

CALFED BAY-DELTA PROGRAM

Office Memorandum

Date: October 28, 1998
TO: Judy
From: Lynda
Subject: Audit Issues

You asked me to pull together information on what issues we may be looking at in an audit of the CALFED Program, and what steps we need to take to ensure we have adequate records.

In evaluating our "audience" for an audit, I categorized the current requests we have for an audit. The categories and related agencies and their role in an audit are as follows:

1. Senator Johannessen Audit Request

In Johannessen's September 1998 report, he **calls for an audit of CALFED's accounting practices**. He indicates he will "ask the Controller of the State of California and the U.S. Government Accounting Office (GAO)" to conduct the audit.

- CALFED does not have an Accounting Office; therefore, the audit will be of DWR's and BOR's Accounting offices, since they provide those services to us (including Category III payments). Both agencies have required us to abide by their established processes and procedures, including legal review when appropriate.

As for tracking expenditures, again DWR's and BOR's accounting systems are the source of that information.

- Category III contracts will probably be the area that comes under some scrutiny in an audit, primarily because of the NFWF Agreement. However:
 - Agency approved the sole source for the \$35.0 million awarded to NFWF;
 - NFWF is a Congressionally authorized agency rather than a private company or corporation.
 - Agency approves all contracts for Category III projects

- Agency approves all invoices for Category III disbursements, and
- All invoices are paid through DWR's Accounting office, using CDF's fund codes.

- Tracking expenditures is a little unique in that no State agency's **automated** accounting system is being used to keep a tabulation of expenditures against the contract because of the funding allocation to Agency. However, DWR's Accounting Office is manually tracking these expenditures.

- **Controller, State of California** - According to DWR's Fiscal Office, Controller's will focus their audit to the Claim Schedules that are sent to them for payment. The Schedules contain a batch of invoices for payment. These invoices will be compared to the document which authorizes them to pay: a contract or Purchase Order, or other official State contractual document. The audit will be done at their offices, not in DWR's Accounting Office.

The GAO will generally not audit a State agencies' accounting practices unless that agency has authority to accept and disperse Federal funds. DWR does not accept or disperse Federal funds on behalf of CALFED.

- **GAO** - The GAO, then, will focus their audit on the accounting practices of the Bureau. Roger Pollock indicated the GAO can look at anything they deem important to the audit. However, if I understood him correctly, he anticipates the GAO will be looking at the BOR's internal practices.

2. DWR's Audit

I met with Eloisa Bunn of DWR's Internal Audit Office who will conduct the audit requested by both DWR and CALFED management. Evidently, DWR wants an audit of Category III expenditures. She indicated that overall, audits are performed to ensure taxpayer monies are not being given to **benefit** individuals or organizations (as in a gift of funds), but in return for goods or services required for the work of the State. She will look at whether we have controls in place to prevent anything unreasonable from happening.

Since we are required to abide by the established processes and procedures DWR has in place, there should be limited, if any problems. Eloise indicated she will use the following process:

- Initial interviews will be conducted with CALFED and DWR management to develop the objective of the audit and scope of review. Through these interviews, she will clarify the intent of the audit and what we hope to accomplish. We will approve her plan before she begins.
- Her staff will then begin their audit.

Eloisa also indicated she hoped to begin her audit about the first of November and finish by January, unless something unusual happens. She has already selected one of her staff to conduct the audit.

It appears that these kinds of audits generally do not target the decision-making process about CALFED's program plan and associated activities, but rather the technical processes in place to accomplish those activities. In evaluating the various financial activities involved in running a program, I know of nothing done outside routine and established procedures. For example:

- we do not pay salaries and wages of people outside the regular payroll system of the State and Federal government;
- we do not pay for services outside the established procedures of letting contracts and paying invoices;
- we do not purchase equipment or commodities outside established procedures.

As for audits on whether an agency or program was being managed appropriately, it's my understanding the Legislative Analyst and/or the Bureau of State Audits would conduct those kinds of audits. Or, if there was an accusation of fraudulent activities, the Department of Justice would be involved.

CALFED'S INTERNAL PROCEDURES

The Management Services unit of CALFED manages their budgeting, contracting and personnel process. All established processes and procedures, rules and regulations established by the State (DWR) and the Bureau are required of, and adhered to by, CALFED.

For contracting activities, all forms and documents used are official State and Federal forms. And, these forms are reviewed, approved, and processed according to established State and Federal rules and regulations, and in the same way as DWR and BOR organizations. This includes all sole source requests. In addition, DWR and BOR keeps the official files for these documents. CALFED's contracts staff has developed a procedures manual which contains flows charts, sample forms, and processing instructions. Staff also has the State's Contract's Manual and access to Federal Acquisition Resources for reference use.

The same is true for all purchasing and personnel activities, and all business functions and activities.

CATEGORY III ACTIVITIES

The area where CALFED may be scrutinized more heavily is the Category III activities. The contract and invoice process for Prop. 204 projects is fragmented and difficult to track. The process remains based on State requirements, but because funding authority resides with Resources Agency, and because RA's services are provided by CDF, contract encumbrances and invoice payments are tracked manually (in DWR). All contracts and invoices are approved by Resources Agency Secretary.

Again, all State and Federal rules and regulations, forms and processes are required and adhered to by CALFED.

Today, however, I learned that additional audits may be initiated by the Federal government to review the decision-making process and performance of the Federal portion of the Category III program. Its my understanding the auditors will likely be from the GAO, and will focus on projects funded by the Bay-Delta appropriation (\$160 million to date) and whether the projects selected for Federal funding are in conformance to Congressional intent and/or direction.

To prepare for this audit, it seems we need, at a minimum, a file for each project which includes information on the decision-making process used to select, and official documentation approving the project, as well as documentation showing the process used to award the project. As I understand the process, CALFED staff develop and solicit the projects, with input from the Round-Table, and approval from Management Team and Policy Group, and final approval by Secretaries of Resources Agency and Department of Interior. Hopefully, everything has been documented and a paper-trail has been kept.

Usually, this kind of audit does not fall to fiscal staff. If, however, the decision is made that my unit will handle, please let me know. There has been and will be staff turn-over in that unit and we will need some knowledgeable assistance in preparing for this kind of audit.

STEPS BEING TAKEN TO PREPARE FOR AUDIT

Currently, we are working to get files and accounts current, accurate, and in order for a fiscal-related audit. There are fiscal accounts which need to be updated as they are currently showing a significant over-statement of encumbrances, and therefore overstating the expenditure of State funds. Allan is working on that project.

I am working with my staff to develop methods for identifying and tracking all the different kinds of charges being made against the CALFED program. There are numerous sources and methods of charging work authorities, and we're finding areas where procedures should be developed and communicated to all participants (State agencies primarily) so costs can be managed more easily.

Olene is working to organize her contracts and requisition files so that documents can be found easily and the files are consistent from one to another. And Allan is doing the same for Category III Prop. 204 contract files.

If my staff will be responsible for the Federal audit of the Federal Category III projects, we may have quite a project; not only in pulling together the documentation, but learning what the GAO will be looking for and the process they will use.

SUMMARY

Since we abide by all State and Federal rules and regulations for operating the CALFED program, I foresee few problems or issues that will arise. For Category III projects, things may get more involved. For an "accounting practices" audit, as Senator Johannessen has called for (I assume for Prop. 204 projects), again I see few complications. For a GAO audit of decision-making processes, there will likely be much more activity and work involved.

If you have questions, or want more information, please let me know.