



Transmitted via e-mail

September 13, 2011

Mr. Mark Cowin, Director
Department of Water Resources
P.O. Box 942836, Room 1115-1
Sacramento, CA 94236-0001

Dear Mr. Cowin:

Final Report—Natural Heritage Institute, Proposition 50 Grant Audits

The Department of Finance, Office of State Audits and Evaluations, has completed its audit of the following Natural Heritage Institute's (NHI) Proposition 50 grants:

<u>Grant Agreements</u>	<u>Audit Period</u>	<u>Awarded</u>
4600004497	January 3, 2006 through January 31, 2009	\$500,000
4600004707	June 1, 2006 through April 30, 2010	\$347,253
4600004715	June 1, 2006 through February 28, 2010	\$400,000

The enclosed report is for your information and use. NHI's response to the report observations and our evaluation of the response are incorporated into this final report. The observations in our report are intended to assist management in improving the effectiveness and efficiency of its operations.

This report will be placed on our website. Additionally, pursuant to Executive Order S-20-09, please post this report in its entirety to the Reporting Government Transparency website at <http://www.reportingtransparency.ca.gov> within five working days of this transmittal.

We appreciate the assistance and cooperation of NHI. If you have any questions regarding this report, please contact Susan M. Botkin, Manager, or Angie Williams, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by Rick Sierra for:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: On following page

cc: Ms. Katherine Kishaba, Deputy Director, Business Operations, Department of Water Resources
Ms. Gail Chong, Chief, Bond Accountability Office, Department of Water Resources
Ms. Perla Netto-Brown, Controller, Department of Water Resources
Ms. Tracie Billington, Chief, Financial Assistance Branch, Department of Water Resources
Mr. Jeffrey Ingles, Chief Auditor, Department of Water Resources
Ms. Sara Denzler, Chief, Riverine Ecosystem Section, Department of Water Resources
Mr. Craig Cross, Staff Environmental Scientist, Implementation Grants Section, Department of Water Resources
Ms. Mina Danieli, Environmental Scientist, Department of Water Resources
Mr. Patrick Kemp, Assistant Secretary, California Natural Resources Agency
Mr. Bryan Cash, Deputy Assistant Secretary, California Natural Resources Agency
Ms. Julie Alvis, Deputy Assistant Secretary, California Natural Resources Agency
Mr. Gregory Thomas, President, Natural Heritage Institute
Ms. Sarah Puckett, Senior Restoration Ecologist, Natural Heritage Institute
Mr. Carson Cox, Project Manager, Natural Heritage Institute
Ms. Fe Hernandez, Financial Manager, Natural Heritage Institute

AUDIT REPORT

Natural Heritage Institute Proposition 50 Bond Program Grant Agreements 4600004497, 4600004707, and 4600004715



Source: Final Report Sierra Mountain Meadow Grant 4600004497

Prepared By:
Office of State Audits and Evaluations
Department of Finance

MEMBERS OF THE TEAM

Susan M. Botkin
Manager

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Final reports are available on our website at <http://www.dof.ca.gov>

You can contact our office at:

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BACKGROUND, SCOPE, AND METHODOLOGY

BACKGROUND

In November 2002, California voters approved the Water Security, Clean Drinking Water, Coastal and Beach Protection Bond Act of 2002 (Proposition 50), which authorized the State of California to sell \$3.44 billion in general obligation bonds. The bond proceeds provide funds for grants and loans to assist in meeting safe drinking water standards; acquisition, restoration, protection, and development of river parkways; and coastal watershed and wetland protection.

The Department of Water Resource (DWR) is one of many state departments that administer Proposition 50 programs. DWR's mission is to manage the water resources of California in cooperation with other agencies, and to protect, restore, and enhance natural and human environments.

The Natural Heritage Institute (NHI) is a non-governmental, non-profit organization founded in 1989 by a group of experienced conservation lawyers and scientists who foresaw the need for a toolkit for the next era of environmental problem-solving: where the technical challenges are more complex, the solutions more elusive, the economics more central, the ramifications more global, and the conventional pathways less efficacious.
(Source: www.n-h-i.org/about-nhi/about-us.html)

NHI received Proposition 50 funds from DWR for the following purposes:

- To complete a new Integrated Regional Water Management (IRWM) plan for the Sierra Meadows project (grant 4600004497).
- To implement the Forgotten Shores Restoration and Outreach Program watershed project, as part of the balanced implementation of the CALFED Bay-Delta Program (grant 4600004707).
- To implement the Marsh Creek Watershed Restoration and Outreach Program watershed project, as part of the balanced implementation of the CALFED Bay-Delta Program (grant 4600004715).

SCOPE

In accordance with the Department of Finance's (Finance) bond oversight responsibilities, Finance conducted an audit of the following grants:

<u>Grant Agreements</u>	<u>Audit Period</u>	<u>Awarded</u>
4600004497	January 3, 2006 through January 31, 2009	\$500,000
4600004707	June 1, 2006 through April 30, 2010	\$347,253
4600004715	June 1, 2006 through February 28, 2010	\$400,000

The audit objectives were to determine whether NHI's grant expenditures were in compliance with applicable laws, regulations, and the grant requirements; and to determine whether the grant deliverables were completed as required. In order to design adequate procedures to evaluate fiscal compliance, we obtained an understanding of the relevant internal controls. We did not assess the efficiency or effectiveness of program operations. Finally, no assessment was performed on the reasonableness or the conservation value of the projects completed.

NHI management is responsible for ensuring accurate financial reporting and compliance with applicable laws, regulations, and grant requirements as well as evaluating the efficiency and effectiveness of the program. DWR and the California Natural Resources Agency are responsible for state-level administration of the bond programs.

METHODOLOGY

To determine whether NHI's grant expenditures were in compliance with applicable laws, regulations, and the grant requirements; and if the grant deliverables were completed as required, we performed the following procedures:

- Interviewed key personnel to obtain an understanding of the grant-related internal controls.
- Examined the grant files maintained by DWR, the grant agreements, and applicable policies and procedures.
- Reviewed NHI's accounting records, vendor invoices, and bank statements.
- Selected a sample of expenditures to determine if costs were allowable, grant-related, incurred within the grant period, supported by accounting records, and properly recorded.
- Performed procedures to determine if other revenue sources were used to reimburse expenditures already reimbursed with grant funds.
- Evaluated whether a sample of grant deliverables required by the grant agreements were met.

The results of the audit are based on our review of documentation, other information made available to us, and interviews with the staff directly responsible for administering bond funds. The audit was conducted from February 2011 through July 2011.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Except as noted below, the Natural Heritage Institute's (NHI) expenditures were in compliance with applicable laws, regulations, and the grant requirements. The Schedules of Claimed and Questioned Amounts are presented in Table 1.

Table 1: Schedules of Claimed and Questioned Amounts

Grant Agreement 4600004497		
For the Period January 3, 2006 through January 31, 2009		
Category	Claimed	Questioned
1. Management and Administration	\$ 36,004	\$ 0
2. Create Integrated Sierra Meadow (SM) Health Database	61,762	0
3. Determine Status and Trends Associated With SM	6,648	0
4. Determine Gaps	14,950	0
5. Develop & Field Test Aquatic Methodology for Monitoring SM	76,395	0
6. Characterize Ecological Services for SM	9,732	0
7. Conduct Upstream-Downstream Pilot Study	113,020	0
8. Initiate Stakeholder Process	35,156	0
9. Identify and Prioritize SM IRWM Objectives, Strategies and Projects	70,071	0
10. Draft SM IRWM Plan	61,977	0
11. Finalize and Approve SM IRWM	13,157	0
Total Expenditures	\$ 498,872	\$ 193,039¹

¹ NHI was unable to provide supporting documentation for \$193,039 of in-kind match or support match amounts by specific category. Therefore, we reported the amount questioned as a total expenditure.

Grant Agreement 4600004707		
For the Period June 1, 2006 through April 30, 2010		
Category	Claimed	Questioned
1. Assessment And Restoration Plan	\$ 62,505	\$ 0
2. Community Visioning and Focus Groups	62,239	0
3. Shoreline Academy	57,410	0
4. Monitoring	67,861	0
5. Native Oyster Restoration	47,917	0
6. Permitting	7,208	0
7. Reporting	15,997	0
8. Administration	25,820	0
Total Expenditures	\$ 346,957	\$ 0

Grant Agreement 4600004715		
For the Period June 1, 2006 through February 28, 2010		
Category	Claimed	Questioned
1. Management and Administration	\$ 46,991	\$ 0
2. Water Assessment and Planning	40,978	0
3. Capacity Building for Community Based Water Management	217,989	0
4. Implementation of Recommendations	93,954	0
Total Expenditures	\$399,912	\$ 0

Observation 1: Unsupported Match

NHI was unable to support the required in-kind match amount of \$193,039 for grant agreement 4600004497. NHI did not maintain invoices or any other evidence of matching costs incurred for this project. In addition, NHI could not provide match deliverables for the project as required by the grant agreement. Therefore, we were unable to determine that the required in-kind services totaling \$193,039 had been completed.

Recommendation:

Ensure match expenditures are supported and appropriate documentation is maintained as required by the grant agreement. DWR will make the final determination on whether to recover the \$193,039 unsupported match from the total grant expenditures.

Observation 2: Competitive Bid Documents Were Not Maintained

The NHI grant project files did not contain all required documents. Specifically, all three grant project files did not contain any bid files for contractors. Therefore, we were unable to determine if NHI obtained at least three bids for the work performed or verify that the least expensive bid was selected. The grant agreements state that the "grantee shall comply with all applicable laws and regulations regarding securing competitive bids." Without proper bid files, the risk of grant funds being misused or not being spent efficiently increases.

Recommendation:

Maintain all significant documents in the official grant project files, including contractor bids.



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August 2, 2011

Department of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento CA 95814

Re: Proposition 50 Grant Audits

Please reference your letter of July 25, 2011 soliciting the response of the Natural Heritage Institute to the attached draft Audit Report on Grant Agreements 4600004497, 4600004707, and 4600004715.

The draft Audit Report contains two observations, quoted verbatim in relevant part below, to which we respond as follows:

Observation 1: Unsupported Match

NHI was unable to support the required in-kind match amount of \$193,039 for grant agreement 4600004497. NHI did not maintain invoices or any other evidence of matching costs incurred for this project. In addition, NHI could not provide match deliverables for the project as required by the grant agreement. Therefore, we were unable to determine that the required in-kind services totaling \$193,039 had been completed.

Response: This observation is factually incorrect. The in-kind match by the University of California, Davis, is documented by the attached documents, which were furnished to the auditor:

- Letter from NHI to the Department of Water Resources, dated August 11, 2006, which explains in detail how the requirement for matching funds was met.
- Cost Sharing Contribution Report from the University of California, Davis to the U.S. Environmental Protection Agency, which provided the matching funds.
- Financial Status Report from the University of California to the U.S. Environmental Protection Agency itemizing the expenditures from the matching grant from USEPA.

Please also note:

- The in-kind contribution of services was provided by, and verified by, an agency of the State of California, the University of California. This is the entire documentation that UC Davis provided pursuant to a request from NHI. If the Department of Finance finds it insufficient, that an issue between the two organs of state government.
- The proper expenditure of the matching funds was supervised by the U. S. Environmental Protection Agency, which has not registered any concerns.

It is also factually incorrect to state that “NHI could not provide match deliverables for the project”. Those deliverables were itemized for the auditor and provided on a DVD. The link to those deliverables is <http://watershed.ucdavis.edu/research/sierra.html#mtn-meadows>. Publications produced with the matching funds includes:

- [Montane Meadows in the Sierra Nevada: A Comparison of Terrestrial and Aquatic Assessment Methods.](#)
Sarah Purdy, Master's Thesis 2010.
- [Mountain Meadows of the Sierra Nevada: An Integrated Means of Determining Ecological Condition in Mountain Meadows—Protocols and Results from 2006.](#)
Sabra E. Purdy and Peter B. Moyle. June, 2009. Work conducted under sponsorship of The Natural Heritage Institute, pursuant to California Department of Water Resources Contract No. 4600004497.
- [Sierra Meadows: Historical Impact, Current Status and Trends, and Data Gaps](#)
Final Report of USEPA Contract CD96911501. June 19, 2007. This report is a joint product of The Natural Heritage Institute, UC Davis, Stillwater Sciences, the US Forest Service and the California Department of Fish and Game. It contains the UC Davis report from the 2005 Mountain Meadows field season and UCD protocol development results.

Observation 2: Competitive Bids Documents Were Not Maintained

All three grant project files did not contain any bid files for contractors. Therefore, we were not able to determine if NHI obtained at least three bids for the work performed or verify that the least expensive bid was selected.

Response:

NHI has prepared the attached table showing all disbursements for services in these three projects with the justification for these arrangements. In a very few cases, we could not reconstruct the justification for the procurement in the short time allowed for this response. These decisions were made some 5 years ago by staff no longer at NHI. If Department of Finance wants NHI to pursue this further, please provide an extension of time.

Please let me know if you have any further questions.

Yours sincerely,

Original signed by:

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EVALUATION OF RESPONSE

We have reviewed the Natural Heritage Institute's (NHI) response and provide the following comments:

Observation 1: Unsupported Match

NHI did provide the auditor with the documents as stated in its response and these documents state the match funds were spent on a University of California Davis grant. However, no evidence was provided that showed the expenditures were actually incurred (i.e. invoices, payroll records) for that grant. In the absence of this supporting evidence we are unable to determine that NHI met its match requirement in whole or by task.

Section 5, Grantee Costs, of contract 4600004497 states: Grantee shall provide the state evidence such funds have been expended by task prior to submittal of a request for state grant fund reimbursement.

Because NHI provided no additional information in its response to support in-kind match expenditures, our observation and recommendation remain unchanged.

Observation 2: Competitive Bid Documents Were Not Maintained

We reviewed the summary table NHI provided with its response. However, we cannot rely on a table prepared by NHI as proof competitive bids were received and reviewed. Without being provided the actual competitive bids NHI received, we are unable to verify their existence.

NHI's Procurement Policies state: If the procurement was not competitively bid, the rationale (including comparable analysis) should be included with the executed contract. NHI did not provide the auditor with the rationale statements or competitive bids when requested.

Also, the Grant Agreements state, the "Grantee shall comply with all applicable laws and regulations regarding securing competitive bids and undertaking competitive negotiations in Grantee's contracts with other entities for acquisition of goods and services and construction of public works with funds provided by the State under this Grant Agreement." Therefore, our observation and recommendation remain unchanged.