

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 November 2008

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.

Since the audit, Water Resources' flood protection program has awarded \$24 million in competitive grants for eight projects being funded under Proposition 84. Water Resources awarded this funding in May 2008 and it is currently developing a Flood Protection Corridor Program Guidelines document that appears to address many aspects of this recommendation. While still in draft form as of late October 2008, Water Resources intends to use this document to guide how it will allocate funding for additional projects under propositions 84 and 1E. The document appears to address many aspects of our recommendation including evaluating the merits of noncompetitive grants [direct-expenditure grants] using a point-based system, requiring applicants to submit evidence that affected landowners are willing participants in any proposed real-property transactions, and evaluating the potential impact of scope changes on a project's benefits. Water Resources has also developed guidelines that should promote greater consistency when it evaluates the merits of a project's proposed structural or recreational enhancements. Specifically, Water Resources will limit project funding for these activities to no more than 30 percent of the award, unless the grant recipient obtains prior approval from the director of Water Resources.

Water Resources' draft guidelines do not change its prior practice of evaluating the merits of potential projects without complete hydrological studies. Instead, Water Resources continues to allow program applicants to submit an engineer or hydrologist's opinion of a project's flood benefits in lieu of a hydrological study, as long as the applicant completes a full analysis early in the project's schedule. However, it does not appear that Water Resources is following this policy in practice. Specifically, Water Resources disbursed more than \$4.5 million in 2008 to a grant recipient without a hydrological study. Instead, Water Resources relied on an engineer's opinion of the project's flood benefits. When we asked a manager in Water Resources why his program had not obtained the full study, he indicated that the project's flood benefits were obvious and requiring a hydrological study was unnecessary and expensive. However, as we state on page 24 of the audit report, such a practice is inconsistent with state regulations and is counter to its intent to use these studies to help reduce the risk of funding projects with uncertain flood protection benefits. Further, our recommendation on page 29 of the audit report suggested that program funds could be used to pay for the hydrologic studies upfront before Water Resources committed more funding to projects.

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: Pending.

Since the audit was published in November 2007, Water Resources has awarded \$24 million for eight projects; however, only one of the eight projects has received funding. As a result, it is too early to assess whether Water Resources is adequately monitoring its projects. Nevertheless, we noted that Water Resources' staff now use software that may help them better monitor their projects. Through the use of templates and procedures that are built in to the software, as well as the requirements described in its guidelines document, we noted the following:

- Water Resources requires grantees to submit progress reports containing actions taken since the previous report, key issues to resolve, an update on whether the project remains on budget and on schedule, and supporting documentation for expenditures.
- Water Resources has communicated its expectations that staff contact grant recipients at least once every six months, regardless of whether any progress has been made and for staff to retain this documentation in project files.
- Water Resources has communicated its expectations that staff should generally conduct site visits twice each year. In addition, it has developed standardized site visit checklists to assess a project's status, timeline, and key issues to be resolved.
- Water Resources has developed a policy of withholding up to 10 percent of certain grant payments to ensure the timely completion of projects. We saw evidence that Water Resources withheld more than \$50,000 for one project when the payment was not going into escrow for land acquisition.

Further, Water Resources indicates hiring an analyst who will be responsible for ensuring that project budget-tracking sheets are accurate and kept up to date.

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: Corrective action taken.

Water Resources reports that this project is now complete and that the grant recipient has provided its final progress report detailing accomplishments and project expenditures. Water Resources was able to provide a letter dated July 30, 2008, from a civil engineer employed by the city of Santee certifying that the project was completed as planned. Further, Water Resources provided a copy of a report from an independent auditor indicating that the project's expenditures were allowable under the grant agreement. As a result, Water Resources reported that the remaining \$250,000 available for the project is included in the Governor's fiscal year 2009–10 budget, and it will release these funds when the budget is approved.

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: Corrective action taken.

Water Resources states it has been providing quarterly updates to its management showing project status. Water Resources provided us with copies of these status reports, which describe each project's status, expenditures, and the anticipated completion date.

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: Corrective action taken.

In its six-month response to the audit, Water Resources indicated that all appraisals are being reviewed by department staff or staff at General Services. To the extent that disagreement exists between its staff and General Services, Water Resources indicates that such disagreement will be elevated to upper management for resolution.

