

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

**Transfer of
Bureau of
Reclamation
Fiscal
Responsibilities
for Central
Valley Project
Jeopardizes
Federal
Revenues**



*Friant Dam and Millerton Lake
Photo Courtesy Bureau of Reclamation*

Review of Central Valley Project Responsibilities Transferred Under Direct Funding Agreements Between BOR and Three California Water Authorities

**Report No. 2002-I-0052
September 2002**



United States Department of the Interior

Office of Inspector General Western Region

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September 30, 2002

Memorandum

To: Assistant Secretary for Water and Science

From: Michael P. Colombo 
Regional Audit Manager

Subject: Final Report, Review of Transferred Responsibilities for Aspects of the Central Valley Project, Bureau of Reclamation (No. 2002-I-0052)

The attached report presents the results of our review of the direct funding agreements between the Bureau of Reclamation's (BOR) Mid-Pacific Region and three California Water Authorities, which transferred aspects of responsibility for the Central Valley Project (CVP) from Federal to local control. Under the agreements, the Water Authorities were authorized to directly fund operation and maintenance (O&M) of certain CVP facilities through assessments of their member water districts. The Water Authorities were also authorized to act as fiscal agents for BOR by assuming responsibility for collecting and accounting for payments due the government for water deliveries.

We found that the direct funding of O&M responsibilities to the Water Authorities has generally been successful. We also found, however, that the transfer of fiscal responsibilities has not been successful. Indeed the Water Authorities' assumption of these responsibilities revealed an inherent conflict of interest between the Water Authorities acting as fiscal agents for BOR and representing their member water districts. The Water Authorities, for example, have no financial incentive to enforce the contracts between the Region and the water districts, deposit revenues to the U.S. Treasury on time, or ensure that the Region has sufficient information to maintain accurate accounting and water measurement records. The Water Authorities also continued their practice of co-mingling certain Federal revenues, even after this practice was found to be illegal by the Department of the Interior's Field Solicitor in Sacramento. The transfer of fiscal responsibilities has been detrimental to the government and has significantly increased the risk of loss or misappropriation to Federal revenues.

In his September 12, 2002 response (Appendix 1), the Commissioner, Bureau of Reclamation, concurred with all four of the report's recommendations. Based on the

response, we consider Recommendations 1 and 2 resolved and implemented and Recommendations 3 and 4 resolved. As such, we are referring Recommendations 3 and 4 to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

The legislation, as amended, creating the Office of Inspector General requires that we report to Congress semiannually on all audit reports issued, actions taken to implement our audit recommendations, and recommendations that have not been implemented.

We appreciate the cooperation shown by BOR staff during our review and commend BOR for taking immediate action to remedy the deficiencies that prompted our recommendations. A response to this report is not required. If you have any questions regarding the report, however, please call me at (916) 978-5653.

Attachment

cc: Audit Liaison Officer, Assistant Secretary for Water and Science (MS 6640)
Commissioner, Bureau of Reclamation (MS 7654)
Associate Solicitor for Land and Water Resources (MS 6412)
Chief of Staff, Bureau of Reclamation (MS 7654)
Audit Liaison Officer, Bureau of Reclamation

Executive Summary

Direct Funding Agreements

Bureau of Reclamation

Transfer of CVP Fiscal Responsibilities to Water Authorities Places Federal Revenues at Risk

The Central Valley Project (CVP), a large Federal water supply project in California's Central Valley, has historically been viewed as a partnership between the Bureau of Reclamation (BOR), which constructed the project, and the local people who benefit from CVP water supplies. Reclamation law¹ and current and past administrations have encouraged transferring responsibility for the CVP and other BOR facilities to local control to the extent possible.

The transfer of operation and maintenance (O&M) responsibilities for the CVP to local control has generally been successful. Over the past 15 years, three California Water Authorities,² representing local water districts that have individually contracted with BOR for CVP water, have demonstrated their ability to operate and maintain the CVP facilities within their service areas. BOR began transferring O&M to the Water Authorities in the 1980s under cooperative agreements that explored the benefits of allowing the Water Authorities to perform O&M using Federally appropriated funds. These agreements were replaced in the mid-1990s by direct funding agreements that allowed the Water Authorities to forego the use of Federal appropriations and directly fund O&M through assessments of the local water districts.

The direct funding agreements also expanded BOR's partnership with the Water Authorities by designating the Water Authorities as "fiscal agents" for BOR and giving them the responsibility to collect Federal revenues due the government for CVP water deliveries to the water districts. We believe, however, that the Water Authorities' assumption of the role of fiscal agents for BOR has proved to be unsound and has, in fact, resulted in a relationship between BOR and the Water Authorities that is adversarial and counter to a mutually beneficial partnership. This adversarial relationship was clearly demonstrated in the

¹ 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 subsequent laws that amended and supplemented the Act.

²The three Water Authorities are the Tehama-Colusa Canal Authority, the San Luis and Delta-Mendota Water Authority, and the Friant Water Users Authority, which collectively represent a significant portion of the service areas served by CVP facilities.

Water Authorities' refusal to comply with BOR's June 7, 2000 letter, which stated that the Water Authorities should not use Federal revenues to offset unpaid O&M assessments and should remit Federal funds within 3 business days of receipt. Instead, the Water Authorities continued to offset unpaid O&M assessments, even after offsets were determined to be illegal, and failed to remit Federal funds within 3 days.

We did not identify any benefit for leaving Federal funds in the control of the Water Authorities and found a significantly increased risk of loss or misappropriation to the revenues if they were not remitted directly to the U.S. Treasury. In addition, there is an inherent conflict of interest between the Water Authorities' responsibilities as representatives for their member water districts and their responsibilities as fiscal agents for BOR. This conflict of interest, combined with the failure of either BOR or the Water Authorities to establish controls ensuring that Federal revenues were accurate and properly accounted for, jeopardized these revenues and hindered BOR from (1) accounting for water deliveries and district payments, (2) reconciling water deliveries to revenues received, and (3) generally maintaining reliable accounting records.

As a result of these control weakness, we were unable to confirm that BOR received all revenues due under contracts with water districts. As long as the government holds title to CVP facilities, BOR is ultimately responsible for enforcing contract terms and ensuring that district payments for water deliveries comply with applicable water service contracts and that appropriate interest and late charges are assessed for late payments. BOR should also ensure that the Water Authorities accurately and consistently measure the water delivered to the water districts by establishing a Quality Assurance Program over water measurement.

We made four recommendations to address the deficiencies identified during our review. In his September 12, 2002 response, the Commissioner, Bureau of Reclamation, concurred with all four recommendations and provided supporting documentation sufficient for us to consider Recommendations 1 and 2 resolved and implemented and Recommendations 3 and 4 resolved. As such, we are referring Recommendations 3 and 4 to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

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List of Abbreviations

BOR	Bureau of Reclamation
CVP.....	Central Valley Project
Friant	Friant Water Users Authority
O&M.....	Operation and Maintenance
San Luis	San Luis and Delta-Mendota Water Authority
Tehama.....	Tehama-Colusa Canal Authority
USC.....	United States Code



**Central Valley Project,
California**

Figure 1

Background

The Central Valley Project (CVP), located in the Central Valley³ of California, is the largest water supply project in the United States. Authorized by Congress in 1937, the CVP was conceived as a means to store the Valley's winter runoff for use in the summer and fall growing seasons and to redistribute water from the northern half of the Valley, which receives most of the rainfall, to the southern half, which has most of the farmland.

The Valley is semi-arid, receiving the majority of its rainfall between December and April. Without irrigation, large-scale farming would not be possible. The irrigation supplied by the CVP has helped turn the Valley into one of the most productive agricultural regions in the world. The CVP is also vital to the water supply of California. Almost 60 percent of the surface water used in California originates in the Central Valley, with nearly half of that amount controlled through the CVP. CVP benefits include flood control; power generation; water for irrigation, municipal and industrial use; recreation; and fish and wildlife enhancement.

The CVP stores and distributes water supplies through a vast network of 20 dams and reservoirs, 11 powerplants, and 500 miles of canals and related facilities (Figure 1). Major canals include (1) the 111-mile-long Tehama-Colusa Canal, which delivers water diverted from the Sacramento River at Red Bluff Diversion Dam to lands on the west side of the Sacramento Valley; (2) the 117-mile-long Delta-Mendota Canal, which delivers water pumped into the canal at the Tracy Pumping Plant in the Sacramento-San Joaquin Delta to lands on the west side of the San Joaquin Valley; and (3) the 151-mile-long Friant-Kern Canal, which delivers water diverted from Friant Dam on the San Joaquin River southward to Bakersfield. The majority of the water districts served by these three major water distribution systems are represented by three Water Authorities, established under California state law. The Water Authorities are the Tehama-Colusa Canal Authority (Tehama), the San Luis and Delta-

³The Valley, which is about 450 miles long and 50 miles wide, covers about one-third of the State of California and is drained by two river systems: the Sacramento River in the north and the San Joaquin River in the south. The Sacramento River and its tributaries flow generally southward; the San Joaquin River and its tributaries flow generally northward. The two rivers meet in the Sacramento-San Joaquin Delta and flow through a narrow gap in the mountains surrounding the Valley into the San Francisco Bay and the Pacific Ocean.

Mendota Water Authority (San Luis), and the Friant Water Users Authority (Friant).⁴

Most farmers receiving CVP water are organized into water districts that have negotiated water service contracts with the Bureau of Reclamation (BOR), which constructed the CVP. BOR is responsible for operating and maintaining CVP facilities, collecting revenues due from the water districts, and keeping official accounting records. The water service contracts establish the terms and conditions for the districts to pay for water deliveries, based on water rates determined by BOR. The rates include BOR's construction costs and operation and maintenance (O&M) costs. The districts also pay annual charges assessed against their water deliveries under the 1992 Central Valley Project Improvement Act. The charges are banked in a Restoration Fund created under the Act to pay for activities to restore fish and wildlife populations and habitats affected by construction of the CVP. Water districts with a limited ability to pay are not required to pay either construction costs or the annual charges on irrigation water deliveries. These districts are, however, required to pay O&M costs.

**CVP—A
Partnership
Between
Federal and
Local
Interests**

Although the Federal government holds title to the CVP, the project is in essence a partnership between the government and CVP beneficiaries. Over the years, Reclamation law and Federal policy have established and encouraged transferring aspects of O&M for the CVP to local control. Water districts, likewise, have expressed a desire for increased control over CVP facilities, particularly O&M. Both BOR and water districts realized that under local control, O&M deficiencies could be identified, budgeted for, and corrected within about a year's time. Federal control of O&M, on the other hand, was subject to the Federal appropriation process, which could take up to 5 years from the time O&M needs were identified to make funds available. In addition, because of the competition with other Federal priorities, there was no assurance that O&M funds would be available when they were needed.

In 1986, BOR began transferring O&M responsibility to the three Water Authorities. Through cooperative agreements executed with

⁴ Each of the three Water Authorities was formed through a joint powers agreement with the local water districts they were to represent. Each of the water districts has a contract with BOR for the delivery of CVP water.

BOR,⁵ these Water Authorities assumed responsibility for operating and maintaining certain CVP facilities using Federally appropriated funds.

**Water
Authorities
Agree to
Assume
Responsibility
for O&M and
Act as BOR's
Fiscal Agents**

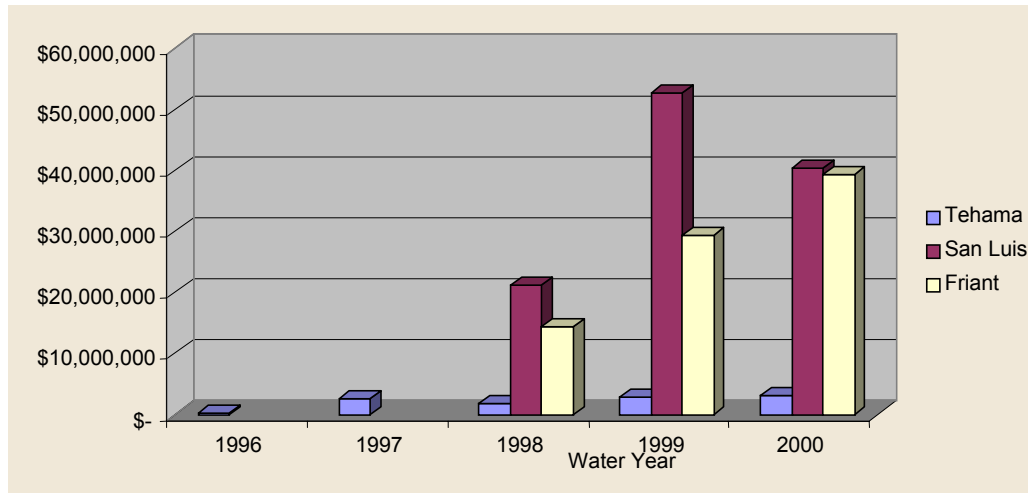
By the mid-1990s, the Water Authorities had demonstrated their ability to perform O&M and were interested in directly funding (without Federal appropriations) their O&M costs via assessments to the water districts they served. Similarly, BOR's policy was to pursue cost-sharing or partnership agreements with CVP beneficiaries to reduce the need for appropriated funds and to continue to implement partnerships with local entities. Accordingly, BOR and the Water Authorities replaced the cooperative agreements with direct funding agreements that confirmed the success of the transfer of O&M responsibility and expanded the partnership between BOR and the Water Authorities by transferring additional responsibilities to the Water Authorities. BOR executed a direct funding agreement with Tehama in September 1996 (effective October 1, 1996) and agreements with San Luis and Friant in May 1998 (retroactive to March 1, 1998). Under the agreements, the Water Authorities continued to perform O&M and assumed responsibilities as BOR's fiscal agents, as follows:

Assumption of O&M Responsibilities	Assumption of "Fiscal Agent" Responsibilities
<ul style="list-style-type: none"> ✓ Allowed Water Authorities to directly fund O&M through assessments of water districts. ✓ Provided for each Water Authority to develop a methodology and budget to cover O&M costs. ✓ Allowed Water Authorities to use Federal revenues to fund (offset) deficiencies in O&M recovery. 	<ul style="list-style-type: none"> ✓ Designated the Water Authorities as BOR's fiscal agents, responsible for collecting revenues due BOR from water districts ✓ Required Water Authorities to invest the collected Federal revenues in accordance with established Water Authority investment policies. ✓ Required Water Authorities to remit Federal revenues and interest earnings to BOR within 60 days following the end of the month in which Water Authorities received funds.

**Water Authority Responsibilities
Under Direct Funding Agreements
Figure 2**

⁵Tehama entered into a cooperative agreement with BOR on October 13, 1988; San Luis on September 30, 1992, and Friant on August 19, 1986.

From the inception of the direct funding agreements through water year 2000 (ending February 28, 2001), the Water Authorities collected Federal revenues totaling \$207 million (see Figure 3).



**Federal Revenues Collected
by Water Authorities
Figure 3**

Objective and Scope

Our objective was to determine whether BOR, in adopting direct funding agreements with the three Water Authorities, established the accounting and management controls necessary to ensure that all Federal funds were collected and deposited to the U.S. Treasury. We generally limited the scope of our audit to water year 2000 (March 1, 2000 to February 28, 2001). During our review, we noted deficiencies related to water measuring that affected the integrity of the revenue collection process and included these water-measuring activities in our review. We conducted our audit in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States, and included such tests of records and other auditing procedures that were considered necessary to meet our objective.

As part of our audit, we evaluated BOR's system of internal controls related to overseeing and managing the accounting and operational aspects of the direct funding agreements and found weaknesses in BOR controls over enforcement of contract payment terms, timeliness of deposits into the U.S. Treasury, maintenance of accurate accounting records, and assurance of

accurate measurement of water deliveries. Our recommendations, if implemented, should correct these weaknesses.

We also reviewed Department of the Interior Reports on Accountability for fiscal years 2000 and 2001, which included information required by the Federal Manager's Financial Integrity Act of 1982, and BOR's annual assurance statements on management controls for fiscal years 2000 and 2001 and determined that BOR had not reported any material weaknesses that directly related to the objective and scope of our review.

To accomplish our audit, we visited BOR's Mid-Pacific Regional Office in Sacramento, California; its South-Central California Area Office in Fresno, California; and its field offices in Willows and Byron, California. We interviewed BOR personnel and reviewed records concerning the negotiation and implementation of the direct funding agreements. We also visited the offices of the three Water Authorities (Tehama in Willows, California; San Luis in Los Banos, California; and Friant in Lindsay, California). We reviewed Water Authority financial statements, operating procedures, and other records pertaining to the collection of Federal funds. We also interviewed Water Authority personnel responsible for administering the direct funding agreements.

Transfer of BOR's Fiscal Responsibilities Jeopardizes Federal Revenues

BOR's execution of direct funding agreements with the three Water Authorities successfully implemented BOR's policy of promoting partnerships with local water users in terms of O&M. The Water Authorities demonstrated their ability to maintain the CVP facilities within their service areas. The Water Authorities, however, were not successful in assuming the responsibility of acting as fiscal agents for BOR because (1) there was an inherent conflict of interest between their role as fiscal agents and their representation of the water districts and (2) the agreements did not provide sufficient accounting and management controls to clearly establish that all funds collected from the sale of water were correct and properly deposited to the U.S. Treasury. The lack of controls stemmed from the failure of BOR to clearly specify the duties and responsibilities of "fiscal agents" in the agreements or issue sufficient augmenting control procedures to the Water Authorities to ensure timely and proper collection and deposit of funds. As a result, the risk of loss or misappropriation of Federal revenues was significantly increased.

**Conflict of
Interest
Inherent in
Water
Authorities
Acting as
BOR's
Fiscal
Agents**

Assuming the role of fiscal agents for BOR was inherently a conflict of interest for the Water Authorities. As representatives of their member water districts, the Water Authorities essentially work for these districts. For example, Water Authority Boards of Directors are made up of senior management officials from member water districts. In addition, the Water Authorities' assumption of the role of fiscal agents created a situation in which the Water Authorities did not have a financial interest in some of the fiduciary responsibilities inherent to BOR. While the Water Authorities and the districts they serve receive a significant financial benefit from O&M of the CVP's delivery systems, the Water Authorities do not have a similar financial interest in ensuring that the Federal government receives revenues owed for the construction of the CVP. Accordingly, establishing adequate controls for BOR and the Water Authorities was critical to the success of transferring fiscal responsibilities for the CVP.

**Direct
Funding
Agreements
Deficient**

In negotiating the direct funding agreements, BOR management officials did not draw on the advice of the accounting and rate-setting personnel who would be responsible for the day-to-day administration of the agreements' financial terms. Consequently, successfully implementing the transfer of fiscal responsibilities was immediately problematic in several areas, as follows:

- **BOR and Water Authority Responsibilities Were Poorly Defined.** The agreements did not clearly delineate the respective responsibilities of BOR and the Water Authorities or contain procedures for effectively transferring financial responsibilities. For example, the agreements did not require the Water Authorities to enforce the payment requirements of BOR's water service contracts with individual water district, which is an essential part of BOR's fiduciary responsibilities. BOR should have issued guidelines and procedures augmenting the direct funding agreements and clarifying the respective roles of the Water Authorities and BOR.
- **Agreements Allowed Offsetting.** The agreements allowed the Water Authorities to use the Federal revenues collected for water deliveries to some water districts to cover other water districts' unpaid O&M assessments, a practice known as offsetting. Offsetting,

however, was determined to be illegal⁶ because Federal revenues must be deposited in the U.S. Treasury before they can be used for other purposes. Congress alone can appropriate Federal money. The practice of offsetting arose from the Water Authorities' need for an additional source of revenue if water districts did not pay their full O&M assessments.⁷ As non-profit entities without any taxing authority, the Water Authorities did not have a way to generate revenue to cover the shortfall. In effect, by allowing the use of offsetting, BOR provided the Water Authorities with another source of revenue, which historically the government has covered by asking for additional appropriations. In addition, as long as the government holds title to CVP facilities, it is ultimately responsible for O&M.

**Risk to
Federal
Revenues
Significantly
Increased**

As a result of the poorly defined roles and responsibilities, the Water Authorities did not assume the fiduciary responsibilities inherent in acting as BOR's fiscal agents; that is, the Water Authorities did not ensure that (1) payments made by water districts for water deliveries complied with district contracts with BOR, (2) payment terms were enforced, and (3) payments to the U.S. Treasury were made on time. Most importantly, they did not establish the controls to properly account for Federal revenues collected or provide BOR with the information required to maintain accurate accounting records. In effect, BOR lost control of Federal revenues and did not ensure that the Water Authorities, acting as its fiscal agent, had assumed control. Rather than acting in tandem as partners, BOR and the Water Authorities became adversaries. We found that when BOR asked for information, the Water Authorities were reluctant to provide it in a manner that was useful to BOR. Also, BOR did not have provisions in the agreements to require compliance.

⁶At the request of BOR's Mid-Pacific Region, the Department of the Interior's Pacific Southwest Regional Solicitor in Sacramento, California, reviewed the legality of the offset provision and in a May 16, 2000 memorandum concluded that the Water Authorities could not invest Federal funds or offset deficient O&M assessments against the Federal revenues collected.

⁷Water districts typically do not pay their O&M costs for two reasons: (1) they cannot afford them or (2) their O&M rates do not cover the full O&M costs. Some of BOR's older contracts provide for the delivery of water at fixed rates, which over time have become insufficient to cover the cost of service. Accordingly, the rates are not high enough to cover both Water Authority O&M assessments and costs due BOR. More recent BOR water service contracts require districts to pay water rates that reflect the cost of service, as determined annually, and as such, do not result in a deficit in O&M funding.

✓ **Payment
Terms
Not
Enforced**

The agreements did not specifically require the Water Authorities to enforce the payment terms of BOR's water service contracts with individual water districts for CVP water deliveries. The districts pay their water rates in advance of water delivery and their water charges in the month following delivery. The Water Authorities maintained records of district payments, but did not report information to BOR on late or missing payments. As such, BOR was not aware that these payments were late and therefore could not enforce the District's payment terms itself. Although the direct funding agreements require the Water Authorities to provide payment data to BOR, the requirement did not specifically provide for identifying untimely payments or payments not made. In addition, BOR did not issue augmenting procedures requiring this information from the Water Authorities. Our review of payments made during water year 2000 identified the following:

- Of the 78 districts reviewed at the three Water Authorities, 12 districts did not pay any of their water rates in advance of delivery. The contracts and Reclamation law⁸ stipulate that no additional water be delivered until appropriate advance payments are made. In our opinion, these 12 districts were not eligible to continue to receive water. BOR, however, did not take sufficient enforcement action to ensure compliance.
- Of payments made to San Luis and Friant,⁹ we were unable to verify that water rates and charges for 1 month were paid at all. There was no proof of payment of about \$985,000 of rates and charges from 22 of 61 districts, and we found no evidence that the Water Authorities or BOR took action to collect these amounts.
- Overall, we found that 44 percent of all payments made by the water districts to the Water Authorities were late. Water districts, however, were not assessed interest and late charges of at least \$320,000 for late payments. Of these payments, almost all districts paid at least one advance payment late. In addition, 50 of 64 districts

⁸Reclamation 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 subsequent laws that amended and supplemented the Act.

⁹Our review of water district payments at Tehama was limited to determining whether payments were timely.

that were required to pay annual charges made at least one of these payments late.

✓ **Water
Authority
Payments
to U.S.
Treasury
Untimely**

The direct funding agreements did not provide an effective means for BOR to ensure that Water Authority deposits to the U.S. Treasury were timely. The agreements require the Water Authorities to remit the revenues they collect to the U.S. Treasury within 60 days after the end of the month in which the revenues were collected, including interest earnings.¹⁰ The agreements, however, did not penalize the Water Authorities for late payments, although BOR would be charged for any late payments it makes to the Water Authorities. Had BOR assessed the Water Authorities similar penalties, we believe the Water Authorities would have been motivated to pay on time. Based on our analysis, San Luis and Friant would have owed an estimated \$270,000 in penalties in water year 2000. Our review of the three Water Authorities for water year 2000 revealed the following:

- San Luis and Friant did not fully comply with the payment terms of the direct funding agreements. While some payments (Restoration Fund charges) were usually paid early, others (district advance water payments) were generally paid late. Further, Friant did not forward interest earnings on the Federal funds in a timely manner.
- For San Luis and Friant, we could not reconcile individual district payments to the Water Authorities with amounts the Water Authorities forwarded to BOR. We therefore determined the maximum amount of Federal revenues each Water Authority could have held each month under the direct funding agreements and compared this to the actual amount on hand for each Water Authority. Both San Luis and Friant had excessive cash balances, with San Luis having, on average, \$5.3 million more than allowed and Friant having approximately \$100,000 in excess funds.
- Tehama forwarded Federal funds within the timeframe specified by the direct funding agreement, but sent its checks to BOR's Willows Office, as was historically done by the districts served by Tehama, instead of paying

¹⁰Under the agreements, the Water Authorities invest the funds they collect and remit both the collected funds and the interest earned to the U.S. Treasury. As such, the monetary effect of Water Authority late payments was minimal.

the U.S. Treasury directly.¹¹ Despite U.S. Treasury regulations to the contrary, BOR allowed Tehama to continue this practice, thereby delaying deposits and losing interest of about \$1,300 for water year 2000.

✓ **BOR
Accounting
Records
Adversely
Affected**

As long as the Federal government holds title to the CVP, BOR must maintain official accounting records to record the outstanding construction debt owed the government by each water district. Under the direct funding agreements, however, BOR no longer had access to key information to ensure that the Federal revenues collected for water deliveries were properly credited to water district account balances. The agreements require each Water Authority to assist BOR in developing and maintaining a system of water accounting¹² to administer Water Authority responsibilities in collecting water payments. The agreements, however, did not sufficiently define such responsibilities, and BOR did not issue augmenting procedures outlining the method and type of documentation required from the Water Authorities to account for district payments and offsets. In our review of BOR accounting records for water year 2000, we identified the following problems:

- Payments to the government for water deliveries did not necessarily agree with district payments to the Water Authorities. San Luis and Friant, for example, conducted their own accounting of water delivered to each district, amounts due the government for those deliveries, and amounts paid by the districts. Payments to the government, however, were based on actual water deliveries and did not include advance payments for future water deliveries.
- Water Authority documentation to BOR to support deposits to the U.S. Treasury was incomplete. BOR either did not have the information available to determine what each district paid or lacked explanations for any differences. San Luis, for example, provided copies of bank statements and district payment summary sheets, but did not provide reconciliations between these documents for the amount deposited as determined by its water accounting. Friant

¹¹In contrast, San Luis and Friant made their payments directly to the U.S. Treasury via electronic fund transfer.

¹²The direct funding agreements refer to water accounting as fully and accurately documenting the allocation and deliveries of water through the CVP and accounting for the financial transactions related to water deliveries.

did not routinely provide BOR with the documentation from the districts supporting their payments.

- San Luis and Friant used Federal revenues to offset unpaid O&M assessments without providing sufficient information to BOR about the transaction. This resulted in BOR not being able to identify which water district accounts should be credited for the payments. Friant offset \$458,000 of O&M assessments for two districts between October 2000 and July 2001, including \$10,000 of O&M assessments for one district that was seriously delinquent in its water payments. Although Friant records did not show any water deliveries to this district in water years 2000 and 2001, Friant continued to assess the district as if it were receiving water. We also found that San Luis expanded the use of offsets to include costs associated with water transfers between water districts. The amount of the offset was about \$217,000.
- Adjustments to the cost of water deliveries based on how the water was ultimately used¹³ were not always validated and complicated the accounting and reconciliation process. The ultimate use of water delivered to a district is determined by that district and also by the appropriate Water Authority as part of the Water Authority's water accounting process. We were told, however, that information on water use reported by the Water Authorities to BOR's Mid-Pacific Regional Office differed from information reported by the districts to BOR's area offices, which entered water delivery data into BOR's water accounting system. Both the area and regional offices would then become involved in resolving differences. We found that water districts adjusted the costs for water used up to 1 year after water delivery, with no validation by BOR or the Water Authorities that the adjustments were correct.
- Transfer of fiscal responsibilities has complicated, rather than simplified the reconciliation of water district and

¹³The ultimate use of the water delivered to the water districts determines the amount charged for the water. Water used for irrigation, for example, costs less than water used for municipal and industrial purposes. Water delivered under the Reclamation Reform Act or transferred between districts can also be charged different water rates. The Water Authorities refer to the process of determining how much water each district used for different purposes as "water coloring."

**Solicitor
Questions
Legality of
Water
Authority
Practices**

BOR records. BOR regional accountants, for example, told us that they had spent several months reconciling payment data for two Friant districts because information provided by Friant conflicted with information provided by the districts. We reviewed the accounting for these two districts and concluded that the Friant water accounting practices had complicated the accounting process for everyone.

At the request of BOR's Mid-Pacific Region, the Department of the Interior's Office of the Solicitor, Pacific Southwest Region, reviewed certain practices of the Water Authorities and in a May 16, 2000 memorandum concluded the direct funding agreements should be revised or amended to comply with 31 USC 3302(c), which requires that Federal revenues must be deposited into the appropriate U.S. Treasury account no later than the third day after the funds were received. In addition, the Solicitor opined that the Water Authorities could not invest Federal funds or offset deficient O&M assessments against the amounts collected because only Congress is empowered to appropriate Federal revenues.

In a June 7, 2000 letter, BOR stated that, effective immediately, the Water Authorities should (1) remit all future Federal funds collected within 3 business days of receipt, (2) remit all previously collected Federal funds and interest within 3 business days of receipt of BOR's letter, and (3) stop offsetting shortfalls in O&M funding against the Federal revenues collected for water deliveries.

BOR intended to modify the direct funding agreements within 30 days of sending the letter, but did not do so. The Water Authorities disregarded BOR's instructions and instead proposed to conduct their own legal review. To our knowledge, however, no such review was conducted. More than 2 years later, the agreements have yet to be amended. The Water Authorities continued to invest Federal funds and hold them well beyond 3 business days, and San Luis and Friant continued to offset O&M assessments against Federal revenues collected.

**Related Issue:
Quality
Assurance
Over Water
Measurement
Needed**

We found that neither BOR nor the Water Authorities had established sufficient controls over water measurement and metering activities to ensure that the measuring devices were accurately recording the quantity of water delivered to each water district. The Water Authorities have been responsible for operating, maintaining, and reading water measurement devices that record the amount of water delivered to water districts. These water measurement activities facilitate the billing and collection process for O&M assessments and other water charges, including assessment and collection of Federal revenues. Since these activities are being performed by outside parties on behalf of BOR, we believe BOR needs to establish a quality assurance program that will ensure the integrity of the billing process.

Fundamental concepts of accounting controls were lacking in water measurement, thereby making the water deliveries more susceptible to misappropriation. Specifically:

- Documentation supporting the calibration and accuracy of water measurement devices was lacking.
- Water measurement testing schedules were intermittent and undocumented.
- Written testing procedures for ensuring the accuracy of water measurement had not been established.
- Water delivered by BOR to the Water Authorities was not reconciled to the amount delivered to the water districts on a regular basis. In addition, neither BOR nor the Water Authorities had established an acceptable range of water that could be gained or lost within the system that would not trigger an investigation of potential misappropriation.
- Written policies or procedures to resolve differences between water district and Water Authority records on the amounts of water delivered were not established. In fact, one Water Authority official stated that since he in essence worked for the water districts, he usually ruled in favor of the district in any dispute.

- Water measurement devices could not always be located.
- Meter-reading responsibilities were not rotated among Water Authority staff to facilitate detection of potential irregularities.
- Many water measurement records were maintained in pencil and could easily be modified to cover up irregularities. In addition, this form of record keeping did not lend itself to ready analysis of potential misappropriations of water.

Recommendations

We recommend that the Commissioner, Bureau of Reclamation, direct the Regional Director, Mid-Pacific Region, to:

1. Take the immediate steps necessary to ensure that the Water Authorities comply with Federal law as outlined by the Office of the Solicitor.
2. Take action to amend the direct funding agreements to terminate Water Authority designation as fiscal agents and re-establish financial mechanisms by which water districts would directly pay BOR for their water use.
3. Work with the Water Authorities to reconcile each of the water district payments with the amounts retained and forwarded by the Water Authorities since the inception of the direct funding agreements.
4. Establish, in conjunction with the Water Authorities, a Quality Assurance Program that will ensure the integrity of the water measurement activities.

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

In his September 12, 2002 response (Appendix 1), the Commissioner concurred with all four recommendations. Based on the response, we consider Recommendations 1 and 2 resolved and implemented and Recommendations 3 and 4 resolved. We are referring Recommendations 3 and 4 to the Assistant Secretary for Policy, Management and Budget for tracking of implementation (Appendix 2).

Appendix 1 does not include the attachments to the Commissioner's response, which documented actions the Bureau has taken to resolve and implement Recommendations 1 and 2 and resolve Recommendations 3 and 4. We commend BOR for taking immediate action to resolve the deficiencies identified in this report.

Appendix 1

Page 1 of 3



IN REPLY REFER TO:

United States Department of the Interior

BUREAU OF RECLAMATION
Washington, D.C. 20240

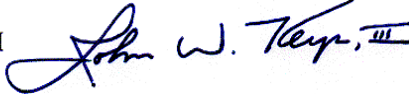


D-5600
ADM-8.00

SEP 12 2002

MEMORANDUM

To: Office of Inspector General
Attention: Western Region, Regional Audit Manager

From: John W. Keys, III 
Commissioner

Subject: Draft Audit Report on Review of Central Valley Project Responsibilities
Transferred Under Direct Funding Agreements Between BOR and California
Water Authorities (Assignment No. A-WIN-BOR-0001-2001)

The Bureau of Reclamation offers the following comments in response to the recommendations issued in the subject audit report.

We recommend that the Commissioner, Bureau of Reclamation, direct the Regional Director, Mid-Pacific Region, to:

Recommendation 1

Take the immediate steps necessary to ensure that the Water Authorities comply with Federal law as outlined by the Office of the Solicitor.

Response

Complied. The final revised direct funding agreement with Tehama-Colusa Canal Authority (TCCA) (Attachment 1) rescinds the offset provisions. The fiscal agent account maintained by TCCA has been closed out.

By attached letters dated June 13, 2002 (Attachments 2 and 3), the Mid-Pacific Region (Region) notified San Luis-Delta Mendota Water Authority (SLDMWA) and Friant Water Users Authority (FWUA) respectively, of the requirement to comply with the legal opinion issued by the Office of the Solicitor. By subsequent letters dated June 26, 2002, (Attachments 4 and 5), the Region specifically instructed SLDMWA and FWUA to (1) cease offsetting contractor payments and (2) close out the fiscal agent account and remit the fund balance to Reclamation.

Recommendation 2

Take action to amend the direct funding agreements to terminate Water Authority designations as fiscal agents and reestablish financial mechanisms by which water districts would directly pay BOR for their water use.

Response

Concur. The final revised direct funding agreement with TCCA terminates their designation as fiscal agents. The Region subsequently sent letters to all TCCA contractors instructing them to remit future payments due to the United States to the United States Treasury lockbox. A sample letter is enclosed (Attachment 6).

Since June 13, 2002, the Region has conducted two follow-up meetings with SLDMWA and FWUA to clarify and finalize the revised direct funding agreements. The most recent agreement (Attachment 7) terminates the water authorities' designation as fiscal agents. During the week of July 9, 2002, the Region sent letters to each individual water contractor instructing them to send payments due and payable to the United States directly to the United States Treasury lockbox. A sample letter is attached (Attachment 8).

The responsible official is the Regional Director, Mid-Pacific Region. The target date for completing the revised direct funding agreements with SLDMWA and FWUA is September 30, 2002.

Recommendation 3

Work with the Water Authorities to reconcile each of the water district payments with the amounts retained and forwarded by the Authorities since the inception of the direct funding agreements.

Response

Concur. By letters dated August 16, 2002, the Region provided specific instructions to SLDMWA and FWUA respectively (Attachments 9 and 10) for documenting individual contractor payments in relation to fiscal agent account balances remitted to the United States. The Region will analyze the documentation against balances received, then request each individual contractor to review and comment. Based upon this process, the Region will determine the need for additional review or audit of the authorities accounting records.

The responsible official is the Regional Director, Mid-Pacific Region. The target date for completing the reconciliation is September 30, 2003.

Appendix 1

Page 3 of 3

3

Recommendation 4

Establish, in conjunction with the Water Authorities, a Quality Assurance Program that will ensure the integrity of the water measurement activities.

Response

Concur. The Region will collaborate with the water authorities to develop and implement a quality assurance program that corrects the deficiencies noted by the Office of the Inspector General in the subject audit report.

The responsible official is the Regional Director, Mid-Pacific Region. The target date for implementing a quality assurance program is March 31, 2003.

Attachments – 10

cc: Assistant Secretary - Water and Science, Attention: Olivia Ferriter
(w/o attachments)

Appendix 2

Status of Audit Recommendations

Recommendation	Status	Action Needed
1 and 2	Resolved and Implemented	No further response is needed
3 and 4	Resolved; Not implemented	We are referring the recommendations to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

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