



**U.S. Department of the Interior  
Office of Inspector General**

## **ADVISORY REPORT**

**PROPOSAL TO MODIFY THE MUNICIPAL AND  
INDUSTRIAL WATER CONTRACTORS' CAPITAL  
AND OPERATION AND MAINTENANCE DEFICIT  
OBLIGATIONS ON THE CENTRAL VALLEY  
PROJECT, BUREAU OF RECLAMATION**

**REPORT NO. 00-I-281  
MARCH 2000**

## **EXECUTIVE SUMMARY**

**Proposal To Modify the Municipal and Industrial Water Contractors'  
Capital and Operation and Maintenance Deficit Obligations  
on the Central Valley Project, Bureau of Reclamation  
Report No. 00-I-281  
March 2000**

### **BACKGROUND**

The Central Valley Project, located in California, was authorized by the Congress in 1937 and built in stages, with initial water deliveries beginning in 1949 and the last major stage completed in 1987. The Bureau of Reclamation (BOR) began delivering Project municipal and industrial water under terms of individual 40-year water service contracts, which contained "fixed" water rates. These water rates were supposed to be sufficient to repay the Government for BOR's annual operation and maintenance expenses, annual interest expense on the Government's construction costs, and an amortized portion of the construction costs. However, by the 1970s, BOR recognized that the use of fixed water rates was not producing sufficient revenues to pay these expenses and that it could not adjust the rates until the respective contracts expired. As such, deficit balances were accruing, which the Government continued to finance.

In 1986, the Congress passed legislation (Public Law 99-546) that required new or amended Project water service contracts to contain provisions to ensure that water contractors repay any outstanding deficits incurred by the Government for their share of the Project's unpaid expenses. However, according to BOR officials, the existing water contractors or other parties that contract for the water supply cannot be held legally responsible for these amounts until they enter into new or amended contracts. In October 1994, BOR estimated that municipal and industrial water revenues will not increase appreciably until 2005, when a large number of fixed-rate contracts expire and are subject to renewal. Based on BOR records, we determined that the accumulated deficit for all Project municipal and industrial water contractors was \$190 million as of September 30, 1998.

Prior to February 1999, the Central Valley Project municipal and industrial water contractors submitted an undated proposal to modify the amount and computation of the total capital and operation and maintenance deficit obligations owed the Government. The proposal consisted of seven principles, which, if accepted, would govern the deficit determination for all Project municipal and industrial water contractors.

## **OBJECTIVE**

The objective of our review was to determine whether BOR's acceptance of the proposal would be in the best interests of the Government.

## **RESULTS IN BRIEF**

We concluded that acceptance of the contractors' proposal would not be in the best interests of the Government in that the acceptance would provide an unwarranted Federal subsidy to the Project's water contractors. Specifically, Department of the Interior and BOR policy applied since 1939 requires water contractors to repay the actual construction and financing costs attributable to municipal and industrial water supplies. Also, BOR's 1994 Interim Municipal and Industrial Water Ratesetting Policy, established specifically for the Project and implemented in accordance with Public Law 99-546, requires BOR to annually account for any deficit balances to enable it to recover those costs in the future in accordance with the Public Law. Furthermore, the Congress, in authorizing water projects under Reclamation law, has historically provided subsidies to irrigation water contractors but not to municipal and industrial water contractors and has not authorized deficits incurred in operating water projects to be financed by the Government. Based on our review of available information, we estimated that if the proposal is accepted, the repayment obligation of 12 of the Project's 51 municipal and industrial water contractors would be reduced by about \$114 million and that future interest revenues would be reduced by about \$54 million (present value). We also believe that accepting the proposal could have precedent-setting impacts on financing and cost-recovery efforts of the Government and, based on BOR's Denver Office analysis, could cost the Government billions of dollars.

Additionally, we found that the \$190 million Project deficit was not recorded in BOR's official accounting records and related financial statements as an amount due the Government.

## **RECOMMENDATIONS**

We recommended that BOR's Commissioner formally reject the water contractors' proposal in its entirety, inform the appropriate Congressional committees of any BOR decisions that would significantly reduce the amount of costs to be recovered from the water contractors, and properly account for the deficit amounts associated with the Project in accordance with generally accepted accounting principles and fully disclose this accounting in BOR's financial statements beginning with fiscal year 1999.

## **AUDITEE COMMENTS AND OIG EVALUATION**

BOR agreed with the report's three recommendations. Based on the response, we considered the recommendations resolved and implemented.



# United States Department of the Interior

OFFICE OF INSPECTOR GENERAL  
Washington, D.C. 20240

MAR 31 1999

## ADVISORY REPORT

### Memorandum

To: Commissioner, Bureau of Reclamation

From: Roger La Rouche *Roger LaRouche*  
Acting Assistant Inspector General for Audits

Subject: Advisory Report on Proposal To Modify the Municipal and Industrial Water Contractors' Capital and Operation and Maintenance Deficit Obligations on the Central Valley Project, Bureau of Reclamation (No. 00-I-28 1)

## INTRODUCTION

This report presents the results of our review of an undated proposal made to the Bureau of Reclamation (BOR) by the Central Valley Project municipal and industrial water contractors to modify the amount and computation of the total capital and operation and maintenance deficit obligations owed the Government. As of October 29, 1999, BOR had not formally responded to the proposal. The objective of our review was to determine whether BOR's acceptance of the proposal would be in the best interests of the Government.

## BACKGROUND

The Central Valley Project, located in California, was authorized by the Congress in 1937 and built in stages, with initial water deliveries beginning in 1949 and the last major stage completed in 1987. BOR began delivering Project municipal and industrial water under terms of individual 40-year water service contracts,<sup>1</sup> which contained "fixed" water rates. These water rates were supposed to be sufficient to repay the Government for (1) BOR's annual operation and maintenance expenses incurred to deliver the water, (2) the interest expense computed at the Project rate on the Government's construction costs associated with building the facilities, and (3) an amortized portion of the construction costs sufficient to repay the Government's investment within the Project's repayment period. By the 1970s,

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<sup>1</sup>Water service contracts are authorized by the Reclamation Project Act of 1939 and essentially sell water on a rate-per-acre-foot basis.

however, BOR recognized that the use of fixed water rates for Project water deliveries was not producing sufficient revenues to pay these expenses. Since the rates were fixed by contract, BOR could not adjust the rates until the respective contracts expired.<sup>2</sup> As such, deficit balances were accruing, which the Government continued to finance.<sup>3</sup>

From 1949 to 1976, BOR computed interest on the Project's operating deficits by using the same interest rate (Project rate) that was applied to the Project's unpaid construction costs. This rate was 2.5 percent from 1949 to 1973 and gradually increased to 2.654 percent in 1976. Beginning in 1983, BOR began to account for and track the unpaid expenses by individual water contractor. In 1986, the Congress passed legislation (Public Law 99-546, Section 106) that required BOR to apply U.S. Treasury-based interest rates to deficits occurring after October 1, 1985. The intent of the legislation was to better reflect the costs incurred by the Government to continue to finance the unpaid expenses and the associated annual deficits that were accruing on the Project. In addition, Public Law 99-546 required that new or amended Project water service contracts contain provisions to ensure that water contractors repay any outstanding deficits incurred by the Government for their share of the Project's unpaid expenses. However, according to BOR officials, the existing water contractors or other parties that contract for the water supply cannot be held legally responsible for these amounts until they enter into new or amended contracts.

In October 1994, BOR estimated that municipal and industrial water revenues would not increase appreciably until 2005, when a large number of fixed-rate contracts expire and are subject to renewal. As such, BOR expects that the deficits will continue to increase until all the contracts are renewed. Based on BOR records, we determined that the accumulated deficit for all Project municipal and industrial water contractors was \$190 million as of September 30, 1998, an increase of \$143 million since 1986. The deficit balance consists mainly of interest expense, as shown in Table 1.

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<sup>2</sup>According to BOR officials, water contractors were required to pay only the amount billed under the terms of their respective contracts and as such were not legally bound to pay any deficit amount.

<sup>3</sup>BOR defined deficits as the accumulation of annual operation and maintenance costs and interest costs in excess of total revenues received from the sale of water under existing water service contracts.

**Table 1. Central Valley Project Deficit  
as of September 30, 1998**

	Amounts* (Millions)
<b>Revenues:</b> Water revenues	\$128
Voluntary payments**	<u>31</u>
Total revenues	\$159
<b>Expenses:</b> Operation and maintenance	51
Capital interest	194
Deficit interest	101
Capital repayment	<u>3</u>
Total expenses	<u>349</u>
Net deficit (total revenues minus total expenses)	<u><u>(\$190)</u></u>

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\*These amounts represent the revenues and expenses of 41 municipal and industrial water contractors that, according to BOR records, had a deficit balance as of September 30, 1998. The remaining 10 municipal and industrial water contractors did not have a deficit balance as of that date.

\*\*Voluntary payments represent amounts paid by certain contractors in accordance with the Mid-Pacific Region's August 6, 1992, policy memorandum. This policy allowed municipal and industrial water contractors to pay more than what was required by their water service contracts in order to reduce or eliminate their deficit, which would in turn reduce future accrued interest on their deficit.

In addition to the deficit balances, only about \$9 million (2 percent) of the \$441 million of construction costs financed by the Government and allocated to the municipal and industrial water supply had been repaid by the water contractors as of September 30, 1998. As such, the total debt the Government continues to finance exceeds \$622 million for this municipal and industrial water supply. The Central Valley Project municipal and industrial water contractors' proposal consists of seven principles (see Appendix 2), which, if accepted, would govern the deficit determination for all Project municipal and industrial water contractors.

## SCOPE

Our review was conducted in September and October 1999, primarily at BOR's Mid-Pacific Regional Office in Sacramento, California. We also contacted and interviewed officials from BOR's Washington and Denver Offices and the Department's Office of the Solicitor in Washington, D.C. To meet our objective, we reviewed and analyzed the contractors' proposal and its impacts in total; the analyses of the proposal performed by BOR; and

applicable laws (including Reclamation law<sup>4</sup>), policies, and other operating criteria. Our analysis and conclusions are presented in the “Discussion” section of this report.

We conducted our review in accordance with the “Government Auditing Standards,” issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances. Because our review was limited to an evaluation of the water contractors’ proposal, we did not evaluate BOR’s system of internal controls over the recovery of Project costs. However, as discussed in the section “Recording of Project Deficits” in this report, we noted that BOR had not recorded in its official accounting records or disclosed in its related financial statements the deficit amounts associated with this water supply. As such, we made a recommendation, which, if implemented, should correct this deficiency.

## **PRIOR REVIEWS**

During the past 5 years, neither the Office of Inspector General nor the General Accounting Office has issued any reports that directly related to the objective and scope of our review.

## **DISCUSSION**

We concluded that acceptance of the Central Valley Project municipal and industrial water contractors’ proposal would not be in the best interests of the Government in that the acceptance would provide an unwarranted Federal subsidy to the Project’s water contractors. Specifically, Department of the Interior and BOR policy applied since 1939 requires water contractors to repay the actual construction and financing costs attributable to municipal and industrial water supplies. Also, BOR’s 1994 Interim Municipal and Industrial Water Ratesetting Policy, established specifically for the Project and implemented in accordance with Public Law 99-546, required BOR to annually account for any deficit balances to enable it to recover those costs in the future in accordance with the Public Law. Furthermore, the Congress, in authorizing water projects under Reclamation law, has historically provided subsidies to irrigation water contractors but not to municipal and industrial water contractors and has not authorized deficits incurred in operating water projects to be financed by the Government. Based on our review of available information, we estimated that if the proposal is accepted, the repayment obligation of 12 of the Project’s 51 municipal and industrial water contractors would be reduced by about \$114 million (see Appendix 1) and that future interest revenues would be reduced by about \$54 million (present value<sup>5</sup>). We also believe that accepting the proposal could have precedent-setting impacts on financing and cost-recovery efforts of the Government and, based on BOR’s Denver Office analysis, could cost the Government billions of dollars.

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<sup>4</sup>Reclamation law is a term used to refer to the total body of public laws governing the reclamation program, beginning with the Reclamation Act of 1902 and including all laws amending and supplementing the Act.

<sup>5</sup>Present value is a financial term referring to the time value of money, which recognizes that \$1 received in the future is worth less than \$1 received today.

## Recovering Project Costs

Since enactment of the Reclamation Project Act of 1939,<sup>6</sup> it has been the policy of the Department and BOR to recover actual costs associated with municipal and industrial water deliveries. In 1949, the Secretary of the Interior stated that construction costs allocated to municipal water supplies should be fully repaid with interest on any unpaid balance and that the rate of interest used, unless otherwise authorized, should correspond to the cost of money to the Government. This policy has been applied consistently over the years, was reiterated by the Secretary in 1996, and has been supported by Departmental legal opinions. For example, a 1947 legal opinion stated that the Secretary of the Interior can charge interest in a water supply contract; a 1948 opinion stated that Section 9(c) of the Act requires repayment of actual construction costs; and a 1980 opinion stated that the Secretary can recover the amount of interest on money borrowed to operate and maintain facilities. The 1980 opinion also stated that the Secretary is not limited to using project interest rates chargeable on the initial investment capital but instead can set the rate to reflect the current cost of money borne by the Government to finance the facilities.

Based on long-standing Departmental and BOR policy, we believe that BOR is clearly authorized to recover the Government's actual costs, including interest and any past operating deficits, associated with the delivery of municipal and industrial water. This position is further supported by Section 106 of Public Law 99-546, which requires that any outstanding Project deficits be repaid. To implement this requirement, BOR developed an Interim Municipal and Industrial Water Ratesetting Policy in 1994, which requires BOR to annually account for any deficit balances attributable to each municipal and industrial water contractor to enable BOR to recover these costs in accordance with the law. Also, based on our review of Reclamation law, we concluded that the Congress intended that municipal and industrial water contractors fully repay the Government's costs associated with municipal and industrial water deliveries and did not intend that annual operating deficits be paid by Federal taxpayers. Although we found that the Congress has historically provided subsidies to irrigation water contractors in the form of noninterest-bearing debt that is subject to their "ability to pay," we did not find similar provisions for municipal and industrial water contractors.

In our opinion, acceptance of the Central Valley Project municipal and industrial water contractors' proposal would not be in the best interests of the Government because such acceptance would result in an unwarranted subsidy financed at the expense of Federal taxpayers. In that regard, BOR's Mid-Pacific Region prepared an analysis of the impact that the proposal's seven principles would have on the computation of the historical deficit and capital balances as of September 30, 1997. Following BOR's methodology, we updated the

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<sup>6</sup>Section 9(c) of the Act authorized the Secretary to enter into water service contracts to provide water for municipal and industrial purposes at "such rates as in the Secretary's judgement will produce revenues at least sufficient to cover an appropriate share of the annual operation and maintenance cost and an appropriate share of such fixed charges as the Secretary deems proper." These fixed charges reflect the interest and capital costs associated with the construction of the facilities.



computations using BOR's annual accounting of Project deficits as of September 30, 1998.<sup>7</sup> Accordingly, we estimated that the deficit balances and capital balances would decrease by about \$114 million. Specifically, deficit balances would decrease by \$71 million, and capital balances would decrease by \$43 million. In addition, we estimated that these decreased balances would result in lost interest revenues amounting to about \$119 million over the Project's repayment period. These estimated lost revenues have a present value of about \$54 million.\* While these estimates represent a large portion of the dollar impact the principles would have on the Project deficit through fiscal year 1998, the dollar effect will be higher because BOR's analysis and our analysis excluded 39 contractors that would also be affected by these principles.

In addition to the impact the proposal would have on the repayment obligation of Central Valley Project water contractors, an analysis prepared by BOR's Denver Office concluded that BOR could be subject to similar requests from municipal and industrial water contractors on all of its projects to waive or forgive interest charges. According to BOR's analysis, applying the contractors' proposal BOR-wide could result in "impacts which potentially could reach into the billions of dollars." Similarly, according to BOR's analysis, the Department of Energy could be subject to requests for the same waiver of interest from its power contractors. As such, acceptance of the proposal may have a substantial impact on the Government's cost recovery efforts.

## **Recording Project Deficits**

During our review of BOR's records associated with the Central Valley Project deficits, we identified an accounting issue that we believe warrants BOR's immediate attention. Specifically, we found that BOR's Finance and Accounting Services had not recorded the \$190 million Project deficit in BOR's official accounting records and related financial statements as an amount due the Government. BOR officials told us that the deficit was not recorded as an account receivable because the current water contractors are not legally required under the terms of their water service contracts to pay the deficit amounts. However, as discussed in the section "Recovering Project Costs" in this report, the Project deficits will become the obligation of contractors that enter into new or renewed contracts to receive future Project water deliveries. Accordingly, as required by Public Law 99-546, these deficits will ultimately be repaid to the Government. As such, we believe that BOR should, at a minimum, disclose the existence of the Central Valley Project deficit, report the cumulative amount of the deficit, and state that the deficit will be repaid by Project water contractors as required by Public Law 99-546 in a note to its financial statements. We also believe that BOR should determine what amount of the deficit, if any, should be recorded as an account receivable or recorded in another asset recognition account in its accounting records, in accordance with generally accepted accounting principles for the recording of assets.

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<sup>7</sup>BOR's accounting as of September 30, 1998, is included in the computation of water rates for the year 2000. This information has been released for public comment but had not been finalized as of October 29, 1999.

\*In this analysis, we used the 1998 deficit interest rate of 6.625 percent and assumed that the remaining outstanding obligations would be amortized in equal installments over the Project repayment period.

In conclusion, we believe that BOR should reject the contractors' proposal because it is not in the best interests of the Government. Based on the significant monetary impact involved, we also believe that any decision which reduces the Government's recovery of Project costs should be coordinated with appropriate Congressional committees.

## **Recommendations**

We recommend that the Commissioner. BOR:

1. Formally reject the Central Valley Project municipal and industrial water contractors' proposal in its entirety.
2. Inform the appropriate Congressional committees of any BOR decisions that would significantly reduce the amount of costs to be recovered from Central Valley Project water contractors.
3. Direct Finance and Accounting Services officials to properly account for the deficit amounts associated with the Central Valley Project in accordance with generally accepted accounting principles and fully disclose this accounting in BOR's financial statements beginning with fiscal year 1999.

## **BOR Response and Office of Inspector General Reply**

In the February 23, 2000, response (Appendix 3) to the draft report from the BOR Commissioner, BOR concurred with the report's three recommendations. Based on the response, we consider the recommendations resolved and implemented.

Since the recommendations are considered resolved and implemented, no further response to this report is required (see Appendix 4).

Section 5(a) of the Inspector General Act (5 U.S.C. app. 3) requires the Office of Inspector General to list this report in its semiannual report to the Congress. In addition, the Office of Inspector General provides audit reports to the Congress.

## CLASSIFICATION OF MONETARY AMOUNTS

<u>Finding Area</u>	<u>Funds To Be Put To Better Use</u>
Recovery of Project Costs	\$114 million
Reduction of Future Interest Revenues	<u>54 million*</u>
Total	<u><u>\$168 million</u></u>

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\*This amount represents our computation, based on U.S. Treasury rates for 1998, of the present value of the future interest revenues lost.

## SUMMARY OF THE CENTRAL VALLEY PROJECT CONTRACTORS' PROPOSAL

The Central Valley Project municipal and industrial water contractors' proposal consists of seven principles, which, if adopted, would govern the deficit determination for all municipal and industrial water contractors from the beginning of the Project through the fiscal year in which a final municipal and industrial rate-setting policy is adopted. The principles also address the transition to a final municipal and industrial rate-setting policy for the Project. We believe that the seven principles, taken as a whole, do not protect the interests of the Government and would provide the contractors with an unwarranted Federal subsidy. The seven principles and our opinions on these principles are as follows:

**- Principle 1.** An operation and maintenance deficit would exist in any fiscal year in which the portion of the Bureau of Reclamation's (BOR) actual operation and maintenance expenses (that is, funds appropriated for BOR purposes and expended during that fiscal year for operation and maintenance of the Project) allocated to a municipal and industrial water contractor exceeds revenues from the contractor during that year.

**- Office of Inspector General Opinion.** Taken by itself, we believe that the principle appears reasonable. However, operation and maintenance expense is not the only expense that the municipal and industrial water contractors' revenues were supposed to cover. The other expenses include the capital (construction costs) repayment and the associated interest on capital that the Government has been financing, in combination with the operation and maintenance expense, for more than 50 years. As such, adoption of this principle would be contrary to long-standing Department of the Interior and BOR policies regarding repayment of project costs and Congressional intent in authorizing projects under Reclamation law, which require water contractors to repay the actual construction and financing costs attributable to municipal and industrial water supplies.

**- Principle 2.** Operation and maintenance deficit balances for each Project municipal and industrial water contractor would be determined and would accrue interest in accord with the same principles that govern Project irrigation operation and maintenance deficit balances, including those contained in the 1986 statute, the 1988 irrigation rate-setting document, and other BOR documents applicable to operation and maintenance deficit balances for Project irrigation water contractors.

**- Office of Inspector General Opinion.** We believe that this principle is contrary to BOR policy and Congressional intent of Reclamation law. Adoption of this principle would have the effect of eliminating from the deficit balances all interest on deficits that occurred before the effective date of Public Law 99-546. We believe that the deficit balances should properly include interest computed in accordance with the policies and Reclamation law in effect at the time that the deficits were incurred. This principle would also change the way that municipal and industrial water revenues are applied. In establishing its Interim Municipal and Industrial Water Ratesetting Policy, BOR stated that it believed that the intent of Public Law 99-546 was to curtail subsidies to municipal and industrial water contractors

and therefore established a requirement in the Ratesetting Policy to apply any annual surplus revenues to the lowest interest-bearing obligation first (the capital balance). In contrast, the policy applicable to Project irrigation water contractors provides for the application of annual surplus revenues to the highest interest-bearing debt first (the deficit balance). In addition, we do not believe that the Congress intended that municipal and industrial water contractors be treated the same as irrigation water contractors with regard to repayment issues, as discussed in the section "Recovering Project Costs" in this report.

- **Principle 3.** Interest on the capital costs allocated to each municipal and industrial water contractor would be computed at the appropriate Project composite capital interest rate for each year. Balances of any unpaid capital interest would be carried forward and would not accrue compound interest.

- **Office of Inspector General Opinion.** This method for computing annual capital interest expense is in compliance with existing BOR policy. However, the provision stating that compound interest should not be accrued on unpaid capital interest is a significant departure from Departmental and BOR policy and Congressional intent of Reclamation law.

- **Principle 4.** The municipal and industrial water contractors will work with BOR to establish a final municipal and industrial rate-setting policy which would apply prospectively.

- **Office of Inspector General Opinion.** Taken by itself, we believe that this principle is reasonable as long as Departmental and BOR policy and Reclamation law are complied with.

- **Principle 5.** All future annual deficits (unpaid operation and maintenance, unpaid capital interest, and unpaid deficit interest) that arise after implementation of the final municipal and industrial rate-setting policy would compound at the "deficit" rate.

- **Office of Inspector General Opinion.** Taken by itself, we believe that adoption of this principle would not reduce the amount of future cost recovery because this method of computing deficits and associated interest would be in compliance with current BOR policy and Reclamation law. We believe that this principle is what the Congress intended when it enacted Public Law 99-546 except that the Congress expected this treatment to be applied to all water delivery years beginning in 1986. However, adoption of this principle in conjunction with the other principles contained in the proposal would significantly reduce cost recovery, as discussed in the section "Recovering Project Costs" in this report.

- **Principle 6.** Beginning with the first year of implementation of the final municipal and industrial rate-setting policy, each contractor would have the option to pay off its unpaid capital interest balance and operation and maintenance deficit balance on the same terms as those given to the irrigation water contractors for operation and maintenance deficit balances (over a 3 to 5 year period, etc.) or incorporate these balances into future rates at the "deficit" interest rate. If a municipal and industrial water contractor chooses to incorporate these

balances into future rates, BOR would not require them to be paid off as a condition of contract renewal.

- **Office of Inspector General Opinion.** Taken by itself, except for the reference to the “same terms as those given to the irrigation water contractors for operation and maintenance deficit balances,” this principle appears reasonable. Since Reclamation law has historically treated municipal and industrial water contractors different from irrigation water contractors in the repayment of the Government’s costs associated with water projects, we believe that BOR has correctly established a separate repayment policy applicable to municipal and industrial water contractors.

- **Principle 7.** Any voluntary payments made by a contractor would be applied as directed by the contractor.

- **Office of Inspector General Opinion.** Taken by itself, we believe that this principle is reasonable as long as Departmental and BOR policy and Reclamation law are complied with.



IN REPLY REFER TO:

## United States Department of the Interior

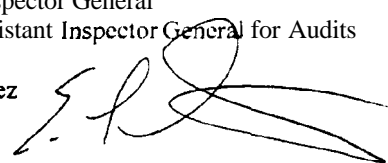
BUREAU OF RECLAMATION  
Washington, D.C. 20240

D-5010

FEB 23 10 00

## MEMORANDUM

To: Office of the Inspector General  
Attention: Assistant Inspector General for Audits

From: Eluid L. Martinez  
Commissioner 

Subject: Draft Advisory Report on a Proposal to Modify the Municipal and Industrial Water Contractors' Capital and Operation and Maintenance Deficit Obligations on the Central Valley Project, Bureau of Reclamation  
(Assignment No. W-IN-BOR-00 1-99(A)-D)

The Bureau of Reclamation offers the following comments in response to the recommendations in the subject report:

We recommend that the Commissioner, Bureau of Reclamation:

Recommendation 1:

Formally reject the Central Valley Project municipal and industrial water contractors' proposal in its entirety.

Response

Complied. By memorandum dated January 14, 2000. (see attachment) the Regional Director: Mid-Pacific Region advised the Central Valley Project municipal and industrial water contractors that the proposal as submitted is not acceptable. Specifically, certain elements of the proposal are unacceptable because they conflict with long-standing Reclamation policy and general accounting practices. However, Reclamation is committed to seeking a solution that meets the fundamental interests of all parties and will continue to work with the contractors to that end.

Recommendation 2:

Inform the appropriate Congressional committees of any BOR decisions that would significantly reduce the amount of costs to be recovered from Central Valley Project water contractors.

Response:

Concur. Reclamation will inform the appropriate Congressional committees of any future decisions that will significantly reduce the amount of costs to be recovered from Central Valley Project water contractors. The responsible official is the Commissioner's Chief of Staff.

Recommendation 3:

Direct Finance and Accounting Services to properly account for the deficit amounts associated with the Central Valley Project in accordance with generally accepted accounting principles and fully disclose this accounting in BOR's financial statements, beginning with fiscal year 1999.

Response:

Complied. In fiscal year 1999 for the Central Valley Project's municipal and industrial operation and maintenance deficit. Reclamation recorded an accounts receivable for \$189.5 million (actual) to include related prior period adjustments for revenue not recorded in previous years. This amount was disclosed in Reclamation's financial statements in accordance with generally acceptable accounting standards.

## Attachment

cc: Assistant Secretary - Water and Science, Attention: Laura Brown





IN REPLY  
REFER TO:

MP-3000  
ADM-10.00

## United States Department of the Interior

BUREAU OF RECLAMATION  
Mid-Pacific Regional Office  
2800 Cottage Way  
Sacramento, California 95825-1898

JAN 14 2000

Honorable Jim Patterson  
Mayor of Fresno  
190 1 East University Avenue  
Fresno, California 93703

Subject: **Central Valley Project (CVP)** Municipal and Industrial **(M&I)** Operations and **Maintenance (O&M)** Deficits

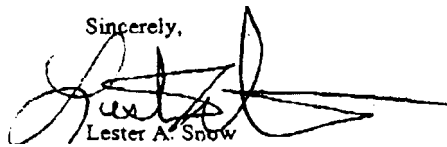
Dear Mayor Patterson:

The purpose of this letter is to update you on our ongoing efforts within the Bureau of Reclamation (Reclamation) to address your concerns regarding M&I O&M deficits. As we have previously discussed, Reclamation agrees that some constructive resolution of this issue is important to everyone concerned.

In collaboration with M&I contractor representatives, we transmitted a proposed resolution on February 19, 1999, to the Commissioner of Reclamation. That proposal has been reviewed by Reclamation staff and by the Department of the Interior Office of the Inspector General (OIG). The Commissioner and the Assistant Secretary of the Interior for Water and Science (Assistant Secretary) endorse the general intent of the proposal. However, the OIG and internal staff advise that certain elements are unacceptable because they conflict with long-standing Reclamation policy and standard accounting practices. Accordingly, the Commissioner returned the proposal to the Mid-Pacific Region for further action.

Reclamation is committed to seeking a solution that meets the fundamental interests of all the parties. Considering the feedback we received on the initial proposal, any solution must necessarily confine the impact especially as it relates to existing Reclamation policy and generally accepted accounting practices. Region staff is currently pursuing alternatives that meet these criteria. We expect to have an initial assessment completed within the next several weeks and will be in a position to discuss progress at our meeting with you or your representative on January 20, 2000, in Reno, Nevada, at 10:00 a.m. at the El Dorado Hotel and Casino, 345 N. Virginia Street, Room 2504.

Sincerely,



Lester A. Snow  
Regional Director

**STATUS OF ADVISORY REPORT RECOMMENDATIONS**

<u>Finding/Recommendation Reference</u>	<u>Status</u>	<u>Action Required</u>
1, 2, and 3	Implemented.	No further action is required.

**ILLEGAL OR WASTEFUL ACTIVITIES  
SHOULD BE REPORTED TO  
THE OFFICE OF INSPECTOR GENERAL**

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# ***HOTLINE***

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