

REPORT OF THE
OFFICE OF THE AUDITOR GENERAL
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

856.2

STATE WATER RESOURCES CONTROL BOARD:
CLEAN WATER GRANT PROGRAM HAS UNREALISTIC GOALS
AND IS HINDERED BY FRAGMENTED AUTHORITY
AND INEFFECTIVE ADMINISTRATIVE PROCEDURES

JANUARY 1980



California Legislature

Joint Legislative Audit Committee

GOVERNMENT CODE SECTION 10500 et al

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856.2

The Honorable Speaker of the Assembly
The Honorable President pro Tempore of the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's report on the State Water Resources Control Board's administration of the Clean Water Grant Program.

The report finds that California will not meet the minimum treatment standards for wastewater discharges by July 1, 1983 as required by federal law. Considering the program's complexities, the 1983 deadline appears unrealistic. Additionally, the report notes that the state board needs to improve its management of certain functions related to administering the Clean Water Grant Program; however, the deadline will still not be attainable.

The Auditor General has recommended action to address these problems and to increase the efficiency and effectiveness of the state board.

The auditors are Eugene T. Potter, Audit Manager; William S. Aldrich; Edwin H. Shepherd; Georgene L. Williams; Richard B. Weisberg; Martha H. Valdes; and Peter A. Wolfe.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "S. Floyd Mori".

S. FLOYD MORI
Chairman, Joint Legislative
Audit Committee

Attachment

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SUMMARY

We reviewed selected areas of the State's water quality control program administered by the State Water Resources Control Board and the nine regional boards. The review focused on the Clean Water Grant Program which includes those aspects of the federal Clean Water Act delegated to the State by the Environmental Protection Agency (EPA). The program is designed to upgrade municipal wastewater treatment plants so that wastes discharged from them will meet federal minimum treatment standards by July 1, 1983.

We found that many of California's publicly owned treatment works will not meet the objectives of the federal Clean Water Act by 1983 even though over \$3 billion in federal, state, and local funds have been expended or encumbered and over \$5 billion more may be spent on eligible projects. Litigation, environmental problems, decreases in federal funding and fragmented administration have contributed to making the 1983 goal unachievable. In view of program complexities, the federal goals are unrealistic and more realistic goals should be established.

Because 1983 goals will not be achieved and federal authorizations expire in 1982, Congress will have to extend authorizations and deadlines to meet the objectives of the

Clean Water Act. Since at least 25 percent of the funding for this program comes from California sources, it is imperative that the state board plan ahead by preparing alternatives for legislative and congressional consideration.

Therefore, we recommend the state board determine when California can realistically achieve federal goals and that it propose legislative action to request amendment of the federal law to establish realistic goals and funding levels. Further, we recommend the state board submit plans for meeting clean water objectives to the Legislature.

In addition, we have identified areas in which the state board could improve its management:

- Not all projects placed in a high priority class are receiving grants. As a result, there is no assurance that projects designed to remedy the most severe water quality problems are being funded.
- EPA-Western Audit Division's audit policies have reduced the state board's effectiveness in administering the grant program by prohibiting the state board from examining the grantee's accounting records to provide technical assistance. As a result, many grantees are not receiving needed assistance and the grant program is not receiving the benefits of an on-going audit strategy to protect program integrity.
- All required operations and maintenance inspections have not been performed. Further, we found no follow-up action for a number of projects that had been rated unacceptable or were in violation of requirements. Some completed projects still do not meet requirements and the state board cannot properly evaluate program results.

- The state board has not established adequate procedures for closing grants. A final audit had not been requested for 61 grants totaling \$197,960,000. In addition, the state board has failed to develop and implement adequate procedures to ensure efficient resolution of final audit findings. Resolution of these findings could make approximately \$5.9 million available to fund other grant projects.
- The state board's accounting system for grant funds is inadequate and incomplete. As a result, the state board is unable to determine the precise balance of available federal funds, cannot reconcile totals to individual project records, and has failed to submit required federal reports on time.

Improvements in these areas will increase the state board's efficiency and effectiveness but will not overcome the program complexities and administrative fragmentation. However, it is incumbent upon the state board to act on these deficiencies by adopting the following recommendations.

We recommend that the state board:

- Ensure that the need for projects is established before they are included on the statewide priority list and that the projects are funded in the order of established priority;
- Obtain authority to conduct financial systems evaluations;
- Conduct all required Operations and Maintenance inspections and follow up to ensure deficiencies are corrected;
- Act immediately to request and resolve all final audits;
- Revise its accounting system to reconcile grant funds.

INTRODUCTION

In response to a request by the Joint Legislative Audit Committee, we reviewed selected areas of the water quality control program administered by the State Water Resources Control Board (state board) and the nine California Regional Water Quality Control Boards (regional boards). This review was conducted under authority vested in the Auditor General by Section 10527 of the Government Code.

The state and regional boards have two major responsibilities: to control water quality and to administer water rights. Our review focused on the water quality control program which has three major components: regulating, planning, and assisting the development of wastewater treatment facilities.* Specifically, this report addresses the administration of the Clean Water Grant Program which is designed to assist in financing treatment works necessary to prevent water pollution. The program includes those aspects of the federal Clean Water Act delegated to the State by the Environmental Protection Agency (EPA).

* Wastewater is sewage, that is, the spent water of a community.

The Auditor General's report No. 856.1 addressed the regulatory aspects of the water quality control program. In a section following the main body of this report, we detail the recommendations in that report and discuss the status of their implementation.

Staffing and Organizational Responsibilities

The state board, composed of five full-time members appointed by the Governor, is supported by a staff of approximately 500 persons headed by an executive director. As of February 1979, approximately 150 members of this staff in the state board's Division of Water Quality (DWQ) were directly involved in the administration of the Clean Water Grant Program. Additionally, the nine regional boards assist the division in administering the clean water grants. With a combined staff of approximately 280, the nine regional boards are primarily responsible for regulating the wastewater treatment plants in accordance with the policies of the state board.

Methodology

Our review of the administration and management of the Clean Water Grant Program included

- An assessment of municipal facilities' compliance with 1983 federal standards for wastewater discharges;

- An Analysis of the management of the statewide priority system for projects for which grant assistance is expected;
- A review of the state board's procedures for processing grants to determine compliance with prior audit recommendations and to evaluate the efficiency of operations;
- A review of EPA audit reports and the state board's procedures for resolving audit exceptions and for closing grants;
- A review of the accounting records and systems maintained by the board.

In gathering our data, we visited 19 grantee agencies and surveyed numerous others through the mail and by telephone.

Scope

Our study covers those areas over which the state board has administrative responsibility. Because certain functions of the federal program were not delegated and other functions covered technical engineering areas, we did not evaluate all functions of the Clean Water Grant Program. In addition, our review was limited to the compliance requirements of municipal treatment works.

BACKGROUND

To clarify the complexities of the administration of the Clean Water Grant Program, we have included this section which explains federal and state legislation pertinent to water quality control in California. Also presented here is information about federal and state funding which enables the state board to execute the Clean Water Grant Program. Finally, this section chronicles the administration of the program at federal and state levels.

Pertinent Legislation

The primary purpose of California's Clean Water Grant Program, established by the Porter-Cologne Water Quality Control Act, is to implement the Clean Water Bond Laws of 1970 and 1974, the Clean Water and Water Conservation Bond Law of 1978, and all subsequent related legislation. The State's program is coordinated with federal grant programs, particularly the Construction Grant Program, established pursuant to the Federal Clean Water Act.

The Federal Water Pollution Control Act amendments of 1972 (PL 92-500) required secondary treatment for discharges from publicly owned treatment works or more stringent

limitations in selected areas to meet water quality standards by July 1, 1977.* In December of 1977, Congress passed the Clean Water Act amendments of 1977 (PL 95-217) allowing for extensions of the 1977 deadline for secondary treatment up to July 1, 1983. The act also allowed for waivers of the secondary treatment requirement for deep ocean dischargers.

The objective of the federal act is to restore and maintain the chemical, physical, and biological integrity of the nation's water. To achieve this objective, the act established two national goals: "that the discharge of all pollutants into navigable waters be eliminated by 1985" and "that whenever attainable, an interim goal of water quality which provides for the protection and propagation of fish, shellfish, and wildlife and provides for recreation in and on the water be achieved by July 1, 1983."

Program Funding

To meet the 1977 water quality standards, the 1972 amendments authorized local agencies to receive 75 percent federal funding of eligible costs of constructing treatment plants. The amendments of 1977 extended federal funding authorization through federal fiscal year 1982.

* Primary treatment is the first major treatment in a wastewater treatment works and usually includes screening and sedimentation. This process removes a substantial amount of suspended matter but little or no dissolved matter. Secondary treatment is the treatment of wastewater by biological methods to remove organic material after primary treatment. The EPA has set standards attainable by secondary treatment.

Table I shows federal funding authority, appropriations, and California allotments.* The table illustrates that the federal appropriations lagged public law authority in the years 1973 to 1975. In addition, \$800 million of the 1979 authority was not appropriated.

TABLE I
 FEDERAL FUNDING AUTHORITY, APPROPRIATIONS,
 AND CALIFORNIA ALLOTMENTS
FEDERAL FISCAL YEARS 1973-1979

<u>Fiscal Year</u>	<u>Authority</u>	<u>National Appropriations</u>	<u>California Allotments</u>
1973	\$ 5,000,000,000	\$ 2,000,000,000	\$ 196,352,000
1974	6,000,000,000	3,000,000,000	294,528,000
1975	7,000,000,000	4,000,000,000	457,420,100
1976	0	9,000,000,000	945,776,800
1977	1,480,000,000	1,480,000,000	82,391,000
1978	4,500,000,000	4,500,000,000	357,804,000
1979	<u>5,000,000,000</u>	<u>4,200,000,000</u>	<u>329,323,400</u>
Total	<u>\$28,980,000,000</u>	<u>\$28,180,000,000</u>	<u>\$2,663,595,300</u>

* State allotments were based on designated percentages of the federal appropriations.

Grants are funded with 75 percent federal, 12½ percent state, and 12½ percent local funds. All costs not eligible for grants must be paid by the local agency. State bond approvals in 1970, 1974, and 1978 have made available \$875 million in funds for these projects. Of these funds up to \$50 million may be used for projects not eligible for federal assistance under the Clean Water Act.

The state board's funding sources, excluding federal grants to local agencies, include the General Fund, Clean Water Bond Fund, State Water Quality Control Fund, Reimbursements, and federal funds for planning, regulation, and construction management assistance. Total funding for fiscal year 1979-80, as requested in the Governors Budget is \$118 million. Approximately \$99 million of this amount is budgeted for facility development assistance.

The General Fund is the only funding source subject to annual appropriation. The State Clean Water Bond Fund does not appear in the annual Budget Bill because funds are continuously appropriated in the authorizing bond acts. The State Water Quality Control Fund is used by the state board for loans to local agencies which are experiencing extreme financial hardships. The loans are for the construction of facilities to prevent water pollution. The reimbursements noted in the Governor's Budget are primarily derived from fees paid by applicants for water rights permits and waste discharge permittees.

Before October 1, 1977, the Clean Water Grants Administration Revolving Fund supported the state board's facility development assistance program, which administers state and federal grants to local agencies for constructing wastewater treatment facilities. Revolving fund revenues were derived from a fee imposed on grantees of one-half of one percent of the total grant award. However, on October 1, 1977, the state board's revolving fund support was replaced by a direct grant from EPA because of a change in EPA procedures resulting from the Federal Clean Water Act amendments of 1977. The state board now receives a grant for administrative costs based on approximately two percent of California's allocation from EPA for clean water construction grants. The state board also receives federal grants for water quality planning and regulation.

Federal Delegation of
Program Administration

The Environmental Protection Agency (EPA) has primary responsibility for administering the Clean Water Act. EPA has delegated responsibility to the state board to administer portions of the Act in California. This responsibility is specified in 26 delegation agreements covering certain administrative functions. EPA retains authority to

- Award federal grants and approve payment of federal funds;

- Approve statements of no significant environmental impact or prepare environmental impact statements;
- Conduct final and interim audits and resolve audit exceptions.

In addition, EPA retains authority to approve the statewide priority list which determines the funding order of projects. EPA maintains ultimate control over the program even while delegating most decision-making and administrative authority to the State.

Program Administration

The State Water Resources Control Board administers the Clean Water Grant Program in five major phases:

- Pre-Step 1 needs assessment and management of a statewide priority list;
- Step 1 grants for facility planning;
- Step 2 grants for the design of treatment facilities;
- Step 3 grants for the construction of facilities;
- Post Step 3 project close out and final payment.

Each of the nine regional boards begins the first phase by ranking projects needed to abate or prevent water pollution within their region. The state board then combines these regional lists into a statewide priority list. The municipalities in the fundable priority classes are requested to submit a plan of study with a completed Step 1 grant application. If the study application and documents are complete and adequate, the Division of Water Quality recommends the project to EPA for a federal Step 1 grant.

After the state board approves the plan of study and a Step 1 grant offer is made, the municipality undertakes the planning of the facility. This process includes (1) the selection of the best apparent treatment alternative, (2) the preparation of the environmental impact report, and (3) the development of a local financial plan and revenue program. When these activities have been completed and have been approved by the division, EPA then determines whether the project will significantly affect the environment. After the environmental review process is completed, the municipality may apply for a Step 2 grant to design the facilities to be constructed.

During Step 2, design plans are submitted to the division where they are evaluated. When the division is satisfied that final plans and specifications are complete and

that they conform with all state and federal requirements, it notifies the local agency of the state board's approval. The division then certifies the project to EPA for a Step 3 construction grant and prepares the State grant offer.

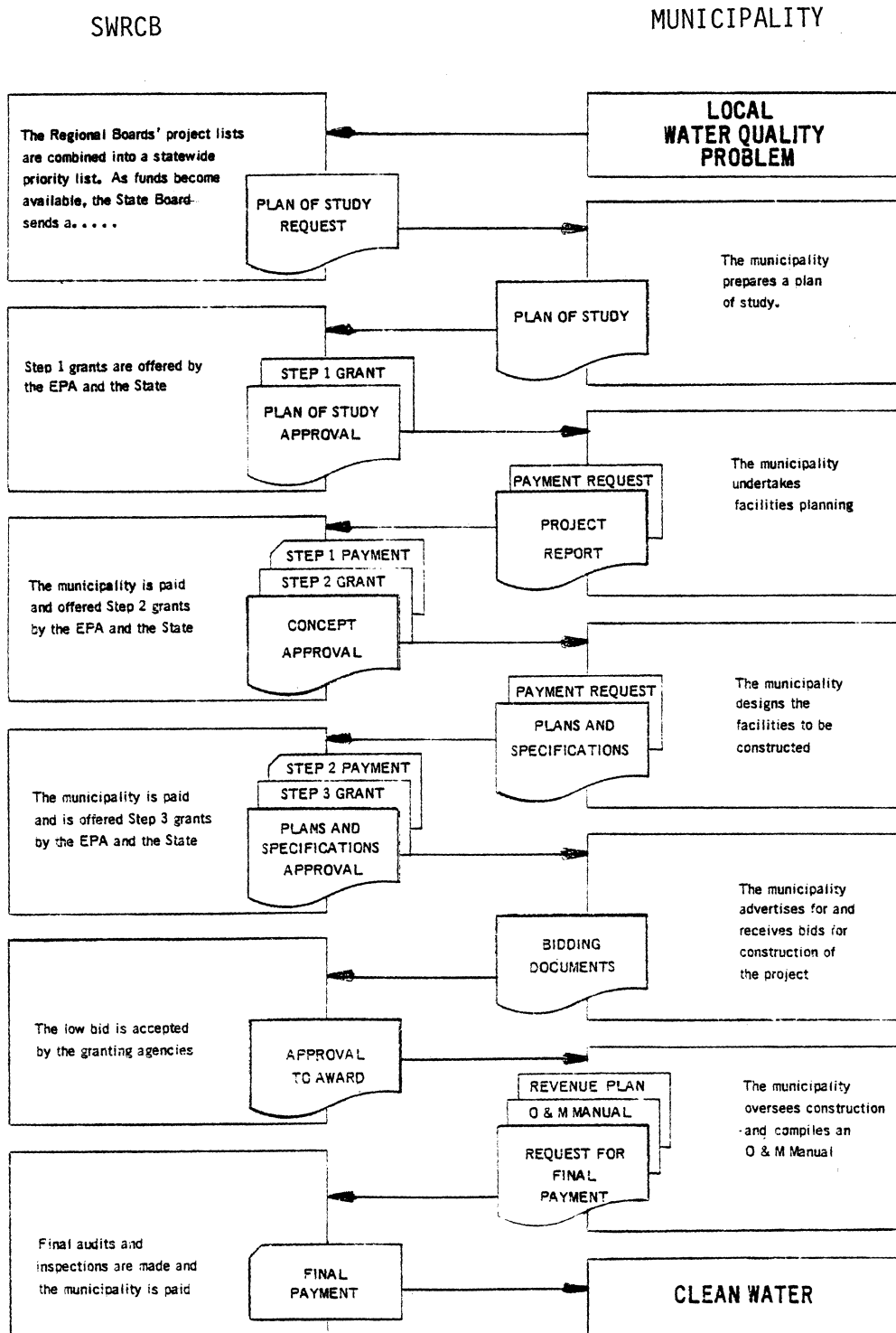
After the municipality is offered a Step 3 grant, it requests and receives bids for the construction of the project. The local agency then submits to the division the lowest bid proposed by an applicant deemed appropriate as well as a summary of all other bids. After the division approves the proposal, the construction contract is awarded and the municipality oversees the construction.

During the course of construction, the state board processes payment requests based upon the progress of the construction. Two to five percent of the total grant amount is withheld pending final audit of the completed facility.

When construction has been completed, the division performs a final inspection to assure that the treatment works have been constructed in accordance with the grant requirements and that the facilities are properly operated and maintained. In addition, a final audit is performed to review the grantee's records to assure expenditures were reasonable and allowable. If the results of these final reviews are acceptable, the state board processes the municipality's final payment request. The award of the final payment completes the grant process. Figure I is a flow chart illustration of this process.

FIGURE I

CLEAN WATER GRANT PROGRAM



Source: EPA/SWRCB Delegation Agreements.

CALIFORNIA WILL NOT MEET FEDERAL
CLEAN WATER ACT GOALS BY 1983

Many of California's publicly owned treatment works, including 16 key facilities discharging over 55 percent of the State's effluent, will not meet secondary treatment standards by July 1983 as required by federal law.* In addition, over 1,000 projects eligible for grants are still in the proposed category, and the statewide priority list indicates that 733 grants with an estimated cost of over \$2 billion may not be funded by the deadline. Litigation, environmental problems, decreases in federal funding and fragmented administration have all contributed to making the 1983 goal unachievable. Considering program complexities, the federal goals are unrealistic and more realistic goals should be established.

Treatment Levels Required
by Federal Standards

As discussed in the Background section, the 1972 amendments to the federal Clean Water Act required a minimum of secondary treatment or more stringent limitations in selected areas to meet water quality standards by July 1, 1977; however, the amendments of 1977 allowed for extension of this deadline to July 1, 1983. Providing certain criteria are met, waivers

* Effluent is wastewater or other liquid, partially or completely treated, or in its natural state flowing out of a reservoir, basin, or treatment plant.

of secondary treatment requirements may be allowed for deep ocean dischargers. In addition, the discharge of all pollutants into navigable waters is to be eliminated by 1985.

Treatment facilities must obtain permits through the National Pollutant Discharge Elimination System (NPDES) for the discharge of pollutants into navigable waters. These permits set limits on the quality and quantity of effluent and establish time schedules for compliance with federal mandates.

Treatment Works in California
and the Nation Did Not Meet 1977
Water Quality Standards

Many publicly owned treatment works in California did not meet the 1977 secondary treatment discharge requirements. A document published by the State Water Resources Control Board in October of 1977 indicated that approximately 34 percent of California's municipal wastewater flows were in compliance with the minimum secondary treatment standards; however, only 12 percent of the total flows were in full compliance with the ultimate requirements of the NPDES permits and the Waste Discharge Requirements.* Nationally, only 34 percent of municipal wastewater flows met the requirements.

* Waste Discharge Requirements are limits on the quality of the effluent and conditions to be maintained in the receiving waters.

According to the 1977 annual report of the U. S. Council on Environmental Quality (CEQ), the nation's municipal treatment plants did not meet the deadline for various reasons, some of which may be beyond the dischargers' control. Two of the problem areas cited in the CEQ report follow:

Project Construction Delays. Litigation, environmental and administrative problems, contractor bidding problems, and siting difficulties are responsible for most delays occurring between the approval of a grant and the beginning of construction.

Funding. The worst problem facing the municipal grants program this year was the threat that a number of states might run out of federal funds. Continuity--the long-term assurance of funding--is essential. It takes two to three years to move a project through planning and design into the construction phase. Interrupted federal funding disrupts state and local government planning and budgets.

Many California Facilities
Will Not Meet Discharge
Standards by the 1983 Deadline

The 1983 deadline appears unrealistic. Yet, the state board has established compliance with that date as a goal. It has developed a system for tracking 28 key municipal dischargers. These agencies operate 63 treatment facilities which discharge 76 percent of the State's total effluent. Sixteen of these facilities discharging approximately 1.3 billion gallons of effluent per day are not expected to meet the requirements by 1983. (The 1.3 billion gallons per day represent approximately 55 percent of the State's municipal effluent.)

Five of these facilities, which have a combined discharge of over one billion gallons of effluent per day, have requested waiver of the secondary treatment requirements for ocean discharge. Even though the 1977 amendments allowed for such waivers, EPA did not publish final regulations implementing these provisions until June of 1979. Whether the waivers are denied or approved, the delays resulting from processing them may prevent these dischargers from meeting the requirements by 1983. The agencies denied waivers must then plan and construct secondary treatment facilities. For those whose waivers are approved, some construction is still necessary to meet proposals in the requests for waiver.

Funding for California's
Clean Water Grant Program

Additionally, a number of other municipalities are not expected to meet the 1983 standards because they will not receive funding in time. An analysis of completed, active, and proposed grants reveals that less than one-half of the projects are completed and that a number of projects are in an unscheduled category and therefore may not be funded until after 1983.

The magnitude of California's Clean Water Grant Program is illustrated by Table II which shows estimated funding for completed, active, and proposed grants in California. Table III shows the corresponding number of projects as of May 1979.

TABLE II

ESTIMATED FUNDS FOR COMPLETED, ACTIVE, AND
PROPOSED CLEAN WATER GRANTS IN CALIFORNIA

<u>Project Step</u>	<u>Completed</u>	<u>Active</u>	<u>Proposed</u>	<u>Total</u>
1. Planning	\$ 39,245,272	\$ 76,678,168	\$ 2,645,256	\$ 118,568,696
2. Design	103,125,393	28,763,112	216,463,000	348,351,505
3. Construction	745,866,089	2,235,427,937	4,687,637,393	7,668,931,419
Awarded - No Construction	--	--	117,214,387	117,214,387
Total	<u>\$888,236,754</u>	<u>\$2,340,869,217</u>	<u>\$5,023,960,036</u>	<u>\$8,253,066,007</u>

Source: Status of Grant Projects, May 1979, State Water Resources Control Board, Division of Water Quality.

TABLE III
ESTIMATED NUMBER OF COMPLETED, ACTIVE, AND
PROPOSED PROJECTS BY CLEAN WATER GRANT PROJECT STEP

<u>Project Step</u>	<u>Completed</u>	<u>Active</u>	<u>Proposed</u>	<u>Total</u>
1. Planning	165	216	68	449
2. Design	187	56	426	669
3. Construction	407	256	568	1,231
Awarded - No Construction	--	--	41	41
Total	<u>759</u>	<u>528</u>	<u>1,103</u>	<u>2,390</u>

Source: Status of Grant Projects, May 1979, State Water Resources Control Board, Division of Water Quality.

To complete the proposed grants identified in Table III, the state board forecasts it will be necessary to offer grant authorizations as late as September 1988, although federal authorizations extend only through fiscal year 1982. The statewide priority list for the five-year period ending in federal fiscal year 1983 showed that 733 grants with an estimated cost of \$2 billion are in an unscheduled category and, therefore, may not be funded until after 1983.

Federal Funding Uncertainties

A possible decrease in federal funding will further impede compliance with 1983 goals. Since the enactment of the Clean Water Act amendments in 1972, approximately \$2.7 billion federal funds have been made available to California for grant projects. As of October 1, 1979, \$226 million of fiscal year

1979 funds remained unobligated; however, the state board has drafted \$222 million of grant offers to obligate these funds. The state board has until September 30, 1980 to obligate these funds. The amount allocated to California for the federal fiscal year 1980 was unknown at the end of our review; however, it is expected to be decreased considerably because of an estimated reduction in federal appropriations.

The expected reduction in federal allocation to California will also result in a corresponding decrease in the Construction Management Assistance Grant for program administration. An analysis by the state board staff indicated that, using an optimistic funding projection, it would take eight years to fund all projects in the top three priority classes. Further, construction management assistance grants based on these funding levels will not provide enough funds for program staffing needs.

Because 1983 goals will not be achieved and federal authorizations expire in 1982, Congress will have to extend authorizations and deadlines to meet the objectives of the Clean Water Act. Since at least 25 percent of the funding for this program comes from California sources, it is imperative that the state board plan ahead by preparing alternatives for legislative and congressional consideration.

Fragmented Administration

The responsibilities for administering California's Clean Water Grant Program are divided among the Environmental Protection Agency, the state board, and the Corps of Engineers. As discussed in the Background section, EPA is ultimately responsible for administering the federal portion of the program; however, most administrative functions have been delegated to the State. These responsibilities have shifted over the years and this fragmentation has increased program complexity. The fragmentation has further increased with the recent delegation of some responsibilities for six major projects to the Corps.

EPA delegation of program administrative functions to the state board began in 1972 with a Memorandum of Agreement for certain review functions. In 1975, a formal Agreement in Principle was signed which incorporates 26 functional subagreements describing specific review responsibilities for both the State and EPA. The 26 original subagreements are revised annually to incorporate the latest changes in federal program regulations and procedures.

Even though most administrative responsibilities have been delegated to the State, the EPA Regional Administrator may, on his own initiative, review any action taken by the state board. The Regional Administrator also retains authority for these significant functions:

- Awarding federal grants;
- Approving payment of federal funds;
- Approving final environmental reviews;
- Resolving audit exceptions;
- Approving the statewide priority list.

On October 1, 1979, the Corps of Engineers assumed certain construction management functions for six major agencies in California. Under this arrangement, the Corps will assume administrative responsibility for the construction phase after the state board has processed the projects through both planning and design stages and the pre-construction conference. The Corps will monitor the project through the final construction inspection. Then, the project will be returned to the state board for final inspection and close out. The division will sample the Corps' actions and report the results to EPA.

This additional fragmentation of administrative functions could create more program inefficiencies. With this arrangement, the state board is in the difficult position of monitoring the activities of one federal agency for another.

CONCLUSION

Many municipal waste treatment plants in California will not meet secondary treatment standards, by July 1, 1983, as required by federal law. In view of program complexities, the federal goals appear unrealistic. The original 1977 goal established in 1972 was not met. Amendments which extended the original goal also appear optimistic.

Litigation, environmental problems, federal reluctance to promptly grant or disapprove waivers of limitations, lack of sufficient funding, and fragmentation of program administration have contributed to making the goals unachievable. To meet the objectives of the Clean Water Act, the State must make plans to address possible changes in federal deadlines and funding.

RECOMMENDATION

We recommend the State Water Resources Control Board

- Determine when California can realistically achieve the federal goals;
- Propose legislative action which will request amendments to the federal law to establish realistic goals and funding levels;
- Submit to the Legislature plans to meet clean water objectives based on potential alternative federal deadlines and funding.

THE STATE BOARD NEEDS TO IMPROVE ITS MANAGEMENT
TO INCREASE EFFICIENCY AND EFFECTIVENESS

California's Clean Water Grant Program was created to financially aid local municipalities in constructing needed water pollution control facilities. Although the Environmental Protection Agency is responsible for the accomplishment of the federal Clean Water Act goals, it has delegated certain administrative functions to the state board. During our review, we identified certain areas in which management by the state board could be improved:

- Federal regulations require that grants be awarded according to the statewide priority list. Our review revealed that not all projects in a high priority class are receiving grants. As a result, there is no assurance that projects designed to remedy the most severe water quality problems are being funded.
- Many grantees need technical assistance early in the process to enable them to correct accounting deficiencies. EPA-Western Audit Division's audit policies have reduced the state board's effectiveness in administering the grant program by prohibiting the state board from examining grantees' accounting records to provide this assistance. As a result, many grantees are not receiving the needed assistance and the grant program is not receiving the benefits of an ongoing audit strategy to protect program integrity.

- The state board is required to conduct final project inspections to assure that the facilities are properly operated and maintained. The Division of Water Quality has not performed all required operations and maintenance inspections. Further, we found no follow-up corrective action for a number of projects that, when inspected, were rated unacceptable or were in violation of requirements. Some completed projects still do not meet requirements, and the state board cannot properly evaluate program results.

- The state board has not established adequate procedures for closing grants. As of July 31, 1979, a final audit had not been requested for 61 grants totaling \$197,960,000. In addition, the division has failed to develop and implement adequate procedures to ensure efficient resolution of final audit findings. Resolution of these findings could make approximately \$5.9 million available to fund other grant projects.

- The accounting system for grant funds is inadequate and incomplete. As a result, the state board is unable to determine the precise balance of available federal funds, cannot reconcile totals to individual project records, and has failed to submit required federal reports on time.

Although improvements in these areas will not materially affect the accomplishment of the 1983 goals, it is incumbent upon the state board to administer the delegated functions efficiently and effectively. The following information details each of the above areas and includes our recommendations for improvement.

IMPROVEMENTS NEEDED IN THE
MANAGEMENT OF THE STATEWIDE
PRIORITY SYSTEM

Projects receiving grants under the Clean Water Grant Program are not funded according to the approved statewide priority list compiled annually by the state board. Forty-two out of 166 projects (25 percent) scheduled to receive initial funding in 1978-79 were not awarded Step 1 grants because of inadequate needs assessment and because of problems in coordinating activities among the state board, regional boards, and potential grantees. Also, some of these projects did not receive grants because of limitations on staffing and local funding. As a result, those 42 projects originally placed on the priority list may not receive grants, and projects with lower priorities are being funded.

Criteria for Priorities

Federal regulations provide that grants will be awarded from allotments according to the state priority list. The State is given full authority to determine priorities based on the following criteria:

- The severity of the pollution problem;
- The number of people affected;
- The need for preservation of high quality waters;

- At the State's option, the specific category of need that is addressed.

Inadequate Needs Assessment
and Coordination Problems

The regional and state priority lists for 1978-79 were compiled with limited information from local grantees. Many local grantee agencies scheduled to receive Step 1 funding in 1978-79 declined to participate in the program. Forty-two out of 166 projects scheduled to receive Step 1 funding became inactive by May 1979. Some of these potential grantees refused to participate because of the state and regional boards' failure (1) to properly assess the need for projects and (2) to coordinate activities among municipalities.

The state board did not adequately assess the needs of the counties within a region and failed to successfully coordinate proposed activities. This placed 33 counties on the priority list for countywide septage studies, which were to assure the safe and proper disposal of septage and recreational waste. These counties were placed on the priority list even though there was no information that they had septic disposal problems. In addition, several of these counties had asked to not be placed on the priority list. Approximately one third of the 33 counties chose not to participate in the septage studies.

Another indication of poor coordination is the disagreement on the need for projects. Some local agencies are unwilling to commit local resources to a project on the statewide priority list because they do not agree it is necessary. In part, this condition exists because the regional boards are not required to contact and work with the local agency representatives before placing them on the regional priority list.

Proper determination of project needs and improved coordination between the regional board and potential grantees could alleviate some of the problems that arise at later stages of the process. More importantly, these improvements could help ensure that higher priority projects are funded before those with lower priorities.

Local Matching Funds Are Unavailable

In addition, some priority projects scheduled to receive Step 1 funding in 1978-79 became inactive because agencies were unable or unwilling to match funds by allocating the necessary 12½ percent. The Water Code requires that the state board provide at least 12½ percent of the eligible costs incurred by a grantee agency in constructing a project under the Clean Water Grant Program.*

* The law allows the state board to reimburse an amount greater than 12½ percent, although the current policy is to only fund 12½ percent and require 12½ percent to be matched with local funds.

A number of agencies did not participate in the program because of a variety of funding problems. Several agencies indicated that funding problems were created by the passage of Proposition 13. Other projects became inactive because the agencies were unwilling to commit the required matching funds. One county considered other projects to be more critical and, thus, more deserving of funds. Because of funding problems, local agencies did not participate and grants were awarded to agencies with lower priorities.

Lack of Sufficient Staff

Federal regulations permit grant funds to be used for professional and consultant services; however, those regulations do not permit grant funds to be used for the ordinary operating expenses of local government. Therefore, unless the grantee has an accounting system to segregate staff costs between grant eligible and ordinary local government expenses, the state board will not approve reimbursement for the salary of an agency employee unless the employee is hired to work primarily on grants.

Some agencies on the statewide priority list declined to participate in the grant program because they lacked sufficient staff. These agencies stated that the grant paperwork and administrative details were too great and that, without additional personnel and funding, it was impossible for them to accept a grant.

Some agencies are funding projects without grants. One water district did not, for example, participate in the program because district staff believed they could act more quickly using their own staff and resources. They completed the project with local funds. In fact, four of the agencies which declined to participate in the Clean Water Grant Program constructed projects using local funding sources.

Funds Offered to Agencies
with Lower Priority

When grantees choose not to participate in the Clean Water Grant Program, the state board funds projects on the statewide lists with lower priorities. Therefore, the projects which are eventually funded are not always the agencies which the state and regional boards initially determined were the most in need of funding and construction. As a result, there is no assurance that projects designed to remedy the most severe water quality problems are being funded.

CONCLUSION

Forty-two projects scheduled for funding in 1978-79 became inactive and were replaced by projects with lower priorities; consequently, the list of funded projects was not the same as the list of projects that should have been funded.

There is no assurance that the worst water quality problems are being addressed by the state board when projects originally on the priority list are not funded and become inactive.

RECOMMENDATION

We recommend that the state board

- Develop regulations requiring the regional boards to work with the grantee agencies to ensure that the need is established before including projects on the statewide priority list;
- Consider methods of reducing the administrative requirements imposed upon local agencies participating in the Clean Water Grant Program;
- Consider paying a portion of the Clean Water Grant costs in excess of 12½ percent.

Increasing the state share of the cost for Clean Water Grant Projects will deplete the bond funds more quickly, but that may be necessary to ensure that higher priority projects addressing severe water quality problems will be constructed.

Corrective Action Taken

The state board has attempted to remedy the problem of Step 1 projects becoming inactive by establishing a new regulation and by creating a unit offering administrative assistance to smaller agencies. The regulation requires the division to request whether each applicant is ready for a Step 1 project before recommending it be placed on the fundable portion of the priority list. This regulation, effective July 21, 1979, may result in fewer projects becoming inactive. The state board has also created the Small Projects Unit in an attempt to offer administrative assistance to the small grantee agencies. However, the unit has limited staff and may be unable to provide much technical assistance.

In view of these actions, we further recommend that the state board determine whether the new regulation is adequately reducing the number of projects which become inactive. If not, a regulation mandating greater pre-project coordination should be developed. Also, we recommend that the state board determine whether this new unit is properly staffed to adequately assist small agencies, and, if not, the state board should consider increasing the capability of the unit to better serve grantees. Prospective grantees should be notified of the Small Projects Units' services and should be encouraged to apply for a grant.

EPA AUDIT POLICIES HAVE REDUCED
THE STATE BOARD'S EFFECTIVENESS

EPA has not delegated to the State the responsibility of auditing agencies participating in the Clean Water Grant Program. Some grantees were not provided interim audits in time to correct deficiencies and make the necessary improvements in their accounting systems. Furthermore, EPA auditing policy prohibits the state board from examining grantee expenditures or accounting records to provide technical assistance. As a result

- Many grantees needing technical assistance are not receiving it early in the project or must wait until EPA's final audit to determine the acceptability of their accounting system;
- The Clean Water Grant Program is not receiving the benefits of an ongoing audit strategy to protect program integrity.

Our review of twelve of EPA's interim audits revealed that nine audit reports were issued over 12 months after an audit request was made. Further, some of the project expenditures had been incurred two to three years prior to release of the audit report. In those instances, the projects were nearly completed before the grantee received the audit report disclosing the improvements needed.

In Haskins and Sells' 1977 report to the state board, the CPA firm concluded that an ongoing audit strategy of pre-award and interim audits provides "one of the single most important steps the board could take to improve the Clean Water Grant Program." This strategy would enable the state board to review accounting systems, identify weaknesses or problems, and provide the grantee information early in the grant program to minimize future problems.

Financial Systems Evaluations Are Needed

Because audits are not delegated to the State, the Audit Management Branch (AMB) in the state board's Division of Audits and Administrations developed a technical assistance program called financial systems evaluations (FSE). The evaluation is designed as a review of the grantee's accounting records. During an FSE, division auditors address certain weaknesses. For example, they may determine whether eligible and ineligible costs are segregated or if proper documentation of costs is maintained. The FSE program does not include testing or rendering an opinion on any project expenditures. And it is timely. The field work requires one to two days; results are supplied to the grantee within 30 days. This system incorporates many features of the Haskins and Sells' strategy previously discussed.

In addition, three of the most frequently occurring audit exceptions as identified by the Audit Management Branch are generally addressed in financial systems evaluations. They are detailed below:

<u>Type of Exception</u>	<u>Number of Times Occurred</u>	<u>Amount of Questioned Costs</u>
Ineligible costs claimed	26	\$585,075
Costs not supported by documentation	17	\$350,471
Normal cost of government	17	\$380,876

Since FSEs are designed to address these areas early in the grant process, such assistance would help reduce questioned costs at the time of final audit.

EPA-Western Audit Division's
Policy Prohibits State Review
of Accounting Records

EPA-Western Audit Division's policy prohibits the state board's Audit Management Branch from examining any grantee expenditures or accounting records without EPA-WAD approval. EPA contends that such a review constitutes an audit. According to this policy, the audit branch cannot examine or comment on specific grantee records without authorization from EPA. Also an auditor from the EPA-Western Audit Division must accompany the AMB staff when an examination is conducted.

Because of this policy, few grantees have received either technical assistance or an interim audit. EPA authorized financial systems evaluations for only five grantees in the past year. During the same period, EPA refused requests for 22 interim audits because three of the grants had outstanding audits in the audit resolution follow-up system. The remaining 19 interim audits requested did not meet EPA criteria which include identification of the "nature of the problem [sic] which have caused delays in finalizing the project."

The most effective use of interim audits is to pinpoint problems early in the grant project. Yet EPA's criteria require the presence of problems of sufficient magnitude to delay a project before it will honor a request for an interim audit. Staff of one grantee told us that because their accounting records were not adequately documented, \$26,000 of Step 3 project costs were declared ineligible for grant funding as a result of an interim audit. An AMB staff member assisted them in correcting the deficiency. Had this assistance been available earlier, the \$26,000 might not have been questioned.

One clear instance of EPA's preventing the state board from assisting a grantee involves the Yucaipa Valley County Water District. EPA had performed an interim audit for the period from September 14, 1972 to May 13, 1976. The audit report was issued January 30, 1978. This grant comprised multiple contracts and the Yucaipa grant manager was concerned regarding the adequacy of their record-keeping. The state board scheduled a financial systems evaluation for July 18 and 19, 1979. EPA refused the state board's request for the evaluation even though the previous audit did not include the last three years of grant activities.

Since a proper audit requires the testing of accounting records and the rendering of an opinion, we do not concur with EPA's contention that a review constitutes an audit. Finally, we believe that more state board evaluations will reduce the dollar amount of questioned and unresolved costs when the final audit is conducted.

CONCLUSION

EPA's audit policies have reduced the state board's effectiveness in administering the grant program. EPA's interim audits are not conducted in a timely manner. EPA-Western Audit Division has prohibited the state board from examining grantee accounting records to provide technical assistance. As a result, many grantees needing such assistance are not receiving it early in the project and must wait until the final audit to determine the acceptability of their accounting systems. Finally, the grant program is not receiving the benefits of an ongoing audit strategy to protect program integrity.

RECOMMENDATION

We recommend the state board request EPA to resolve this impasse so that the board can conduct financial systems evaluations as needed. Should this strategy fail, the state board should seek assistance from the California Congressional delegation, through the State Legislature, to notify the Administrator of EPA of this problem.

MANAGEMENT OF OPERATIONS AND
MAINTENANCE ACTIVITIES NEEDS
IMPROVEMENT

The state board is required to conduct final project inspections to ensure that the treatment works have been constructed in accordance with the grant requirements and that the facilities are properly operated and maintained. We found that the state board's Division of Water Quality has not performed all required operations and maintenance (O&M) inspections and that it does not have an adequate record-keeping system to ensure that reports are maintained in file. Further, we found no follow-up corrective action for a number of projects that, when inspected, were rated unacceptable or were in violation of Waste Discharge Requirements. Some completed projects still do not meet requirements, and the state board cannot properly evaluate program results.

Inspections Not Conducted

We reviewed the operation and maintenance inspection files for 250 completed grant projects for the construction, expansion, modification, or improvement of a wastewater treatment facility. We found 79 projects had not been inspected to ensure they were being properly and efficiently operated and maintained. Also, 19 inspection reports were missing, and officials were unable to locate them. Six reports were in processing; seven inspections were classified as due, and three projects did not require inspection. The remaining 136 projects had inspection reports on file.

We were told that, beginning in January of 1978, the operations section of the division was to perform O&M inspections on all completed projects. However, when we sought the O&M reports for the eight projects we identified as completed since January 1, 1978, and requiring inspection, we found that only four inspections had been conducted and that only one report had been issued.

Because inspections have not been performed and some inspection reports are missing, the division does not have sufficient information to determine if 98 projects, costing approximately \$160,000,000 are properly operated and maintained. Without this information, the division is unable to identify deficiencies needing correction and to establish follow-up activities to correct them.

Lack of Follow-Up

The state board does not follow up to ensure that the grantees correct deficiencies identified during operation and maintenance inspections. We reviewed 136 inspection reports which contained information about both the operation and maintenance of a facility and the quality of the waste it discharges. Of these reports, 130 contained ratings evaluating the operation and maintenance of a facility as either acceptable, conditionally acceptable, or unacceptable. Six reports did not contain a rating. Eleven of the 130 projects were rated unacceptable; 13 were conditionally acceptable, and 106 were acceptable.

There are no formal guidelines for the rating categories. However, we were told that a rating of conditionally acceptable means the project has minor deficiencies. If a project is rated unacceptable, it has major problems.

In addition to a review of the O&M ratings, we examined compliance with Waste Discharge Requirements. This compliance is evaluated during the O&M inspection. Of the 136 O&M inspection reports reviewed, 103 contained evaluations for compliance with discharge requirements. Thirty-five of these projects at 31 facilities did not fully meet the requirements. Twenty-nine of the 31 were discharging inadequately treated wastewater. The other two were discharging effluent in excess of design capacities. Yet 20 (57 percent) of these projects not meeting all requirements were rated as acceptable in the O&M inspection. (A plant could conceivably pass an O&M inspection but fail to meet Waste Discharge Requirements.)

Although O&M inspections and evaluations for compliance of discharge requirements have identified deficiencies in projects, the state board has not established a follow-up process to ensure corrective action has been taken.

In fact, information supplied by the regional boards indicated that 16 (52 percent) of the 31 facilities were not meeting discharge requirements at the time of the latest regional board inspection. For 4 of these 16, it had been over three years between the state board's O&M inspection and the latest regional board inspection. Yet all 16 are still in violation of Waste Discharge Requirements.

CONCLUSION

The state board's management of its operation and maintenance activities needs improvement. The division has not performed all required operation and maintenance inspections and does not have an adequate system for retaining records. Without adequate records, the division cannot properly evaluate projects. Also, the state board has not taken actions necessary to ensure that deficiencies noted in the inspections have been corrected.

RECOMMENDATION

We recommend the state board

- Conduct all required operations and maintenance inspections;
- Establish a reliable record-keeping system to ensure that reports are maintained in file;

- Follow up to ensure grantees correct deficiencies identified in inspections.

Corrective Action Taken

The state board is conducting a survey to determine the number of facilities with operations and maintenance problems and the extent of the problems at each facility. When the survey is completed, a consulting engineer will assist the facility operators in correcting problems.

FINAL AUDITS ARE NOT PROMPTLY
REQUESTED AND AUDIT EXCEPTIONS
ARE NOT EXPEDITIOUSLY RESOLVED

The Division of Water Quality within the state board has not established adequate procedures for closing grants. Final audits have not been requested for 61 grants totaling \$197,960,000 even though construction on these projects has been completed. In addition, the division has failed to develop and implement adequate procedures to ensure that final audit findings are efficiently resolved. Resolution of these findings could make approximately \$5.9 million available to fund other grant projects.

Final Payment Process

When construction is completed on a grant project, the grantee is to submit a Grantee's Final Payment Review form to initiate the final payment process. When the division receives this request, it conducts a final inspection and completes a final payment review checklist. If the federal grant exceeds \$250,000, the division requests a final audit by EPA. However, if the federal share is less than \$250,000, the state board's Division of Audits and Administration (DAA) conducts a comprehensive final payment review. When the audit is completed and exceptions have been resolved, a final payment is made and the grant file may be closed. Any unused funds may be unencumbered and returned to the State for use on other projects.

Grant Files Still Open

Our review found that on July 31, 1979, 61 grants had been open for an average of 19 months since the completion of project construction. Of these, 39 had been open over a year, yet the division had not requested a final audit for any of them. Table IV shows the number of grants still open and the length of time since construction was completed.

TABLE IV
GRANTS REMAINING OPEN AFTER
COMPLETION OF CONSTRUCTION
AS OF JULY 31, 1979

<u>Number of Months</u>	<u>Number of Grants</u>	<u>Dollar Amount of Grants</u>
0 to 6	14	\$ 36,388,078
7 to 12	8	18,050,580
13 to 18	8	28,480,649
19 to 24	9	48,643,921
25 to 30	12	49,636,954
31 to 36	5	10,200,175
37 to 42	0	--
43 to 48	<u>5</u>	<u>6,559,741</u>
Total	<u>61</u>	<u>\$197,960,098</u>

Actual Project Costs

Since final audits have not been performed, the final project costs for these grants have not been established. Therefore, the amount of funds that may be due to the State and the Federal Government from the reimbursement of ineligible expenditures cannot be determined. Also, the amount encumbered in excess of actual costs that could be released for other projects cannot be determined. These excess funds could be returned for use in other California projects.

Officials of the Division of Water Quality said that they allowed the projects to remain open because they believed they had no authority to initiate a request for a final audit without a request for a final payment from the grantee. The state board's legal division has determined that EPA regulations give the division sufficient authority to request a final audit without the submission of the final payment request. As a result, the division has recently begun requesting final audits and will continue this procedure when a final payment request has not been received within 60 days of the completion of construction.

Final Audit Resolution Process

The division is required to notify both the EPA Region and the EPA Office of Audit of any action taken or disposition of all audit exceptions. EPA Order Number 2750.2 issued June 8, 1979, established timeframes for resolution of audit exceptions. Before this order was issued, the EPA Office of Audit requested the division to advise them within 60 days of any action taken on the final audit findings. The division must now submit within 60 days a written notification of actions taken to resolve specific audit recommendations. Any significant audit finding not resolved within 270 days must be submitted to the newly established EPA Audit Resolution Board for final resolution. Although the division has no written time limitations for resolving audit exceptions, management staff told us that most final audit findings should be resolved within 60 days.

Audit Findings Pending Resolution and Closeout

The EPA Office of Audit provided a listing of 63 final audit reports that had not been resolved for 60 days or more. Fifty-three final audit reports were still pending action on August 1, 1979. One of the 53 final audit reports was awaiting resolution by EPA in Washington; 20 were being appealed to the local EPA Region, and 32 were pending division action.

The following table indicates the time that the final audit reports pending division action have been open and the dollar amount of the questioned or unresolved items. As shown, forty-one percent (13) of those projects requiring action by the division had been pending for at least six months.

TABLE V

FINAL AUDIT REPORTS PENDING DIVISION ACTION
AS OF AUGUST 1, 1979

<u>Time Since EPA Issued</u>	<u>Number of Grants</u>	<u>Percentage</u>	<u>Total Questioned or Unresolved Costs</u>
60 days to 3 months	6	19%	\$ 946,293
3 to 5 months	13	41%	3,079,859
6 to 8 months	2	6%	1,452,357
9 to 11 months	6	19%	1,079,138
12 to 24 months	<u>5</u>	<u>16%</u>	<u>1,247,796</u>
Totals	<u>32</u>	<u>100%</u>	<u>\$7,805,443</u>

Based on the new EPA guidelines and on the opinion of division management, the division is taking excessive time to resolve final audit exceptions.

Factors Affecting
Efficient Resolution of
Final Audit Findings

Several factors contribute to processing delays in resolving audit findings:

- Lack of control procedures and inadequate filing and documentation;
- Inadequate staffing;
- EPA audit resolution procedures.

Lack of Control
Procedures and Inadequate
Filing and Documentation

The division has failed to develop sufficient procedures to monitor and control the resolution of final audit findings. The final payments unit within the division operates without time limitations on processing, without proper documentation, and without an adequate filing system. The unit cannot locate files nor can it easily provide data concerning the number and status of grant projects pending.

We were able to locate within their files only 25 of the 63 final audit reports pending resolution. When we gave the unit a copy of the list from the EPA Office of Audit with 63 reports pending final action, they were able to locate 30 additional files. The unit was never able to locate eight reports. The status of 22 of the audit reports still could not be determined from the information in the division files. To account for the eight missing reports, we had to obtain data from the EPA Office of Audit records. The unit does not have a complete and accurate system with which to determine audit status. Management staff said they are developing such a system.

Inadequate Staffing

Another factor affecting resolution of final audit findings is inadequate staffing. When this study began, division management had not given final audit resolutions high priority. Only one person within the division was processing final audit resolutions. After we began our audit, the division began emphasizing the resolution of final audit exceptions and assigned eight additional staff members, including a unit supervisor, to process interim audits and final audit resolutions.

EPA Audit Resolution Procedures

In addition, the EPA final audit procedures can cause delays in resolving audit exceptions. When the grantee and the division do not concur with the auditor's opinion and recommendations, the division must submit its recommendation to the EPA Regional Administrator who reviews the exceptions and is responsible for their resolution. Sometimes the division must submit sufficient data and documentation to the EPA Regional Administrator to rejustify and resubstantiate entire projects. In our review of the 53 grant projects pending final resolution, we found six projects in which 90 to 100 percent of the total costs claimed by the grantee were questioned or unresolved by the auditor. Because of these unresolved costs, the division must undergo a lengthy process of rejustifying the costs of an entire project.

Availability of Funds Affected by Delays

Because the division has not resolved final audit findings in a timely manner, it cannot promptly determine which questioned or unresolved costs should be disallowed and what funds would be available for other grant projects. An initial review made by the EPA-Western Audit Division comparing the rate of recovery of questioned costs revealed a recapture rate of 50 percent for the local EPA Region. From our review of the

53 projects pending final audit resolution, we ascertained that a total of \$11,883,088 has been questioned. Assuming that at least 50 percent of the questioned costs were ineligible, an estimated \$5.9 million could be made available to fund other projects if the audit exceptions were resolved.

CONCLUSION

The Division of Water Quality has not ensured that grants are closed out in a timely manner. Funds may be made available for additional projects by closing out grants and recovering the inappropriate expenditures. Additional funds may be made available through the release of encumbrances in excess of actual expenditures.

In addition, the division has failed to develop and implement procedures to ensure timely and efficient resolution of final audit findings. The division has not given sufficient priority to the resolution of final audit findings, and the division does not have complete and accurate file and documentation systems.

RECOMMENDATION

We recommend that the state board continue the policy of self-generated final audit requests to close out grants. The state board should also ensure that those grants open beyond construction completion dates are closed out as soon as possible.

In addition, we recommend that the state board act immediately to resolve and close out final audit findings in an efficient manner by

- Giving higher priority to the resolution of final audit exceptions;
- Improve their centralized tracking system to enable management to monitor the status of grant projects pending final audit resolution;
- Developing a system of file documentation that provides accurate information for determining the status and historical background of final audit exceptions.

IMPROVEMENTS ARE NEEDED IN THE STATE BOARD'S ACCOUNTING SYSTEM

The state board's accounting system for grant funds is inadequate and incomplete. The state board is unable to determine the precise balance of available federal funds, cannot reconcile totals to individual project records, and has failed to submit required federal reports on time. Because of the system deficiencies, the amount of the deficit in the Grants Administration Revolving Fund could not be determined for approximately 10 months. The deficit, which is estimated at \$1.1 million, represents General Fund expenditures which should have been funded from federal sources. The state board has requested that EPA reimburse the General Fund for this amount.

Two Separate Accounting Systems

The Division of Water Quality maintains registers of federal construction grant funds for each fiscal year. Each register shows the amount obligated to individual grantees and the remaining balance available for each allotment. DWQ does not adjust this balance to reflect decreases in grants and the subsequent reallocation of federal funds. As a result, the Division of Water Quality cannot determine the precise amount of federal grant funds available for obligation. In addition, there is no mechanism to reconcile the computer-generated summary totals of federal construction grant funds to the individual project records.

At the same time, the Division of Audits and Administration (DAA) maintains the accounting system for both State Clean Water Bond funds and the administration funds. Part of the administrative costs are funded by EPA based on the federal construction grant funds. Because these DWQ records of construction grant funds are incomplete, the DAA cannot efficiently account for and manage all administration funds. This problem also affects the accuracy and reliability of reports. The Division of Audits and Administration is trying to reconcile a \$4.4 million difference in federal construction grant allotments and grant obligations for the period from May 1975 through September 30, 1978.

A recognized and accepted principle of internal control requires that record-keeping and expenditure decisions be segregated. The state board would benefit from centralizing the record-keeping functions in one division. This consolidation could provide a consistent method of handling state and federal funds.

State Board Has Failed
to Submit Required Reports

The delegation agreement-in-principle requires the state board to keep sufficiently detailed accounting records and to make periodic reports. According to an EPA audit, the state board has failed to submit the required federal reports when due.

Grant Administration
Revolving Fund Deficit

These accounting deficiencies are further illustrated by the problems the Division of Audits and Administration encountered in determining the Grants Administration Revolving Fund deficit. State board guidelines and changes in the basis of funding the costs of administering the Clean Water Grant Program have caused a deficit of approximately \$1.1 million in the Grants Administration Revolving Fund. These costs should have been funded from federal sources; however, they were funded by the State General Fund. The state board has requested reimbursement of this amount from EPA.

Costs of administering the Clean Water Grant Program between May 1, 1975 and September 30, 1977 were funded by a grant processing fee of one-half of one percent charged against total eligible costs of individual projects. The state board guidelines regarding this fee system were that

- A grant processing fee would be charged on projects receiving a federal grant offer after May 1, 1975;
- The grant processing fee would not be assessed until the Step 3 grant was awarded.

Subsequent changes in the federal system affected the collection of grant processing fees. EPA discontinued the grant processing fee assessed against individual projects and provided a single grant of approximately two percent of the total federal appropriation. Because grants in the process at this time had not received a Step 3 grant, the fee was not collected.

This situation caused an insufficient recovery (deficit) of costs incurred. Because record-keeping was inadequate, the Division of Audits and Administration spent approximately 10 months reconciling records within the state board and with EPA to determine the amount of the deficit. The state board has determined that \$1,070,622 is required to close out the Grants Administration Revolving Fund and has submitted a proposal requesting an EPA grant to the State for this amount. If EPA does not accept this proposal, the General Fund will not be reimbursed for expenditures incurred.

CONCLUSION

The state board does not adequately account for federal grant funds, and the accounting system for federal construction grant funds is incomplete. The state board needs improved procedures to (1) ensure that federal reports are promptly submitted and to (2) determine the amount of federal funds available for obligation.

RECOMMENDATION

We recommend that the state board revise its accounting system so that all grant funds can be reconciled periodically. Accounting for all grant funds should be centralized in the Division of Audits and Administration for consistency and improved efficiency.

OTHER MATTERS FOR CONSIDERATION
BY THE STATE BOARD

FAILURE TO COMPLY WITH WATER CODE
COSTS STATE GENERAL FUND OVER \$500,000

The state board has failed to comply with provisions of the Water Code, and as a result, over \$500,000 of the General Fund has been inappropriately used to subsidize the state board's Operator Certification Unit since fiscal year 1974-75. The Water Code requires the state board to "establish a fee schedule to provide revenues to cover the cost of this program." The state board has failed to adopt sufficient fee schedules and/or decrease the program's cost so that fee revenue would cover expenditures for the program. Our audit disclosed the following deficiencies:

- Since July 1974, General Fund support has been required to fund approximately 76 percent of the cost of the Operator Certification Unit;
- The state board has failed to sufficiently adjust fee schedules and/or reduce the cost of operator certification; and
- The state board has failed to maintain adequate cost records needed to segregate the cost of the program from other duties performed by the Operator Certification Unit.

The Water Code requires that the cost of the Operator Certification Program be funded by certification fees for wastewater treatment plant operators. The state board is responsible for establishing a fee schedule to provide revenues to cover the cost of this program. The original fee schedule was adopted in 1973 and amended in 1974 and 1977; however, the changes were minor and did not radically change the fee structure.

Revenues from fees covered approximately 28 percent of the program's cost during fiscal year 1977-78. The 1977-78 expenses and funding for the Operator Certification Unit follows:

Expenses:

Direct	\$121,263
Program Administration	9,555
General Support	<u>17,024</u>
Total Expenses	<u>\$147,842</u>

Funding:

Operator Certification Fees	\$ 40,777
General Fund Support	<u>107,065</u>
Total Funding	<u>\$147,842</u>

It appears that operator certification fees have never been sufficient to cover program costs; however, detailed accounting records were only available for periods since 1974-75. From July of 1974 through December of 1978, over \$500,000 of the State's General Fund has been inappropriately expended for administration of this program. The state board has failed to both charge fees necessary to comply with the Water Code and make the program self-supporting.

The state board is considering modifying its fee schedules and has published a notice of proposed changes to its regulations. Additionally, an internal staff report on the feasibility of increasing fees indicated that possibly only \$90,000 can be directly related to operating costs of the unit and only this amount should be supported by the fee schedule.

RECOMMENDATION

The state board should adopt fee schedules to comply with the requirements of the Water Code. That is revenues should be sufficient to cover program costs or expenditures for the programs should be decreased so that existing revenues cover the program cost.

The state board should establish a program accounting system permitting a comparative analysis of program costs and fees received.

Corrective Action Taken

On September 20, 1979, the state board amended its administrative regulations increasing operator certification fees. Division staff stated this will make the Operator Certification Program self-supporting from fees. However, due to inadequate program accounting records, we were unable to verify that the increased fees would make the program self-supporting.

OTHER FACTORS INHIBITING EFFICIENCY

In addition to the deficiencies reported in prior sections of this report, we found that program efficiency was inhibited because of a failure to implement recommendations to improve program integrity, an inaccurate management information system, and rapid personnel turnover.

In 1976, the state board contracted with Haskins and Sells to review its operation and to make recommendations to improve program integrity. The state board has not fully implemented all of the recommendations. Two specific areas addressed in the report--project management and the management information system--still warrant state board action.

Project Management
Recommendations
Not Implemented

The state board has established a project coordinator system to expedite projects, but, according to an audit management branch report, the coordinator system has not been totally successful because several units have decision-making roles for particular aspects of each project. The coordinator system appears to need a better mechanism to prevent delays. The internal audit recommended that the coordinator system be modified to provide coordinators with more authority to expedite projects. We agree with this recommendation.

Inaccurate Management
Information System

Another information system, the California Wastewater Information and Control System for project and financial control is still under development. During our review, we found numerous inaccuracies in the computer-generated status reports. We recommend the state board expedite implementation of this system to improve the accuracy of information available to management.

The Rapid Turnover of
Personnel Caused Delays

From July 1977 to June 1979, the Evaluation Section of the Facilities Planning Branch had approximately 30 engineers. These engineers functioned as project coordinators and served as managers for an assigned group of projects from the time the projects were placed on the priority list until construction began. Each coordinator tracked the projects and attempted to keep the projects on schedule.

During this same period, 22 coordinators (approximately 73 percent) left the section. Such a high turnover of personnel has caused delays and problems for grantees. When these experienced coordinators are replaced, the new employees need time to acquire expertise and to understand the projects. Many of the coordinators who left the evaluation section went to engineering positions outside of state service. A State Personnel Board survey estimated that on July 1, 1978, the position of assistant or associate engineer was paid 10.5 percent less than the prevailing wage. On July 1, 1979, the salary lag was estimated to have increased to 19.6 percent. The recent salary increase raised engineers' salaries by 17 percent.

FOLLOW-UP ON AUDITOR GENERAL'S
REPORT NO. 856.1

The Auditor General's report No. 856.1, issued April 25, 1979, identified a need for uniform regulatory policies and procedures. Our review found that (1) the regional boards do not have uniform procedures for conducting inspections and self-monitoring functions required in regulating persons discharging pollutants into the waters of the State and that (2) considerable resources have been expended on developing a management information system that is inaccurate, incomplete, and underutilized.

We recommended that the state board establish and enforce uniform policies, procedures, and formats for inspections, self-monitoring functions, and renewal of permits. We also recommended that the state board both reevaluate the objectives of the waste discharger management information system, considering state and regional needs, and develop and implement minimum reporting/utilization requirements.

Agency Action

The state board is revising its administrative regulations and procedures manual to establish more consistent inspection and self-monitoring review systems. Staff estimate that revised regulations will be published by January 1, 1980.

The regional boards have made improvements that will increase the accuracy of data in the Waste Discharger System. Even though all regional boards now participate in this centralized information system, the state board has failed to establish minimum reporting/utilization requirements. Until this is done, we believe the information supplied by regions will be incomplete, inconsistent, and of little use to the state board. Staff who have recognized these problems have proposed that the state board assign a program manager the responsibility and the authority to improve the system.

During our review of the Clean Water Grant Program, inaccuracies in the Waste Discharger System hindered the assessment of program results statewide. The state board could not supply an accurate listing of all state municipal waste treatment facilities. The listing of municipal dischargers supplied contained gross errors. For example, a number of facilities on the list were not in operation, a number of addresses were incomplete, and some that had completed the grant program were not included.

Respectfully submitted,


THOMAS W. HAYES
Auditor General

Date: January 21, 1980

Staff: Eugene T. Potter, Audit Manager
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STATE WATER RESOURCES CONTROL BOARD

P. O. BOX 100 • SACRAMENTO 95801

**JAN 18 1980**

Mr. Thomas W. Hayes
Auditor General
Office of the Auditor General
925 "L" Street
Sacramento, CA 95814

Dear Mr. Hayes:

DRAFT - AUDITOR GENERAL'S REPORT NO. 856.2

Thank you for the opportunity to review the draft of your audit report number 856.2 regarding the State Water Resources Control Board's Clean Water Grant Program. The Board is very interested in this multi-billion dollar public works program and we appreciate your review and comments.

CALIFORNIA WILL NOT MEET FEDERAL CLEAN WATER ACT GOALS BY 1983

The Board has been aware for sometime of the fact that the goals of the Clean Water Act will not be met by 1983. The achievement of the goal is directly related to the availability of Federal funds. The Federal funds have declined from \$4.5 billion nationwide in Federal Fiscal Year (FFY) 1978 to \$3.4 billion in FFY 1980. We have proposed legislative action in recent correspondence with California Congressmen regarding their support in providing a constant level of funding. We anticipate the 1983 goal will be revised after the 1980 Needs Survey by the Environmental Protection Agency (EPA) is completed later this year.

IMPROVEMENTS NEEDED IN THE MANAGEMENT OF THE STATEWIDE PRIORITY SYSTEM

The Board also has recognized that improvements in management of this program are needed. In December 1979, the staff of the Division of Water Quality (DWQ) was directed to study the problem of ensuring that Federal and State funds are maximized by funding the best water quality projects first. Their report will be presented to us at the February 1980 Board Workshop.

EPA - WESTERN AUDIT POLICIES HAVE REDUCED THE BOARD'S EFFECTIVENESS

The EPA has not delegated responsibility for grantee financial system evaluation to the Board. EPA auditors consider it an inappropriate expenditure of Federal funds for the Board to conduct grantee financial system evaluations. We are currently exploring alternative methods of funding financial system evaluations.

MANAGEMENT OF OPERATIONS AND MAINTENANCE ACTIVITIES NEEDS IMPROVEMENT

The Board has taken steps to increase the operation and maintenance inspection efforts. A waiver from the hiring freeze has been obtained to staff to

the level funding will allow. Efforts are underway to identify problem facilities that need our immediate attention to ensure deficiencies are corrected.

FINAL AUDITS ARE NOT PROMPTLY REQUESTED AND AUDIT EXCEPTIONS ARE NOT EXPEDITIOUSLY RESOLVED

The DWQ has taken steps to accelerate the resolution of final audits. A better tracking system is in use and additional personnel have been assigned to this function. Since August 1, 1979, fifty-four final audits have been resolved and forwarded to EPA for processing.

IMPROVEMENTS ARE NEEDED IN THE STATE BOARD'S ACCOUNTING SYSTEM

The Board believes that our accounting system meets both Federal and State requirements and all reports due EPA have been submitted. The precise balance of Federal funds can be verified with EPA by phone at any time. At times the DWQ records prove to be more accurate than EPA records.

OTHER MATTERS FOR CONSIDERATION BY THE BOARD

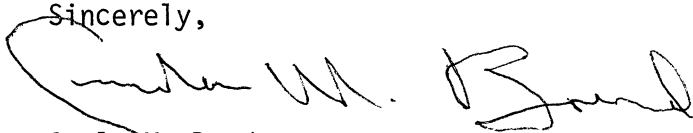
The Board has taken measures to reduce the administrative requirements imposed upon the local agencies. On July 21, 1979, the Board adopted revised regulations that eliminated State regulations where a Federal regulation also existed. Shortly will be issued one manual of guidelines that replaces three manuals. Also, a special unit has been established within DWQ to help small agencies through the process.

The Board will consider your recommendation to issue grants for more than 12½ percent. Our current policy limits the State grant to 12½ percent. We believe this ensures the grantee's financial interest in their project. Also, to increase the amount of the State grant would deplete the Bond Fund faster than anticipated. In light of the current trend to limit government spending, it might be impossible to get a favorable vote on another bond issue. If this is true, future grantees would end up paying 25 percent or twice what previous grantees paid. For these reasons we believe it inadvisable to increase the State grant at this time, but would consider increasing the State grant if conditions change.

Detailed comments are contained in the attachments.

Thank you for the opportunity to comment on your draft audit.

Sincerely,



Carla M. Bard
Chairwoman

Attachments

COMMENTS ON
THE REPORT OF
THE OFFICE OF THE AUDITOR GENERAL
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

<u>COMMENT NUMBER</u>	<u>PAGE NUMBER</u>	<u>COMMENT</u>
1	18	Paragraph two states several problems that cause project delays. Another major factor is the reluctance on the part of the grantees to go ahead with their project. Some grantees use every means possible to delay or eliminate their project and only through concentrated efforts by the Regional Boards are they persuaded to continue with their project.
2	23	<p>In the face of declining Federal funds, the State program has been kept intact until this Federal Fiscal Year (October 1, 1979). In view of the drastically reduced Federal funds this year, the State was forced to return to EPA a portion of the responsibility for construction reviewing and approval of change orders. Before these functions were returned to EPA, every means possible were taken to retain the full program in California. Delegated functions were reduced to the bare minimum. When further reductions in reviews would have resulted in compromising program integrity the State Water Resources Control Board (Board) made the decision to return the construction review delegation on six major agencies. This area was negotiated with EPA and accepted because of their nationwide contract with the Corps of Engineers (COE).</p> <p>Since this phase has only been in existence since October 1, 1979, it is too early to tell if this will have any effect on a project that is under construction not meeting the 1983 goal.</p>

<u>COMMENT NUMBER</u>	<u>PAGE NUMBER</u>	<u>COMMENT</u>
3	27	<p>The first item (paragraph two) states that not all projects on the priority list are funded. The Board adopted new regulations on July 21, 1979 that require the DWQ to contact all new grantees to ensure that they are ready to proceed. If they are not ready, the Regional Board is notified and further action on the Regional Board's part may be required.</p> <p>Further, the new regulations require public hearing be held for the 1981 priority list. This list will be adopted by the Board in September of 1980. This will give all parties the opportunity to determine which projects are needed most and which ones are ready to proceed.</p>
4	30	<p>The problem stated in the first paragraph has been addressed in the new regulations and has shown improvement beginning with the project priority list for Federal Fiscal Year 1980. Staffing limitations severely restricted the level of analysis that could be done on each project. It is the intention of DWQ to improve this situation significantly in the new priority system.</p>
5	30	<p>The Regional Board and staff did place 33 counties on the FFY 1978 priority list for septage studies. Over the past ten years the Regional Board has been aware of numerous and increasing instances involving illegal dumping of septage</p>

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5	30(cont'd)	<p>and the resulting instances of water pollution or threats thereof. Some of the smaller counties may not have been aware of the problem because they did not have adequate staff for surveillance.</p> <p>Objectives of these studies include determinations regarding (1) the volumes of septage and the locations where significant amounts are generated, and (2) the adequacy and/or problems of facilities presently receiving these wastes. The studies are also designed to obtain County Health and Public Works Departments' recommendations (and rationale) for (1) expansion of existing septage treatment and disposal facilities, (2) construction of new septage facilities, and/or (3) discontinuance of certain existing facilities.</p> <p>Of the 33 counties on the priority list, twenty-one are in or have completed their studies. It is believed that three more counties will find it expedient to proceed with their studies this year.</p>
6	31	<p>While it is true that the non-availability of local matching funds is a problem that results frequently in grants not being awarded, Federal law and regulation does not recognize this as a reason for not complying with the requirements. It is not considered the grantee's prerogative to ignore the requirements because they choose not to provide local funds. Adequate provisions of law exists to ensure compliance.</p>

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7	33	It is also not considered the grantee's prerogative to ignore requirements because they lack sufficient staff and the cost of adding staff may not be eligible for grant assistance.
8	35	The first paragraph says the Small Projects Unit has limited staff and may be unable to provide much technical assistance. This unit is now fully staffed and should be able to effectively manage all of their assigned projects.
9	37-42	The Board developed and implemented an audit strategy which included providing technical accounting and management assistance to grantee agencies. Anticipating reduced 205(g) funds beginning October 1979, a series of seminars were sponsored which were open to and designed to provide all grantee agencies with the necessary expertise to manage their programs. When Federal funds were in fact reduced, all individual Financial Systems Evaluations were cancelled. The Division of Water Quality will evaluate making the use of Financial and Management Consultants grant eligible to encourage private sector replacement of such services.
10	43-46	The Board does concur with the conclusion and recommendations regarding management of operations and maintenance (O&M) activities. The Board has had difficulty retaining qualified personnel due to the higher wages paid by the private and municipal agencies. Uncertainty of Federal funding and a hiring freeze have also contributed to a shortage of staff. The Board now has a waiver to

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10	43-46 (cont'd)	the hiring freeze and sufficient funds this year to staff this function. Recruitment is underway and hopefully additional personnel will be hired soon.
11	49	Paragraph one says that the Division is not requesting final audits as soon as the construction is complete. The Board agrees that projects should be closed out as quickly as possible. The Division has been able to supply EPA with a sufficient number of unassigned audits. This has ensured that final audits are being conducted as quickly as the EPA auditors can start the audit. EPA will not accept a request for a final audit unless the grantee has requested final payment. Otherwise, the auditors would have to audit a project without knowing what the grantee was going to request final payment for. Also, due to contractor claims, the grantee may not request final payment for years until all of the final costs are known. There are more EPA auditors in California and California has closed out more audits than any other state. Until EPA hires more auditors, the Board believes that the grantee should be given sufficient time to claim <u>all</u> eligible cost including contractor's claims.
12	51-55	The Board has taken action since August 1, 1979 to correct the findings stated in paragraph two. DWQ has developed new tracking systems, adopted the EPA 60-day limitation on resolution of audit exceptions, all files have been located and are accounted for and adequate staffing provided as noted in the audit on page 54, paragraph two. These changes have resulted in a noticeable

<u>COMMENT NUMBER</u>	<u>PAGE NUMBER</u>	<u>COMMENT</u>
12	51-55 (cont'd)	reduction in pending audit resolutions. Between August 1, 1979 and January 17, 1980, fifty-four audit resolutions have been completed by the Division and forwarded to EPA for final processing. This is double the average output of audit resolutions.
13	58	<p>The second paragraph recommends that the Division of Audits and Administration (DA&A) track Federal funds. The EPA is responsible for tracking Federal funds. The DWQ keeps a set of parallel books that can be checked with EPA in a matter of minutes over the phone. As a matter of course the DWQ books are checked with EPA at the end of each month and any discrepancies are reconciled. EPA's books have been found in error on several occasions and thanks to DWQ's books, have been corrected. This is a very simple bookkeeping system and is used by DWQ on a daily basis. To put it under DA&A would cause unnecessary delays in obtaining needed information necessary to write the Federal grant. DA&A and DWQ also reconcile the State grant funds on a monthly basis.</p> <p>DA&A did help EPA reconcile a \$4.4 million difference in Federal grant allotments and grant obligations. Had DWQ began keeping books in 1977 this problem could have been solved quicker. In the final analysis, EPA accepted DWQ's grant records and the matter has been settled.</p>

<u>COMMENT NUMBER</u>	<u>PAGE NUMBER</u>	<u>COMMENT</u>
14	59	<p>Since the audit field work has been completed, the SWRCB has submitted all fiscal reports requested by EPA Audits Division and Region IX. The reports requested by EPA audits were sent to Mr. Paul De Falco, Regional Administrator on October 22, 1979 by Larry Walker, Executive Director.</p> <p>The intent of these reports was to identify the administrative expenditures and fees collected between May 1, 1975 and September 30, 1977. During this period the administrative expenditures were reimbursed by a grant processing fee. The changes in both State and Federal regulations abolishing the fee system required several "legal opinions" from both SWRCB and EPA attorneys in order to determine the revenues available to California.</p> <p>Based upon the information sent to Mr. De Falco in October by SWRCB, EPA offered a Federal Grant of \$1,070,622 to cover the costs of the deficit. Therefore, no additional State funds will be required to close the revolving fund.</p>
15	63	<p>The first paragraph states that \$500,000 was inappropriately used to subsidize the State Board's Operator Certification Unit. There appears to be some misunderstanding with regard to the general fund and non-general fund components of the Operator Certification Unit activities. The operator licensing activities including testing and application evaluation are required by State regulations to be self-supportive.</p>

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15	63 (cont'd)	<p>The treatment plant classification program, training program evaluation and related administrative costs are not required to be self-supporting, but are required by State regulation. This component of Operator Certification Unit must receive general fund support to be conducted. At present these activities are not being conducted because of the general fund support has been removed.</p>
16	67	<p>Paragraph one says the project coordinators should be given more authority. In the interest of program integrity, management made a conscious decision that project coordinators should have limited authority. The reasoning was that the project coordinators are usually recently graduated engineers and unfamiliar with all Federal and State regulations. While they have a general knowledge of these regulations, they cannot give total assurance that all regulations have been complied with. Failure to comply could mean millions of dollars would be lost to California taxpayers if eligibility is lost.</p> <p>Also, there are two additional reasons. First, people that process the same non-engineering and technical documents everyday quickly become famaliar with what is required and therefore can accomplish the needed review in a shorter time than a person that would process the same document only a few times. Second, the people used to process other non-engineering and technical documents tend to be of a lower classification than the project coordinator thus saving the taxpayer additional money.</p>

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16	67 (cont'd)	Project coordinators can go to their supervisor to request them to place their project in a high priority for review by other sections. The supervisor, after considering all such requests, can request a higher priority from other sections.
17	67	Paragraph two refers to the "California Wastewater Information and Control System" (CWICS) currently under development. This system is running parallel to the Federal and State grants computer systems which it will replace. Some inaccuracies have been found but are being eliminated as part of the CWICS "debugging" process. CWICS will be fully implemented in February 1980 and the Federal and State grants computer system will be discontinued.
18	68	The SWRCB has noted the high turnover of engineers in the past several years. The former Chairman, Mr. Don Maughan, asked Governor Brown to consider this as the 1980 budget was being considered. As noted in the audit, the engineers received a 17 percent wage raise in lieu of the 19.6 percent. Their pay remains behind the private sector and they continue to leave State service.
19	69-70	DA&A has studied the need for uniform regulatory policies and procedures. Staff will shortly make a proposal to the Board that a single program authority and responsibility be assigned to a program manager at the State Board level to coordinate Regional Board policies and procedures, establish standards and handle data issues.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
Secretary of State
State Controller
State Treasurer
Legislative Analyst
Director of Finance
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
California State Department Heads
Capitol Press Corps