

February 17, 2011

Mr. Charles R. Hoppin, Chair
State Water Resources Control Board
1001 I Street, 25th Floor
Sacramento, CA 95814

Dear Mr. Hoppin:

Management Letter—State Water Resources Control Board, Review of Santa Barbara County Water Agency Grant Agreement 08-613-550

In accordance with our bond oversight responsibilities, the Department of Finance, Office of State Audits and Evaluations (Finance), initiated a fiscal compliance audit of a Proposition 50 (Prop 50) grant awarded by the State Water Resources Control Board (State Water Board) to the Santa Barbara County Water Agency (County Water Agency). The audit was to be conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain sufficient, appropriate evidence to support our conclusions.

Finance outlined the engagement in a letter dated February 25, 2010 and held an entrance conference on March 2, 2010. Because all disbursed grant funds were returned to the State Water Board, Finance changed its focus to a review of the County Water Agency's grant controls and monitoring processes. Accordingly, this letter summarizes the results and risks specific to the following:

- Information about the double billing incident identified by the State Water Board.
- Grant-related internal controls and oversight activities of the County Water Agency and other related parties, including controls that failed or were overridden.
- The County Water Agency's Corrective Action Plan (CAP) to determine if it is adequately designed to ensure an effective system of internal accounting and administrative controls over grant funds.

Various interviews of key personnel were conducted, and applicable policies, procedures, and documentation were reviewed to gain an understanding of relevant internal controls.

BACKGROUND

Under the Integrated Regional Water Management Grant Program, the State Water Board awarded the County Water Agency a \$25 million Prop 50 implementation grant (Prop 50 grant) in December 2008. This grant (Grant Agreement 08-613-550) is comprised of 14 separate project components.

Of the \$25 million awarded, \$631,700 was budgeted for the Casmalia Community Services District's (Casmalia CSD) Water System Retrofit Project (Project C4). Project C4's objective was to replace Casmalia CSD's leaking water storage tank, repair an access road leading to the tank, and replace service laterals connecting the tank to the Casmalia CSD's main water lines.

In September 2008, Casmalia CSD was also awarded a \$410,579 Community Development Block Grant (CDBG grant) from the United States Department of Housing and Urban Development (HUD). Both grants were awarded to improve the Casmalia CSD's water system. The County Water Agency administers the Prop 50 grant while the CDBG grant is administered by the County of Santa Barbara (County), HUD Unit (County HUD Unit).

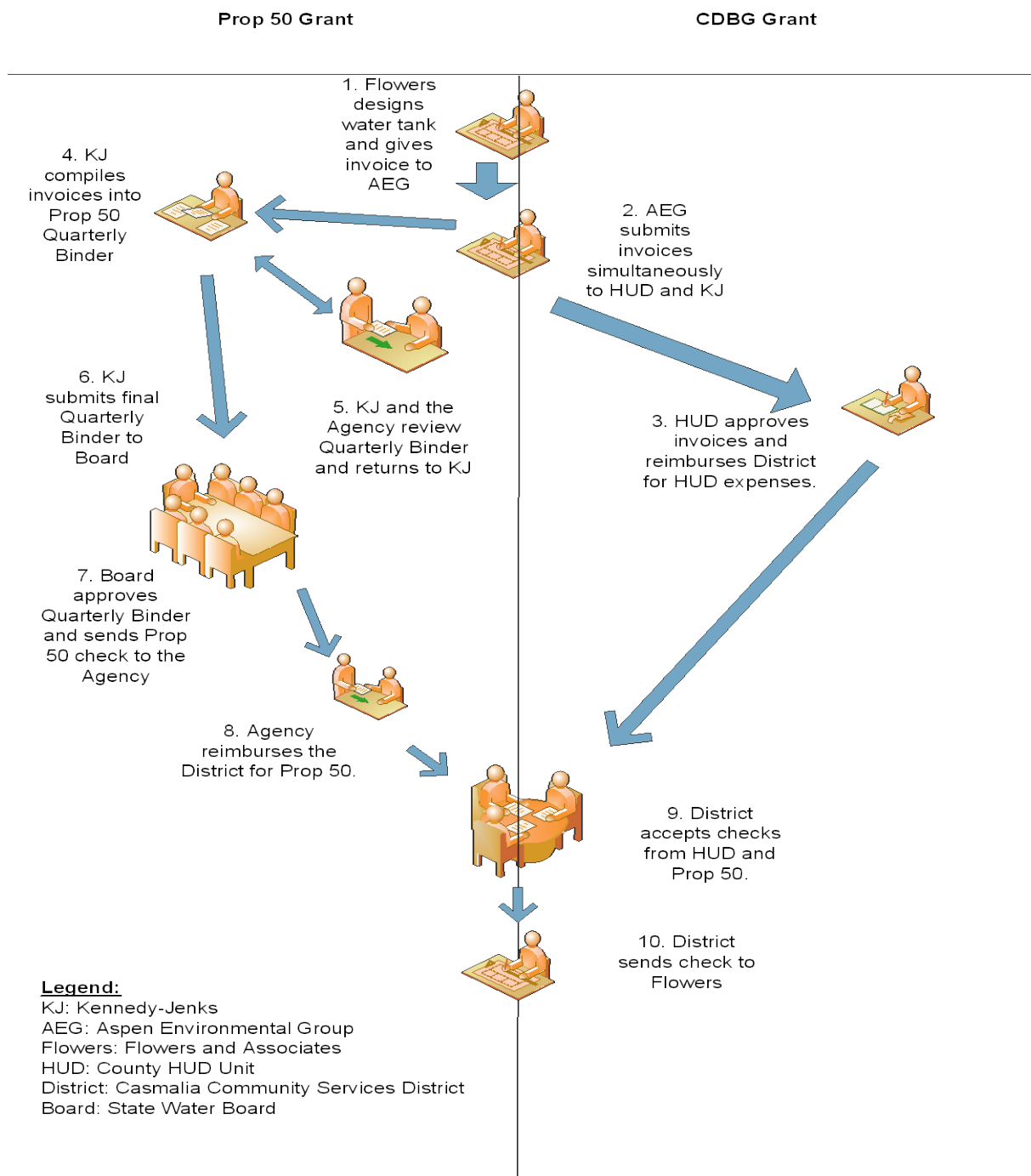
The Casmalia CSD selected Flowers and Associates (Flowers) to act as Project C4's prime contractor. Flowers also has a financial interest as a contractor in two other components—C1 and C2—which are not subject to this review. The key parties involved in Project C4's claims process are:

Figure 1: Key Parties Involved in Project C4

Flowers	<ul style="list-style-type: none"> • Prime Contractor for Casmalia CSD's water project; designed and engineered the project; hired subcontractors to perform labor, invoicing, and reimbursement claims; was awarded the original bid from the County HUD Unit and the Prop 50 bid due to already working on the CBDG Grant.
Aspen Environmental Group (AEG)	<ul style="list-style-type: none"> • Hired by Flowers and provided environmental design services; oversaw day-to-day project operations; prepared subcontractors' invoices; compiled supporting documents for the Prop 50 and CDBG claimed costs. AEG submitted data electronically to Kennedy Jenks for approval.
Kennedy Jenks	<ul style="list-style-type: none"> • Hired by the County Water Agency to review, compile, and report fiscal and project information submitted by AEG. Their web-based system allowed sub-recipients to upload images of financial and project reporting documents. Once the County Water Agency approved the Quarterly Binder, it was submitted to the State Water Board for final approval and reimbursement. The Quarterly Binder contains all invoices claimed for reimbursement for a particular quarter, including the supporting documentation.
County Water Agency	<ul style="list-style-type: none"> • The Prop 50 grantee who provided technical support to the sub-recipients, verified the mathematical accuracy of the information in the Quarterly Binder, and submitted approved Quarterly Binders to Kennedy Jenks.
County HUD Unit	<ul style="list-style-type: none"> • The CDBG grantor who provided technical support to Casmalia CSD to build a water tank and put in new laterals. Approved invoices from Flowers and paid Flowers for work completed.
County Auditor-Controller's Office	<ul style="list-style-type: none"> • Performed other administrative duties. Accounting Unit prepared the necessary accounting entries and the County Auditor-Controller's Office performed desk reviews of the Quarterly Binders for the County Water Agency.

In March 2009, Flowers—through its agent Aspen Environmental Group (AEG)—billed the Prop 50 grant using the same invoices previously submitted and reimbursed by the County HUD Unit. Figure 2 illustrates how Flowers was able to obtain duplicate payments.

Figure 2: Process Flowchart of Prop 50 and CDBG Claimed Costs



Although our review was limited to Project C4, our recommendations should be implemented to ensure the success of the entire \$25 million Prop 50 grant project.

RESULTS

Observation 1: Double Billing Occurred Due to Controls Being Overridden

In June 2009, AEG submitted a project scope change to the State Water Board. In July 2009, the State Water Board received a second letter stating “extra” funds were available, which drew attention to the CDBG grant. After the State Water Board researched the issue, it came to their attention a duplicate claim for Prop 50 reimbursement was already paid by the CDBG grant. The State Water Board demanded repayment and corrective measures be implemented. Funding for the entire project was halted.

In response to the State Water Board’s demands, the County Auditor-Controller’s Office conducted an investigation and confirmed the duplicate payment. The County Water Agency repaid the State Water Board \$131,371 in September 2009 and submitted a Corrective Action Plan (CAP) in January 2010 to address the State Water Board’s concerns. Further, the County Auditor-Controller’s Office referred the incident to the Santa Barbara County Sheriff’s Office for further investigation. Resumption of grant funding is contingent on the State Water Board’s approval of the CAP.

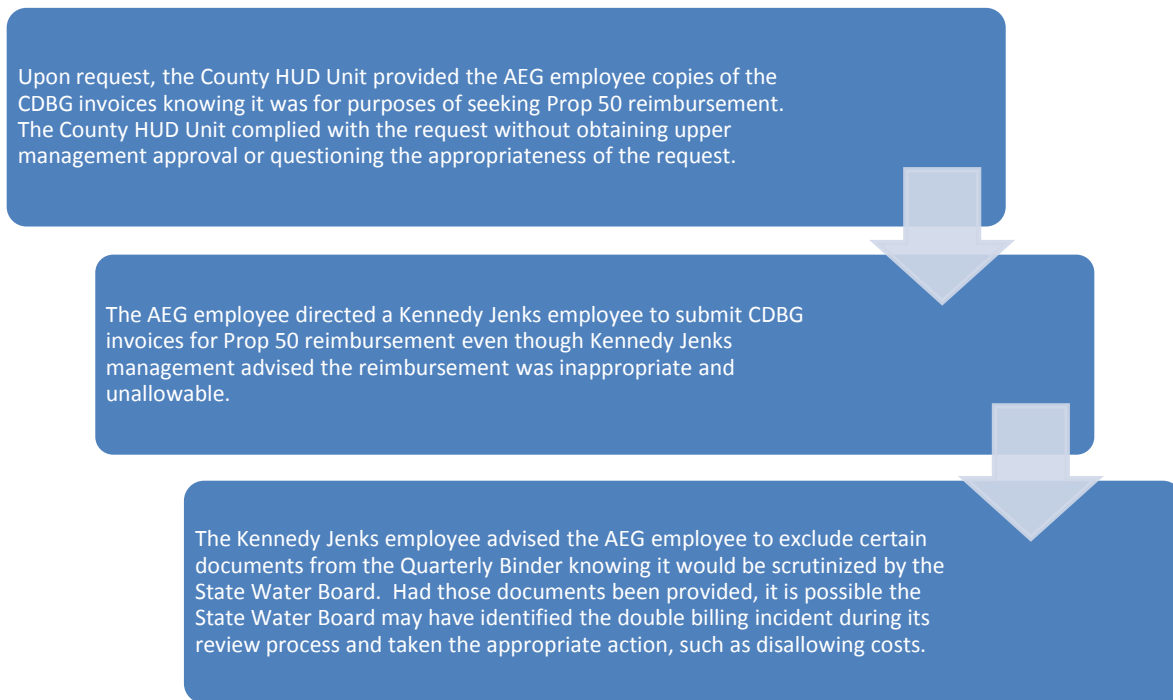
As stated in the *Background*, different parties are expected to perform distinct types and levels of review over claimed costs to ensure accuracy and propriety. However, weak implementation of certain controls permitted the double billing incident to occur.

Our interviews indicated Flowers had a closer working relationship with the County HUD Unit rather than the Casmalia CSD. This relationship may have impaired objective and independent project oversight. For example, the County HUD Unit performed duties for the CDBG grant that should have been performed by the Casmalia CSD, such as invoice preparation. The County HUD Unit compiled invoice information from Flowers, created the invoices, obtained the Casmalia CSD’s signature, and submitted signed invoices to HUD for reimbursement. This practice prohibits proper segregation of duties.

At times, Flowers would inquire directly with the County HUD Unit about payment information and funding opportunities. As the grantor, the County HUD Unit should be less involved with invoice preparation, and conduct oversight functions to ensure the project is within scope and cost. This County HUD Unit practice demonstrates a weak control environment.

AEG would receive invoices from Flowers and submit the invoices to both the County HUD Unit and to the County Water Agency on behalf of Flowers. Since Flowers employs AEG and guided their actions, it appears Flowers influenced the double billing incident. Based on our interviews, the following chain of events led to the double billing incident:

Figure 3: Chain of Events Leading to Double Billing Incident



Recommendations:

The State Water Board should ensure the County Water Agency:

- A. Provides ongoing training for key personnel to ensure local, state, and federal policies are followed, and to increase awareness on topics such as independence, conflicts of interest, unethical activities, and fiduciary controls.
- B. Re-evaluates the grant-related internal control structure to ensure adequate segregation of duties.

Observation 2: Grant Management Practices Require Improvement

As the administrator over grant funds, the County Water Agency should implement stronger grant management practices to increase its effectiveness. Based on our interviews, the County Water Agency and the County Auditor-Controller’s Office dedicated about three days to review a voluminous Quarterly Binder. The County Water Agency’s Grant Manager claims he spends approximately five hours to review Quarterly Binders, which provide the basis for all reimbursed claims. The Grant Manager’s review mostly consists of recalculations and a cursory review to ensure completeness. This level of project review is insufficient.

Given all parties have a large investment in this project, those charged with project oversight should be dedicated to monitoring the project to ensure it is within scope, schedule, and cost. An overall plan should be developed to address potential risks affecting the 14 components. Potential risks may be events or issues preventing the achievement of the project’s objectives. For example, disadvantaged communities with limited experience and knowledge in grant

management, such as the Casmalia CSD, may require the County Water Agency to provide a higher level of technical assistance and support.

Recommendations:

The State Water Board should ensure the County Water Agency develops:

- A. A project risk assessment/plan for the 14 project components to ensure limited resources are monitoring the higher risk components.
- B. Stronger grant management practices to increase its effectiveness by employing continuous interim monitoring. Such efforts could include regular communications with the sub-grantees, periodic site visits, and unannounced reviews of selected invoices. Documentation of such efforts should be maintained for audit purposes.

Observation 3: The Corrective Action Plan Appears Adequate if Implemented as Designed

The double billing incident demonstrates signs of ineffective communication and poor coordination among personnel charged with Prop 50 grant responsibility, and that grant management practices need to be improved. As a result, the County Water Agency submitted a CAP to demonstrate steps planned or taken with respect to administration of the Prop 50 grant and any future state grants.

If the CAP is implemented as designed, the County Water Agency's controls would improve. We provide comments with respect to certain Exhibits in the CAP:

- *Exhibit 1 (Listing of Invoices) and Exhibit 4 (Project Budget Sheet):* These documents will be submitted to the State Water Board along with the Quarterly Binder. However, the risk exists these Exhibits may not be completed uniformly. It is also unclear if supporting documentation for match and other funding source information will be submitted.
- *Exhibit 2 (Letter of Notification):* This letter explains the double billing incident and reminds all grant managers about their responsibilities. Based on our review, it appears Exhibit C, Items 13 and 15 of the Grant Agreement 08-613-550 are not being complied with; however, these provisions are not addressed in this Exhibit.
- *Exhibit 3 (Sub-Grantee Certification):* The certification includes a provision that the sub-grantee will submit their most recent audited annual financial statements to the County Water Agency prior to finalizing the grant agreement. However, no mention is made that invoices reimbursed with Prop 50 funds are subject to audit at any time. It is unclear if this certification is incorporated in the sub-grant agreements.

The CAP's Exhibits have since been completed by the County Water Agency and sub-grantees. Those documents were marked as "received" by the State Water Board.

Recommendations:

To ensure the CAP is implemented as designed, the State Water Board should:

- A. Continue to review the CAP on an ongoing basis. This can be performed in conjunction with other interim monitoring efforts, such as attending the quarterly meetings.
- B. Review the Exhibits submitted and, if necessary, provide guidance if they were not completed uniformly or consistently. In addition, provide clarity regarding the requirements of maintaining supporting documentation.
- C. Ensure the County Water Agency as well as sub-grantees are complying with the grant agreement.
- D. Include a provision in Exhibit 3 or amend the sub-grant agreements to include additional audit requirements. A common provision included in grant agreements is state funds are subject to audit at any time during the grant agreement period and for a defined time period after project completion (e.g., three years after final payment is made).

We appreciate the assistance and cooperation of all parties involved. If you have any questions regarding this report, please contact Frances Parmelee, Manager, or Rich Hebert, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

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

cc: Mr. Esteban Almanza, Deputy Director, State Water Resources Control Board
Ms. Laura McLean, IRWM Program Manager, State Water Resources Control Board
Mr. Doug Wilson, Interim Administrative Manager, State Water Resources Control Board
Ms. Kelley List, Engineering Geologist, State Water Resources Control Board