environmental Water Account Program that was established by federal and state agencies to protect fish in the Delta, Water Resources entered into an agreement with the Yuba County Water Agency to purchase 60,000 acre-feet of water per year for an eight-year period. Water Resources obtained statistics from the Yuba County Water Agency to track water deliveries, and verified these amounts annually against independent stream-flow measurements taken by the U.S. Geological Survey. This independent verification enabled Water Resources to ensure that the water-flow measurements were accurate.

Water Resources Has Difficulty Meeting Its Obligations to Provide the Public with Complete, Accurate Information on Projects Supported by Certain General Obligation Bonds

Propositions 50, 84, and 1E all have public transparency and accountability requirements designed to ensure that the public is aware of what projects are being funded with general obligation bonds and, in some cases, how much has been spent on these projects. For example, Proposition 50 requires each agency expending those bond funds to report to the Legislature no later than January 1 of each year on the recipient and amount of each project, grant, or loan awarded during the previous fiscal year and the balance of funds available for future expenditures or grants. Similarly, the former governor's executive order issued in January 2007 requires state agencies to post a listing of all projects and activities funded with Strategic Growth Plan bonds—such as those issued under propositions 84 and 1E—on a public Web site and to disclose the amounts spent for each project. Eight of the 10 projects we reviewed received funding from at least one of these three bond acts, and thus imposed a requirement on Water Resources to satisfy these requirements.

We found problems with Water Resources' methods for addressing the transparency requirements within propositions 50, 84, and 1E for all eight projects we reviewed.

We found problems with Water Resources' methods for addressing the transparency requirements for all eight projects we reviewed. The results of our testing and interviews with Water Resources' staff revealed that for all eight projects Water Resources lacked a formalized, documented review process to ensure that it provides complete and accurate information on general obligation bonds to the public. Further, for five of the eight projects, we found problems ranging from Water Resources not providing the public with any information at all on a particular project to the posting of inaccurate information, such as how much money Water Resources had awarded to grant recipients.

For the Lower Yuba River Accord Project and the Delta Salmon Migration Study—two of the eight projects we reviewed—Water Resources failed to post any information on its Proposition 50 accountability Web site (Proposition 50 Web site). Specifically, Water Resources' State Water Project Analysis Office (State Water Office) did not report the \$30.9 million water purchase from Yuba County on the Proposition 50 Web site, which the Natural Resources Agency (Resources Agency) created to meet its Proposition 50 transparency requirements. As we mentioned in the previous section, this project entailed Water Resources purchasing water from the Yuba County Water Agency in order to improve fishery conditions. When we asked the Resources Agency why it had not reported information for this project on its Proposition 50 Web site, the Resources Agency indicated that it was likely an oversight, speculating that there could have been confusion as to how to post the information since a water purchase is not a typical project. A manager at Water Resources had a different explanation for not posting information for this project, explaining that the particular section of Proposition 50 authorizing the project did not have a requirement to report information to the Legislature. Thus, with no clear policies or procedures in place to report this project, Water Resources explained that it had not listed this project on the Web site. Nevertheless, the reporting requirements contained in Section 79575 of the Water Code apply to all sections of Proposition 50.

Similarly, our review found that Water Resources' Bay-Delta Office did not report any information on the Proposition 50 Web site for the Delta Salmon Migration Study that it managed. When we asked Water Resources why it did not report this project on the Proposition 50 Web site, a program manager responsible for the project indicated that the Delta Salmon Migration Study was not individually listed but that it was a component of a larger project posted to the Web site. However, Water Resources entered into a \$5.1 million grant agreement specifically for the Delta Salmon Migration Study, a portion of which was funded by Proposition 50. Therefore, it seems reasonable to expect that Water Resources

would provide the public with specific information on this activity and the public benefits realized as a result of this investment of public funds.

For three of the projects we reviewed, we noted that Water Resources had posted inaccurate project information on the Bond Accountability Web site. For the Feather River Levee Improvement Project, we found discrepancies between the Flood Division's project files and the Bond Accountability Web site regarding the amount of bond funds awarded to the project. In November 2010 we noted that the Web site showed the amount awarded from Proposition 1E as \$163.2 million; however, contract agreements for this project showed a total expected cost of \$154.79 million. When we checked the information for this project on the Bond Accountability Web site three months later, in February 2011, we noted that the Flood Division continued to post inaccurate award amounts, this time showing \$88.3 million awarded under Proposition 1E. According to a manager at Water Resources, our discovery of the error took place while Water Resources was updating information on the Bond Accountability Web site. However, this explanation seems unlikely, given that we reviewed the information on this project twice, roughly three months apart, and the award information following the update in February was less accurate. In March 2011 we reviewed the Bond Accountability Web site a third time and found that the award amounts finally agreed with the amounts in the funding agreement. We found a similar issue with inaccurate award amounts being reported for the All-American Canal Lining Project. For this project, Water Resources did not update the amount awarded from Proposition 84 funds following an augmentation in bond funding intended to reduce the amount of financial assistance provided from the General Fund. As a result, the amount awarded from Proposition 84 for the project was understated by roughly \$2.3 million.

The third project for which Water Resources posted inaccurate information was the Rock Stockpile Project. According to the chief of the FloodSAFE Program Management Office, although the Rock Stockpile Project was completed in May 2008, Water Resources did not post this information to the Bond Accountability Web site until November 2010. Moreover, Water Resources posted the information under the incorrect program. Water Resources' posting of the project under the wrong program on the Bond Accountability Web site for Proposition 1E was also problematic because each program generally has its own Bond Accountability plan. By posting information for the Rock Stockpile Project under the Early Implementation Program—as opposed to the Flood Emergency Response Program—Water Resources did not provide the public with information on accountability actions that it would take in administering the project. Each bond accountability plan

For three of the projects we reviewed, Water Resources had posted inaccurate project information on the Bond Accountability Web site.

is to contain such information. For example, bond accountability plans are required to describe how agencies will select projects for funding. When Water Resources posted the project under the Early Implementation Program, the public may have believed that the Rock Stockpile Project—part of Water Resources' flood preparedness efforts in the Delta—was part of a competitive local assistance program designed to provide flood protection at the State's 200-year flood standard.

However, the Rock Stockpile Project was not a local assistance grant; rather the project involved the purchase of rock by Water Resources to stockpile along the Delta to use for repairing levees during an emergency. Water Resources corrected its posting error as of early 2011, nearly three years after the project was completed. However, when Water Resources did post information on this project under the correct bond program, it combined it with other projects to create one high-level project on the Web site, thus limiting how specific it could be regarding the results of state spending on the Rock Stockpile Project we reviewed. For example, since the project we reviewed was combined with others, the public does not know what portions of the Delta can now be protected by the deployment of rock materials, or what other portions of the Delta are expected to benefit in the future from the \$80 million that remains to be spent.

During our review of project files and interviews with Water Resources' staff, we expected to see internal controls or other policies and procedures in place to demonstrate a formalized managerial review process. However, for each of the eight projects we reviewed, we found that Water Resources could describe only verbally the process for updating project information on the Bond Accountability Web site, and it could not provide any documentation of a formal review and approval process for the posting of project information.

For each of the eight projects we reviewed, Water Resources could describe only verbally the process for updating project information on the Bond Accountability Web site—it did not have a written review and approval process.

Water Resources Plans to Use Its New Bond Management System to Improve Its Reporting to the Bond Accountability Web Site

As part of its efforts to respond to public transparency and accountability requirements, Water Resources has been attempting to implement a system that would provide a single online system to initiate, evaluate, award, manage, and report on bond-funded projects and programs. According to Water Resources, the new system is intended to be the sole source for generating mandatory reports and complying with the former governor's executive order. One of the many benefits Water Resources expected to receive from this system was the ability to export project management data for reporting-required information to the Bond Accountability Web site.

However, after nearly two years of development and a cost of \$1.5 million through February 2011, Water Resources is not using the system to report information to the Bond Accountability Web site. As the project progressed, Water Resources and its contractor determined that identifying the data necessary for reporting to the Web site was more complicated than originally expected. Currently, certain aspects of the system are operational—for example, the public is able to log into the system to submit or review funding applications—but Water Resources expects that the system will not interface with the Bond Accountability Web site for reporting purposes until August 2011.

The origins of the system began with a report from Deloitte Consulting LLP (Deloitte) in February 2008, which recommended that Water Resources make improvements to its accounting- and bond-reporting processes to become more efficient in responding to the increased bond accountability and transparency requirements of propositions 84 and 1E. One of the key weaknesses identified by Deloitte's analysis was that Water Resources lacked a standardized method and tools to comprehensively track, manage, and report project status and expenditure data. Deloitte also found that Water Resources' staff use ad-hoc spreadsheets to track project status and expenditure data, but that such a process lacks quality control to ensure accuracy.

In response to these findings, in late November 2008, Water Resources hired—through the State's competitive bid process—an information technology services and consulting firm to build the new system. The maximum amount of Water Resources' original agreement with the consulting firm was just under \$1 million, and it had a term of December 1, 2008, through November 30, 2009. By the end of the contract in late November 2009, the contractor had invoiced Water Resources for over \$881,000—or roughly 88 percent of the total contract. However, Water Resources determined that more time and expense was necessary to successfully implement the system and requested approval from General Services to amend its contract on a noncompetitive basis. Specifically, Water Resources sought to extend the term to September 30, 2010—an extension of 10 months beyond the original contract's end date of November 2009—and to increase the value of the contract by \$500,000 to a new total of roughly \$1.5 million. In its request to General Services, Water Resources explained that the time-sensitive nature of complying with the former governor's executive order was the driving force for its request, indicating that the contractor's in-depth knowledge of its business processes and technology environment was critical to successful implementation. Water Resources also explained that the new transparency, compliance, and reporting requirements outlined in the executive order are complex and required the new system to provide project tracking

The new online Bond Management System is intended to be the sole source for generating mandatory reports and complying with the former governor's executive order.

At the time the contractor submitted its final invoice in February 2011 for the amount remaining on the \$1.5 million contract, Water Resources still lacked the reporting functionality called for in the agreement.

and invoice integration functionality in a more extensive way than was originally anticipated. General Services approved the contract amendment.

However, by the time the contractor submitted its final invoice in February 2011 for the amount remaining on the \$1.5 million contract, Water Resources still lacked the reporting functionality called for in the agreement. Included in the amounts billed to Water Resources under the agreement was more than \$181,000 for software development costs, \$208,000 for project tracking capabilities, \$205,000 for invoice tracking functionality, and various other costs associated with the contractor developing system user guidelines and training materials. When we asked why Water Resources had not obtained the reporting functionality called for in the original contract, the deputy assistant of Water Resources' Bond Accountability Division (deputy) explained that the contractor had difficulty understanding Water Resources' accounting system and that there was not enough collaboration between the contractor and Water Resources' Division of Technology Services (Technology Services). The deputy further explained that Water Resources plans to develop this reporting capability with its own staff and has established a goal of having this functionality operational by August 2011.

The final costs associated with the new system will exceed \$1.5 million. In March 2011 Water Resources entered into another agreement worth approximately \$427,000 with a different lead contractor to further refine the system. The term of this agreement runs through March, 23, 2012, and includes a minimum of 3,100 hours of senior technical expertise to build, test, train, and deploy changes or enhancements to the system. Additionally, the contractor will coach and mentor Technology Services' staff on how to use the system on an as-needed basis, due to the lack of expertise and experience with the new system and its associated technologies. When asked to clarify the new contractor's role given that Water Resources staff would be developing the reporting functionality themselves, the deputy indicated that the new contractor would be adding additional invoice tracking capabilities to the system.

Finance Should Do More to Enhance Transparency and Accountability for Bond Spending

In January 2007, the former governor issued an executive order requiring Finance to establish a Bond Accountability Web site that would provide the public with readily accessible information about how the State spends certain general obligation bond funds and about the public benefits that result from such spending.

However, four years after the former governor's executive order, the Bond Accountability Web site established under Finance's direction provides limited value to the public. Specifically, because the Web site does not provide the public with information about the amounts spent on bond projects, it does little to help the public monitor the progress of projects in California's neighborhoods and communities. Further, we found that Finance lacks processes to ensure that information on the Web site is periodically updated and that the public can easily understand the expected or realized benefits of bond-funded projects. Specifically, the vague descriptions used for certain projects can create uncertainty surrounding what taxpayers' dollars are actually achieving. The cause of these problems appears to be Finance's limited guidance and its decision to delegate much of its responsibilities for establishing the Web site to the different state agencies that are administering bond funds. Finally, we noted that Finance has not performed any audits of Water Resources' administration of Strategic Growth Plan bond-funded projects since propositions 84 and 1E passed in 2006.

Finance Should Do More to Ensure That the Public Receives Better Information About the State's Spending of Certain Bond Funds

The executive order issued by the former governor in January 2007 asserted that the state government has an obligation to show the public how the State spends proceeds from Strategic Growth Plan bonds. It also stated that accountability consists of ensuring both that expenditures contribute to long-lasting, meaningful improvements to critical infrastructure and that the public has readily accessible information about how the State is spending the bonds voters approved. As part of the executive order, the former governor required Finance to create a Bond Accountability Web site to provide the public with readily accessible information on how the proceeds from certain general obligation bonds are being expended. Although Finance believes it has complied with the former governor's executive order, the information on the Web site could be enhanced with additional information already maintained by the State. For example, Finance designed the Web site to provide only limited financial information, instructing administering agencies to report only the amounts committed to specific projects—as opposed to what has actually been spent. Consequently, the public cannot use expenditure information to assess the pace of progress on projects in their neighborhoods. Further, although Finance has issued audit bulletins reminding all administering agencies of the requirements to report a list of bond-funded projects, it has not taken steps to track or verify that Water Resources posts information on all bond-funded activity or articulates in simple terms the public benefits derived from completed projects. Without information on amounts spent, assurance that posted activity

Four years after the former governor's executive order, the Bond Accountability Web site established under Finance's direction provides limited value to the public.

Finance has not taken steps to track or verify that Water Resources posts information on all bond-funded activity or articulates in simple terms the public benefits derived from completed projects.

is complete, and consistently understandable explanations of state spending, the public is not fully informed about how the State is spending certain general obligation bond funds.

One of the key transparency requirements of the former governor's executive order was the expectation that state agencies would report the amounts spent on each project or activity receiving bond funds. To comply with this requirement, Finance directed state agencies to provide information on the amounts they allocated to projects—called *committed* on the public Web site—rather than also requiring information on what has actually been spent. Although providing information on the amounts committed for specific projects might be useful for the public to know because it informs citizens of how much spending is planned in their communities and neighborhoods, also providing information on how much has actually been spent on projects would be more beneficial. As a hypothetical example, informing the public that \$100 million has been committed to a 10-year levee repair project in their neighborhood, without posting the amount spent at certain points in time, does not provide the public with information needed to assess project progress. Although the Bond Accountability Web site has some information on the pace of progress, such as estimated completion dates and check marks indicating whether agencies believe a project is on schedule, such information can be subjective. Having information regarding the amount actually spent to compare against the amount awarded would be a useful measure for the public to assess project progress.

We asked Finance's chief operating officer (operating officer)—who helped draft the executive order—about Finance's expectations for how agencies should comply with the requirement to report the amounts spent on each project. The operating officer explained that the intent of requiring the amount expended for each project was to provide the public with information on the amount expected to be spent on bond-funded projects and activities in their neighborhoods. The operating officer further explained that when Finance worked with other state agencies to implement the executive order, it became apparent that the term *expended* could mean different things. For example, the operating officer said that *expended* could mean checks that have cleared the bank, it could mean specific amounts that were set aside and dedicated to a project, or it could mean a contract had been entered into to fund a specific project. In order to bring some consistency to the public Web site, the operating officer maintained that a broader definition of *expended* was necessary.

Finance's solution was to require agencies to post the amounts committed to programs and projects, and each agency was to define *committed* as a decision made—by whatever authority that

makes such decisions under each agency's laws governing their bonds—to allocate funds to a particular project, such that the funds were then unavailable for other projects. Although Finance did not provide us with documentation of any formal guidance it provided to agencies in setting this requirement, such as a policy memo or other communication, we noted that Water Resources had a similar understanding of Finance's instructions. We did observe that, according to the agenda the operating officer prepared for Finance's February 2007 planning meeting for the Bond Accountability Web site, it instructed state agencies that they were tentatively expected to report the amount of bond funds allocated for each project.

When we raised the issue regarding reporting expenditures with Finance, the operating officer and a budget manager maintained that Finance instructed agencies to update their committed amounts to actual expenditures once projects were complete. However, such a practice has limited value to the public and does not provide an objective measure of a project's progress, since the amounts spent at the end of the project would likely equal the amount committed unless the State spent less than originally expected. Furthermore, the public would have no knowledge of what has been spent on a project until after it was completed—usually several years after the project funds are committed.

Finance's operating officer also told us that he believes providing the public with expenditure information on projects would provide misleading information about project activity under way; however, we disagree with this assertion. The operating officer contended that in many cases, bond funds are not paid until the project is finished, since grant recipients pay for the costs up front and the State provides payment only when the project is complete. In situations like these, according to the operating officer, reporting what has been paid would give the public a misleading understanding of the activity under way. Similarly, for state construction projects, the operating officer indicated that it is common for the State to make progress payments in which funds are provided to a contractor only after certain work is completed or milestones are met. Based on this practice, the operating officer believes what has been spent at a given point in time does not necessarily reflect the activity being supported with taxpayer-funded bonds. The operating officer believes that the executive order was intended to give the public meaningful information on what their tax dollars are paying for, not the daily status of the bank account, since cash on hand and expenditure commitments made are different kinds of information.

The practice of updating their committed amounts to actual expenditures once projects are complete has limited value and does not provide an objective measure of a project's progress.

Two of the 10 projects we reviewed involved construction contracts in excess of \$100 million.

While we agree that commitments, or amounts awarded, provide different financial information than amounts spent, periodically updating the Bond Accountability Web site to provide the public with information on the amounts spent on projects would be a more transparent and meaningful way of providing information to the public. Further, the operating officer's contention that the State typically pays when bond-funded projects are complete is different from our experience auditing a sample of projects at Water Resources. For example, two of the 10 projects we reviewed involved construction contracts in excess of \$100 million. In each case, Water Resources made periodic payments during the life of the project, rather than waiting until the project was complete to disburse funds. Many other projects in our sample also received progress payments. The operating officer's contention that the State makes periodic progress payments on construction contracts when milestones are achieved gives further support to the idea that providing expenditure information on the Web site, along with the amounts committed, has value as an objective measure of project progress.

The public benefit of having expenditure information can be demonstrated with an example. On the Bond Accountability Web site, Water Resources provides award information indicating that the Feather River Levee Project is "on time" because Water Resources expects it to be finished in June 2011, a date earlier than expected. However, over the life of the project, if residents of Yuba County were to consult the Bond Accountability Web site, they could not ascertain when work started in their neighborhoods or the work's rate of progress. If Finance had required Water Resources to provide expenditure information for the Feather River Levee Project at least semiannually, the public would have seen that the State had cumulatively spent \$79.4 million through December 2008, \$102.1 million through June 2009, and \$129.3 million through December 2010. As of March 2011 the State had spent \$135.5 million, or roughly 87.5 percent of the \$154.8 million awarded—an amount suggesting that the State's expectation of a June 30, 2011, project completion might indeed be reasonable. However, without this expenditure information, the public can only assume that the State is providing accurate information about the anticipated date of a project's completion. Table 4 provides additional comparisons between what the Web site reported and what the public could have seen had Finance required Water Resources to update expenditure information periodically.

Table 4
Comparison of Current Information on the Bond Accountability Web Site to Enhanced Information
(Dollars in Millions)

PROJECT NAME	PROJECT STATUS	SCHEDULE/ FINANCIAL INFORMATION	TOTAL PROJECT COST*	TOTAL STRATEGIC GROWTH BONDS AWARDED†	EXPECTED COMPLETION DATE	CONTRACT/ AGREEMENT AMOUNT	CONTRACT AMOUNT SUPPORTED BY STRATEGIC GROWTH BONDS	INFORMATION THAT COULD BE ADDED TO BOND ACCOUNTABILITY WEB SITE					PERCENTAGE OF BOND AWARD SPENT
								CUMULATIVE SPENDING THROUGH					
								JUNE 2009	DECEMBER 2009	JUNE 2010	DECEMBER 2010	APRIL 2011	
Natomas Levee Improvement Project	Implementation	On Time; Within Budget	\$276.1	\$193.3 (Prop 1E)	June 30, 2012	\$193.3	\$193.3	\$17.5	\$41.7	\$113.1	\$114.2	\$134.7	69.7%
Feather River Levee Improvement Project	Implementation	On Time; Within Budget	200.5	154.8 (Prop 1E)	June 30, 2011	154.8	154.8	102.1	115.3	129.3	129.3	135.5	87.5
All-American Canal Lining Project	Implementation	On Time; Within Budget	250.4	34.7 [‡] (Prop 84)	April 30, 2009	170.4 [§]	37.0	33.3	34.4	34.5	35.1	35.1	94.9
Rock Stockpile Project	Implementation	On Time; Within Budget	90.0	90.0 (Prop 1E)	December 31, 2014	4.3	4.3	4.3	4.3	4.3	4.3	4.3	100.0
Santa Ana River Mainstem Project	Implementation	On Time; Within Budget	312.4	73.4 (Prop 84); 239.0 (Prop 1E)	June 30, 2018	#	#	42.9	42.9	52.9	52.9	57.9 ^{**}	#

Sources: Bond Accountability Web Site; Department of Water Resources' (Water Resources) accounting records and project files.

* Represents all funding sources.

† The Bond Accountability Web site provides information on the total expected cost of a project and how much of that amount will come from Strategic Growth Plan bonds.

‡ According to Water Resources' accounting records and contract for this project, it provided an additional \$2.3 million in Proposition 84 funds for this project that Water Resources had not reported on its Bond Accountability Web site.

§ The contract award is based on the value of the agreement per Water Resources' project files and may not agree with information contained on the Bond Accountability Web site. For example, the All-American Canal Lining Project had a total contract value of \$170.4 million, of which \$37 million came from Proposition 84. Further, the difference between the total project cost of \$250.4 million and the contract amount of \$170.4 million consists of funding provided by the local entity and other state funds.

|| Water Resources did not separately report this project on the Bond Accountability Web site. It asserted that it has included the project as part of an over-arching \$90 million project to store materials in the Delta for use during an emergency.

The Santa Ana River Mainstem project receives funding under the Flood Control Subventions Program, which provides financial support to local entities participating in federal flood control projects. Water Resources does not enter into contracts with local entities under this program.

** The \$57.9 million in spending for the Santa Ana River Mainstem Project only includes amounts provided by Strategic Growth Plan bonds. Table A.9 in Appendix A shows a total of \$73.8 million in spending for this project, which includes amounts provided by the State's General Fund.

Some of the projects or activities listed on the Bond Accountability Web site appear to be comingled with other projects or activities.

As the Rock Stockpile Project shown in Table 4 demonstrates, some projects or activities listed on the Bond Accountability Web site appear to be comingled with other projects or activities, making it difficult for an interested taxpayer to see how much was spent on an individual project. Under this project, Water Resources spent roughly \$4.3 million to stockpile rocks along the Delta to repair levees during an emergency. The project was completed in May 2008 and was fully supported with Proposition 1E funds under Water Resources' Flood Emergency Response Program. Although Water Resources initially posted information for this project under the wrong bond program on the Web site, an issue we discussed earlier, it ultimately combined this project with others under the broader Delta Flood Preparedness Response and Recovery Project. Water Resources described this broader project, which cost \$90 million, as an effort to stockpile flood response and recovery materials needed for an effective response to catastrophic flood events. Water Resources' Web site indicates that some of the \$90 million allocated to the project during fiscal year 2007-08, which it asserted includes funds for the Rock Stockpile Project, has been used to distribute material to various locations in the Delta. However, without project-specific information on the \$4.3 million project we reviewed, the public is unclear about what portions of the Delta are now protected by this material, and what the status is of other projects, if any, currently underway to protect additional parts of the Delta. We noted that the Bond Accountability Web site includes a map of the location of each project, but in this particular case, the map was of limited value because it points to the middle point of the Central Valley by the city of Turlock, which is different than the Rio Vista and Port of Stockton locations where the rock from the project we reviewed was stockpiled.

Aside from missing an opportunity to enhance transparency by requiring agencies to report expenditure information on projects, Finance lacks procedures to ensure that agencies update project information on the Bond Accountability Web site. When we spoke with Finance about the extent to which it reviews information on the Bond Accountability Web site to ensure that the data are accurate and periodically updated, a manager from Finance's Office of State Audits and Evaluations (OSAE) explained that Finance's approach requires agencies to update project information semiannually in lieu of submitting semiannual progress reports to Finance as called for in the 2007 executive order. The manager further explained that OSAE instructed the agencies to notify it via email when new information was posted to the Bond Accountability Web site. The OSAE manager acknowledged that Finance does not have a tracking method in place to ensure that

agencies are updating project status at least two times per year; instead, OSAE relies on periodic cursory reviews of the Web site, testing performed during its departmental audits, and periodic informal inquiries to the departments to verify that posted information is updated. However, OSAE has not audited Water Resources' administration of projects funded by propositions 84 and 1E since Water Resources began spending funds under these propositions in fiscal year 2007–08. In fact, it has not audited Water Resources since fiscal year 2005–06.

Had Finance required state agencies to post expenditure information that was consistent with their existing accounting records, it might have discovered that Water Resources had not posted all project activity to its Bond Accountability Web site for propositions 84 and 1E. For example, as of mid-February 2011, the Web site for Proposition 84 provided background information on its Alluvial Fan Floodplain Evaluation and Delineation Program, yet the Web site showed no specific project information. However, according to a project listing provided by Water Resources at the beginning of this audit, a \$2.5 million grant was actively incurring expenditures under the program. The purpose of this program is to provide assistance to local agencies, such as counties, to develop maps showing potential flood areas and elevated sedimentation hazards. This particular grant was for 10 southern California counties to create alluvial floodplain maps—maps that will show areas of potential flooding—that are in compliance with the standards approved by the Federal Emergency Management Agency. Water Resources' listing also identified contract numbers associated with this grant and indicated that costs had been incurred. As of early April 2011 we noted that Water Resources still had not posted information on this project. We noted a similar condition in February 2011 with the Proposition 84 information posted on the Bond Accountability Web site for the Flood Emergency Response Program. Similarly, Water Resources did not appear to include complete project information on the Bond Accountability Web site regarding its project under Proposition 1E. For example, the Delta Levee System Integrity Program lacked project-specific information, even though Water Resources' internal project listing identified active projects under this program.

A critical requirement stemming from the former governor's executive order is that the public be able to know the results of completed projects. In some cases, we noted that Water Resources did a good job of telling the public what they were paying for and what was ultimately achieved. For example, the entry for the Natomas Levee Improvement Project under Proposition 1E's Early Implementation Program describes a \$193.27 million project to raise and reconstruct levees that will result in 200-year flood protection for residents and structures in the Natomas basin.

Water Resources does not provide enough information about projects and their benefits to demonstrate their value.

In other cases, based on what has been posted on the Bond Accountability Web site, the public would have difficulty understanding the expected results and benefits of a project in their neighborhood or community, because the description of the project or activity is too vague. For example, under Proposition 84 on the Bond Accountability Web site, Water Resources posted some project-specific information for the Delta Levee System Integrity Program. One completed project took place on Bouldin Island, which is located between Sacramento and Stockton. The general objective of the project was to improve a levee and protect water flow and water quality in the Delta. At a total cost of \$1.9 million, of which \$725,000 was from Proposition 84 bond proceeds, the project was reported as complete on July 31, 2008. However, beyond the implication that the levee was improved, there is no readily accessible description of the additional flood control benefit obtained by California taxpayers. For example, Water Resources does not inform the public what level of flood protection Bouldin Island is receiving as a result of the repair. Consequently, the public is left to wonder how much flood protection Bouldin Island received for the money spent.

Moreover, Water Resources does not always provide enough information about projects and their benefits to demonstrate to the public that they are valuable projects that should be supported with bond funds. Specifically, some of the project descriptions Water Resources provides on the Web site are so general that members of the public may wonder why Water Resources is investing bond funds in the project to begin with. For example, the Proposition 1E Web site describes a Central Valley Flood Management Planning Project. Costing \$41.5 million, of which approximately \$11 million was awarded from Proposition 1E bond funds, the project is expected to be completed by July 1, 2012. The Web site describes the project as one that will result in a “descriptive document reflecting a system-wide approach to protect the lands currently protected from flooding by existing facilities of the State Plan of Flood Control.” While an informed employee at Water Resources may fully appreciate the value of this effort, we believe it is unreasonable to expect that the average citizen would understand or appreciate why the State is spending millions of dollars to develop a plan to protect lands currently protected by existing flood control facilities. We believe that Finance, as the state entity responsible for establishing the Web site, can do more to ensure that these results are clearly articulated to the public.

In addition to reviewing some of the project-specific Web pages to see if they describe the results of completed projects, we reviewed information contained under the link called “Accomplishments.” Finance instructed agencies to add this link to provide a plain

English summary of overall progress broken down by program. We expected to see a project-by-project description of the public good achieved after the completion of various projects under these bond programs. However, a review of the information provided for propositions 84 and 1E revealed limited information on actual accomplishments that would be meaningful to the public. Instead, these Web pages generally included outdated and irrelevant information, such as links to application workshops from 2007 and old press releases from the former governor and former Resources agency secretary.

Finance Has Completed Few Audits of Funds From Strategic Growth Plan Bonds

One of the requirements of the former governor's executive order was for agencies to ensure that all Strategic Growth Plan bond proceeds were subject to audit to determine whether the expenditures were made according to established front-end criteria and processes, were consistent with all legal requirements, and achieved the intended project outcomes. To meet this requirement, the executive order directed state agencies to contract with Finance for the performance of these audits unless alternative audit arrangements were made with Finance's approval. As a fiscal control agency, Finance is in the unique position both to identify inefficiency and noncompliance through its audit work and to compel agencies—such as Water Resources—to take corrective action to address the problems found. However, Finance has performed relatively few audits of bonds associated with the State's Strategic Growth Plan. As of late April 2011 OSAE had issued only three audit reports on Strategic Growth Plan bonds—none of which were of Water Resources. In October 2010 OSAE issued an audit report on the administration of Proposition 1B funding by the California Emergency Management Agency (CalEMA), observing that CalEMA advanced funds to grant recipients that lacked immediate cash needs, lacked a bond accountability plan that complied with the executive order, and used inadequate monitoring practices to ensure that projects meet the approved scope and costs. Another Strategic Growth Plan bond report was issued earlier in June 2010. However, this OSAE product was limited to a letter identifying potential audit redundancies between itself and other auditors working for General Services' Office of Public School Construction. In late April 2011 OSAE issued a third audit report—its review of Sierra Nevada Conservancy's use of Proposition 84 funds as of the end of June 2009.

Finance has performed relatively few audits of bonds associated with the State's Strategic Growth Plan.

Strategic Growth Plan Bond Audits in Progress as of April 2011

- California Department of Forestry and Fire Protection
- Department of Transportation
- Santa Monica Mountains Conservancy
- Office of Public School Construction
- Air Resources Board, Audit of Proposition 1B Bond Funds
- California Community Colleges, Audit of Proposition 1D Bond Funds

Source: Department of Finance Web site.

We reviewed OSAE's Web site listing of its bond accountability audits in late April 2011 and noted six audits in progress as shown in the text box.

It appears that OSAE intends to leave most of the auditing of bond projects to the state agencies administering those projects. In May 2007 Finance held an audit workgroup meeting with other state agencies involved with administering Strategic Growth Plan bonds. According to the notes for the meeting, Finance planned to discuss its understanding of the executive order's requirement that all bond proceeds be subject to audit. Specifically, the meeting notes indicate that Finance staff intended to inform departments that it was the expectation of the former administration that "all" projects be

audited. Finance defined these audits in broad terms, explaining in its notes for the May 2007 meeting that the phrase *subject to audit* entails a review process throughout all phases of a project and can include different types of review and audits depending on the project. Further, Finance indicated that *subject to audit* would not mean that all projects are subject to a financial audit when the project is complete and bond funds are fully spent. Finance then recommended steps departments could take to have an internal review process throughout all phases of a project, such as having a preaward review process prior to committing bond funds to a project, using progress reports to monitor projects on an ongoing basis, and conducting desk reviews or site visits prior to issuing final payment for a project. Finally, OSAE delineated its roles and responsibilities versus those of departments administering bond funds. OSAE explained that its audit responsibilities would entail performing biennial audits of department oversight—equating to roughly five agencies per year—while agencies would be responsible for ongoing audits, as well as preaward, interim, and close-out reviews. When we asked an OSAE manager for her perspective on OSAE's audit role with respect to Strategic Growth Plan bonds and the former governor's executive order, the manager indicated that OSAE does not audit every grant recipient and completed project, but rather it audits grant recipient's projects using a risk-based approach, and will perform additional audits of completed projects at the request of administering agencies.

Responding to directives from the governor and Legislature, as well as to requests for audits by state agencies, is how OSAE gets its audit work, and the scope of these reviews is outlined in OSAE's contracts with these state entities. Based on the scope of work detailed in OSAE's contracts with Water Resources and the Resources Agency, OSAE was asked to determine whether

agencies, such as Water Resources, were awarding and expending bond funds in compliance with applicable laws, adequately monitoring bond-funded projects to ensure that they stay within scope and cost, accurately and timely reporting appropriate information regarding bond-funded projects in accordance with laws and other criteria, and ensuring that the activities achieved the intended outcomes of the bond-funded project or program. Under the “responsibilities” section of both contracts, OSAE agreed to review and rely on the work performed by other auditors, where appropriate, to avoid duplication. When we asked an OSAE manager why Finance has not audited Water Resources’ administration of bond funds since fiscal year 2005–06, the manager cited previous audits performed by the Bureau of State Audits (bureau)—both in 2007 and our current audit—explaining that the bureau’s audit objectives were consistent with Finance’s objectives. Therefore, to avoid duplication, the manager told us that Finance postponed its audit.

Recommendations

To ensure that its expenditures of bond funds achieve the intended purposes, Water Resources needs to strengthen its monitoring of project deliverables. For example, it should review the policies and practices of its various divisions, ensuring that periodic progress reports are obtained from grant recipients, and that final site visits document the results of the reviews performed.

To provide the public with accurate and complete information on the bond-funded projects it administers, Water Resources should develop and consistently use a formalized, documented review process that will provide greater assurance that project information posted to the Bond Accountability Web site is regularly updated and contains accurate information.

To enhance transparency and accountability regarding the State’s use of general obligation bond funds, the governor should require administering agencies to report actual amounts spent on bond-funded projects and update the expenditure information at least semiannually.

To enhance the value of the Bond Accountability Web site, Finance should:

- Require administering agencies to provide information about the actual amounts of bond funds spent on posted projects at least semiannually.

- Develop a tracking and review process to periodically assess the completeness of the project information posted to the Bond Accountability Web site. Such a process should include a review of whether state agencies are describing, in terms the public can easily understand, the expected or realized benefits of bond-funded projects.

To ensure that expenditures were consistent with bond laws and that the project achieved the intended benefits or outcomes agreed to when the project was originally awarded, Finance should conduct audits of, or approve and assure that, Water Resources and other agencies obtain audits of, Strategic Growth Plan bond expenditures.

We conducted this audit 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. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the scope section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: May 19, 2011

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Appendix A

AUDIT RESULTS FOR A SAMPLE OF BOND-FUNDED PROJECTS ADMINISTERED BY THE DEPARTMENT OF WATER RESOURCES

Table 3 on page 18 of the audit report provides the summary results of our review of the Department of Water Resources' (Water Resources) administration of a sample of 10 projects receiving funding under propositions 13, 50, 84, and 1E. Tables A.1 through A.10 on the following pages provide more detailed information on the results of our review for these 10 projects. In general, we evaluated Water Resources' administration of general obligation bond funds by examining how it decided to award funds to these 10 projects, ensured that its payments were consistent with project agreements or program guidelines, maintained ongoing monitoring of the project's status, and ensured that key deliverables—including principal planning documents or such evidence of project completion as final construction reports—were obtained. Finally, for projects receiving funding under propositions 50, 84, and 1E, we evaluated the extent to which Water Resources complied with applicable public transparency and accountability requirements, such as those established under the former governor's January 2007 executive order or under state law.

Table A.1
Oversight Report Card for Delta Regional Salmon Outmigration and Salinity Intrusion Study

Contract Award Date:	January 10, 2008
Expected Completion Date:	Initially June 30, 2011; currently unknown
Funding Sources:	Proposition 13, Proposition 50, State Water Project
Amount Awarded:	\$5,060,956
Amount Spent:	\$3,938,551*
Grant Recipient/Contractor:	U.S. Geological Survey
Water Resources Division:	Bay-Delta Office

Brief Description of the Project/Activity:

To study and investigate the impacts of the Sacramento River flow rate and Delta Cross Channel gate operations on salmon migration and salinity intrusion. However, the Department of Water Resources (Water Resources) indicated that with 50 percent of the fieldwork completed, the project came to a halt in December 2008 as a result of the bond freeze. Despite ending fieldwork early, the contractor collected millions of data points, and the Bay-Delta Office is seeking funding to analyze the data.

	EXPECTATION MET	COMMENTS
Award Issuance		
Internal controls exist to ensure project/activity was consistent with bond act.	✓	Project proposal was reviewed by Water Resources' legal counsel and was presented to the California Bay-Delta Authority prior to contract award.
Project and/or funded activity was consistent with allowable uses of the bond act.	✓	Project was consistent with California Water Code, sections 79190 and 79550.
Fiscal Payments		
Internal controls exist to ensure project or activity was consistent with grant contract.	✓	Water Resources' project manager reviewed reports of the project's progress and approved invoices prior to payment.
Payments appeared consistent with the grant contract/activity.	✓	Partial payment of the grant was processed in February 2010 for \$3.9 million for activities such as installation of acoustic tags in fish, fish handling, and coordination activities.
Ongoing Project Monitoring		
Internal controls exist to ensure project remains on scope and on schedule.	✓	Water Resources assigned an employee to coordinate project activities with the grant recipient. E-mail records indicate regular communication with project stakeholders and attendance at project meetings.
Water Resources obtained periodic progress reports from the grant recipient.	NA	Water Resources required the contractor to submit various technical reports and data as stipulated in the contract to fulfill a quarterly reporting requirement, but it did not require periodic progress reports.
Progress reports are sufficiently detailed to discern progress since the prior progress report.	NA	See above.
Site visits were performed for projects or activities involving construction.	NA	This project did not involve construction.
Project Deliverables		
Internal controls exist to ensure bond funds ultimately achieve project deliverables.	✓	Water Resources assigned an employee to coordinate project activities with the grant recipient. E-mail records indicate regular communication with project stakeholders.
Water Resources could demonstrate that key project deliverables were obtained.	✓	Water Resources obtained interim project deliverables prior to the project being suspended. Specifically, Water Resources received the "final work study plan," and two draft reports in June 2008.
External Accountability and Transparency		
Internal controls exist to ensure accurate project information is posted on the public Web site as required.	✗	Water Resources could not demonstrate that it had controls in place to ensure accurate and complete project information on the Proposition 50 Web site.
Requirements of Executive Order S-02-07 for strategic growth plan bonds were met for the project/activity.	NA	Project was not funded with Strategic Growth Plan bonds.
Water Resources reported required information on the project to the public (non-strategic growth plan bonds).	✗	This project was not listed on the Proposition 50 Web site.

* Expenditures as of mid-April 2011.

Table A.2
Oversight Report Card for All-American Canal Lining Project

Contract Award Date:	October 1, 2001
Expected Completion Date:	December 31, 2008
Funding Sources:	Prop 50; Prop 84; General Fund; Colorado River Management Account
Amount Awarded:	\$170,390,000
Amount Spent:	\$170,059,018*
Grant Recipient/Contractor:	Imperial Irrigation District
Water Resources Division:	Division of Planning and Local Assistance (currently known as Integrated Regional Water Management Division—Southern Region)

Brief Description of the Project/Activity:

California Water Code, Section 12560 et seq., authorized and continuously appropriated \$200 million, subject to specified conditions, to help fund the canal lining projects in furtherance of implementing the California Plan for reducing the State's use of Colorado River water to its basic apportionment of 4.4 million acre-feet. The All-American Canal Lining Project is proposed to construct a 23-mile concrete-lined canal. By lining the canal with concrete, California intended to reduce the amount of water loss resulting from seepage as water flowed through the canal. Pursuant to California Water Code, Section 12562, the canal lining project was to be completed by December 31, 2008.

EXPECTATION MET		COMMENTS
Award Issuance		
Internal controls exist to ensure project/activity was consistent with bond act.	NA	Propositions 50 (California Water Code, Section 79567) and 84 (Public Resources Code, Section 75050) specifically allocated funding for work pertaining to the canal lining projects along the Colorado River to reduce water use. As a result, there was no need for an internal control to ensure the project was consistent with the bond act.
Project and/or funded activity was consistent with allowable uses of the bond act.	✓	See above. Propositions 50 and 84 specifically discussed canal lining projects along the Colorado River.
Fiscal Payments		
Internal controls exist to ensure project or activity was consistent with grant contract.	✓	The Department of Water Resources (Water Resources) required the Imperial Irrigation District to submit monthly invoices for eligible costs incurred, along with documentation supporting incurred costs, such as contractors' paid invoices, payroll entries, or bills of materials. Water Resources' staff review the invoices and approve payment after identifying and deducting any ineligible expenses.
Payments appeared consistent with the grant contract/activity.	✓	Invoices tied back to discrete work elements in the grant contract and were for allowable purposes.
Ongoing Project Monitoring		
Internal controls exist to ensure project remains on scope and on schedule.	✓	Water Resources required Imperial Irrigation District to submit monthly project progress reports.
Water Resources obtained periodic progress reports from the grant recipient.	✓	See above.
Progress reports are sufficiently detailed to discern progress since the prior progress report.	✓	Project reports discussed project achievements during the reporting period, provided an updated project schedule, and displayed photographs of project progress.
Site visits were performed for projects or activities involving construction.	NA	Water Resources relies on monthly progress reports from the Imperial Irrigation District and relies on the U.S. Bureau of Reclamation to ensure that construction meets plan specifications.
Project Deliverables		
Internal controls exist to ensure bond funds ultimately achieve project deliverables.	✓	Water Resources' contract required that it retain 10 percent of the funds requested for reimbursement of approved eligible project costs until the U.S. Bureau of Reclamation approved the discrete element of work called for in the invoice. Our testing noted that Water Resources consistently withheld 10 percent of requested funds.
Water Resources could demonstrate that key project deliverables were obtained.	✓	Water Resources approved the payment of all remaining retention funds on March 8, 2011, based on approval by the U.S. Bureau of Reclamation that certain discrete work elements are complete.
External Accountability and Transparency		
Internal controls exist to ensure accurate project information is posted on the public Web site as required.	✗	We noted the lack of formalized and documented internal controls to ensure that project data is posted accurately, and updated as necessary, to the Bond Accountability Web site for propositions 50 and 84.
Requirements of Executive Order S-02-07 for strategic growth plan bonds were met for the project/activity.	✗	The Bond Accountability Web site was not updated to show that an additional \$2.26 million in Proposition 84 funds were committed to the project through a budget change proposal.
Water Resources reported required information on the project to the public (non-strategic growth plan bonds).	✓	The information on the Proposition 50 Web site meets the reporting requirements for Proposition 50.

* Expenditures as of early May 2011.

Table A.3
Oversight Report Card for Water Quality Exchange Partnership Program

Contract Award Date:	March 9, 2001
Expected Completion Date:	No later than March 8, 2009
Funding Source:	Proposition 13
Amount Awarded:	\$20,000,000
Amount Spent:	\$20,000,000*
Grant Recipient/Contractor:	Metropolitan Water District of Southern California
Water Resources Division:	Division of Planning and Local Assistance (currently known as Integrated Regional Water Management Division)

Brief Description of the Project/Activity:

The Department of Water Resources (Water Resources) entered into a letter agreement with the Metropolitan Water District of Southern California (MWD) to use Proposition 13 funds for a water quality exchange partnership with San Joaquin Valley agricultural districts that would explore opportunities to improve water quality and to better manage water supplies. As the deadline for spending Proposition 13 funds by early March 2009 approached, MWD spent its remaining grant funds on construction costs associated with the Arvin-Edison South Canal Improvement Project. MWD reported that construction on the canal was completed in early March 2009.

	EXPECTATION MET	COMMENTS
Award Issuance		
Internal controls exist to ensure project/activity was consistent with bond act.	NA	The former governor who was in office in 2000 had the authority to approve projects for program funding. According to the program manager, the Governor's Office provided Water Resources with the list of projects that were to receive funding.
Project and/or funded activity was consistent with allowable uses of the bond act.	✓	California Water Code, Section 79205.8, discusses how grants can be provided for programs that facilitate water transfers or water exchanges.
Fiscal Payments		
Internal controls exist to ensure project or activity was consistent with grant contract.	✓	We noted multiple layers of approval from Water Resources' staff prior to the approval of disbursements under the grant contract.
Payments appeared consistent with the grant contract/activity.	✓	Invoices highlighted activities that appeared consistent with the grant award.
Ongoing Project Monitoring		
Internal controls exist to ensure project remains on scope and on schedule.	✓	Water Resources obtained semiannual progress reports that detailed activities completed for the reporting period and the amount of funds expended.
Water Resources obtained periodic progress reports from the grant recipient.	✓	As noted above.
Progress reports are sufficiently detailed to discern progress since the prior progress report.	✓	As noted above.
Site visits were performed for projects or activities involving construction.	✗	According to an external audit of the project, more than \$15 million of the \$20 million grant was directed towards construction costs associated with the Arvin-Edison South Canal Improvement Project. However, Water Resources indicated that it lacked funds to perform site visits.
Project Deliverables		
Internal controls exist to ensure bond funds ultimately achieve project deliverables.	✓	Water Resources withheld nearly 10 percent of grant funding until the grantee submitted its final progress report and an audit report from an independent Certified Public Accountant firm concerning project costs and compliance with the grant agreement.
Water Resources could demonstrate that key project deliverables were obtained.	✓	Water Resources received a final report for the Water Quality Exchange Partnership Program on June 9, 2009, following the March 8, 2009 deadline, for project completion.
External Accountability and Transparency		
Internal controls exist to ensure accurate project information is posted on the public Web site as required.	NA	Proposition 13 did not contain external accountability and transparency requirements.
Requirements of Executive Order S-02-07 for strategic growth plan bonds were met for the project/activity.	NA	Project was not funded with Strategic Growth Plan bonds.
Water Resources reported required information on the project to the public (non-strategic growth plan bonds).	NA	Proposition 13 did not contain external accountability and transparency requirements.

* Expenditures through mid-April 2011.

Table A.4
Oversight Report Card for Pajaro Valley Groundwater Storage Project

Contract Award Date: June 15, 2005
 Expected Completion Date: September 25, 2007
 Funding Source: Proposition 13
 Amount Awarded: \$16,250,444
 Amount Spent: \$13,757,675*
 Grant Recipient/Contractor: Pajaro Valley Water Management Agency
 Water Resources Division: Division of Planning and Local Assistance (currently known as Integrated Regional Water Management Division)

Brief Description of the Project/Activity:

The Department of Water Resources (Water Resources) provided the Pajaro Valley Water Management Agency (agency) a \$16.25 million award from Proposition 13 funding to implement the agency's 2002 Basin Management Plan (BMP). The BMP outlines the extent of the Pajaro Valley's overpumping and seawater intrusion problems. The funded project intends to address these concerns in part, by building a 26-mile coastal water distribution system that will allow the agency to deliver piped water to coastal properties, allowing these properties to stop pumping their wells.

	EXPECTATION MET	COMMENTS
Award Issuance		
Internal controls exist to ensure project/activity was consistent with bond act.	✓	Water Resources developed project proposal review guidelines to ensure that projects were consistently evaluated and adhered to bond requirements. Water Resources also scored project proposals and ranked potential projects, providing funding to the highest ranked projects.
Project and/or funded activity was consistent with allowable uses of the bond act.	✓	The scope of this project is consistent with a groundwater storage project pursuant to Proposition 13 (California Water Code, Section 79171).
Fiscal Payments		
Internal controls exist to ensure project or activity was consistent with grant contract.	✓	The agency was required to submit invoices with supporting documentation prior to receiving reimbursement for eligible project costs. Water Resources' staff review the invoices and detail behind the costs incurred and ultimately authorize payment amounts.
Payments appeared consistent with the grant contract/activity.	✓	Claimed costs appeared to be for eligible activities, such as project design, project management, and construction costs.
Ongoing Project Monitoring		
Internal controls exist to ensure project remains on scope and on schedule.	✓	Water Resources requires the agency to submit quarterly progress reports.
Water Resources obtained periodic progress reports from the grant recipient.	✗	During our testing of a sample of 10 progress reports, we noted two instances when Water Resources could not demonstrate that it had received a progress report from the agency. In a few other instances, the progress reports that Water Resources did receive did not discuss the fiscal status of the project as a whole or other potential barriers to timely project completion.
Progress reports are sufficiently detailed to discern progress since the prior progress report.	✗	See above.
Site visits were performed for projects or activities involving construction.	✗	Water Resources asserted that it conducted a post-construction site visit in August 2008; however, evidence of this site visit does not demonstrate what was observed or the conclusions reached. The materials provided to the auditors supporting the site visit consisted of a compilation of planning documents prepared prior to project completion.
Project Deliverables		
Internal controls exist to ensure bond funds ultimately achieve project deliverables.	✓	Water Resources withholds 10 percent of requested funds until the project is completed as certified by a registered civil engineer. We noted that Water Resources had withheld 10 percent when approving payment requests from the agency.
Water Resources could demonstrate that key project deliverables were obtained.	✗	Water Resources acknowledged that it has not received the "certification of completion" from a civil engineer and final project report as called for in the grant agreement.
External Accountability and Transparency		
Internal controls exist to ensure accurate project information is posted on the public Web site as required.	NA	Proposition 13 did not contain external accountability and transparency requirements.
Requirements of Executive Order S-02-07 for strategic growth plan bonds were met for the project/activity.	NA	Project was not funded with Strategic Growth Plan bonds.
Water Resources reported required information on the project to the public (non-strategic growth plan bonds).	NA	Proposition 13 did not contain external accountability and transparency requirements.

* Expenditures through late-March 2011.

Table A.5
Oversight Report Card for Whittier Narrows Project

Contract Award Date: July 18, 2008
 Expected Completion Date: December 31, 2013
 Funding Source: Proposition 50
 Amount Awarded: \$2,000,000
 Amount Spent: \$1,800,000*
 Grant Recipient/Contractor: Los Angeles County Flood Control District
 Water Resources Division: Division of Planning and Local Assistance (currently known as Integrated Regional Water Management Division)

Brief Description of the Project/Activity:

The Department of Water Resources (Water Resources) provided \$25 million to the Los Angeles County Flood Control District (district) to assist in financing for various projects associated with the Greater Los Angeles Region Integrated Regional Water Management Plan. One of the projects funded under this grant agreement focuses on converting the Whittier Narrows Water Reclamation Plant from using a chlorination process to disinfect water to a new process that includes ultraviolet irradiation. The district estimated that the total cost of the project would be \$12.6 million, of which it would seek \$2 million from Water Resources. Construction was originally expected to be completed by January 2010.

	EXPECTATION MET	COMMENTS
Award Issuance		
Internal controls exist to ensure project/activity was consistent with bond act.	✓	Water Resources developed guidelines for evaluating project proposals and followed a process to review and rank each project proposal. For Los Angeles County, Water Resources considered Los Angeles' portfolio of projects to reach one overall score.
Project and/or funded activity was consistent with allowable uses of the bond act.	✓	Modification of the water treatment plant is consistent with the language of Proposition 50, specifically sections 79560 and 79561 of the California Water Code.
Fiscal Payments		
Internal controls exist to ensure project or activity was consistent with grant contract.	✓	Water Resources' staff assigned to administer the grant reviewed and approved the invoice prior to payment.
Payments appeared consistent with the grant contract/activity.	✓	As of early February 2010, only one invoice and payment have been made for the Whittier Narrows Project, amounting to \$1.8 million. The itemized costs on the invoice, including personnel and materials, appear consistent with the grant agreement.
Ongoing Project Monitoring		
Internal controls exist to ensure project remains on scope and on schedule.	✓	The grant recipient was required to submit quarterly status reports containing a summary of the work completed during the reporting period, a statement of progress compared to the original schedule, and a comparison of actual costs to budget.
Water Resources obtained periodic progress reports from the grant recipient.	✓	See discussion above.
Progress reports are sufficiently detailed to discern progress since the prior progress report.	✓	See discussion above.
Site visits were performed for projects or activities involving construction.	NA	Water Resources has a practice of requiring a project completion report certified by a registered civil engineer to verify completion of projects. However, Water Resources indicated that the Whittier Narrows Project is not yet complete, so no project completion report has been filed.
Project Deliverables		
Internal controls exist to ensure bond funds ultimately achieve project deliverables.	✓	Water Resources withholds 10 percent of the award amount until final deliverables are received and the grant recipient has satisfied all close-out procedures. Through our review of payments under this project, we noted that \$1.8 million of the \$2 million award has been disbursed, leaving \$200,000 (or 10 percent) of the total award as a retention.
Water Resources could demonstrate that key project deliverables were obtained.	NA	Even though the grant recipient originally expected to complete construction on the Whittier Narrows Project by January 2010, the project has not yet achieved its objectives and thus the grantee has not submitted a project completion report.
External Accountability and Transparency		
Internal controls exist to ensure accurate project information is posted on the public Web site as required.	✗	Water Resources lacks a formalized and documented process for ensuring that the information it posts on its Proposition 50 Web site contains complete and accurate information. Water Resources' staff indicated that the review and upload process is informal and documentation of review is not retained.
Requirements of Executive Order S-02-07 for strategic growth plan bonds were met for the project/activity.	NA	Project was not funded with Strategic Growth Plan bonds.
Water Resources reported required information on the project to the public (non-strategic growth plan bonds).	✓	Water Resources posted global information for all projects funded under the \$25 million grant agreement.

* Expenditures through mid-April 2011.

Table A.6
Oversight Report Card for the Rock Stockpile Project

Contract Award Date: November 15, 2007
 Expected Completion Date: June 27, 2008
 Funding Source: Proposition 1E
 Amount Awarded: \$4,349,576
 Amount Spent: \$4,349,576*
 Grant Recipient/Contractor: George Reed Inc.
 Water Resources Division: Division of Engineering[†]

Brief Description of the Project/Activity:

In response to a directive by the former governor in July 2007 to improve the State's ability to respond to Delta emergencies, the Department of Water Resources (Water Resources) purchased more than 200,000 tons of rock for \$4.3 million and stockpiled this material at various locations to repair damaged levees during an emergency.

	EXPECTATION MET	COMMENTS
Award Issuance		
Internal controls exist to ensure project/activity was consistent with bond act.	✓	Funding for projects is discussed in meetings that include Water Resources' management.
Project and/or funded activity was consistent with allowable uses of the bond act.	✓	The purchase was consistent with Public Resources Code, Section 5096.821.
Fiscal Payments		
Internal controls exist to ensure project or activity was consistent with grant contract.	✓	The Division of Engineering verified rock deliveries and provided approvals for the payment.
Payments appeared consistent with the grant contract/activity.	✓	See above.
Ongoing Project Monitoring		
Internal controls exist to ensure project remains on scope and on schedule.	✓	A Water Resources' construction inspector was on site to monitor and report on rock deliveries.
Water Resources obtained periodic progress reports from the grant recipient.	NA	A Water Resources' construction inspector performed daily monitoring and reporting of rock deliveries in lieu of quarterly progress reports.
Progress reports are sufficiently detailed to discern progress since the prior progress report.	NA	See above.
Site visits were performed for projects or activities involving construction.	NA	Project did not involve construction.
Project Deliverables		
Internal controls exist to ensure bond funds ultimately achieve project deliverables.	✓	A Water Resources' construction inspector was on site to monitor and report on rock deliveries.
Water Resources could demonstrate that key project deliverables were obtained.	✓	Water Resources tracked rock deliveries that agreed with on-site inspection reports.
External Accountability and Transparency		
Internal controls exist to ensure accurate project information is posted on the public Web site as required.	✗	Water Resources lacked formalized and documented procedures for posting project information to the Bond Accountability Web site.
Requirements of Executive Order S-02-07 for strategic growth plan bonds were met for the project/activity.	✗	Although Water Resources completed the project in 2008, it did not list the project under the correct program on the Bond Accountability Web site until early 2011.
Water Resources reported required information on the project to the public (non-strategic growth plan bonds).	NA	Project was funded with a Strategic Growth Plan bond (Proposition 1E).

* Expenditures through mid-April 2011.

[†] The Flood Division was responsible for identifying funds and for external accountability requirements, while the Division of Engineering supervised the rock deliveries.

Table A.7
Oversight Report Card for Feather River Levee Improvement Project

Contract Award Date:	April 25, 2008	
Expected Completion Date:	June 30, 2012	
Funding Source:	Proposition 1E	
Amount Awarded:	\$154,790,000	
Amount Spent:	\$135,507,421*	
Grant Recipient/Contractor:	Three Rivers Levee Improvement Authority	
Water Resources Division:	Division of Flood Management	
Brief Description of the Project/Activity:		
The Department of Water Resources (Water Resources) awarded \$154.8 million to the Three Rivers Levee Improvement Authority (authority) to assist in financing an Early Implementation Project under the State-Federal Flood Control System Modification Program. After local contributions amounting to \$45.7 million, total project costs are budgeted at \$200.5 million. According to the grant agreement, the authority was to use the grant award to acquire land and to provide 200-year flood protection to south Yuba County through improvements to a levee along the Feather River between the Bear and Yuba rivers.		
	EXPECTATION MET	COMMENTS
Award Issuance		
Internal controls exist to ensure project/activity was consistent with bond act.	✓	Water Resources established a project evaluation process that considered whether this project met eligibility requirements associated with the Early Implementation Program. These eligibility criteria included consideration that the project is critically needed or will otherwise significantly maximize public benefits, safety, reduce state liability, and whether the project was part of obtaining 200-year flood protection for the region.
Project and/or funded activity was consistent with allowable uses of the bond act.	✓	This project is consistent with the activities described in Public Resources Code, Section 5096.821, which allows for the repair or replacement of levees.
Fiscal Payments		
Internal controls exist to ensure project or activity was consistent with grant contract.	✓	Water Resources receives quarterly work plans that are due 45 days before the start of the quarter, outlining the activities to be performed. Within 45 days following the end of the quarter, the grant recipient submits a quarterly progress report that describes the activities performed and a statement of progress compared to the project schedule. Invoices are approved for payment by Water Resources' management.
Payments appeared consistent with the grant contract/activity.	✓	Our testing of a sample of invoices indicated that payments appeared to be for eligible project costs as specified in the grant contract.
Ongoing Project Monitoring		
Internal controls exist to ensure project remains on scope and on schedule.	✓	See discussion of quarterly work plans and quarterly progress reports under "Fiscal Payments" above.
Water Resources obtained periodic progress reports from the grant recipient.	✓	See above.
Progress reports are sufficiently detailed to discern progress since the prior progress report.	✓	See above.
Site visits were performed for projects or activities involving construction.	✓	Water Resources' staff submit daily inspection reports, which discuss project site activity such as observations of construction in progress, labor activity, and safety concerns.
Project Deliverables		
Internal controls exist to ensure bond funds ultimately achieve project deliverables.	✓	Water Resources limits the amount of funds it will advance in any particular payment period, reducing subsequent advance payments if actual project costs are less than the amounts previously advanced. When considering actual costs incurred and its impact on future advance payments, Water Resources' practice is to also retain 10 percent of its share of cost on discrete project elements until those tasks are complete.
Water Resources could demonstrate that key project deliverables were obtained.	✓	Water Resources has received the construction completion reports for completed components of the project, certified by a registered civil engineer.
External Accountability and Transparency		
Internal controls exist to ensure accurate project information is posted on the public Web site as required.	✗	According to Water Resources' staff, it does not have written procedures or guidelines to ensure information posted to the Bond Accountability Web site is accurate and complete.
Requirements of Executive Order S-02-07 for strategic growth plan bonds were met for the project/activity.	✗	We noted inconsistencies with information posted to the Bond Accountability Web site regarding amounts awarded from Proposition 1E. In November 2010 and February 2011, posted award amounts were \$163.2 million and \$88.3 million respectively. However, Water Resources finally posted correct information in March 2011.
Water Resources reported required information on the project to the public (non-strategic growth plan bonds).	NA	Proposition 1E is a Strategic Growth Plan bond.

* Expenditures through mid-April 2011.

Table A.8
Oversight Report Card for the Natomas Levee Improvement Project

Contract Award Date:	May 1, 2009
Expected Completion Date:	June 30, 2014
Funding Source:	Proposition 1E
Amount Awarded:	\$193,270,000
Amount Spent:	\$134,693,045*
Grant Recipient/Contractor:	Sacramento Area Flood Control Agency (SAFCA)
Water Resources Division:	Division of Flood Management
Brief Description of the Project/Activity:	
The Department of Water Resources (Water Resources) awarded \$193.3 million to the Sacramento Area Flood Control Agency (SAFCA) to assist in financing an Early Implementation Project to address deficiencies in the Natomas perimeter levee system for those segments that do not currently meet the 100-year flood protection standard adopted by the Federal Emergency Management Agency. By completing this project, SAFCA hopes to lay the groundwork for eventually meeting a 200-year flood protection standard and avoid any substantial increase in residual risk of property damage as new development occurs in the Natomas basin.	
EXPECTATION MET	
COMMENTS	
Award Issuance	
Internal controls exist to ensure project/activity was consistent with bond act.	✓ Water Resources established a project evaluation process that considered whether this project met eligibility requirements associated with Early Implementation projects. The deputy director and director approved the project before Water Resources executed the agreement.
Project and/or funded activity was consistent with allowable uses of the bond act.	✓ This project is consistent with the activities described in Public Resources Code, Section 5096.821, which allows for the repair or replacement of levees.
Fiscal Payments	
Internal controls exist to ensure project or activity was consistent with grant contract.	✓ Water Resources receives quarterly work plans that are due 45 days before the start of the quarter, outlining the activities to be performed. Within 60 days following the end of the quarter, the grant recipient submits a quarterly progress report that describes the activities performed and a statement of progress compared to the project schedule. Invoices are approved for payment by Water Resources' management.
Payments appeared consistent with the grant contract/activity.	✓ Our testing of a sample of invoices indicated that payments appeared to be for eligible project costs as specified in the grant contract.
Ongoing Project Monitoring	
Internal controls exist to ensure project remains on scope and on schedule.	✓ See discussion of quarterly work plans and quarterly progress reports discussed under "Fiscal Payments" above.
Water Resources obtained periodic progress reports from the grant recipient.	✓ See above.
Progress reports are sufficiently detailed to discern progress since the prior progress report.	✓ See above.
Site visits were performed for projects or activities involving construction.	✓ Water Resources' staff submit daily inspection reports, which discuss project site activity such as construction in progress, labor activity, and safety concerns.
Project Deliverables	
Internal controls exist to ensure bond funds ultimately achieve project deliverables.	✓ Water Resources limits the amount of funds it will advance in any particular payment period, reducing subsequent advance payments if actual project costs are less than the amounts previously advanced. When considering actual costs incurred and the impact on future advance payments, Water Resources' practice is to also retain 10 percent of its share of the cost on discrete project elements until those tasks are complete.
Water Resources could demonstrate that key project deliverables were obtained.	NA Work on project elements is not complete, so the project completion report and post-construction performance reports detailed in the grant contract were not due at the time of our review.
External Accountability and Transparency	
Internal controls exist to ensure accurate project information is posted on the public Web site as required.	✗ According to Water Resources' staff, it does not have written procedures or guidelines to ensure information posted to the Bond Accountability Web site is accurate and complete.
Requirements of Executive Order S-02-07 for strategic growth plan bonds were met for the project/activity.	✓ Reported project information appears consistent with information contained in project files.
Water Resources reported required information on the project to the public (non-strategic growth plan bonds).	NA Project was funded with a Strategic Growth Plan bond (Proposition 1E).

* Expenditures through early April 2011.

Table A.9
Oversight Report Card for the Santa Ana River Mainstem Project

Contract Award Date:	Not applicable —no contract
Expected Completion Date:	June 30, 2018
Funding Sources:	Proposition 84; General Fund
Amount Awarded:	Not applicable
Amount Spent:	\$73,771,267*
Grant Recipient/Contractor:	Orange County
Water Resources Division:	Division of Flood Management

Brief Description of the Project/Activity:

The Legislature has established a policy of providing financial assistance to local agencies cooperating in the construction of federal flood control projects. The federal government is responsible for the construction of such projects. State assistance is limited to reimbursement of a portion of the project's costs. Prior to receiving reimbursement from the State, the local agency must demonstrate that the project to be funded is eligible to receive federal funding and is authorized by Congress. Once the State's conditions for reimbursement have been met, the Legislature will authorize the project for reimbursement depending on the availability of funds. The Santa Ana River Mainstem Project is authorized under California Water Code, Section 12678.1, and includes various flood control projects such as the construction and enlargement of dams.

	EXPECTATION MET	COMMENTS
Award Issuance		
Internal controls exist to ensure project/activity was consistent with bond act.	NA	Proposition 84 specifically allocated funding to pay the State's share of nonfederal costs. Since the Department of Water Resources (Water Resources) did not have discretion in selecting projects for funding, we did not expect to see an internal control.
Project and/or funded activity was consistent with allowable uses of the bond act.	✓	Public Resources Code, Section 75034, allows Proposition 84 funding to be spent to pay for the State's share of nonfederal costs on federally authorized projects, such as those under the State Water Resources Law. Congress authorized the project in 1986 and the Legislature authorized state participation in the project under California Water Code, Section 12678.1.
Fiscal Payments		
Internal controls exist to ensure project or activity was consistent with grant contract.	✓	Water Resources' staff verify costs are eligible for reimbursement and consistent with project plans. An evaluation of the claim package is prepared by a Water Resources' engineer and payment is ultimately approved by division management.
Payments appeared consistent with the grant contract/activity.	✓	Most of the sampled payments we reviewed were for land acquisition costs, which are consistent with program guidelines.
Ongoing Project Monitoring		
Internal controls exist to ensure project remains on scope and on schedule.	NA	The federal government is responsible for construction. Water Resources' role is generally limited to disbursing funds to local agencies for their share of nonfederal costs. As a result, Water Resources does not monitor project status.
Water Resources obtained periodic progress reports from the grant recipient.	NA	See above.
Progress reports are sufficiently detailed to discern progress since the prior progress report.	NA	See above.
Site visits were performed for projects or activities involving construction.	NA	See above.
Project Deliverables		
Internal controls exist to ensure bond funds ultimately achieve project deliverables.	NA	The federal government is responsible for construction. Water Resources' role is generally limited to disbursing funds to local agencies for their share of nonfederal costs. As a result, Water Resources does not have a responsibility in this area.
Water Resources could demonstrate that key project deliverables were obtained.	NA	See above.
External Accountability and Transparency		
Internal controls exist to ensure accurate project information is posted on the public Web site as required.	✗	According to Water Resources' staff, it does not have written procedures or guidelines to ensure information posted to the Bond Accountability Web site is accurate and complete.
Requirements of Executive Order S-02-07 for strategic growth plan bonds were met for the project/activity.	✓	Information posted for the project appeared accurate.
Water Resources reported required information on the project to the public (non-strategic growth plan bonds).	NA	Project was funded with a Strategic Growth Plan bond (Proposition 84).

* Expenditures between August 2006 and mid-April 2011.

Table A.10
Oversight Report Card for Long-Term Purchase of Water from Yuba County Water Agency

Contract Award Date: December 4, 2007
 Expected Completion Date: No later than December 31, 2025
 Funding Source: Proposition 50
 Amount Awarded: \$30,900,000
 Amount Spent: \$30,900,000*
 Grant Recipient/Contractor: Yuba County Water Agency
 Water Resources Division: State Water Project Analysis Office

Brief Description of the Project/Activity:

The Department of Water Resources (Water Resources) entered into a contract with the Yuba County Water Agency to purchase water. Under the terms of the contract, the Yuba County Water Agency is to deliver 480,000 acre-feet of water over the first eight years of the contract (through December 31, 2015). Water Resources decided to purchase this water in an effort to improve fishery conditions on the Yuba River and improve water supplies for the California Bay-Delta Authority's (CalFED) Environmental Water Account programs. The contract also allowed Water Resources to buy additional amounts of water, beyond the 480,000 acre-feet for \$30.9 million, based on certain environmental conditions and other factors.

	EXPECTATION MET	COMMENTS
Award Issuance		
Internal controls exist to ensure project/activity was consistent with bond act.	✓	Water Resources' legal counsel reviewed the form and sufficiency of the contract. Further, the purchase of this water from the Yuba County Water Agency is specified in the Environmental Water Account Program Plan for fiscal year 2006-07.
Project and/or funded activity was consistent with allowable uses of the bond act.	✓	California Water Code, Section 79550(d), provides \$180 million for water supply reliability projects that allow for, among other things, the acquisition of water for the CALFED Environmental Water Account. Proposition 50 specifies that preference shall be given to long-term water purchase contracts and water rights.
Fiscal Payments		
Internal controls exist to ensure project or activity was consistent with grant contract.	NA	Water Resources made a lump-sum payment of \$30.9 million as specified in the water purchase agreement. However, the controls to ensure the water was delivered as scheduled are detailed in the deliverables and ongoing monitoring sections below.
Payments appeared consistent with the grant contract/activity.	✓	The grant agreement required Water Resources to pay a lump-sum of \$30.9 million within 60-days of receiving an invoice from Yuba County following the effective date of the contract.
Ongoing Project Monitoring		
Internal controls exist to ensure project remains on scope and on schedule.	✓	Yuba County Water Agency provides Water Resources with data that tracks water flow rates on a daily basis. Annually, Water Resources compares and verifies the statistics provided by the Yuba County Water Agency to similar data prepared by the U.S. Geological Survey.
Water Resources obtained periodic progress reports from the grant recipient.	✓	See above.
Progress reports are sufficiently detailed to discern progress since the prior progress report.	✓	See above.
Site visits were performed for projects or activities involving construction.	NA	This project did not involve construction.
Project Deliverables		
Internal controls exist to ensure bond funds ultimately achieve project deliverables.	✓	Tracking of daily flow rates provided by the grant recipient, and corroborating the data against similar information prepared by the U.S. Geologic Survey are adequate controls to ensure that the water is ultimately delivered to the State per the grant agreement.
Water Resources could demonstrate that key project deliverables were obtained.	✓	Water Resources could demonstrate that it received more than 60,000 acre-feet of water for 2008 and 2009.
External Accountability and Transparency		
Internal controls exist to ensure accurate project information is posted on the public Web site as required.	✗	Water Resources' staff could not describe or document any internal controls that would ensure that this project is included in the annual Proposition 50 report to the Legislature, as required by California Water Code, Section 79575.
Requirements of Executive Order S-02-07 for strategic growth plan bonds were met for the project/activity.	NA	Project was not funded with Strategic Growth Plan bonds.
Water Resources reported required information on the project to the public (non-strategic growth plan bonds).	✗	This project was not listed on the Proposition 50 Web site.

* Expenditures through mid-April 2011.

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Appendix B

THE CALIFORNIA STATE WATER PROJECT BENEFITS IN ONLY LIMITED WAYS FROM THE DEPARTMENT OF WATER RESOURCES' SPENDING OF GENERAL OBLIGATION BOND FUNDS

The Joint Legislative Audit Committee asked us to determine whether the Department of Water Resources (Water Resources) has used general obligation bond funds to pay for projects or programs that the State Water Project could have funded and whether State Water Project funds are tracked separately from other general obligation bonds. Fundamentally, these audit objectives are aimed at evaluating whether the State Water Project—which is supposed to be a financially self-sustaining endeavor—has received support from other general obligation bonds or from the State's General Fund.

As we explain in the following sections, although there may be a relationship between the purposes for which State Water Project funds may be expended and the various purposes supported by the general obligation bonds we reviewed, we see only very limited circumstances in which expenditures from these other bond measures provide a direct benefit to the State Water Project. Aside from those limited circumstances, these other bond measures do not provide financial support to the State Water Project. We also describe how Water Resources accounts for its spending on the State Water Project and were able to conclude, based on its financial statements, that the State Water Project is a self-sustaining project, as contemplated by law.

In Some Very Limited Circumstances, the General Obligation Bonds We Reviewed Provide a Benefit to the State Water Project

The State Water Project is a major water storage and delivery system that comprises various reservoirs, aqueducts, power plants, and pumping stations throughout California. Its main purpose is to store water and distribute it to 29 urban and agricultural water suppliers in Northern California, the San Francisco Bay Area, the San Joaquin Valley, the Central Coast, and Southern California. According to Water Resources, the State Water Project was designed and built to deliver water, control floods, generate power, provide recreational opportunities, and enhance habitat for fish and wildlife. Water Resources also indicated that the State Water Project delivers water to two-thirds of California's population and is the nation's largest state-built water and power development and conveyance system.

The State Water Project is authorized by the Burns-Porter Act (Burns-Porter), which was approved by California voters in 1960 and authorizes the issuance of \$1.75 billion in general obligation bond funds to support the project. The ballot pamphlet presented to voters in 1960 advised that the project would “pay for itself.” To achieve this goal, Burns-Porter calls for an approach whereby the revenue from 29 water contractors who have long-term water supply contracts is used to pay off the bonds.

Burns-Porter specifies the purposes for which State Water Project funds may be expended. The funds may be used to construct various facilities that are described by Section 12934 of the California Water Code, also known as state water facilities, which include such facilities as the Oroville Dam. In addition, Burns-Porter specifies that State Water Project funds may be used to construct facilities authorized by the Legislature after the enactment of Burns-Porter as part of the Central Valley Project (CVP); facilities authorized by the California Water Plan; and “such other additional facilities the Department of Water Resources determines are necessary and desirable to meet local needs,” including for such purposes as flood control. The various components of the State Water Project, as well as the CVP facilities that were constructed prior to the development of the State Water Project, work together in a coordinated fashion to deliver water throughout the State.

Our review of the statutes that govern the State Water Project and the various other bond acts (propositions 13, 50, 84, and 1E) revealed only limited circumstances in which the bond acts enacted by the four propositions expressly allow bond funds to be used in a way that may provide a direct benefit to the State Water Project. As one example, certain funds made available under Proposition 13 must be used by Water Resources for projects that improve flood control for State Highway 269 in the area north of the city of Huron or that improve flood control for the California Aqueduct in the area of the Arroyo Pasajero Crossing. The California Aqueduct is part of the State Water Project, so to the extent that a portion of this \$5 million appropriation for improved flood control may have been expended for flood control improvement for the California Aqueduct, there would be a benefit to the State Water Project. In addition, Proposition 84 authorized the use of funds for various projects identified in the *June 2005 Delta Region Water Quality Management Plan*. This plan identified three projects—the North Bay Aqueduct Alternate Intake Project and two other related intake projects at the Stockton Water Agency and Contra Costa Water Agency. Water Resources has informed us that the North Bay Aqueduct Alternate Intake Project is at a location that is part of the State Water Project. Thus, the State Water Project may have derived a benefit from the use of this funding. It is important

to note that the use of these bond funds for these projects was entirely consistent with the purposes authorized by the respective bond acts.

In addition, Water Resources staff have informed us that bond funds were authorized to be used to replace General Fund obligations of the State. Water Resources has directed our attention to an example in which bond funds from Proposition 84 were used to offset what otherwise would have been a General Fund obligation. As part of a legal proceeding, the Quantification Settlement Agreement (settlement agreement) was entered into by Water Resources, on behalf of the State, in 2003. From 2003 through September 2008, money from the General Fund was continuously appropriated in support of the settlement agreement. In fiscal year 2008–09 the Legislature appropriated \$13.5 million in Proposition 84 funding that was authorized for Integrated Regional Water Management, interregional funds to fulfill the remaining General Fund obligations of the settlement agreement. Water Resources has indicated that this appropriation offset, or reduced, obligations that would otherwise have been borne by the General Fund. Water Resources has also informed us that \$20 million in bond funding authorized by Proposition 50 and \$36 million authorized by Proposition 84 augmented the General Fund funding that was made available for purposes of the settlement agreement.

Although some of the purposes for which the State Water Project was established—such as flood control—may appear to overlap with the purposes of the other bond measures, we found that the funds made available under these other bond measures, with the exceptions noted earlier, do not support the State Water Project. One example of the apparent overlap in the purposes for which State Water Project funds and certain other bond funds may be used is flood control. However, it is important to note that the flood control paid for by the State Water Project occurs only at the Oroville Dam location. In contrast, the funds made available under the other bond measures for purposes of various flood control activities generally support local flood control efforts or other flood control efforts that are not a part of the State Water Project. Thus, the funds made available under the other bond acts for the purpose of flood control do not support the State Water Project.

Water Resources Accounts Separately for Revenues and Expenditures Associated With the State Water Project and With Other General Obligation Bond Activity

Water Resources uses three funds to separately account for the revenue and expenditure activity associated with the State Water Project. These three funds are distinct from other funds that the

State has established to track the spending activity associated with other general obligation bonds, such as those authorized under propositions 13, 50, 84, and 1E. The State has established the three State Water Project funds as enterprise funds, meaning that the spending activity from these three funds is paid for by user charges—similar to those found in the private sector—as opposed to the proceeds of taxes levied on the State’s citizens. Government functions that are funded by enterprise funds are generally viewed as self-sustaining, businesslike endeavors. Further, although general obligation bonds typically burden the General Fund, they sometimes finance the acquisition of assets that generate revenue for the State, which is used to reimburse the General Fund for the principal and interest owed on this debt. The State Treasurer’s Office refers to these types of general obligation bonds as *self-liquidating*, or *enterprise*, general obligation bonds because the revenue generated from the activity—such as building dams or hydroelectric power generation facilities—is expected to be sufficient to cover the State’s repayment obligations.

The three funds that comprise the State Water Project, more formally known as the California Water Resources Development System, were established at different times as the State Water Project has evolved. The two funds pertaining to the CVP were established in 1933 when voters approved \$170 million in bonds. However, according to Water Resources, the bonds were unmarketable during the midst of the Great Depression, so the federal government took over the CVP as a public works project. Today, the U.S. Bureau of Reclamation administers the CVP. The third fund was established in 1960 with the passage of Burns-Porter, otherwise known as the California Water Resources Development Bond Act. As a result of Burns-Porter allowing funds to be spent on CVP facilities, portions of the State Water Project consist of facilities developed and used jointly with the federal government. The State and the federal government share costs for the jointly developed facilities, with approximately 55 percent of the costs paid by the State. In 1986 the State and the federal government entered into a coordinated operation agreement under which the State Water Project and the CVP work collaboratively, such as when coordinating the release of water from upstream reservoirs.

Water Resources has arranged for the State Water Project, including the jointly developed facilities that are part of the CVP, to be audited annually by an independent Certified Public Accountant firm. We reviewed the audited financial statements of the State Water Project for five fiscal years—fiscal years 2005–06 through 2009–10. Our review focused on whether the State Water Project has been self-sustaining based on its annual operating revenues and expenses. As Table B indicates, the State Water Project has consistently had operating revenues that were adequate

to cover its operating expenses. Table B also distinguishes financial information for facilities that are part of the CVP. The table lists, in the columns headed “Burns-Porter Act,” the facilities not related to the CVP.

Table B
California State Water Project Operating Revenue and Expense
Activities by Segment
(In Thousands)

	FISCAL YEAR 2005-06		FISCAL YEAR 2006-07		FISCAL YEAR 2007-08		FISCAL YEAR 2008-09		FISCAL YEAR 2009-10	
	BURNS-PORTER ACT	CENTRAL VALLEY PROJECT ACT								
Operating Revenues										
Water supply	\$409,524	\$232,798	\$441,261	\$263,660	\$467,291	\$285,562	\$454,921	\$266,332	\$547,435	\$305,723
Power sales	267,963	23,830	204,582	17,624	203,978	11,452	160,858	14,460	158,427	7,237
Federal reimbursements	13,724	1,853	23,355	1,108	20,209	783	16,234	2,032	22,491	1,530
Total Operating Revenues	\$691,211	\$258,481	\$669,198	\$282,392	\$691,478	\$297,797	\$632,013	\$282,824	\$728,353	\$314,490
Operating Expenses										
Depreciation expense	\$28,704	\$49,276	\$27,768	\$50,297	\$28,806	\$50,330	\$29,482	\$50,150	\$30,653	\$50,160
Other operating expenses	616,752	88,951	626,665	67,395	634,277	139,085	546,452	148,145	654,613	182,846
Total Operating Expenses	\$645,456	\$138,227	\$654,433	\$117,692	\$663,083	\$189,415	\$575,934	\$198,295	\$685,266	\$233,006
Operating Income	\$45,755	\$120,254	\$14,765	\$164,700	\$28,395	\$108,382	\$56,079	\$84,529	\$43,087	\$81,484

Sources: PricewaterhouseCoopers LLP and Macias Gini & O’Connell LLP audits of the State Water Resources Development System, various fiscal years.

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(Agency comments provided as text only.)

California Natural Resources Agency
1416 Ninth Street, Suite 1311
Sacramento, CA 95814

May 3, 2011

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

Dear Ms. Howle:

Thank you for providing the Agency and with an opportunity to review the Bureau of State Audits' (BSA) draft report entitled "General Obligation Bonds: The Department of Water Resources and Finance Should Do More to Improve Their Oversight of Bond Expenditures," which was in response to the Joint Legislative Audit Committee (Committee) "Analysis Of Audit Request", 2010-117, May 5, 2010.

The audit focused on Department of Water Resources (DWR) tracking and management of general obligation bond funds during the period of July 1, 2005 to June 30, 2010. I commend the BSA audit staff for their efforts in working cooperatively with DWR. My staff and I have reviewed the report with DWR and discussed the issues identified. I believe that this audit clearly demonstrates that DWR is administering the current volume of general obligation bond funds programmatically and fiscally in accordance with the Bond Acts and Legal Based requirements. DWR has implemented plans, programs, processes, and procedures to effectively manage the use of future GO bond funds.

While the report notes improvements that can be made, DWR has taken actions to remediate these short comings. The report identified two specific recommendations for DWR to comply with public transparency and accountability requirements associated with certain GO bonds. DWR acknowledges the need to continue their ongoing efforts to address both of these issues. DWR has made significant progress towards developing written processes and procedures, one of the deficiencies noted during this BSA audit. DWR's Bond Management System, developed prior to the audit, further supports audit recommendations to manage GO bond-funded programs consistent with the authorizing legislation, and in a manner that is transparent and complies with Executive Order S-02-07.

In closing, I would like to acknowledge the efforts of the BSA audit team; they conducted the audit in a professional and courteous manner that was appreciated by my staff.

Sincerely,

(Signed by: John Laird)

John Laird,
Secretary for Natural Resources

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(Agency comments provided as text only.)

Department of Finance
915 L Street
Sacramento, CA 95814-3706

May 5, 2011

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

Dear Ms. Howle:

This letter is in response to the audit report titled: *“General Obligation Bonds: The Departments of Water Resources [DWR] and Finance Should Do More to Improve Their Oversight of Bond Expenditures”*. We appreciate the opportunity to respond to the draft report. While we share the importance of audits and continued improvements to fiscal accountability, we respectfully disagree with several areas of this report. This report states that two issues need to be changed to improve transparency and oversight. These are (1) include by project expended amounts on an ongoing basis on the website and (2) few audits have been performed.

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Regarding the issue to report expended amounts on the website, the report makes several statements that the reporting of expended amounts would provide a higher level of transparency and a significant benefit to the public. However, nowhere in the report is it stated why this is more useful than reporting the cost of a project, the amount committed to it, its location, and schedule, as the website does. Nor does the report convey specifically how this would provide more transparency and oversight for bond expenditures. These statements seem to be asserting that there is some correlation between the amount of money “expended” and the status toward the project’s completion. If 50 percent of the money has been “expended”, then the project is 50 percent complete. In some instances, there may in fact be a rough correlation between expenditures and project status, but in many instances, this is not the case.

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There are various examples of why expenditures and project status are not necessarily related. These examples are based on discussions and meetings held with the agencies administering Strategic Growth Plan (SGP) bond funds, which includes 28 departments and over 100 programs. The report’s conclusion is based on one department, DWR, which represents less than 15 percent of SGP funding and doesn’t fully consider the complexities of the programs and why the expended amount would not provide the additional oversight, transparency, or benefit to the public. In fact, it would do just the opposite for much of the project and program information provided on the website. For example, some programs provide up-front grant funding for a project. In those instances, using “expended” would suggest a project is 100 percent complete, when in fact it has not even begun. Conversely, some programs only provide their grantees funding on a reimbursable basis after a project is complete. In those cases, showing the amount expended would indicate no progress on a project until it was entirely complete. As a third example, in those instances where a project has multiple funding sources, the bond funds may be the first expended, but only be a fraction of the cost of the project. In this case, the public might be misled into believing that the project was complete when in fact it has been only partially funded. Because of these and other real-world disconnections between what has been expended and the status of a project, we do not believe that showing expenditure data during a project under development would be more beneficial or more transparent to the public. It is for this reason that the website envisioned a much more robust approach to informing the public in a meaningful way.

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* California State Auditor’s comments begin on page 73.

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 May 5, 2011
 Page 2

With regard to bond expenditure oversight, the report states that Finance's Office of State Audits and Evaluations (OSAE) "...has performed relatively few audits of Strategic Growth Plan" (SGP) bonds. We do not agree with this statement.

④ Since 2003, OSAE has had bond oversight over 20 agencies administering Propositions 12, 13, 14, 40, and 50 and has performed over 400 department and project-level audits of those bond programs. Except for Proposition 14, these same programs and departments are also receiving Propositions 1E and 84. As a result, the audit observations and recommendations are applicable to the fiscal and grant management process used to administer Propositions 1E and 84.

With the passage of over \$42.7 billion in SGP bonds in 2006, the following seven additional agencies became subject to OSAE's bond audit oversight. As noted below, OSAE has performed audits or audits are in progress for all seven departments, which represents over 78 percent of SGP bond funds.

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Proposition	Agency	Audit Status
1B	CalEMA	Completed—Issued October 2010
1B	Caltrans/CTC	In Progress
1B	ARB	In Progress
1D	OPSC	Completed—pending report
1D	California Community Colleges	In Progress
1D	California State University	Completed—pending report
1D	University California	In Progress

⑥ Regarding DWR's audit coverage, OSAE performed four consecutive department audits between 2003 through 2006 as well as various project audits. In 2007, OSAE planned to audit DWR; however, BSA commenced an audit of DWR's bond administration in 2007. In 2010, OSAE planned to audit DWR but again, BSA commenced its audit in July 2010. Consistent with Government Code section 12430, which requires control agencies to coordinate audit plans in order to avoid duplication, and because of the BSA audits of DWR in 2007 and 2010, OSAE deferred its planned department audit but continued to perform DWR project audits. In addition, *Governmental Auditing Standards* require auditors to consider the work of other auditors if applicable.

⑦ The report states, "OSAE intends to leave most of the auditing to the agencies administering bond funds and defines audits in broad terms." *Government Auditing Standards* require audit results be based on sufficient and appropriate evidence to provide a reasonable basis for its conclusions. The auditors base their conclusion on one set of meeting notes, instead of the other documents provided to them such as written interagency agreements, audit bulletins, audit reports, and reference to Finance's bond accountability website. This evidence clearly demonstrates no intent to delegate audit responsibilities. The agreements state OSAE will perform bond audits in accordance with *Government Auditing Standards* to determine if:

- 1) Awards and expenditures are in compliance with applicable laws, regulations, and established criteria.
- 2) Bond funded projects are adequately monitored to ensure they stay within scope and cost.
- 3) Bond funded programs and projects achieved the intended outcomes.

Ms. Elaine M. Howle
May 5, 2011
Page 3

Regarding the conclusion that OSAE defines audits in broad terms, we believe the meeting notes being referenced have been taken out of context or misinterpreted. The internal review process recommended by Finance was merely guidance to ensure bond-funded projects are adequately monitored. Our recommendations were not meant to substitute an audit as demonstrated by the written agreements that explicitly state OSAE would perform both department and project audits. As you are aware, these department and project audits are posted to the bond accountability website. Although the meeting notes indicate that the then Administration's intent was "all" projects be audited, auditing 100 percent is fiscally irresponsible. Because each agency and project is unique, audits are tailored and conducted on a risk-based approach.

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Our goal and message was and continues to be that 1) all projects are subject to audit, 2) state agencies should implement grant management processes to adequately monitor projects, and 3) OSAE will perform bond audits.

If you have further questions or concerns, please contact Karen Finn, Program Budget Manager, at 916-445-9694.

Sincerely,

(Signed by: Karen Finn for)

Fred Klass
Chief Operating Officer

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Comments

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

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

We stand by the findings and conclusions reached in our audit report and we provide clarification on Finance's response in the comments below.

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Finance incorrectly claims that our report does not say why reporting amounts spent provides a higher level of transparency than reporting the amounts committed to a project. On page 38 of the audit report, we explain that although the Bond Accountability Web site currently has certain information, such as estimated completion dates and check marks indicating whether agencies believe a project is on schedule, such information can be subjective and having information regarding the amounts actually spent to compare against amounts awarded would be a useful addition that allows the public to assess progress.

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Finance's response argues that providing the amount expended would not provide additional oversight, transparency, or benefit to the public, and that expenditures and project status are not necessarily related. However, we disagree. As we state on page 40 of our report, many of the projects we reviewed, including large construction projects, received periodic payments from the State as opposed to receiving payment up front or at completion. On page 40, we also provide an example of how expenditure information, if provided on the Bond Accountability Web site, could be used by the public to assess the reasonableness of the expected project completion dates provided by the State. While we recognize that some projects may receive payment up front or at completion, Finance's concern could be easily mitigated by requiring administering agencies to provide the public with information on how the State determines the timing of its payments for bond-funded projects—thus providing even more transparency.

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Finance's response appears to downplay the limited number of audits it has completed of the State's spending under propositions 84 and 1E, claiming that its audit work under previous bond acts is still relevant. We do not believe Finance's prior audit work relieves or lessens its responsibility to perform audits of state spending under propositions 84 and 1E per the former governor's January 2007 executive order. As we note on page 45 of the audit report, as of

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April 2011 Finance has issued only three audit reports on Strategic Growth Plan bonds, none of which were of the Department of Water Resources (Water Resources).

- ⑤ Finance's response provides a table that lists its assertion of the in-progress and completed audits of Strategic Growth Plan bonds. However, we note that the listing contained in Finance's response includes different audits in-progress than the ones we list on page 46 of our audit report. The information contained in our audit report is based on information posted on Finance's Web site as of April 22, 2011. The list provided in Finance's response has removed in-progress audits of the California Department of Forestry and Fire Protection and the Santa Monica Mountains Conservancy, and added audits of the California State University and University of California. We did not audit Finance's response and cannot speak to the accuracy of this list. Nevertheless, Finance's response still supports our overall conclusion that few audits have been completed of Strategic Growth Plan bond funds.
- ⑥ Finance's response indicates that it planned to audit Water Resources in 2007 and 2010, but that it postponed those audits because we were already performing an audit and it wanted to avoid duplication of effort. However, we issued our previous audit on November 1, 2007, and did not commence our current audit of Water Resources until July 2010, leaving more than two and a half years for Finance to conduct an audit of Water Resources' spending of funds under propositions 84 and 1E, as required by the executive order. For additional context, the scope of our 2007 audit was limited to one bond-funded program—the Flood Protection Corridor Program—and thus Finance could have performed an audit of Water Resources' other bond programs at that time without duplicating audit effort.
- ⑦ Finance's response takes issue with our conclusion that its audits unit intends to leave most of the auditing of bond projects to state agencies administering bond funds and defines audits in broad terms, suggesting that we did not follow audit standards in reaching this conclusion and ignored other evidence. We strongly disagree with Finance's remarks and believe we do have sufficient and appropriate evidence for our conclusion. On page 46 of the report, we provide one of Finance's audit manager's perspective that it does not audit every grant recipient and completed project, but rather it audits grant recipients' completed projects on a risk-based approach, and will perform additional audits of completed projects at the request of administering agencies. This view is reiterated later in Finance's own response to the audit. This perspective is also consistent with the May 2007 meeting notes Finance provided during our audit fieldwork. As we discuss on page 46 of the report, Finance's notes indicated that although its understanding was that

the former administration had an expectation that all projects be audited, Finance defined what *subject to audit* meant. The notes we used from the May 2007 meeting were the only documentation on this topic Finance was able to provide during our fieldwork.

Finance's response states that its internal review guidelines to departments, discussed in its May 2007 meeting, were not meant as a substitute for an audit by Finance. However, Finance's response is perplexing. As we discuss on page 46 of the audit report, Finance's May 2007 meeting with state departments and agencies was to explain the meaning of the executive order's audit requirements and to distinguish the different audit responsibilities assigned to Finance and administering agencies. We also provide on that same page Finance's audit manager's statement that it does not audit every grant recipient and completed project, but rather it audits grant recipients' projects using a risk-based approach, and will perform additional audits of completed projects at the request of administering agencies.

Finance's response states that auditing 100 percent is fiscally irresponsible. However, our report does not recommend that Finance audit every project. Instead, as we state on page 48, our audit report recommends that Finance either conduct audits of, or approve and assure that Water Resources and other agencies obtain audits of, Strategic Growth Plan bond expenditures.

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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