

LOWER TULE RIVER IRRIGATION DISTRICT

Audit Report

FLOOD CONTROL SUBVENTIONS PROGRAM

Success Reservoir Enlargement Project

July 1, 2017, through December 31, 2018



BETTY T. YEE
California State Controller

October 2019



BETTY T. YEE
California State Controller

October 30, 2019

Eric Nichol, Acting Chief
Division of Flood Management
California Department of Water Resources
3310 El Camino Avenue
Sacramento, CA 95821

Dear Mr. Nichol:

The State Controller's Office audited claims submitted by the Lower Tule River Irrigation District for costs related to the Flood Control Subventions Program.

The district claimed costs of \$154,581 for the Success Reservoir Enlargement project for the period of July 1, 2017, through December 31, 2018. Our audit found that \$113,690 is allowable and \$40,891 is unallowable. Costs totaling \$40,891 are unallowable because the district was reimbursed for overhead costs that are prohibited by the funding agreement between the California Department of Water Resources and the district. The State share of allowable costs is \$79,583. The State share represents the percentage of state funding stipulated in California Water Code section 12585.5.

The district received \$97,386 in reimbursements. Therefore, the amount reimbursed in excess of the state share of allowable costs, totaling \$17,803, should be returned to the State through the California Department of Water Resources.

If you have any questions, please contact Efren Loste, Chief, Local Government Audits Bureau, by telephone at (916) 324-7226.

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/as

cc: Patrick Luzuriaga, Manager
Flood Control Subventions Program
Division of Flood Management
Department of Water Resources
Eric Limas, General Manager
Lower Tule River Irrigation District
Gary Fernandes, President
Board of Directors
Lower Tule River Irrigation District

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Audit Report

Summary

The State Controller's Office (SCO) audited the reimbursement claims of the Lower Tule River Irrigation District for costs related to the Flood Control Subventions Program. Our audit included the Success Reservoir Enlargement project, for the period of July 1, 2017, through December 31, 2018.

The district claimed costs of \$154,581 for the Success Reservoir Enlargement project for the period of July 1, 2017, through December 31, 2018. Our audit found that \$113,690 is allowable and \$40,891 is unallowable. Costs totaling \$40,891 are unallowable because the district was reimbursed for overhead costs that are prohibited by the funding agreement between the California Department of Water Resources (DWR) and the district. The State share of allowable costs is \$79,583. The State share represents the percentage of state funding stipulated in California Water Code section 12585.5.

The district received \$97,386 in reimbursements. Therefore, the amount reimbursed in excess of the state share of allowable costs, totaling \$17,803, should be returned to the State through the DWR.

Background

The State of California provides financial assistance to local agencies participating in the construction of federal flood control projects. Under the Flood Control Subventions Program (California Water Code, Division 6, Part 6, Chapters 1 through 4), the DWR pays a portion of the local agency's share of flood control project costs, including the costs of rights of way, relocation, and recreation and fish and wildlife enhancements.

California Water Code section 12832 requires the State Controller to audit completed projects to determine whether the state funds received were expended for the purposes and under the conditions authorized.

Objectives, Scope, and Methodology

Our audit objectives were to determine whether the costs claimed by the Lower Tule River Irrigation District for the Flood Control Subventions Program were:

- Allowable and in compliance with the DWR Guidelines for State Reimbursement on Flood Control Projects;
- Adequately supported and documented; and
- Reduced by applicable credits to program expenditures.

Our audit included the Success Reservoir Enlargement project, for the period of July 1, 2017, through December 31, 2018.

To achieve our objectives, we:

- Gained a limited understanding of the internal controls over the claim preparation process and the related accounting records by interviewing key personnel, completing an internal control questionnaire, reviewing the district's organization chart, and assessing the reliability of computer-processed data;
- Conducted a risk assessment to determine the nature, timing, and extent of substantive testing;
- Reviewed all of the DWR's claim evaluation reports on the district's claims;
- Determined whether the district received revenues that should have been offset against the flood program expenditures;
- Reviewed the district's claim detail for any condemnation interest, and determined whether the district had received interest on condemnation deposits;
- Determined whether the district had received from DWR advances on its flood control project expenditures; and
- Verified that the costs claimed were supported by source documents by judgmentally selecting non-statistical samples for the following categories:
 - Cash Contributions – We tested all \$200,000 in total cash contributions to the Army Corps of Engineers.
 - Labor – We tested all \$100,843 in labor costs.

For the selected samples, errors found, if any, were not projected to the intended (total) population.

We did not audit the district's financial statements. We limited our audit scope to planning and performing audit procedures necessary to obtain reasonable assurance that costs claimed were allowable for reimbursement. We considered the district's internal controls only to the extent necessary to plan the audit.

We conducted this performance audit under the general authority of Government Code section 12410 and the specific authority under California Water Code section 12832. We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Conclusion

Our audit found an instance of noncompliance with the requirements outlined in our audit objectives. This instance is quantified in the Schedule and described in the Finding and Recommendation section.

The district claimed costs of \$154,581 for the Success Reservoir Enlargement project for the period of July 1, 2017, through December 31, 2018. Our audit found that \$113,690 is allowable and \$40,891 is unallowable. Costs totaling \$40,891 are unallowable because the district was reimbursed for overhead costs that are prohibited by the funding agreement between DWR and the district. The State share of allowable costs is \$79,583. The State share represents the percentage of state funding stipulated in California Water Code section 12585.5.

The district received \$97,386 in reimbursements. Therefore, the amount reimbursed in excess of the state share of allowable costs, totaling \$17,803, should be returned to the State through the DWR.

**Views of
Responsible
Officials**

We issued a draft audit report on July 31, 2019. Eric Limas, General Manager, Lower Tule River Irrigation District, responded by mail dated August 9, 2019, disagreeing with the audit results. This final audit report includes the district's response as an attachment.

Restricted Use

This audit report is solely for the information and use of the Lower Tule River Irrigation District, the DWR, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

October 30, 2019

Schedule—
Summary of Project Costs
July 1, 2017, through December 31, 2018

Project/ Claim Number	Agency Claim Number	Actual Costs Claimed	Audit Adjustments ¹	Allowable per Audit	State Share of Eligibility % ²	State Share of Allowable Costs	Reimbursements Received by the District	Excess Reimbursements
3860-PM-919	226	\$ 120,439	\$ (26,767)	\$ 93,672	70%	\$ 65,570	\$ 75,877	\$ (10,306)
3860-PM-919	227	34,142	(14,124)	20,018	70%	14,013	21,509	(7,497)
Totals		<u>\$ 154,581</u>	<u>\$ (40,891)</u>	<u>\$ 113,690</u>		<u>\$ 79,583</u>	<u>\$ 97,386</u>	<u>\$ (17,803)</u>

¹See the Finding and Recommendation section.

²The state share of allowable project costs represents the percentage of state funding, as stipulated in the California Water Code, for each project cost category.

Finding and Recommendation

FINDING— Unallowable overhead costs

During the audit period of July 1, 2017, through December 31, 2018, the district submitted claims of \$154,581 for costs associated with the Success Reservoir Enlargement project. Of the \$154,581, the DWR will reimburse the district 70%, or \$108,207, for the State share. The district was reimbursed \$97,386; the remaining \$10,821 was retained pending SCO's audit of the project costs.

We tested \$100,843 in labor costs and found that \$40,891 associated with overhead is unallowable. The \$40,891 in overhead costs is unallowable because overhead costs are specifically prohibited by the Funding Agreement between the DWR and the district.

Section 7.10 of the funding agreement states:

Overhead and Indirect costs. "Indirect Costs" means those costs that are incurred for a common or joint purpose benefiting more than one cost objective and not readily assignable to the funded project (i.e., costs that are not directly related to the funded project). Examples of Indirect Costs include, but are not limited to: central service costs; general administration of the Funding Recipient; non-project-specific accounting and personnel services performed within the Funding Recipient's organization; depreciation or use allowances on buildings and equipment; the costs of operating and maintaining non-project-specific facilities; tuition and conference fees; and, generic overhead or markup. This prohibition applies to the Funding Recipient and any subcontractor or sub-agreement for work on the Project that will be reimbursed pursuant to this Agreement.

The district claimed ineligible overhead costs because it interpreted the definition of eligible costs incorrectly.

As a result of the unallowable costs of \$40,981, the district's total claim is reduced to \$113,690. The State share is 70%, or \$79,583. The district received \$97,386 in reimbursements, \$17,803 in excess of the total State share of reimbursable costs.

Recommendation

We recommend that the district return \$17,803 in excess reimbursements to the State through the DWR.

District's Response

The district responded to the draft audit report on August 9, 2019, disagreeing with the finding, stating, in part:

The Lower Tule River Irrigation District (District) disagrees with the finding and recommendations...

The audit claimed the District submitted costs of \$154,581 for the SREP of which \$40,891 was not allowed. The reason cited for the unallowable costs of \$40,891 was because the district submitted overhead costs that

were prohibited under the funding agreement between the California Department of Water Resources and the District. The audit cited Section 7.10 of the Funding Agreement as the reason for the unallowable cost.

Section 7.10 of the Funding Agreement describes costs that are ineligible to include overhead and indirect costs. Section 7.10 goes on to describe overhead and indirect costs as those that are incurred for a common purpose that benefit more than one cost objective and provides examples such as depreciation of assets, costs of operations and maintenance, tuition, conference fees or generic overhead or markup....

In the case of the agreement between the District and the DWR, the project was an updated economic analysis and the work was performed entirely by the U.S. Army Corps of Engineers (USACE) Sacramento District staff. The auditor requested the costs incurred by USACE and they provided a list of the staff time and rates. The USACE summary included a breakdown of their staff costs including salary, benefits, leave time etc. USACE labelled the costs that were not salary as "overhead." That is partially what created some of the confusion. The total of the USACE cost for staff overhead was the \$40,981 that the auditor determined was ineligible....

The audit also claimed the District submitted reimbursement for the ineligible costs because "it lacked the adequate procedures to ensure that only eligible costs" were charged to the SREP. That is false. The District has very adequate procedures in place and submitted the costs for reimbursement because it had determined those costs were allowed for under Section 7.0 of the agreement.

SCO Comment

Our recommendation that the district return \$17,803 in excess reimbursements to the state through the DWR remains unchanged.

The funding agreement between the district and the DWR for the Success Reservoir Enlargement project specifically lists eligible project costs and prohibits certain costs that are not eligible for reimbursement, which include overhead and indirect costs. Per the agreement, the prohibitions apply to the funding recipient, any subcontractor, or any sub-agreement for work on this project. Therefore, the prohibitions apply to the costs incurred by the USACE, which included unallowable overhead costs subsequently claimed for reimbursement by the district.

We modified the cause of the finding previously noted in the draft audit report. Further review of the documentation obtained throughout this audit showed that the district may have had procedures in place based on the representation letters included with the district's invoices to the DWR. The representation letters indicate that the district's claimed costs do not include Lower Tule River Irrigation District administrative overhead. However, we believe that the district incorrectly interpreted eligible costs, because it included in its invoices overhead costs incurred by a subcontractor, which are prohibited by the agreement.

**Attachment—
Lower Tule River Irrigation District's
Response to Draft Audit Report**



Lower Tule River

Irrigation District

SINCE 1950

Gary Fernandes
President

Tom Barcellos
Vice President

Jim Costa
Director

Joshua Pitigliano
Director

Alex Garcia
Director

Eric Limas
General Manager

Beth Grote-Lewis
Assessor

Alex Peltzer
Legal Counsel

August 9, 2019

Efran Loste, Chief
Local Government Audits Bureau
Division of Audits
P.O. Box 942850
Sacramento, Ca. 94250

Re: State Controller's Office Audit – Lower Tule River Irrigation District costs related to Flood Control Subventions Program

Dear Mr. Loste:

The Lower Tule River Irrigation District (District) disagrees with the finding and recommendations of the audit conducted for the Success Reservoir Enlargement Project (SREP) for the period of July 1, 2017 through December 31, 2018. We offer the following comments and request modification of the report accordingly:

The audit claimed the District submitted costs of \$154,581 for the SREP of which \$40,891 was not allowed. The reason cited for the unallowable costs of \$40,891 was because the district submitted overhead costs that were prohibited under the funding agreement between the California Department of Water Resources and the District. The audit cited Section 7.10 of the Funding Agreement as the reason for the unallowable cost.

Section 7.10 of the Funding Agreement describes costs that are ineligible to include overhead and indirect costs. Section 7.10 goes on to describe overhead and indirect costs as those that are incurred for a common purposed that benefit more than one cost objective and provides examples such as depreciation of assets, costs of operations and maintenance, tuition, conference fees or generic overhead or markup.

Read in context, Section 7.10 describes general "cost of doing business charges" that benefit multiple objectives. This would imply things like rent, light bills etc. that exist regardless as the common purpose to cover the overall work load and aren't attributable to a specific action or personnel group.

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Section 7.0 Eligible Project Cost precedes the list of ineligible items and specifically includes “reasonable costs of studies, engineering, design” and preparation of documentation as costs that are acceptable for reimbursement. Section 7.0 further provides for the payment of reimbursable administrative expenses that “are necessary costs incidental but directly related” to the purpose of the project for which the agreement was executed.

In the case of the agreement between the District and the DWR, the project was an updated economic analysis and the work was performed entirely by the U.S. Army Corps of Engineers (USACE) Sacramento District staff. The auditor requested the costs incurred by USACE and they provided a list of the staff time and rates. The USACE summary included a breakdown of their staff costs including salary, benefits, leave time etc. USACE labelled the costs that were not salary as “overhead.” That is partially what created some of the confusion. The total of the USACE cost for staff overhead was the \$40,981 that the auditor determined was ineligible.

The rationale behind the auditor’s recommendation does not track. The agreement allows for eligible costs to include study costs, engineering etc. If the District had retained a separate private engineering firm to perform the work, they would have applied rates for services which automatically take into account typical personnel overhead costs. In the case of this project, it was a joint effort between the District, DWR and the USACE who performed the work.

In summary, Section 7.10 was not intended to apply to personnel costs. It applies to charges that are common but not specific to any one project; Again, items like rent, electric bills etc. The costs USACE submitted were for each staff person who worked on the project and the breakdown of that person’s staff related charges specific to the project.

The audit also claimed the District submitted reimbursement for the ineligible costs because “it lacked the adequate procedures to ensure that only eligible costs” were charged to the SREP. That is false. The District has very adequate procedures in place and submitted the costs for reimbursement because it had determined those costs were allowed for under Section 7.0 of the agreement.

We believe the information provided in this letter properly addresses the accuracy of the findings of the audit. We respectfully request you review the audit in the context of the issues we have addressed and reverse the draft determination. Please contact our office if we can provide and additional information.

Sincerely,



Eric Limas
General Manager

**State Controller's Office
Division of Audits
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Sacramento, CA 94250**

<http://www.sco.ca.gov>