



Transmitted via e-mail

September 8, 2014

Mr. John Laird, Secretary
California Natural Resources Agency
1416 Ninth Street, Suite 1311
Sacramento, CA 95814

Dear Mr. Laird:

Final Report—Three Rivers Levee Improvement Authority, Proposition 1E Project Audits

The Department of Finance, Office of State Audits and Evaluations, has completed its audits of the Three Rivers Levee Improvement Authority's (TRLIA) agreements 4600008049 and 4600008654 issued by the California Department of Water Resources.

The enclosed report is for your information and use. TRLIA's response to the report is incorporated into this final report. TRLIA agreed with the observations and we appreciate its willingness to implement corrective actions. This report will be placed on our website.

We appreciate the assistance and cooperation of TRLIA. If you have any questions regarding this report, please contact Diana Antony, Manager, at (916) 322-2985.

Sincerely,

Richard R. Sierra, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: Ms. Laura King Moon, Chief Deputy Director, California Department of Water Resources
Ms. Katherine Kishaba, Deputy Director of Business Operations, California Department of Water Resources
Ms. Gail Chong, Deputy Assistant DWR Executive, Bond Accountability, California Department of Water Resources
Mr. Jeff Ingles, Chief Auditor, California Department of Water Resources
Ms. Kelly Fucciolo, Chief, Early Implementation Program, California Department of Water Resources
Mr. Michael Sabbaghian, Branch Chief, Project Development Branch, California Department of Water Resources
Mr. Patrick Kemp, Assistant Secretary for Administration and Finance, California Natural Resources Agency
Ms. Julie Alvis, Deputy Assistant Secretary, California Natural Resources Agency
Mr. Bryan Cash, Deputy Assistant Secretary, California Natural Resources Agency
Mr. Paul Brunner, Executive Director, Three Rivers Levee Improvement Authority
Ms. Mary Jane Griego, Board Chairperson, Three Rivers Levee Improvement Authority

Three Rivers Levee Improvement Authority
Proposition 1E Bond Program
Funding Agreements 4600008049 and 4600008654



Feather River Setback Levee

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

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

You can contact our office at:

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BACKGROUND, SCOPE AND METHODOLOGY

BACKGROUND

California voters approved the Disaster Preparedness and Flood Protection Bond Act of 2006 (Proposition 1E) for \$4.09 billion. The bond proceeds provide financing to rebuild and repair California's most vulnerable flood control structures.

The California Department of Water Resources (DWR) established the Early Implementation Program (EIP) to fund eligible flood control projects in certain portions of the Central Valley and adjacent areas. EIP was designed to secure federal and local matching funds while prioritizing the selection and project design to achieve maximum public benefits from use of the funds. Local agencies apply for funding which is authorized by the Legislature through the budget process.¹

The Three Rivers Levee Improvement Authority (TRLIA) is a joint powers agency established in 2004 by the County of Yuba and Reclamation District 784 to finance and construct levee improvements in south Yuba County. TRLIA's mission is to provide 200-year flood protection. Four work phases were identified to achieve that goal along the Yuba, Feather, and Bear Rivers and the Western Pacific Interceptor Canal.² DWR awarded the following grants:

- **Funding Agreement 4600008049 (Feather River)**—\$154.8 million to fund the fourth phase of the Feather River project. This agreement funds land acquisitions, construction of setback levees, and new levee construction along the Feather River between the Bear River and the Yuba River. Total project cost is estimated at \$191.7 million.
- **Funding Agreement 4600008654 (Upper Yuba River)**—\$47.4 million to complete phase four of the Yuba River project. This phase includes slope flattening, seepage remediation, correcting deficiencies in levee geometry, and erosion protection from Highway 70 upstream to the Yuba Goldfield. Total project cost is estimated at \$67.8 million.

¹ Source: www.water.ca.gov/floodsafe/docs/2010_%20EIP_Guidelines_Admdendments_12-6-10_Final.pdf.

² www.trlia.org.

SCOPE

In accordance with the Department of Finance's bond oversight responsibilities, we audited the following funding agreements:

<u>Funding Agreement</u>	<u>Audit Period</u> ³
4600008049	November 7, 2006 through March 31, 2013
4600008654	November 7, 2006 through March 31, 2013

The audit objectives were to determine whether TRLIA's claimed project expenditures were in compliance with applicable laws, regulations, and grant requirements; and to determine whether project deliverables were completed as required. We did not assess the efficiency or effectiveness of program operations. Further, no assessment was performed on the reasonableness of the land acquisition costs.

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

METHODOLOGY

To determine whether project expenditures were in compliance with applicable laws, regulations, and the funding agreement requirements; and if the project deliverables were provided, we performed the following procedures:

- Interviewed key personnel to obtain an understanding of the project-related internal controls.
- Examined the project files, the funding agreements, and applicable policies and procedures.
- Reviewed TRLIA's accounting records, vendor invoices, and copies of paid checks.
- Selected a sample of claimed expenditures and determined whether they were allowable, agreement-related, incurred within the agreement period, supported by accounting records, and properly recorded.
- Evaluated whether other revenue sources were used to reimburse expenditures claimed for reimbursement under the project agreements.
- Evaluated whether a sample of project deliverables were met by reviewing supporting documentation and DWR's oversight process.

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

³ Interim audits were conducted since the agreement terms end June 30, 2014 and September 30, 2015, respectively.

The results of the audit are based on our review of documentation, other information made available to us, and interviews with staff directly responsible for administering project funds.

Except as noted below, the project expenditures claimed complied with the funding agreement requirements. Because the projects were active at the time of our site visit, not all deliverables were completed; however, The Three Rivers Levee Improvement Authority (TRLIA) has completed interim deliverables in accordance with the funding agreements. The Schedules of Claimed and Questioned Amounts are presented below.

Schedules of Claimed and Questioned Amounts

Funding Agreement 4600008049 (Feather River)		
Task	Claimed ¹	Questioned
Land Acquisition (Capital Outlay)	\$ 19,900,488	\$ 0
Segment 1 - Levee Improvement	7,525,664	0
Segment 1 - Crack Repair	371,951	0
Segment 2 - New Levee	65,363,282	0
Segment 2 - Levee Tie-ins	6,461,737	0
Segment 2 - Levee Degradation	15,124,127	0
Segment 3 - Levee Improvement	5,240,077	0
Segment 3 - Erosion Site 2	479,162	0
Land Management	933,063	0
Project Management, Legal Support, Community Relations, Land Management Support, Overhead	3,020,124	0
Project Close-out Efforts	6,303	0
Prior Completed Work (Local Credit Paid) ²	15,454,060	164,032
Total Grant Funds	139,880,038	164,032
Match Funds	29,106,957	0
Total Project Expenditures	\$ 168,986,995	\$ 164,032

¹ The interim audit covered expenditures claimed through March 31, 2013.

² The funding agreement provides credit for eligible project costs incurred after November 7, 2006 (passage of Proposition 1E) and before the effective date of the agreement. Costs relate to more than one budget category.

Funding Agreement 4600008654 (Upper Yuba River)		
Task	Claimed^{3,4}	Questioned
Flatten Waterside Levee Slope	\$ 278,044	\$ 0
Landside Levee Improvement	629,278	0
Pre-CEQA & CEQA Determination Support Efforts	606,945	0
Levee Improvements Support Work	5,023,928	0
Levee Improvements Construction	6,182,272	0
Prior Completed Work (Local Credit Paid) ⁴	5,905,525	0
Project Management, Legal Support, Community Relations, Land Management Support, Overhead	1,789,146	0
Land Acquisition (Capital Outlay)	784,000	0
Project Close-out Efforts	43	0
Total Grant Funds	21,199,181	0
Match Funds	10,267,110	0
Total Project Expenditures	\$ 31,466,291	\$ 0

Observation 1: Expenditures Claimed Twice

TRLIA double claimed \$164,032 in project expenditures resulting in an overpayment. TRLIA paid five Feather River construction invoices, less ten percent retention; however, TRLIA claimed and was paid the full invoice amounts. Subsequently, when TRLIA paid the retention of \$164,032, TRLIA claimed the amount as project expenditures again.

Recommendations:

- A. Future TRLIA advances should be adjusted to account for the overbilling. DWR will make the final determination of the appropriate method to recover the overpayment.
- B. Develop and implement procedures to ensure claimed amounts are incurred and allowable expenditures.

Observation 2: Administration of Lease Revenues Needs Improvement

Lease revenues received by TRLIA are not consistently collected or credited against project expenditures. Specifically, eight parcels of land purchased by TRLIA for the Feather River setback levee were leased back by the original owners for farming purposes. The parcels are subject to rent based on a percentage of crop sales or income. However, based on our review, several lease payments were late, including one lessee that had not paid for three years. TRLIA pursued the lease revenue collection after we brought the nonpayment issue to their attention. In addition, lease payments are self-reported. As a result, it is unclear if lease payments are accurate. The lease agreements do not require documentation to support the lease calculation and do not have a clause to enforce the due date, such as a late fee.

In addition, lease revenue of \$164,865 has been reported in the quarterly progress reports; however, TRLIA has not credited claimed project expenditures as required by the funding agreement.

³ The interim audit covered expenditures claimed through March 31, 2013.

⁴ The funding agreement provides credit for eligible project costs incurred after November 7, 2006 (passage of Proposition 1E) and before the effective date of the agreement. Costs relate to more than one budget category.

Funding Agreement 4600008049, item 21(b)(3)(d), states all net proceeds received as lease revenue shall be applied as a credit to the state on the statement of costs submitted to DWR.

Recommendations:

- A. Follow-up on late or outstanding lease revenue payments. Consider adding a late payment fee clause to lease agreements.
- B. Require verifiable support with lease payments to document quantity of produce sold and prices obtained.
- C. Apply the \$164,865 credit plus any future lease revenues received against claimed project expenditures.

Observation 3: Advance Balance of \$317,550 Not Credited to the State

The unused advance balance of \$317,550 for funding agreement 4600008049 has not been credited to the state since March 2012. Specifically, in March 2012 TRLIA completed an eminent domain real estate transaction. DWR advanced the full state share of the estimated acquisition cost; however, the final property cost was less than originally estimated, resulting in an unused balance of \$317,550 for its share of the property acquisition. As of January 2014, TRLIA had not remitted the fund balance nor utilized it as a credit against claimed project expenditures.

Recommendation:

- A. Apply the \$317,550 balance against claimed projects expenditures. DWR will make the final determination of the appropriate method to recover the overpayment.



THREE RIVERS LEVEE IMPROVEMENT AUTHORITY

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July 31, 2014

Richard R. Sierra, CPA
Chief, Office of State Audits and Evaluations
California Department of Finance
915 L Street
Sacramento, Ca. 95814-3706

Re: Your letter to TRLIA, dated July 22, 2014, Subject: Draft Report – Three Rivers Levee Improvement Authority, Proposition 1E Project Audits

Thank you for the opportunity to review and provide comments on the draft report that dealt with TRLIA Early Implementation Program (EIP) Funding Agreements 4600008049 and 4600008654 for the time period of November 7, 2006 through March 31, 2013. Below are TRLIA responses to your Observations noted in the Draft Report:

Observation 1: Expenditures Claimed Twice

TRLIA double claimed \$164,032 in project expenditures resulting in an overpayment. TRLIA paid five Feather River construction invoices less ten percent retention; however, TRLIA claimed and was paid the full invoice amounts. Subsequently, when TRLIA paid the retention of \$164,032, TRLIA claimed the amount as project expenditures again.

TRLIA Response: TRLIA concurs with this observation. The double claiming of this expense was unintentional and due to an error in compiling the initial 2008 credit request by including a contractor's retention amount that had not yet been paid during the credit time period. Later, when TRLIA made the request for payment of the State share of the contractor's retention in 2011, the fact that the contractor retention had been previously claimed was not caught.

Recommendations:

A. Future TRLIA advances should be adjusted to account for the overbilling. DWR will make the final determination of the appropriate method to recover the overpayment.

TRLIA Response: TRLIA made adjustments in the 23rd Quarterly Progress Report and Statement of Costs to account for this double billing. DWR sent TRLIA a letter, dated June 11, 2014, which states this over payment will be accounted for in a future Feather River EIP retention release.

B. Develop and implement procedures to ensure claimed amounts are incurred and allowable expenditures.

TRLIA Response: During the course of this audit the two large EIP TRLIA funding agreements were audited. The total audited amount for the two funding agreements was \$200,453,287. After extensive auditing, one error was observed that was due to human error that is less than one tenth of a percent based on total dollars. TRLIA believes its current financial practices and processes are more than sufficient.

This observation arose out of the credit submission process which is unique and only happens at the outset of a project or change in scope of work for a funding agreement. TRLIA's invoice review and approval/coding process has evolved and the additional review of invoices has and continues to occur.

The need to ensure claimed amounts have been incurred and are allowable expenditures has been emphasized to the TRLIA financial team.

Observation 2: Administration of Lease Revenues Needs Improvement

Lease revenues received by TRLIA are not consistently collected or credited against project expenditures. Specifically, eight parcels of land purchased by TRLIA for the Feather River setback levee were leased back by the original owners for farming purposes. The parcels are subject to rent based on a percentage of crop sales or income. However, based on our review, several lease payments were late, including one lessee that had not paid for three years. TRLIA pursued the lease revenue collection after we brought the nonpayment issue to their attention. In addition, lease payments are self-reported. As a result, it is unclear if lease payments are accurate. The lease agreements do not require documentation to support the lease calculation and do not have a clause to enforce the due date, such as a late fee. In addition, lease revenue of \$164,865 has been reported in the quarterly progress reports; however, TRLIA has not credited claimed project expenditures as required by the funding agreement. Funding Agreement 4600008049, item 21(b)(3)(d) states all net proceeds received as lease revenue shall be applied as a credit to the state on the statement of costs submitted to DWR.

TRLIA Response: TRLIA partially concurs with this observation.

Lease revenues for 6 of the 8 parcels have been consistently collected. The other two parcels both had reasons why their payments were late. One of the late payments was originally submitted on time; but the payee found an error in their payment and then corrected it within two weeks past the due date. The 2nd late payment was being withheld by the payee due to an eminent domain issue that they needed resolved prior to making payment. Once the eminent domain issue was resolved, the payee made a lump sum payment for three years.

TRLIA concurs that the lease agreements should be modified to include late payment clauses and the need to submit verifiable support information with payments.

TRLIA acknowledges that Agricultural Lease revenues have not been directly paid to DWR. As identified in TRLIA Quarterly Progress Reports and discussed with DWR

staff, 100% of the Agricultural revenues have been placed into separate TRLIA fund to account for State Advance Funding Fund so that interest is allocated to that fund on behalf of the State until further details from DWR are provided to address the disposition of these Agricultural Lease payments.

DWR sent TRLIA a letter, dated June 11, 2014, which indicated that the Agricultural Lease revenues up to March 31, 2014 (which includes the \$164,865) would be deducted from a pending retention release. TRLIA has received the retention release and the Agricultural Lease revenues were deducted; thus, the State has been provided credit for these lease revenues pursuant to the funding agreement. TRLIA has subsequently transferred the Agricultural Lease revenues up to March 31, 2014 to TRLIA's Special Project Fund.

Recommendations:

A. Follow-up on late or outstanding lease revenue payments. Consider adding a late payment fee clause to lease agreements.

TRLIA Response: With DWR review and approval, TRLIA has modified the lease agreements to include a late payment fee clause. There have been no late payments under the new leases.

B. Require verifiable support with lease payments to document quantity of produce sold and prices obtained.

TRLIA Response: With DWR review and approval, TRLIA has modified the lease agreements to include verifiable support with lease payments to document quantity of produce sold and prices obtained.

C. Apply the \$164,865 credit plus any future lease revenues received against claimed project expenditures.

TRLIA Response: DWR sent TRLIA a letter, dated June 11, 2014, which indicated that the Agricultural Lease revenues up to March 31, 2014 (which includes the \$164,865) would be deducted from a pending retention release. TRLIA has received the retention release and the Agricultural Lease revenues were deducted; thus, the State has been provided credit for these lease revenues pursuant to the funding agreement. TRLIA has subsequently transferred the Agricultural Lease revenues up to March 31, 2014 to TRLIA's Special Project Fund.

Observation 3: Advance Balance of \$317,550 Not Credited to the State

The unused advance balance of \$317,550 for funding agreement 4600008049 has not been credited to the state since March 2012. Specifically, in March 2012, TRLIA completed an eminent domain real estate transaction. DWR advanced the full state share of the estimated acquisition cost; however, the final property cost was less than originally estimated resulting in an unused balance of \$317,550 for its share of the property acquisition. As of January 2014, TRLIA had not remitted the fund balance nor utilized it as a credit against claimed project expenditures.

TRLIA Response: TRLIA acknowledges this observation, but believes it complied in good faith with the requirements of the funding agreement. There were multiple property acquisitions for the Feather EIP project. There are also multiple property acquisitions that the state has not yet paid their full share of the cost, which offsets the amount to be refunded to the state as cited in this observation.

Recommendation:

A. Apply the \$317,550 balance against claimed projects expenditures. DWR will make the final determination of the appropriate method to recover the overpayment.

TRLIA Response: TRLIA agree's that DWR will make the final determination. The historical and current agreement between TRLIA and DWR staff is that instead of sending individual checks to each other for each property acquisition, it is more effective and efficient to wait to process many of the acquisitions at strategic times to avoid redundant paperwork and issuing additional checks.

Please feel free to contact me, if you have questions or comments. My phone numbers are: 530-749-5679 (office), and 916-765-4981 (cell).

Sincerely,



Paul G. Brunner, P.E.
Executive Director

cc: Ms. Laura King Moon, Chief Deputy Director, California Department of Water Resources
Ms. Katherine Kishaba, Deputy Director of Business Operations, California Department of Water Resources
Ms. Gail Chong, Deputy Assistant DWR Executive, Bond Accountability, California Department of Water Resources
Mr. Jeff Ingles, Chief Auditor, California Department of Water Resources
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Ms. Julie Alvis, Deputy Assistant Secretary, California Natural Resources Agency
Mr. Bryan Cash, Deputy Assistant Secretary, California Natural Resources Agency
Mr. Sean Powers, Yuba County
Mr. Seth Wurzel, Larsen Wurzel & Associates (TRLIA)
Ms. Andrea Clark, Downey Brand (TRLIA)