Implementation of State Auditor's Recommendations

Audits Released in January 2006 Through December 2007

Special Report to
Senate Budget and Fiscal Review Subcommittee #2—Resources, Environmental Protection and Energy

February 2008 Report 2008-406 S2

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Elaine M. Howle
State Auditor
Doug Cordiner
Chief Deputy

CALIFORNIA STATE AUDITOR
Bureau of State Audits

555 Capitol Mall, Suite 300 Sacramento, CA 95814 916.445.0255 916.327.0019 fax www.bsa.ca.gov

February 21, 2008 2008-406 S2

The Governor of California
Members of the Legislature
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents its special report for the Senate Budget and Fiscal Review Subcommittee No. 2—Resources, Environmental Protection and Energy. This report summarizes the audits and investigations we issued during the previous two years that are within this subcommittee's purview. This report includes the major findings and recommendations, along with the corrective actions auditees reportedly have taken to implement our recommendations.

This information is also available in a special report that is organized by policy areas that generally correspond to the Assembly and Senate standing committees. This special policy area report includes an appendix that identifies monetary benefits that auditees could realize if they implemented our recommendations, and is available on our Web site at www.bsa.ca.gov. Finally, we notify auditees of the release of these special reports.

Our audit efforts bring the greatest returns when the auditee acts upon our findings and recommendations. This report is one vehicle to ensure that the State's policy makers and managers are aware of the status of corrective action agencies and departments report they have taken. Further, we believe the State's budget process is a good opportunity for the Legislature to explore these issues and, to the extent necessary, reinforce the need for corrective action.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

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Introduction

This report summarizes the major findings and recommendations from audit reports we issued from January 2006 through December 2007, that relate to agencies and departments under the purview of the Senate Budget and Fiscal Review Subcommittee No. 2—Resources, Environmental Protection and Energy. The purpose of this report is to identify what actions, if any, these auditees have taken in response to our findings and recommendations. We have placed this symbol ➲ in the margin of the auditee action to identify areas of concern or issues that we believe an auditee has not adequately addressed.

For this report, we have relied upon periodic written responses prepared by auditees to determine whether corrective action has been taken. The Bureau of State Audits' (bureau) policy requests that the auditee provides a written response to the audit findings and recommendations before the audit report is initially issued publicly. As a follow-up, we request the auditee to respond at least three times subsequently: at 60 days, six months, and one year after the public release of the audit report. However, we may request an auditee to provide a response beyond one year or we may initiate a follow-up audit if deemed necessary.

We report all instances of substantiated improper governmental activities resulting from our investigative activities to the cognizant state department for corrective action. These departments are required to report the status of their corrective actions every 30 days until all such actions are complete.

Unless otherwise noted, we have not performed any type of review or validation of the corrective actions reported by the auditees. All corrective actions noted in this report were based on responses received by our office as of January 2008.

To obtain copies of the complete audit reports, access the bureau's Web site at www.bsa.ca.gov or contact the bureau at (916) 445-0255 or TTY (916) 445-0033.

The Carl Moyer Memorial Air Quality Standards Attainment Program

Improved Practices in Applicant Selection, Contracting, and Marketing Could Lead to More Cost-Effective Emission Reductions and Enhanced Operations

REPORT NUMBER 2006-115, JUNE 2007

State Air Resources Board and local air districts' responses as of December 2007

The Carl Moyer Memorial Air Quality Standards Attainment Program (Moyer Program) is an incentive program offered by the State Air Resources Board (state board) in conjunction with participating air pollution control districts and air quality management districts (collectively, local air districts). The Moyer Program provides funds to help private companies, public agencies, and individuals undertake projects to retrofit, repower, or replace existing engines to reduce pollution emissions beyond what is required by law or regulations. A local air district can fund a project that provides cost-effective emission reductions. Emission reductions are considered cost-effective when the cost to reduce 1 ton of emissions is at or below the cost ceiling imposed by the state board.

The Joint Legislative Audit Committee asked the Bureau of State Audits to review how the state board and key local air districts manage the Moyer Program. We limited our review to the four largest districts in terms of the Moyer Program funds they received—the Bay Area Air Quality Management District (Bay Area air district), Sacramento Metropolitan Air Quality Management District (Sacramento Metropolitan air district), San Joaquin Valley Unified Air Pollution Control District (San Joaquin Valley air district), and South Coast Air Quality Management District (South Coast air district). In addition to the findings and recommendations discussed below, we also examined the policies and procedures of the state board and the local air districts; the state board's use of liaisons to the local air districts and desk audits of reports from the local air districts to monitor their Moyer Programs; the high cancellation rate at one entity relative to others; the availability of Moyer Program funds to projects operating in multiple air districts; the project inspections local air districts conduct; monitoring of projects after they have been implemented; and the length of time it takes local air districts to move projects through the Moyer Program process. We found the following:

Finding #1: State law impedes maximum emission reductions.

California law impedes emission reductions by allowing the state board to set aside only 10 percent of Moyer Program funds for projects that operate in more than one local air district. A higher cap could lead to emission reductions with lower costs per ton. For example, if the cap for multidistrict projects were increased to 15 percent for funds appropriated in fiscal year 2004–05, the state board could have selected three additional projects with intended emission reductions costing an average of $2,600 per ton. Shifting this funding would have reduced

Audit Highlights . . .

Our review of the Carl Moyer Memorial Air Quality Standards Attainment Program (Moyer Program) revealed the following:

- *California law impedes emission reductions by allowing the State Air Resources Board (state board) to set aside only 10 percent of Moyer Program funds for projects that operate in more than one local air district.*
- *The methodology the state board used to select projects for the multidistrict component undervalues the cost per ton of intended emission reductions.*
- *For fiscal year 2003–04, 14 of the 16 projects the Bay Area Air Quality Management District designated as matching projects exceeded the Moyer Program's ceiling for cost per ton of intended emission reductions.*
- *The South Coast Air Quality Management District did not spend $24.1 million in Moyer Program funds within the required two years and the state board is monitoring the district to ensure these funds are spent by July 1, 2007.*
- *We identified several best practices that, among other things, can help local air districts select projects with lower costs per ton of intended emission reductions.*

the money available to districts, thus preventing the four districts we visited from selecting 13 projects. However, the average cost of the intended emission reductions from those projects was nearly $11,000 per ton, clearly not as good a value as the multidistrict projects.

We recommended the state board seek legislation to revise state law to increase the 10 percent maximum proportion it can allocate for multidistrict projects. If the state board opts not to seek this revision, the Legislature may wish to consider it.

Legislative Action: Legislation proposed.

Senate Bill 895, which would increase to 20 percent the maximum proportion the state board can allocate for multidistrict projects, was in the Senate Committee on Rules as of December 2007.

Finding #2: The methodology the state board uses to select projects has undervalued the cost-effectiveness of emission reductions.

Three of the six categories the state board uses to assign points when scoring applications for multidistrict projects are neither required nor encouraged by state law. Of the 100 possible points, these three categories accounted for 35 and 55 points, respectively, in the two fiscal years we reviewed. An applicant who received no points for any one of the three categories likely had limited ability to compete with other applicants under consideration. As a result, the state board selected some projects with higher costs per ton of intended emission reductions than it would have if the point values for the three optional categories were lower.

We recommended the state board, when evaluating applications for multidistrict projects, assign more points to scoring categories that help the state board achieve the lowest cost per ton of emission reductions.

State Board's Action: Pending.

According to the state board, it will increase the weight of the cost per ton of emission reductions when assessing projects in 2008. It told us that as of December 2007, it was still in the process of developing the scoring criteria. The state board plans to solicit project applications in early 2008 and select projects in spring 2008.

Finding #3: Some projects the Bay Area air district funded for matching purposes do not meet the Moyer Program requirements for cost-effective emission reductions.

State law requires local air districts to provide their own funds to match Moyer Program funds provided by the state board. Further, projects funded with these matching funds must meet all Moyer Program criteria. Our review revealed that projects funded by one local air district did not meet the Moyer Program requirements for cost per ton of intended emission reductions. As allowed by state law, the Bay Area air district designated 16 projects funded by other programs it administered as matching projects for the Moyer Program for fiscal year 2003–04. However, 14 of the 16 projects it identified exceeded the state board's cost ceiling of $13,600 per ton. The Bay Area air district knew the costs per ton for the projects it selected for matching exceeded the cost ceiling. Instead of selecting other eligible projects, the district attempted to make the 14 projects qualify as match under the Moyer Program by counting only a portion of the projects' total costs when it calculated the projects' costs per ton. Specifically, the district counted as the matching fund portion for the Moyer Program only $740,000 of the $2.5 million it awarded to these 14 projects. This approach is contrary to state law and Moyer Program guidelines because the district did not include all funds under its budgetary control when it calculated the costs per ton of intended emission reductions.

We recommended that local air districts include all funds under their budgetary authority as part of the calculations when determining the cost per ton of a project's intended emission reductions. Further, districts should develop and implement policies and procedures that enable them to meet the requirements in the Moyer Program guidelines regarding matching funds.

Bay Area Air District's Action: Partial corrective action taken.

The Bay Area air district stated that work is underway to recalculate the cost per ton of emission reductions for Moyer projects it has approved. It also stated that this recalculation will allow the district to reallocate matching funds if necessary. The district also plans to assess the cost-effectiveness of those projects designated as match beginning in January 2008. The Bay Area air district also states that it is in the process of reviewing and updating its procedures manual for the Moyer Program.

Finding #4: Unspent Moyer Program funds remained at local air districts after availability had expired.

State law requires that local air districts expend Moyer Program funds allocated by the state board by June 30 of the second year following the allocation; otherwise, the unexpended funds revert to the state board. As of December 2006 the South Coast air district had $24.1 million in Moyer Program funds it had not spent within the two-year time frame established by law. Unspent Moyer Program allocations are a strong indicator that intended emission reductions likely are not occurring. When allocating its fiscal year 2004–05 Moyer Program funds, the South Coast air district selected projects intended to reduce 1 ton of emissions for every $4,256 it spent, on average. Had the South Coast air district spent the $24.1 million on similarly cost-effective projects by the statutory deadline of June 30, 2006, 5,600 tons of pollutants would have been removed.

The South Coast air district interprets the word "expended," as it appears in state law, to mean obligated. Under that interpretation, as long as a local air district had obligated a specific amount of Moyer Program funds to pay for a project that will be completed in the future, unspent funds would not revert to the state board. However, both the state board and the Department of Finance (Finance) have criticized the South Coast air district for its lack of spending in audit reports issued in October 2006 and April 2007, respectively. It is clear that, within the context of their reports, both the state board and Finance expected the district to spend Moyer Program funds within the two-year availability period, not merely obligate them for projects.

The state board is withholding future Moyer Program allocations to the South Coast air district until it spends its expired funds. The state board noted that it has the district's assurance that it will fully expend all applicable Moyer Program funds by July 1, 2007. The state board is monitoring the district to ensure that this happens.

We recommended that the South Coast air district ensure that it spends by July 1, 2007, all remaining Moyer Program funds that are beyond the two-year availability period.

Also, to help ensure that the South Coast air district spends the allocations, the state board should continue monitoring the district's efforts and take appropriate action should its efforts falter. If the South Coast air district does not spend the funds by July 1, 2007, the state board should initiate appropriate administrative action, up to or including recovering all remaining unspent funds.

State Board's Action: Corrective action taken.

The state board reported that it continues to monitor the South Coast air district's expenditures through quarterly progress reports; the October 2007 progress report shows that the district is on track with the timely expenditure of funds. Further, the state board determined that, based on a June 2007 site visit, the South Coast air district had met its expenditure requirements. In addition to implementing these recommendations, the state board stated that it will update the Moyer

Program guidelines regarding consequences for local air districts should they fail to meet the two-year expenditure requirement. It plans to present the proposed revisions to board members at the March 2008 meeting.

South Coast Air District's Action: Corrective action taken.

See 'State Board's Action' above.

Finding #5: Infrequent on-site audits are a concern.

The state board may not be performing on-site audits of local air districts with sufficient frequency. It conducted four on-site audits in 2006 and plans to complete four more in 2007. If it maintains the rate of four audits per year, the state board will audit districts participating in the Moyer Program, on average, once every seven years. Audits released in 2006 demonstrate that some local air districts improperly administer the Moyer Program. More frequent audits would address identified problems earlier.

The state board is updating the procedures it uses to conduct on-site audits of local air districts, according to a program manager. These changes are based on findings from a 2006 review by Finance of the Moyer Program guidelines as well as feedback from the audited districts and from the state board's audit staff about the on-site audits it had already completed. In its report in December 2006, Finance made eight observations with recommendations for ways the state board could improve the Moyer Program guidelines and procedures, including a recommendation that the state board adopt a systematic, risk-based approach to selecting local air districts to audit. Finance also recommended 12 revisions to the guidelines to make the language clearer, define terms, and provide more detail.

We recommended that, to ensure that it monitors local air districts' implementation of the Moyer Program effectively, the state board continue to implement its planned changes to audit procedures and address the recommendations in Finance's 2006 audit report, including the development of a risk-based approach to selecting districts to audit. As part of this effort, the state board should consider how frequently it will audit districts.

State Board's Action: Partial corrective action taken.

According to the state board, it has taken several steps to improve its evaluation and audit procedures for local air districts; it has created a new oversight section, received approval to hire six new positions, and is close to fully staffing the new section. Also, the state board plans to audit seven local air districts in 2008, three more than it audited in 2007. To select the local air districts to be audited, the state board stated that it used a risk-based methodology developed in cooperation with Finance. Finally, the state board affirms that it has updated its policies and procedures for auditing the Moyer Program, in part to incorporate recommendations from Finance's report.

Finding #6: Although local air districts market the Moyer Program in various ways, they could do more to evaluate the results of their efforts.

Local air districts use various methods to market the Moyer Program, such as brochures, mailing lists, Web pages, and workshops, but they do not adequately evaluate their efforts to determine whether they are reaching the business sectors that might be able to provide more cost-effective emission reductions. The districts rely primarily on one measure—whether they receive enough applications to distribute all Moyer Program funds—to evaluate their marketing efforts. Thus, they cannot ensure that their marketing efforts are resulting in applications that help maximize cost-effective emission reductions.

We recommended that the local air districts develop and implement techniques to measure the effectiveness of their marketing methods. Specifically, local air districts should identify business sectors from which they will obtain applications for more cost-effective projects, evaluate whether their

current marketing efforts are reaching those sectors, implement marketing efforts to target sectors not being reached, and assess whether their marketing efforts enable them to select projects with more cost-effective emission reductions.

Local Air Districts' Actions: Partial corrective action taken.

Two of the four local air districts included in our review are taking steps regarding this finding. The Bay Area air district states that it is starting a marketing study and will use cost per ton of emission reductions across various industries, business sectors, and locations to optimize its marketing, develop a marketing plan, and follow up with measures of success. The South Coast air district stated that it has entered into a contract with a company to complete this task and that the final report will include cost-effective marketing techniques that will generate desirable projects. On the other hand, the San Joaquin Valley air district acknowledged that as emission reductions become more expensive, it may be necessary to perform more targeted outreach while the Sacramento Metropolitan air district stated that, based on the results of a survey it conducted, it believes the best way to reach participants is to continue to provide a high level of customer support to applicants.

Finding #7: Timing requirements for preinspections can be overly restrictive.

Timing requirements for conducting preinspections—inspecting the engine to be retrofit, repowered, or replaced to ensure that it is still operational—are overly restrictive. The Moyer Program guidelines generally require local air districts to perform preinspections after the districts have awarded funds but before they execute the related contracts. One district chose not to follow this requirement because delaying the execution of the contract would have delayed project implementation.

We recommended that, to help streamline the process for performing preinspections, the state board revise its requirement that local air districts must perform preinspections before executing contracts.

State Board's Action: Partial corrective action taken.

The state board is proposing to amend its guidelines that require preinspections before executing contracts. Revisions to the guidelines are under development and the state board expects to present the proposed revisions to board members at a March 2008 meeting. The state board also stated that in the interim it is providing local air districts with flexibility regarding the timing of preinspections.

Finding #8: Local air districts use some best practices for contracting and administering Moyer Program funds.

During our visits to the state board and the four local air districts, we observed best practices that we believe can help districts select projects with lower costs per ton of intended emission reductions, reduce district workloads, and allow more time for project completion. Given the differences that exist among the districts, these practices may not be applicable in all cases. However, we believe they deserve serious consideration by the districts.

The Bay Area and South Coast air districts included a measure of pollution or the effects of pollution in their approaches for identifying disproportionately impacted communities—those communities with the most significant exposure to air contaminants, including communities of minority or low-income populations or both.

The state board included a measure of the cost per ton of emission reductions when selecting projects from disproportionately impacted communities for the multidistrict component of the Moyer Program, which increases the state board's ability to maximize emission reductions from multidistrict projects.

The Bay Area and Sacramento Metropolitan air districts include requirements in their contracts that projects selected from disproportionately impacted communities must continue to operate at least a specified percentage of their time in those communities after the project is completed and operational, which helps ensure that completed projects reduce emissions in disproportionately impacted communities.

The Sacramento Metropolitan air district uses only one application form for all its incentive programs, including the Moyer Program, which streamlines the application process for potential projects.

All but one of the four local air districts we visited had, by December 31, 2006, already allocated to projects their Moyer Program funds appropriated in fiscal year 2005–06, well ahead of the June 30, 2007, deadline. By making allocations before the deadline, these three districts allow more time for completing projects before the end of the two-year availability period.

Three local air districts issue one contract per project owner, as opposed to one contract per vehicle, which reduces the administrative burden on the districts.

The Bay Area and South Coast air districts included more detailed project milestones in their contracts, which allows the districts to more easily track the progress of their Moyer Program projects and take appropriate action if the projects veer off track.

The local air districts required projects to be completed before the statutory limit for expending funds, which helps districts ensure that they have sufficient time to perform required inspections and pay project owners before the two-year availability period for Moyer Program funds expires.

The Sacramento Metropolitan and San Joaquin Valley air districts delegated limited project approval and contract execution authority to staff of the local air districts, which may enable local air districts to issue contracts more quickly, thereby allowing more time for implementing projects before the end of the availability period.

The South Coast air district performed multiple inspections at the same time when possible. The district's staff found that this practice allowed them to save time and allowed the affected projects to move forward without unnecessary delay.

The South Coast and San Joaquin Valley air districts imposed stricter funding requirements on some projects, such as requiring certain types of projects to meet a lower threshold for cost per ton of emission reductions, or requiring project owners to pay a greater share of the costs. These practices could enable the districts to fund more projects with their Moyer Program dollars.

We recommended that, to improve their administration of the Moyer Program, local air districts consider implementing the following best practices:

- Include measures of pollution or the effects of pollution in their approaches for identifying disproportionately impacted communities.
- Include a measure for comparing the cost per ton of intended emission reductions when selecting projects from disproportionately impacted communities.
- Include in their contracts the requirement that projects selected from disproportionately impacted communities continue to provide benefits from reduced emissions to those communities after implementation.
- Use a single application for their Moyer Program application process.

- Allocate Moyer Program funds to applicants as soon as possible.
- Implement a system of one contract per project owner.
- Include in their contracts specific milestones against which the project owners and local air district staff can measure the progress of their projects.
- Include in their contracts the requirement that project owners complete projects and submit invoices a specific number of days or weeks before the June 30 deadline.
- Obtain delegated authority from their governing boards to approve Moyer Program projects and execute contracts. If their governing boards are not comfortable in providing delegated authority to approve all Moyer Program projects, obtain delegated authority to approve the more routine projects or projects costing less than a specified amount.
- Conduct consolidated preinspections to the extent practicable.
- Impose stricter standards (for example, caps on individual contract amounts or lower costs per ton of intended emission reductions) on project categories to the extent that such action does not reduce involvement in the Moyer Program.

Local Air Districts' Actions: Partial corrective action taken.

The four local air districts we reviewed have considered the best practices we identified. In many instances, the air districts have implemented or are implementing many of the best practices we identified. For instance, three of the four air districts report they have implemented the best practice of using one contract per project owner while the fourth is exploring whether to implement it. However, the air districts also indicate that some best practices are not practicable for them. Regarding our best practice that districts include in their contracts requirements that projects selected from disproportionately impacted communities continue to provide benefits to those communities after implementation, the South Coast air district states that upon review by its legal counsel, it does not believe it is possible to incorporate language in its contracts that requires continued use of equipment in a specific location.

Department of Conservation

Investigations of Improper Activities by State Employees, July 2006 Through January 2007

INVESTIGATION I2006-0908 (REPORT I2007-1), MARCH 2007

Department of Conservation's response as of September 2007

We investigated and substantiated an allegation that an employee with the Department of Conservation (Conservation) engaged in various activities that were incompatible with his state employment, including using the prestige of his state position and improperly using state resources to perform work for the benefit of his spouse's employer, a charitable organization.

Finding #1: The employee misused state resources to engage in improper activities.

We found that the employee misused state resources to engage in numerous activities that were incompatible with his state employment, including misusing the prestige of his state position. We believe that the nature and extent of these improper activities caused a discredit to the State. Specifically, the employee engaged in the following improper activities:

- Failed to disclose stock ownership in oil industry companies and regulated companies.[1]
- Owned stock in a company at the time he issued permits to that company.
- Used state time and resources for fundraising.
- Solicited charitable contributions from oil industry companies and regulated companies.
- Used his state position to assist a charity.
- Requested and received personal discounts from a state vendor.
- Sent more than 65 e-mails that were insubordinate or of a nature to discredit the State.

The employee owns or has owned stock in a number of oil industry companies, including at least two regulated companies (Company A and Company J). However, he failed to disclose his ownership of stock in these companies, in violation of the Political Reform Act of 1974 (act).

As required by the act, Conservation requires the employee, who works in Conservation's Division of Oil, Gas & Geothermal Resources (division), and others in his job classification to annually complete

[1] The employee is required to disclose his stock ownership in companies regularly engaged in oil and gas exploration and related industries (oil industry companies), which includes regulated companies.

Investigative Highlights . . .

An employee at the Department of Conservation:

» *Failed to disclose his stock ownership in at least 18 instances.*

» *Owned stock in two companies at the time he made business decisions affecting those companies.*

» *Misused state resources to assist his spouse's employer.*

» *Used his state e-mail to directly solicit donations from oil industry and regulated companies.*

» *Used the prestige of his state position to obtain discounts on his personal cell phone purchases.*

» *Sent more than 65 e-mails that were insubordinate or were of such a nature to cause a discredit to the division.*

In addition, the employee's manager failed to adequately monitor the employee's improper activities and failed to disclose his own stock ownership in at least seven instances.

statements of economic interests because these employees have the authority to approve permits that allow companies to extract or produce oil or geothermal resources. Accordingly, the employee, his manager, and others in their job classifications are required to include on their statements of economic interests any investments in, interests in business positions in, and income from any business entity of the type that may be affected by their decisions. This includes, but is not limited to, stock ownership with a value of $2,000 or more in businesses that are regularly engaged in the extraction and/or production of oil, gas, or geothermal resources.

We obtained the employee's statements of economic interests for each year from 2000 to 2005. In each statement, the employee certified under penalty of perjury that he had no reportable business interests. However, information the employee stored on his state computer that he later confirmed as accurate indicated that the employee failed to disclose reportable investments every year during this time period. In particular, we found for those years at least 18 instances where the employee failed to disclose that his stock ownership in various companies exceeded $2,000 in value.

In addition, we believe the employee conducted himself in a questionable manner when he communicated with and approved permits for Company A, a company whose stock he owned at the time he approved its permit requests. Specifically, we believe that in doing so the employee may have violated the common law doctrine against conflicts of interest (doctrine). Similarly, we believe he also violated the doctrine when he made business decisions affecting Company B, the division's vendor for cellular phone services, while he owned stock in that company. The doctrine provides that a public officer is implicitly bound to exercise the powers conferred on him with disinterested skill, zeal, and diligence and primarily for the benefit of the public. Because he owned stock at the same time he approved permits for Company A and made purchases in his state capacity from Company B, we question whether the employee was able to make these business decisions with disinterested skill for the primary benefit of the State.

Further, we found that the employee misused his state e-mail—as well as other state resources—in a number of ways, and engaged in activities that were incompatible with his state employment while assisting his spouse in securing contributions on behalf of her employer, a charitable organization (Charity 1) in various capacities. These activities include soliciting donations from regulated companies even though he had been admonished for doing so in the past, and using his state position to facilitate Charity 1's potential purchase of a property on which he previously performed regulatory work.

The employee used his work e-mail account to send or receive more than 340 e-mails involving discussions of Charity 1 activities and events over the three-year period we reviewed. Nearly 80 of these e-mails involved soliciting donations for Charity 1 and in several instances he directly solicited donations from either oil industry or regulated companies. Many of the 340 e-mails indicate that the employee spent considerable state time and resources when serving as co-chairperson for an annual sponsorship event benefiting Charity 1 by assisting in planning and organizing the event and soliciting sponsorship donations from regulated and other oil industry companies for the event.

The employee also misused his state e-mail and improperly used his state position to facilitate Charity 1's attempt to purchase property from a property owner with whom he had previously interacted in his regulatory capacity as a state employee. The employee violated state law and Conservation's policy prohibiting its employees from using the prestige of their state positions for the gain of themselves or others when he contacted the property owner on behalf of Charity 1.

Moreover, the employee serves as the contact for the division's vendor for cell phone services, Company B. In this capacity, he has regular dealings with representatives of Company B. On two separate occasions the employee requested Company B to waive a $35 fee associated with his personal cell phone purchases. In his e-mail requests, the employee informed Company B that a large number of Conservation offices switched to Company B based on his recommendations. One could easily surmise from this request that Company B may have felt compelled to provide the discount in exchange for his continued efforts to recommend Company B to other Conservation offices. The employee's e-mail records show that Company B's representative agreed to waive the fee on both occasions.

Finally, our review of the employee's e-mail records also indicates that he regularly misused his state e-mail and engaged in a pattern of behavior that likely could be considered insubordinate or apt to cause a discredit to the State. Specifically, for the three-year period we reviewed, the employee sent or received more than 130 e-mails regarding personal financial matters. Most of these e-mails pertain to the potential value of specific stocks. At least 15 of them involved discussions of potential investments in either the oil industry or oil and gas industry companies. Further, we found that the employee sent more than 65 e-mails to coworkers, superiors, representatives of oil industry and regulated companies, and others that we believe were insubordinate or were of such a nature as to discredit the division.

Conservation's Action: Partial corrective action taken.

Conservation reported that it pursued adverse action against the employee and he resigned from state service. In addition, Conservation reported it has taken action to ensure that similar misconduct is not repeated. Included in its corrective action, Conservation stated that it has:

- Developed a web page that its employees can use to review ethics and conflict-of-interest requirements.
- Established an internal ethics advisory panel.
- Required all employees who complete statements of economic interests to complete the Attorney General's online ethics training seminar.
- Continued an internal investigation to ensure that the misconduct is not more widespread than identified in our report.

Finding #2: The manager failed to adequately monitor the employee and failed to disclose his own interests in oil industry companies.

Information the employee stored on his state computer indicates that the manager should have known that the employee was involved in charitable functions involving regulated companies and Charity 1. These documents show that the manager participated in the annual charity event in 2005 and 2006 for which the employee and a representative of a regulated company were co-chairpersons in 2006. Additionally, these documents indicate that nine oil industry companies were sponsors for the event. We determined that six of them had previously submitted applications to the manager's district office for approval. Thus, it appears that the manager was aware—or should have been aware—that the employee was again soliciting donations from the regulated companies.

Documents stored on the employee's state computer also indicate that Company L, a company engaged in an industry related to oil and gas exploration, paid the manager's $150 entry fee for the annual charity event in 2006. When we questioned the manager, he stated that he was not certain whether Company L paid his entry fee but said he did not pay the fee. The manager added that he also did not pay for his entry into the previous year's event and stated that it was not uncommon for oil industry companies to pay for his entry into similar events. When we reviewed information relating to the annual charity event held in 2005, we found indications that Company M, which has submitted applications to the manager's office for his approval, paid his entry fee for the event. By accepting gifts from companies his office regulates, the manager may have violated conflict-of-interest laws and policies that prohibit a state employee from receiving any gift from anyone seeking to do business of any kind with the employee or his department under circumstances from which it reasonably could be substantiated that the gift was intended to influence the employee or was intended as a reward for official actions performed by the employee.

Finally, in the course of our interview, the manager also acknowledged that he has owned stock in a regulated company as well as in other oil and gas industry companies. Specifically, the manager informed us that in 2004 he held stock exceeding $2,000 in value in three oil and gas industry companies, including Company A, and four oil and gas industry companies in 2005. When we asked why he did not report his ownership of stock in regulated companies on his annual statement of economic interests, the manager responded that he did not believe he owned enough to require him to report them.

Conservation's Action: Partial corrective action taken.

In addition to taking the corrective actions Conservation reported for finding #1, it also placed the manager on administrative leave while it further investigates his actions.

Department of Fish and Game

Investigations of Improper Activities by State Employees, July 2005 Through December 2005

INVESTIGATION I2004-1057 (REPORT I2006-1), MARCH 2006

Department of Fish and Game's response as of February 2007

We investigated and substantiated the allegation, as well as other improper acts. The Department of Fish and Game (Fish and Game) allowed several state employees and volunteers to reside in state-owned homes without charging them rent. Consequently, Fish and Game violated the state law prohibiting state officials from providing gifts of public funds.

Finding #1: Fish and Game provided free housing to employees and volunteers and failed to report housing fringe benefits.

Fish and Game allowed several state employees and volunteers to reside in state-owned homes without charging them rent. Consequently, Fish and Game violated the state law prohibiting state officials from providing gifts of public funds. We identified seven volunteers and six employees who resided in state-owned homes in Fish and Game's North Coast Region but were not required to pay rent for a total of 718 months between January 1984 and December 2005. Because Fish and Game provided free rent to some employees and volunteers, the State did not receive more than $87,000 in rental revenue to which it was entitled between January 1984 and December 2005.[1] Therefore, that amount represents a gift of state funds to the employees and volunteers residing in the state-owned homes and a loss in revenue to the State. State regulations provide that departments shall review the monthly rental and utility rates of state-owned housing every year and report those rates to the Department of Personnel Administration (DPA).

Based on a review of state-owned housing conducted by DPA, as well as on information provided by the departments to DPA, it appears that Fish and Game understated its employees' wages by more than $867,000 each year from 2002 through 2005 because it did not report any fringe benefits for its employees who reside on state property at below-market rates. As a result, over the four-year period, state and federal tax authorities were unaware of the potential $1.3 million in taxes associated with a total of nearly $3.5 million in potential housing fringe benefits.

Investigative Highlights . . .

The Department of Fish and Game:

» *Provided gifts of free rent of more than $87,000 to employees and volunteers.*

» *Failed to report housing fringe benefits totaling almost $3.5 million over a four-year period.*

» *Deprived state and federal taxing authorities of as much as $1.3 million in potential tax revenues for tax years 2002 through 2005.*

Other state departments:

» *May have failed to report housing fringe benefits of as much as $7.7 million.*

» *May have failed to capture as much as $8.3 million in potential rental revenue.*

[1] This conservative amount is based on the nominal rents Fish and Game charges when it requires its employees to pay rent. However, if fair market value, as determined by the Department of Personnel Administration, were applied to the 718 months of free rent, this figure could be greater.

Fish and Game's Action: Partial corrective action taken.

Fish and Game reported that in August 2006 it began the process of adjusting rental rates to fair market values in accordance with DPA regulations and applicable collective bargaining agreements and began raising rental rates in October 2006. Fish and Game also reported that it last obtained appraisals approximately 14 years ago and in order for it to report accurate taxable fringe benefit information, it must first obtain current fair market appraisals for its properties. Fish and Game added that it has identified funding to obtain fair market appraisals and will do so after DPA establishes the master agreement for appraisers.

Finding #2: Other state departments have also failed to report housing fringe benefits.

Although we focus on Fish and Game's management of state-owned housing in this report, the housing review conducted by DPA shows that all 13 state departments that own employee housing may be underreporting or failing to report housing fringe benefits. For example, the Table shows that in 2003 state departments may have failed to report housing fringe benefits totaling as much as $7.7 million, depriving state and federal tax authorities of as much as $3 million annually in potential tax revenues. Additionally, because state departments have chosen to charge employees rent that is well below market rates, the State may have lost as much as $8.3 million in potential rental revenue in that year.[2]

Table

Potential Income and Benefits Related to Rental Housing Units Held by State Departments, 2003

DEPARTMENT	RENTAL UNITS	ANNUAL INCOME IF RENTED AT FAIR MARKET VALUE (FMV)	ANNUAL RENT CHARGED	LOST STATE REVENUE (DIFFERENCE BETWEEN FMV AND RENT CHARGED)*	TAXABLE FRINGE BENEFIT REPORTED	UNREPORTED TAXABLE FRINGE BENEFITS†
Department of Parks and Recreation	487	$ 4,778,496	$ 763,488	$4,015,008	$373,198	$3,641,810
Department of Corrections and Rehabilitation	176	2,139,972	909,732	1,230,240	0	1,230,240
Department of Developmental Services	99	1,254,360	309,240	945,120	5,728	939,392
Department of Fish and Game	168	1,124,532	257,316	867,216	0	867,216
Department of Forestry and Fire Protection	72	559,332	218,400	340,932	53,078	287,854
Department of Mental Health	40	366,720	125,472	241,248	34,031	207,217
Division of Juvenile Justice	51	371,760	136,740	235,020	69,152	165,868
Department of Transportation	42	294,984	144,324	150,660	17,300	133,360
Department of Veterans Affairs	22	235,224	97,512	137,712	9,240	128,472
Santa Monica Mountains Conservancy‡	9	82,512	0	82,512	0	82,512
California Highway Patrol	6	41,184	12,732	28,452	0	28,452
Department of Food and Agriculture	5	29,18	5,844	23,340	0	23,340
California Conservation Corps	4	36,888	20,748	16,140	3,058	13,082
Totals	**1,181**	**$11,315,148**	**$3,001,548**	**$8,313,600**	**$564,785**	**$7,748,815**

Source: 2003 Department of Personnel Administration Departmental Housing Survey.

* This amount represents what should have been reported to taxing authorities as a taxable fringe benefit.

† Taxable housing fringe benefits exist when the rental rate charged is less than the fair market rate. Thus, no taxable fringe benefit exists when employees pay fair market rates.

‡ No rent was charged for any department properties.

[2] Taxable fringe benefits exist when the rental rate charged is less than the fair market rate. Thus, no fringe benefit exists when employees pay fair market rates.

Department of Parks and Recreation's Action: None.

The Department of Parks and Recreation (Parks and Recreation) believes that the state regulations relevant to state-owned housing for employees not represented by collective bargaining agreements (non-represented employees) do not allow it to raise rental rates beyond those listed in the regulations and stated that non-represented employees reside in approximately one-third of its properties. However, after reviewing the information Parks and Recreation submitted to DPA, it appears that non-represented employees reside in less than one-tenth of its inhabited properties. Regardless, Parks and Recreation believes that in order for it to raise rental rates for its non-represented employees and not violate state regulations, DPA must update the rates listed in state regulations. Parks and Recreation added that many of the collective bargaining agreements, under which most of its remaining employee residents work, limit its ability to raise rental rates. However, DPA, the agency responsible for administering state housing regulations, has specifically given Parks and Recreation direction to raise rental rates to fair market value and acknowledges that it should do so in accordance with employee collective bargaining agreements. These agreements generally allow Parks and Recreation to raise rental rates by 25 percent annually up to fair market value. After receiving this direction, Parks and Recreation responded to DPA, requesting that DPA provide clear authority and policy direction to departments, and inform employee unions of this direction; however, DPA has not responded to this request.

Parks and Recreation also reported that it believes the fair market values used in DPA's review do not fairly represent the true value of its homes. We acknowledge that the fair market values used in DPA's review may not reflect the actual value of all department holdings; however, DPA was unable to use the actual fair market values because Parks and Recreation failed to determine and report to DPA accurate fair market value rates for all of its properties—rates it also needed to fulfill its responsibility to accurately report the housing fringe benefits realized by its employees. After reviewing the information it submitted to DPA, it appears that it provided fair market determinations for only 298 of the 817 properties it owns. Moreover, Parks and Recreation failed to indicate when the last appraisal was conducted for all but 90 of the 298 properties and had conducted appraisals on only 14 of those properties in the previous 10 years, thus demonstrating that it did not report accurate, up-to-date fair market rates to DPA.

Parks and Recreation also takes issue with the amounts identified by DPA as losses in state revenue and underreported fringe benefits because many of its employees live on state property as a condition of employment and therefore, there is no loss in rental revenue to the State or fringe benefit to report. However, after reviewing the information provided to DPA, it appears that Parks and Recreation did not clearly indicate which, if any, of its residents resided on state property as a condition of employment. Specifically, even though the survey guidelines instructed Parks and Recreation to indicate the reason for occupancy for each of its properties, it did not list as a reason condition of employment for any of its properties. Parks and Recreation has not reported any updated information since March 2006.

Department of Corrections and Rehabilitation's Action: Pending.

The Department of Corrections and Rehabilitation (Corrections), including the Division of Juvenile Justice, reported that DPA is anticipating awarding a contract for state-owned housing appraisal services that can be used by all state agencies. Corrections stated that it intends to obtain fair market appraisals for its properties through the contract, which is expected to be awarded by April 2007.

Department of Developmental Services' Action: Pending.

The Department of Developmental Services (Developmental Services) reported that it will obtain fair market appraisals once DPA establishes a master agreement of licensed appraisers and has authorized departments to begin contracting for appraisals. Developmental Services also reported that it has evaluated its systems and processes for reporting fringe benefits to ensure it will be in compliance with reporting guidelines once it is able to establish and update its rental rates.

Department of Forestry and Fire Protection's Action: Partial corrective action taken.

The Department of Forestry and Fire Protection (Forestry) reported that it has taken several steps to resolve state housing issues since it reported information to DPA for its review in 2003. Specifically, Forestry reported that it now reviews rental rates each year and rents that are below fair market value will be raised by 25 percent annually in accordance with applicable collective bargaining agreements. It also reported that it currently reports taxable fringe benefits for residents in Forestry housing on a monthly basis. In addition, Forestry reported that the fair market rates used by DPA do not accurately reflect the true values of its properties because most are located within the boundaries of conservation camps primarily occupied by prison inmates; however, it acknowledged that annual appraisals are necessary to document the accurate value of each unit. Finally, due to increased rental rates and additional vacancies, Forestry reported that the difference between fair market value and actual rental income for all of its properties in 2005 was $32,805 and that by increasing rents 25 percent each year, the difference will continue to decline. Forestry has not reported any updated information since March 2006.

Department of Mental Health's Action: Partial corrective action taken.

The Department of Mental Health reported that it updated its special order addressing employee housing in December 2006. This special order requires all four of its hospitals to perform appraisals of fair market rental rates for their properties by March 2007 and to reassess those rates annually. In addition, the special order requires its hospitals to report accurate taxable fringe benefit information in a timely manner.

Department of Transportation's Action: Corrective action taken.

The Department of Transportation (Caltrans) reported that it performed additional analysis to determine what amount of taxable fringe benefits it should have reported for 2003. It determined that the net total of additional income that should have been reported was $1,232 for six of its employees residing in state homes. Caltrans added that as of April 2006, this amount was reported to the tax authorities.

Department of Veterans Affairs' Action: Corrective action taken.

The Department of Veterans Affairs (Veterans Affairs) reported that it conducted fair market assessments of its properties in September 2005 and that it submitted its corrected housing information to DPA in October 2005. Veterans Affairs also reported that it established new rental rates based on the assessments and informed its residents that the new rates would take effect March 1, 2006.

Santa Monica Mountains Conservancy's Action: Corrective action taken.

The Santa Monica Mountains Conservancy reported that it has only six employees, none of whom live on state property. It added that in lieu of rent, it currently allows non-state employees to reside on eight of its properties to provide and ensure resource protection, site management, facilities security and maintenance, and park visitor services.

California Highway Patrol's Action: Partial corrective action taken.

The California Highway Patrol reported that it has adjusted rental rates for its properties in accordance with applicable state regulations and that because all of its employees reside on state property as a condition of employment, it has not underreported housing fringe benefits.

Department of Food and Agriculture's Action: Corrective action taken.

The Department of Food and Agriculture (Food and Agriculture) reported that its employees currently reside on two state properties as a condition of employment. As a result, there is no fringe benefit to report for those residents. Food and Agriculture added that because these properties are located near popular resort areas, fair market values are not comparable to values of homes in surrounding communities.

California Conservation Corps' Action: Pending.

The California Conservation Corps (Conservation) reported that it will be conducting new appraisals to determine updated fair market values for its properties and that rental rates will be increased to the extent allowed by law and applicable collective bargaining units. Conservation also stated it would report on the fringe benefit amount—the difference between the rent charged and the fair market value determined by these new appraisals—for employees residing on its properties, and has informed affected employees of this fact. Conservation has not reported any updated information since March 2006.

Department of Personnel Administration's Action: Pending.

The Department of Personnel Administration (DPA) reported that it became aware that some departments, which attempted to contract for appraisal services, received bids that were too costly and not in the best interest of the State. As a result, in February 2007 DPA issued a request for proposal in an effort to solicit bids for a statewide master agreement of licensed appraisers. DPA expects to finalize agreements in June 2007 with the seven appraisal firms awarded contracts.

Department of Forestry and Fire Protection

Investigations of Improper Activities by State Employees, January 2006 Through June 2006

INVESTIGATION I2006-0663 (REPORT I2006-2), SEPTEMBER 2006

Department of Forestry and Fire Protection's response as of August 2007

We investigated and substantiated an allegation that Employee A, an employee of the Department of Forestry and Fire Protection (Forestry) submitted false time sheets and took time off without charging his leave balances.

Investigative Highlights . . .

An employee with the Department of Forestry and Fire Protection:

» ***Submitted false claims to receive $17,904 in wages for 672 hours he did not work.***

» ***Submitted a majority of his false claims to a supervisor with little or no knowledge of his actual attendance.***

Finding #1: Employee A fraudulently claimed hours he did not work.

Between January 2004 and December 2005, Employee A improperly claimed and received $17,904 in wages for 672 hours he did not work. He submitted nine false claims over this two-year period. Because these false claims were submitted on numerous occasions over a significant period of time and under a variety of different circumstances, we believe it is reasonable to infer that this individual acted intentionally when submitting these false claims. Employee A's supervisor told us that having accurate staffing information is critical, and that he reviews daily staffing reports each morning to ensure that he has sufficient staff to respond to emergencies. We found numerous instances in which Employee A's time sheets conflicted with these reports.

For example, Employee A received $9,884 by claiming he worked 372 hours when he was not present at work. During these hours, Employee B reported working to provide vacation coverage for Employee A. When questioned, Employee B stated that he worked all the hours he indicated for the purpose of covering for Employee A's vacation and that Employee A was not present during those hours. Furthermore, staffing reports confirm that Employee B was present for work and that Employee A was not.

Conversely, we identified 108 hours for which Employee A claimed he was providing vacation coverage for Employee B, even though Employee B's time sheet indicates he did not take leave and was at work during all these hours. Staffing reports confirm that Employee B was present for work and that Employee A was not present. When asked about these hours, Employee B asserted he did not charge his vacation balances because he was at work. He added that he did not know why Employee A claimed to work these hours because Employee A was not present during any of the hours claimed. Employee A received $2,906 for claiming these hours.

Finally, Employee A claimed to work 192 hours for which he received $5,114, but staffing reports indicate Employee A was not present during this time. Neither Employee A's nor Employee B's time sheet indicates that Employee A was providing vacation coverage during these hours. Employee A claimed that he worked his regular work schedule on his time sheet, but staffing reports indicate that he was not at work during any of these hours.

Forestry's Action: Pending.

Forestry requested to review our work papers in August 2006 to pursue corrective action. In addition, Forestry reported in March 2007 that it agreed that Employee A collected wages to which he was not entitled and had conducted its own investigation. Forestry also reported that it was assessing the adequacy of the documentation of its investigation and planned to recover overpayments and determine disciplinary action once the assessment was complete.

Forestry had not provided any other update as of August 2007.

Finding #2: The employee took advantage of poor supervision and weak controls to receive payments for hours not worked.

By claiming wages for hours he did not work, Employee A took advantage of his supervisor's lack of effective oversight and communication among the various staff with the authority to sign time sheets. Simply comparing Employee A's time sheets and daily staffing reports with those of Employee B would have shown that Employee A was submitting inaccurate time sheets. Although we acknowledge that efficient and effective firefighting is one of Forestry's critical responsibilities, responding to emergency situations does not relieve Forestry of its responsibility to maintain adequate payroll controls or to keep complete and accurate attendance records, as required by state law.

The supervisor acknowledged that he had not been as diligent in verifying the authorization and hours worked for his employees as he should have been and when one employee claimed he was providing vacation coverage for the other, he did not always compare time sheets for both employees when approving them for payment.

The supervisor also pointed out that other supervisors may approve these time sheets. Because employees and supervisors may work in the field or at headquarters at any given time, Forestry's practice is to allow individuals other than an employee's direct supervisor to sign time sheets. Up to nine people have the authority to approve Employee A's and Employee B's time sheets. As a result, it is possible that the direct supervisor may sign one, both, or neither Employee A's or Employee B's time sheets for that month. Four individuals other than his direct supervisor signed a total of eight of Employee A's time sheets for the two-year period we reviewed. We believe Employee A was able to claim wages for hours not worked without being detected because he took advantage of a lack of oversight and communication among those with the authority to sign his time sheets. Additionally, it appears Employee A may have exploited this relaxed management practice by frequently having supervisors other than his direct supervisor sign his time sheets when he claimed hours he did not work.

For example, a battalion chief who rarely works in the field approved 240 of the 672 hours Employee A improperly claimed. With multiple approving authorities available, Employee A had the opportunity to have his time sheets approved by someone who, at best, would have limited firsthand knowledge of the hours he claimed. Most of the false claims Employee A submitted were signed by someone other than his direct supervisor.

Forestry's Action: Partial corrective action taken.

Forestry issued a memo on December 1, 2006, to all stations in the unit in which the employee worked, outlining several steps intended to address the findings in the investigative report.

Supervisors with direct supervisory responsibility over a given employee are the only supervisors authorized to sign time reports for that employee. Program managers will compare each employee's work time with the appropriate daily staffing report. Employee's requesting time off that is not part of their annual vacation request process will be required to forward their request to a Division Chief or Duty Chief for approval per the "Master Schedule" for the unit. The memo includes a reminder to Battalion Chiefs to ensure that station log books, which are legal documents used to record and verify personnel transactions at the station level, are complete, accurate, and secure.

Management will also have the ability to access the department's personnel database to review staffing and personnel transactions, as well as recorded phone lines and radio transmissions to review conversations related to staffing and personnel decisions.

Finally, the memo reminds recipients that Battalion Chiefs will have the primary oversight responsibility for all personnel in their Battalions, and that Division Chiefs will conduct audits to ensure that all policies and procedures are followed and report their findings to the Unit Chief.

Forestry did not provide any other updates as of August 2007.

Department of Forestry and Fire Protection

Investigations of Improper Activities by State Employees, July 2005 Through December 2005

INVESTIGATIONS I2005-0810, I2005-0874, AND I2005-0929 (REPORT I2006-1), MARCH 2006

Department of Forestry and Fire Protection's response as of February 2007

We investigated and substantiated an allegation that several Department of Forestry and Fire Protection (Forestry) employees improperly received overtime payments.

Finding #1: A Forestry supervisor authorized improper overtime for his employees.

The State's collective bargaining agreement with the firefighters' union provides for around-the-clock compensation when certain employees are assigned to a fire, but does not include air operations officers among those eligible for this type of compensation. Rather, air operations officers should be compensated only for actual hours worked instead of the duration of a fire incident. Further, department policy limits the number of work hours per day that its pilots are able to work to 14 hours. Because the air operations officers' reported overtime hours involved pilot coverage, these employees were subject to Forestry's 14-hour workday for pilots.

From January 2003 through July 2005, five air operations officers working as pilots received more than $58,000 for 1,063 overtime hours charged in violation of either department policy or their union agreement. In addition, two air operations officers working in maintenance received nearly $3,890 for overtime hours that it is not clear they actually worked. Specifically, we found that one air operations officer working in maintenance claimed five consecutive 24-hour workdays and the other maintenance officer claimed three consecutive 24-hour workdays, resulting in 80 total hours of overtime.

The supervisor of the air operations officers indicated that he mistakenly believed they were all entitled to around-the-clock pay when assigned to a fire.

Forestry's Action: Partial corrective action taken.

Forestry reported that, for the air operations officers acting as pilots, it has actively started to process the overpayments as receivables. It also reported that it has taken steps to inform supervisors and managers of any significant changes to union agreements that would impact rank and file salary, benefits, or classification status.

Investigative Highlights . . .

» *A Department of Forestry and Fire Protection (Forestry) supervisor approved improper overtime resulting in payments totaling more than $58,000.*

» *A Forestry employee took advantage of a lack of oversight and improperly received $3,445 for time he did not work.*

Finding #2: A lax control environment allowed another Forestry employee to charge excessive and questionable overtime.

Between January 2004 and December 2005, Forestry paid a heavy fire equipment operator approximately $87,000 for 3,919 overtime hours, of which we identified $12,588 that is questionable and $3,445 that is improper.

As opposed to the air operations officers we discussed previously, heavy fire equipment operators are entitled to around-the-clock compensation when they are assigned to a fire. The State's collective bargaining agreement with the firefighters' union provides that heavy fire equipment operators working this employee's schedule work a 12-hour day on the last day of their duty week. This employee improperly claimed 120 hours of overtime by reporting 24-hour shifts on the last day of his duty week, despite being counseled by his supervisor and being specifically told that he should report only 12 hours on the last day of his duty week. As a result, this employee improperly received $2,769. In addition, this employee improperly claimed 27 hours related to training, receiving $676 for hours he did not work. The aggregate amount of these improper payments totaled $3,445.

Additionally, we question $12,588 paid for 549 hours in which this employee reported hours for covering the shift of another employee who was also scheduled to work these same hours or reported hours for working the shift of another employee who was not scheduled to work.

Although this employee's direct supervisor acknowledged that he was not as diligent as he could have been when approving time sheets, he pointed out that when other battalion chiefs approve this employee's time sheets, he does not review those time sheets for accuracy.

Forestry's Action: Partial corrective action taken.

Forestry agreed that the heavy equipment operator was overpaid and it has started to process a receivable for repayment. Further, Forestry is evaluating adverse action for this employee.

State Water Resources Control Board

Its Division of Water Rights Uses Erroneous Data to Calculate Some Annual Fees and Lacks Effective Management Techniques to Ensure That It Processes Water Rights Promptly

REPORT NUMBER 2005-113, MARCH 2006

State Water Resources Control Board's response as of March 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct an audit of the operations of the Division of Water Rights (division) within the State Water Resources Control Board (water board). Specifically, the audit committee requested that we (1) examine the division's policies and procedures for carrying out its roles and responsibilities, including those for complying with the California Environmental Quality Act and other relevant laws; (2) evaluate the timeliness and effectiveness of the division's processing of applications for new water rights permits and petitions to change existing water rights permits (petitions); (3) determine how the division allocates its resources to fulfill its responsibilities and determine if the division uses those resources to address matters other than the processing of applications and permits—including enforcement, complaint resolution, and board-initiated amendments of the terms of permits and licenses; (4) identify the extent of any demands placed on the division's resources by other agencies, including the Department of Fish and Game, and by other interested parties that have not filed applications and petitions; (5) determine how the division established its new fee structure and assess its reasonableness and fairness, including the validity of the data the division used when it established its fees; and (6) determine what procedures and mechanisms the division has in place to review the fee structure and modify the fees when necessary. We found that:

Finding #1: The division uses erroneous data to determine some of its annual fees for permits and licenses.

The California Water Code (Water Code), Section 1525, requires the water board to implement a fee-based system so the total amount it collects each year equals the amount necessary to support the program's costs. It specifies that the division is to develop a fee schedule that consists of annual fees and filing fees and also requires the division to review and revise its fees each year to conform to the revenue levels set forth in the annual budget act and to make up for undercollection or overcollection of revenues from the previous fiscal year. The division's annual fees for permits, licenses, and certain pending applications consist of a $100 minimum fee plus a fixed rate per acre-foot (which is about 326,000 gallons) of water authorized for beneficial use in excess of 10 acre-feet. The division assesses other annual fees for petitions, water leases, and certain hydroelectric projects. Holders of riparian water rights, which usually come with ownership of land bordering a water source, or other water rights obtained before 1914 are not under the water board's jurisdiction and are not assessed fees.

Audit Highlights . . .

Our review of the operations of the State Water Resources Control Board's Division of Water Rights (division) revealed the following:

- *Because the division's database does not always contain the correct amount of annual diversion authorized, some of the annual fees the division charged over the past two fiscal years were wrong.*
- *The division's method of charging annual fees may disproportionately affect holders of multiple water rights that authorize them to divert small amounts of water.*
- *Because the division does not factor in certain limitations on permits and licenses, it charges some fee payers based on more water than they are authorized to divert.*
- *The number of permits and licenses the division has issued over the past five fiscal years has significantly decreased.*
- *Although the process of approving a water right is complex and can be legitimately time-consuming, the division may cause unnecessary delays because it has a poor process for tracking its pending workload and is sometimes slow to approve documents to be sent to applicants.*
- *The data in the division's electronic tracking systems related to applications and petitions are unreliable for the purpose of tracking the progress and status of those files.*

continued on next page . . .

» *The electronic bar-code system the division uses to track the location of its files has limited usefulness as a management tool because more than 5,200 of its permit and license files are not present in the system.*

The division relies on its Water Rights Information Management System (WRIMS) to calculate the annual fees it charges for permits and licenses. However, we found that the WRIMS data fields that the division uses to calculate the fees did not always contain the correct amount of annual diversion authorized by permits or licenses. Because this information is necessary to calculate annual fees accurately, the fees that the division charged over the past two fiscal years for 18 of the 80 water rights we tested were wrong. Specifically, during this period the division undercharged the holders of 10 of the water rights in our sample by a total of $125,000, and it overcharged the holders of eight of the water rights by a total of $1,300. In addition, the division did not bill two water rights a total of $406 because WRIMS did not list them as active in the system. Furthermore, the division could potentially be setting its rate per acre-foot too high or too low by not having the correct amount of annual authorized diversion for all the permits and licenses in the system.

Contributing to the problem, the invoice the Board of Equalization (Equalization) sends on the division's behalf does not contain sufficient detail for fee payers to recalculate the annual fee. Specifically, critical details of the terms of the permit and license, such as the total annual amount of acre-feet of authorized diversion and the rate the division charges for each acre-foot, are not included. By relying on fee payers to identify billing errors, the division assumes that permit and license holders are able to recalculate their fees based on the terms of their water rights and the division's fee schedule. Furthermore, the largest problems we found related to undercharging rather than overcharging, and fee payers who are undercharged do not have a monetary incentive to report that their bills are too low.

At a cost of $3.2 million, the water board is seeking to replace the division's current WRIMS with a new system that purportedly will deliver a variety of enhanced features. However, the division must first ensure that its current system contains key data that are accurate and complete, such as the maximum annual diversion amounts that are specified on permits and licenses, before it implements a new system. If it does not ensure the accuracy of its current data, the division is at risk of continuing to assess incorrect annual fees. Further, the division's new system would not be implemented for more than one year, so ensuring that its current system has accurate and complete data would greatly enhance its ability to bill fee payers accurately before converting to the new system.

We recommended that the division review all the water rights files for those that pay annual fees and update WRIMS to reflect all the necessary details specified on a permit or license, such as the maximum authorized diversion and storage and the applicable seasons and rates of diversion to ensure that its WRIMS contains all the necessary information needed to calculate annual fees accurately for the next billing cycle. We recommended this be completed before the division's conversion to any new database system, so that the data are accurate and complete.

To ensure that fee payers have sufficient information to review the accuracy of their bills, we recommended that the division work with Equalization to include more detail on its invoices, such as listing all the

water rights identification numbers or application numbers for which the fee payer is subject to fees, along with the corresponding maximum amount of authorized diversion and the cost per acre-foot. Alternatively, the division could provide this information as a supplement, using its own resources, by sending out a mailer at about the same time that Equalization sends the invoice to fee payers, or by providing the information on its Web site.

Water Board's Action: Partial corrective action taken.

The water board stated that it has developed a plan to update its WRIMS data associated with annual fee calculations. The water board indicated that its plan has seven priority groups of water right records, with a goal of correcting all necessary data before the water board implements its final conversion to its new database system in September 2007. The water board asserts that, as of February 2007, it has reviewed and corrected 2,737 of the 12,571 water right files and it intends to review another 1,899 by September 7, 2007. However, the water board stated that it believes the marginal returns of completing the work associated with the remaining 7,935 water right files do not warrant redirecting staff to complete those reviews.

The water board also stated that it intends to work with Equalization to include more detail on its invoices and until that time, it intends to provide the recommended information on its Web site. The water board stated that it has posted an example invoice on its Web site. In addition, the water board stated that it intends to send a letter to all of the fee payers in its next billing providing instructions on how to read the bill and directions to Web site locations for more detailed information.

Finding #2: The division's method for calculating annual fees may disproportionately affect certain holders of multiple water rights.

We also found that the division's method for calculating annual fees may disproportionately affect some fee payers who divert small amounts of water under multiple water rights. The division's approach is to generally distribute the fees among its fee payers in proportion to their overall authorized diversion of water. However, because the division charges a $100 minimum fee for each individual water right, fee payers who have multiple water rights with small authorized diversion amounts pay proportionately more than those holding a single water right with the same, or in some cases an even greater, amount of diversion. Although we agree that assessing a minimum fee is reasonable, the division could address this issue by charging a single minimum fee for each fee payer rather than for each water right. Our suggested modification to the division's current approach would continue to use existing data sources but would require the division to change the way it sorts the data. In addition, such a change would require a slight increase in the fee rate per acre-foot to offset the reduction in revenues from the minimum fees. Nevertheless, we believe this approach would more precisely distribute the fees in proportion to the authorized diversion of water. We recognize that there may be a variety of ways to structure valid regulatory fees. Therefore, this change is not required in order for this fee to retain its validity as a regulatory fee.

To more precisely distribute the fees in proportion to the annual fee payers' authorized diversion, we recommended that the division consider revising its emergency regulations to assess each fee payer a single minimum annual fee plus an amount per acre-foot for the total amount of authorized diversion exceeding 10 acre-feet, or other specified threshold.

Water Board's Action: None.

The water board stated that it met with its Fee Stakeholder Group (stakeholder group) on April 11, 2006, to explain and discuss our recommendation and again on September 5, 2006, and February 7, 2007, to discuss pertinent water right fee issues. The water board stated that to date, there has been no support for the recommended change from members of the stakeholder group. According to the water board, on January 17, 2007, the State of California Third District Court of Appeal (court) ordered the water board to revise its water rights fee regulations within 180 days of the date the court's order becomes final and to direct Equalization to provide refunds to parties

where applicable. The water board asserted that the court overturned the annual water right permit and license fee because a segment of the regulated community (primarily riparian and pre-1914 water right holders) benefits from the regulatory program but does not pay fees. However, the water board stated that the court did not find the $100 minimum fee the water board charges per water right to be unreasonable. The water board stated that it and Equalization are seeking review by the Supreme Court. In the meantime, the water board states that it will continue to meet with its stakeholder group when it revises its fee regulations.

Finding #3: Some fee payers are charged based on more water than they are authorized to divert.

Some fee payers hold multiple water rights that include a term limiting their combined authorized diversion to an amount that is less than the total diversion authorized for their individual rights. Their annual fees are calculated in a manner that is inconsistent with the calculation of annual fees for fee payers who hold a single water right that includes a term limiting the authorized diversion.

The California Code of Regulations, Title 23, Section 1066(b)(3), states that if a person or entity holds multiple water rights that contain an annual diversion limitation that is applicable to a combination of those rights, but may still divert the full amount authorized under a particular right, the fee shall be based on the total annual amount for that individual right. For example, a person may hold five water rights, each with a face value of 200 acre-feet, for a total of 1,000 acre-feet, but the overall authorized diversion on those five water rights may be limited by one of the rights to 800 acre-feet. The division implements the regulation just described by charging holders of multiple water rights annual fees based on the face value of each permit or license and does not take into account the overall limitation on authorized diversion. Consequently, the fee charged to the holder of these five water rights would be based on 1,000 acre-feet rather than the 800 acre-feet the fee payer actually is authorized to divert. The division does take a diversion limitation into account when it is a specific term on a single permit or license. Although the division has considerable discretion in interpreting its regulations, we find this inconsistency in the treatment of single and multiple water rights holders particularly noteworthy, given that the division may bring an enforcement action against a water right holder who violates the terms and conditions of a permit or license by exceeding the annual use limitation applicable to combined water rights. Consequently, the holder of multiple water rights may be required to pay an annual fee for an amount of water that, if actually diverted, could subject the holder to an enforcement action.

We recommended that the division revise its emergency regulations to assess annual fees consistently to all fee payers with diversion limitations, including those with combined limitations, so fee payers are not assessed based on more water than their permits and licenses authorize them to divert.

Water Board's Action: None.

The water board stated that it met with its stakeholder group on April 11, 2006, to explain and discuss our recommendation and again on September 5, 2006, and February 7, 2007, to discuss pertinent water right fee issues. The water board stated that to date, there has been no support for the recommended change from members of the stakeholder group. According to the water board, on January 17, 2007, the court ordered the water board to revise its water rights fee regulations. The water board asserted that the court did not express concern over the water board assessing fees based on face value of individual water right permits and licenses or over the way in which the water board addressed diversion limitations. However, the water board stated that if its stakeholder group supports the Bureau of State Audits' recommended change, the water board will consider implementing such a change in its revised regulations.

Finding #4: The division has weaknesses in its process of tracking applications and petitions.

The division does not have an effective method of tracking its pending workload. The division has two independent electronic systems designed to track information pertaining to pending applications: the application tracking system, which tracks general information relating to an application; and

the environmental tracking system, which tracks information more specific to the application's environmental review process. The division uses another system to track information pertaining to pending petitions. Our review of these systems found the information to be unreliable because the division failed to ensure that the systems contain accurate and complete data necessary to track pending workload. As a result, the division cannot rely on these systems as an effective management tool to track the progress and status of its pending workload, which may contribute to delays in processing applications and petitions.

Of the 615 pending applications in the division's application tracking system, 41 percent were assigned to supervisors who no longer are employed by the division and 44 percent did not have any staff assigned to them. Furthermore, we found that the "next step date" field in the application tracking system, used to track upcoming stages of the application process, such as the dates the division expects to send public noticing instructions or issue a permit, was not always updated or was blank. The division identified future action for fewer than 30 applications. The remaining applications indicated activity that was long past due, and 189 applications did not have any "next step date." Therefore, the application tracking system is incomplete and inaccurate for the purpose of tracking the progress and status of applications. The division's environmental tracking system is unreliable as well because it too is incomplete and inaccurate for the purpose of tracking applications. For example, 74 percent of the applications in the environmental tracking system did not have any staff assigned to them, and 85 percent of the applications did not contain any data in the "activity target date" field, which could be used to identify when the division is supposed to complete a certain activity. When a tracking system does not accurately reflect the staff assigned to process an application, it cannot be used to monitor staff progress or to ensure that workload is distributed in a manner that facilitates efficient and timely processing. Moreover, a tracking system that lacks reliable dates cannot be used to determine workload status or to monitor processing times.

Similar to the division's application and environmental tracking systems, we found that its petition tracking system does not contain accurate or complete data in some fields necessary for effective management. Specifically, of the 530 active petitions in the petition tracking system as of December 2005, 44 petitions did not show what action has been taken, 65 petitions did not include the date that the last action occurred, and 219 petitions did not include information regarding which staff members were assigned. In addition to finding that critical information was missing, we found inaccuracies in some of the populated fields. Namely, for three of the six petitions we examined, the information regarding the last action taken by staff and when that action occurred was incorrect.

We recommended that the division ensure that its tracking systems for pending applications and petitions are complete and accurate by reviewing its pending workload and updating the systems to reflect current information before it upgrades to a new system. The division also should strengthen its procedures to ensure that staff maintain the accuracy of the data in the systems.

Water Board's Action: Partial corrective action taken.

The water board stated that to ensure the applications, petitions, and environmental tracking systems are complete and accurate, it is in the process of reviewing each of these tracking databases. By February 23, 2007, the water board stated that it had reviewed and updated 533 of the 571 pending applications in its application and environmental tracking databases. It further stated that the information is being updated by designated staff and will be reviewed by the division's management for accuracy. The water board also stated that it has implemented procedures to ensure staff maintains the accuracy of the tracking systems.

Finding #5: Unexplained delays exist between various phases of water rights processing.

In our sample of 15 recently issued permits and licenses, we found significant and sometimes unexplained delays between various phases of the water rights application process. The California Code of Regulations (regulations) requires the division to review permit applications for compliance with the

requirements of the Water Code and the regulations. The regulations also specify that an application will be accepted for filing when it substantially complies with the requirements, meaning the application is made in a good faith attempt to conform to the rules and regulations of the water board and the law. Generally, the Water Code does not specify the length of time in days within which the division must complete each step of processing an application. In November 2003, the division directed staff to accept permit applications in one working day. However, we question whether this goal is realistic because the division would not have met it for any of the 12 permits and licenses for which we could determine the number of days. Specifically, in 11 of the 12 cases, the division took 29 to 622 days to accept the applications. Moreover, the division stated that its goal is to send noticing instructions to applicants within 30 days after it accepts an application. However, it did not meet this goal for 14 of the 15 recently issued permits and licenses we tested.

Contributing to some of the delays in the water rights application process was the time taken by the division's management to approve and issue some of the documents it sent to applicants. In one example, the division took 85 days to approve a permit and cover letter, and it did not send them for an additional 56 days. The permitting section chief stated that it took about three months to review the file to ensure technical accuracy, but he did not know why it took 56 days to mail the final permit after the chief approved the letter. In another example, the division issued a permit cover letter to an applicant 60 days after it approved the letter for issuance. According to the permitting section chief, this delay occurred because the division's file room had a backlog of assignments. However, we are uncertain why a backlog of assignments would delay for 60 days the issuance of a letter that was ready for mailing.

We recommended that the division consider establishing more realistic goals that are measurable in days between the various stages of processing an application and implement procedures to ensure that staff adhere to these goals. In addition, the division should develop procedures for improving the timeliness of management review and issuance of documents.

Water Board's Action: Partial corrective action taken.

The water board stated that it has a number of efforts underway to address this recommendation, such as reviewing its business practices to identify needed improvements, updating the procedures manual, revising route slips, and revising templates, as appropriate. Further, the water board stated that the chief of the division (division chief) directed all of the division's staff to identify where the "log jams" occur in processing. The program managers have been tasked to set a realistic goal measurable in days to complete each step in each process.

Moreover, the water board stated that it convened a group of stakeholders who are concerned with pending applications in northern California coastal counties. According to the water board, this is the geographic area where the bulk of its pending applications are located. The water board indicated that the stakeholder group has discussed a number of issues related to improving the water right application and petition process, and has discussed appropriate time frames for various processes. The water board asserted that, based on these discussions, it initiated a pilot project with a subgroup of these stakeholders to simultaneously process a group of pending water right applications within a single watershed and to coordinate the environmental and technical analyses for these applications to obtain a comprehensive and expeditious conclusion. The water board asserted that it hopes this pilot project will be successful and result in a model that can be used to expedite application processing in other watersheds.

Lastly, to improve management review times, the water board stated that the division chief has started a review of current delegations to determine if certain actions that are currently performed by division management should instead be delegated to lower level staff.

Finding #6: Weak file tracking causes inefficiency.

The division does not effectively track water rights files, causing its staff to spend valuable time searching for files when they could be involved in more productive activities. The division uses an electronic bar-code scanning system to track the location of several types of water rights files. The files scanned

into the system as of September 2005 generally were related to permits, licenses, and small domestic use registrations. Ideally, scanning allows the division to identify the location of the file and the individual who possesses it. However, when we compared the data in the bar-code system to application numbers that were billed in fiscal year 2005–06, we found that more than 5,200 permit and license files did not appear to have been scanned into the division's bar-code system. We selected a random sample of 30 of these files to determine whether they in fact had a bar-code label and to see if we could readily locate the files in the division's records room. From this sample, we found 28 of the files in the records room and each file had a bar-code label. One of the remaining two files was in the records room, but it did not have a bar-code label. We could not locate the last file, and since it was not in the bar-code system we could not determine its location using the system. Thus, the division's bar-code system as currently implemented is not as effective a management tool as it could be for tracking the location of its files.

Moreover, we found that the bar-code system does not have the necessary controls over data entry, resulting in invalid entries in the system. The system is designed to capture an employee's name and the file number that the employee is trying to scan. However, some scanning errors can occur if an employee scans a file number before scanning his or her name, or if the employee simply scans a file number too quickly, which results in the system capturing the file number more than once in the same field. The system does not have controls to reject these incorrect entries. For example, we queried the list of files that had been checked out to a staff member and found instances where there were employee names in the application number field for several files and multiple application numbers in a single entry.

We recommended that the division continue to work with the water board's Office of Information Technology to improve the controls over data entry in its bar-code system. We also recommended that the division conduct a complete physical inventory of its files and ensure that each file has a bar-code label and is scanned into the system.

Water Board's Action: Partial corrective action taken.

The water board stated that it is implementing a replacement of its existing bar-coding system with a wireless bar-coding feature to simplify and increase frequency of file inventory and reduce the number of scanning errors. The water board asserts this new wireless bar-coding scanning system will also allow file room staff to move freely around the water board to scan files on a weekly basis, providing an updated record of file locations. In addition, the water board stated that its Office of Information Technology will ensure that proper controls are in place to provide quality assurance in the data. Furthermore, the water board asserted that it conducted a complete physical inventory of its water right files and has ensured that each file has a bar code label and is scanned into the system.

Department of Water Resources

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

REPORT NUMBER 2007-108, NOVEMBER 2007

Department of Water Resources' response as of December 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the Department of Water Resources' (Water Resources) administration of the Flood Protection Corridor Program (flood protection program). California's voters created the flood protection program by approving the Safe Drinking Water, Clean Water, Watershed Protection and Flood Protection Bond Act (Proposition 13) in March 2000. With an initial funding of $70 million, of which $57 million was available for projects, the program aims to increase flood protection, agricultural land preservation, and wildlife habitat protection throughout the State by taking various actions, such as acquiring real property interests and setting back and strengthening existing levees. The audit committee asked us to review and evaluate Water Resources' processes for selecting projects under the flood protection program. We were also asked to assess Water Resources' policies and procedures for monitoring projects and its fiscal controls over payments to grantees. In addition, the audit committee asked us to assess how Water Resources holds grantees accountable to the terms of their grant agreements and to determine whether it has properly reported on project status.

In November 2006 California's voters approved two propositions—the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006 (Proposition 84) and the Disaster Preparedness and Flood Prevention Bond Act of 2006 (Proposition 1E)—that will provide Water Resources an additional $330 million for similar flood protection projects.

Finding #1: Water Resources selected projects using poorly defined criteria and made funding decisions based on incomplete information.

Decisions made by Water Resources to award first $28 million and then $29.1 million more in local grants were based on poorly defined selection criteria and incomplete information. Water Resources awarded the initial $28 million to five projects without a scoring process to consistently compare the benefits in flood protection, agricultural land conservation, and wildlife habitat protection specified in each project proposal. Although Water Resources had developed a scoring tool for this purpose, it chose not to use the tool based on the advice of its legal counsel. As a result, it is unclear why the five projects Water Resources chose to fund were better investments of Proposition 13 funds from the flood protection program than the six projects it rejected. Most notably, the flood protection program's highest priced grant, the purchase of Staten Island at a cost of $17.6 million, has yet to result in a tangible flood protection project.

Audit Highlights . . .

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

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

When awarding $29.1 million in a second round of grants, Water Resources did not require applicants to submit two key types of information mandated in the flood protection program's regulations—hydrologic studies and evidence that owners were willing to sell their properties—for Water Resources to evaluate the relative merits of potential projects. Water Resources was also inconsistent when deciding whether to approve funding requests for structural and recreational enhancements, like pedestrian bridges and bike trails.

To provide consistency in its project selection process and to better justify its future funding decisions for the additional $330 million that it will receive from propositions 84 and 1E, we recommended that Water Resources select projects in a manner that allows it to justify its funding decisions. One way Water Resources could achieve this would be to develop and use a consistent scoring process and use the scores as a basis for making funding decisions. We also recommended that Water Resources adhere to the flood protection program regulations by requiring applicants to submit hydrologic studies and evidence that owners are willing to sell their properties. Finally, Water Resources should develop policies and procedures to consistently evaluate whether proposed structural and recreational enhancements conform to the goals of the flood protection program and are the most effective use of funds.

Water Resources' Action: Pending.

The department indicates it will implement a number of actions to improve its evaluation of proposed projects. Specifically, the department will use its existing scoring process for competitive grants to evaluate direct expenditure grants until it develops a new scoring process for direct expenditure grants. Further, the department states that it will require hydrologic studies either with a grantee's application or early in the project scope of work and provide for early termination of the project if the hydrologic study does not support the hydrologic benefits anticipated in the project application. For projects involving land acquisitions, the department now requires a willing seller letter as part of the project application and projects will not be scored without this letter. Finally, the department is developing criteria for evaluating scope changes and procedures for evaluating whether a proposed project's structural and recreational enhancements conform to the goals of the flood protection program. The department is incorporating these actions into its funding decisions for propositions 84 and 1E and expects to implement them by May 2008.

Finding #2: Water Resources has not adequately monitored projects.

Although Water Resources has established a monitoring approach that would be effective if enforced, it did not always follow good monitoring practices. Progress reports for nine of 12 projects we reviewed failed to discuss schedule and budget status, did not include records of project expenditures to support costs incurred, and did not report on any key issues affecting timely project completion. This lack of critical information has compromised Water Resources' ability to effectively monitor these flood protection program projects.

Further undermining the inadequate progress reports received was Water Resources' inability to meet its goal of regularly visiting project sites to monitor progress, inconsistent documentation of communication with grantees, and inadequate tracking of project expenditures against their budgets. Additionally, Water Resources chose not to withhold a percentage of each progress payment to grantees to ensure project completion, which may have contributed to the delays that most projects have encountered. Water Resources claims that staff turnover, staff redirection, vacancies caused by the hiring freeze, and travel restrictions due to budget restrictions contribute to these monitoring weaknesses, but its lack of formal procedures to guide staff also likely contributed to its inconsistent monitoring approach.

To effectively monitor projects, we recommended that Water Resources develop policies and procedures to ensure that it receives sufficiently detailed and complete progress reports from grantees; communicates to staff its expectations for conducting and documenting site visits; develops a process to consistently record communication with grantees; and accurately track and monitor funds disbursed

to grantees. To help ensure projects are completed timely and in accordance with the grant agreements, Water Resources should withhold a percentage of payments to a grantee when appropriate and release the funds only after it is satisfied that the project is reasonably complete.

Water Resources' Action: Partial corrective action taken.

The department reports it will take several actions to improve its monitoring of projects. For example, it indicates that grantees' progress reports are now required to contain a description of actions taken since the previous report, key issues to resolve, whether the project remains on budget and on schedule, and also include supporting expenditure records. In regards to site visits, the department states it now uses a standardized site visit form and is developing a policy manual to describe program expectations, prescribed staff activities during site visits, and expected communication with grantees. Further, the department indicates hiring an analyst who will be responsible for ensuring that project budget-tracking sheets are accurate and kept up to date. Finally, the department states that it will not withhold payments for projects that are on track and where doing so would not further the program's objectives. However, the department indicates the new policy manual, which it expects to complete by May 2008, will address when it is appropriate to withhold payments from grantees.

Finding #3: Water Resources failed to adequately monitor the $5 million project with the city of Santee.

Even though Water Resources executed what appears to be a strong letter of agreement with the city of Santee, its efforts to enforce the fiscal and reporting provisions governing the project were minimal. Proposition 13 specifically earmarked $5 million to Santee for flood protection of its streets and highways, of which Water Resources withheld $250,000 for its administrative costs. We found that Water Resources had not contacted the city of Santee since March 2004, when it disbursed the remaining $3.65 million to the city. Although Water Resources' agreement with Santee required the city to submit semiannual progress reports detailing the project's progress and expenditures, we noted that Santee had submitted only two progress reports to Water Resources since November 2000, when the agreement between them was executed. Water Resources issued a letter in March 2004 asking the city to provide an accounting of its spending, but did not follow up or take any further action when it did not receive the requested information. Additionally, Water Resources has not received from Santee an audit report with an accounting of how the $4.75 million disbursed to the city was spent or a final inspection report by a registered civil engineer, even though they are required in the letter of agreement. Our inquiry of Santee resulted in obtaining expenditure records that were not always consistent with the invoices the city had previously submitted to Water Resources for payment.

We recommended that Water Resources follow up with Santee to determine how the city spent its allocated funds. Additionally, because Water Resources has not spent most of the $250,000 withheld for its administrative costs, it should release these funds to the city only after Santee demonstrates it can use the funds for flood protection purposes, provides an audit report with an accounting of how the city used the $4.75 million previously disbursed, and submits a final inspection report by a registered civil engineer as the letter of agreement with Santee requires.

Water Resources' Action: Pending.

The department indicates that the manager of the flood protection program has contacted Santee to arrange a site visit and to obtain the requested accounting and engineering reports by April 1, 2008.

Finding #4: Water Resources needs to develop a process for reporting future costs of the flood protection program.

Although Water Resources has informally reported project status in the past, it lacks an adequate internal reporting process on the flood protection program. Because the flood protection program will administer additional grants and projects with the $330 million it will receive from propositions 84 and 1E, Water Resources will need to develop processes to report to the Legislature and the Department of Finance to comply with the State General Obligation Bond Law and a January 2007 executive order from the governor that directs agencies to exhibit greater accountability over expenditures financed by bonds.

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

Water Resources' Action: Pending.

To improve project management, the department indicates it has implemented a software package for use on propositions 84 and 1E projects. It states that the software has an automated reporting capability and that department management will receive reports at least quarterly. However, the automated reporting capability of the software is still under development because the department has not yet selected projects for funding under propositions 84 or 1E. The department anticipates that reporting will take place at the end of each quarter and that the reports will include a variety of information on projects including issues that may affect project deliverables or schedule.

Finding #5: Although it is not legally required to do so, Water Resources has voluntarily chosen to seek General Services' advice on some land acquisition grants.

Water Resources is not legally required to obtain the advice of the Department of General Services (General Services) on appraisals for land acquisitions unless it is taking title to property valued at $150,000 or more. Nevertheless, on several occasions Water Resources did seek General Services' advice but did not always heed it, potentially resulting in overpaying for land. In the case of the acquisition of Staten Island, Water Resources did not resolve the concerns noted by its staff or General Services that the appraised value of the land was too high. Specifically, both its staff and General Services noted problems with the appraisal for Staten Island, which General Services noted at that time could be a basis for negotiating a lower overall value for the island.

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

Water Resources' Action: Pending.

The department indicates that all appraisals are reviewed by its land and right-of-way staff or sent to General Services for review. It states that if department staff has concerns or a different opinion than General Services' staff, the conflicting opinions will now be elevated to upper management of the department for resolution. The department indicates the new policy manual, which it expects to complete by May 2008, will include the policy for resolving conflicting opinions on appraisals.