

CASMALIA COMMUNITY SERVICES DISTRICT

Annual Financial Report

For the Fiscal Year Ended
June 30, 2010



*Issued by the Office of Santa Barbara County Auditor-Controller
Robert W. Geis, CPA, Auditor-Controller*

Casmalia Community Services District
Annual Financial Report
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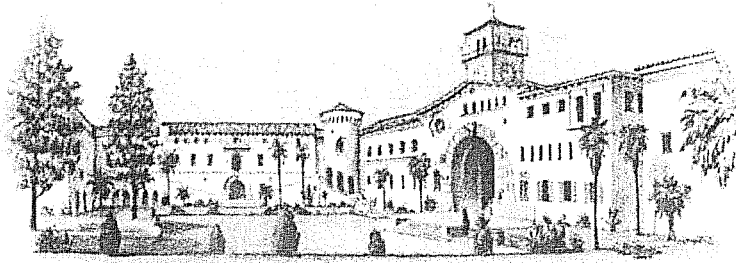
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BASIC FINANCIAL STATEMENTS

COUNTY OF SANTA BARBARA

ROBERT W. GEIS, C.P.A.
Auditor-Controller

THEO FALLATI, C.P.A.
Assistant Auditor-Controller



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OFFICE OF THE AUDITOR-CONTROLLER

Independent Auditor's Report

To The Board of Directors of the Casmalia Community Services District:

We were engaged to audit the accompanying basic financial statements of the Casmalia Community Services District (District) as of June 30, 2010, and for the year then ended. These financial statements are the responsibility of the District's management. We were engaged to express an opinion on the basic financial statements. Because of the matter described below we were not able to provide a basis for an audit opinion.

A management representation letter is a written confirmation by management to the auditor about the fairness of the District's financial statement information. Audit standards require that management acknowledge its responsibility for the accuracy of the District's financial statement information. The letter that the District provided to us failed to acknowledge this responsibility.

Because of the significance of the matter discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the basic financial statements.

Robert W. Geis, CPA
Auditor-Controller
September 9, 2011

Casmalia Community Services District
Statement of Net Assets
As of June 30, 2010

Assets

Current assets:

Cash	\$	40,078
Accounts receivable		
Charges for services		13,021
Intergovernmental		65,838
Prepaid assets		1,225
Insurance deposit		467
Total current assets		120,629

Noncurrent assets:

Restricted cash, customer deposits		3,568
Capital assets, net		404,350
Total noncurrent assets		407,918
Total assets		528,547

Liabilities

Current liabilities:

Salaries payable		737
Accounts payable		65,913
Total current liabilities		66,650

Noncurrent liabilities:

Customer deposits		3,568
Total noncurrent liabilities		3,568
Total liabilities		70,218

Net assets

Invested in capital assets		404,350
Unrestricted		53,979
Total net assets	\$	458,329

The accompanying notes are an integral part of these financial statements.

Casmalia Community Services District
Statement of Revenues, Expenses, and Changes in Fund Net Assets
For the Fiscal Year Ended June 30, 2010

Operating revenues:	
Water sales	\$ 104,726
Total operating revenues	104,726
Operating expenses:	
Salaries	6,776
Water and water testing	49,600
Insurance	2,619
Other services and supplies	25,247
Depreciation	70
Total operating expenses	84,312
Operating income	20,414
Nonoperating revenues:	
Intergovernmental	222,448
Total nonoperating revenues	222,448
Change in net assets	242,862
Net Assets - Beginning	240,682
Prior Period Adjustment	(25,215)
Net Assets - Beginning, restated	215,467
Net Assets - Ending	\$ 458,329

The accompanying notes are an integral part of these financial statements.

Casmalia Community Services District
Statement of Cash Flows
For the Fiscal year Ended June 30, 2010

Cash flows from operating activities:

Receipts from customers and users	\$ 104,323
Payments to suppliers	(73,653)
Payments to employees	(6,746)
Net cash provided by operating activities	23,924

Cash flows from capital and related financing activities

Subsidy from federal grant	156,610
Acquisition and construction of capital assets	(156,610)
Net cash provided by noncapital financing activities	-

Cash, July 1, 2009	19,722
Cash, June 30, 2010	\$ 43,646

Reconciliation of cash to the Statement of Net Assets

Cash per the Statement of Net Assets	\$ 40,078
Restricted cash per Statement of Net Assets	3,568
Total cash per Statement of Net Assets	\$ 43,646

Reconciliation of operating income to net cash provided by operating activities:

Operating income	\$ 20,414
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation expense	70
Decrease in accounts receivable	3,335
Increase in accounts payable	75
Increase in salaries payable	30
Total adjustments	3,510
Net cash provided by operating activities	\$ 23,924

The accompanying notes are an integral part of these financial statements

NOTES TO THE BASIC FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Casmalia Community Services District is an independent division of local government authorized by California Government Code Section 61000 et seq. The District is governed by a Board of Directors elected to serve four-year terms. These financial statements have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. There are no component units included in this report, which meet the criteria of a blended, or discretely presented, component unit as set forth by the Governmental Accounting Standards Board (GASB), which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The accounts of the District are organized into one fund, the Enterprise Fund. It accounts for all the financial resources and the legally authorized activities of the District. The fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The single fund is maintained consistent with legal and managerial requirements.

The Enterprise Fund is a proprietary fund used to account for the District's general government activities. Enterprise funds are used to account for those operations that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs of providing goods and services to the general public on a continuing basis be financed or recovered primarily through user charges. Proprietary funds use the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when incurred, regardless of the timing of related cash inflows and outflows. In addition, long-lived assets (such as buildings and equipment) are capitalized and depreciated over their estimated economic lives.

The District has elected not to apply Financial Accounting Standards Board (FASB) Statements and Interpretations issued after November 30, 1989. The District applies all applicable GASB pronouncements as well as statements and interpretations of FASB, the Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of Casmalia Community Services District's Enterprise Fund are charges to customers for water sales. Operating expenses for the Enterprise Fund include salaries, water and water testing, insurance, depreciation on capital assets, and other services and supplies. If any revenues and expenses did not meet this definition, they would be reported as non-operating revenues and expenses.

Financial Statements

Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements and Managements' Discussion and Analysis for State and Local Governments* (GASB 34), was issued to improve governmental financial reporting for citizens, district representatives, and creditors involved in the lending process. GASB 34 requires special-purpose governments engaged only in business-type activities to present the following financial statements:

- Statement of Net Assets
- Statement of Revenues, Expenses and Changes in Fund Net Assets
- Statement of Cash Flows

Cash

Pursuant to California Government Code Section 61053, District cash is on deposit in a financial institution checking account and not in the County Treasury. For the purposes of the Statement of Cash Flows, restricted cash and cash on deposit in the financial institution checking account are considered cash.

Receivables

Accounts receivable are deemed to be collectible at June 30, 2010, and as such, the District has no allowance for uncollectible accounts for these receivables.

Restricted Cash

The "customer deposits" account reflects cash from deposits held for services and will be eventually returned to the customer. These amounts are recorded as restricted cash on the Statement of Net Assets.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Capital Assets

Capital assets are recorded in the District's Statement of Net Assets at cost if purchased or constructed. Donated capital assets are recorded at the estimated fair market value at the date of donation.

The costs of normal maintenance that do not add to the value of the asset or materially extend assets' lives are expensed as incurred. Capital assets are depreciated at cost using the straight-line method over a 20 to 50 year useful life.

Net Assets

Net Assets are categorized as Invested in Capital Assets, Restricted, and Unrestricted Net Assets. Invested in Capital Assets represents the government's equity interest in its capital assets. Restricted Net Assets are reported when constraints placed on net assets are either externally imposed or imposed by law through constitutional provisions or enabling legislation. Unrestricted Net Assets represents net assets of the District that are not restricted for any project or other purpose.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

2. CASH

As of June 30, 2010, the District had total cash of \$43,646. The District has not formally adopted a deposit or investment policy that limits the allowable deposits or investments and addresses the specific types of risk to which the District is exposed.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits that are in the possession of an outside party. This risk is mitigated in that the District's deposits are protected by Federal depository insurance coverage up to the amount of \$250,000.

3. INTERGOVERNMENTAL RECEIVABLE

On June 24, 2008, the District was awarded a Federal grant for the improvement of the District's water system. On June 30, 2010, the District had \$65,838 receivable from the Federal granting agency for cost reimbursement of expenses incurred in replacing the District's water system.

4. CAPITAL ASSETS

Capital assets activity for the fiscal year ended June 30, 2010 is as follows:

	Balance July 1, 2009	Additions	Deletions	Balance June 30, 2010
Capital assets, not being depreciated:				
Construction in progress*	\$ 180,992	\$ -	\$ (180,992)	\$ -
Total capital assets, not being depreciated	<u>180,992</u>	<u>-</u>	<u>(180,992)</u>	<u>-</u>
Capital assets, being depreciated:				
Structures and improvements	189,149	403,440	(24,949)	567,640
Total capital assets, being depreciated	<u>189,149</u>	<u>403,440</u>	<u>(24,949)</u>	<u>567,640</u>
Less accumulated depreciation for:				
Structures and improvements	(188,169)	(70)	24,949	(163,290)
Total accumulated depreciation	<u>(188,169)</u>	<u>(70)</u>	<u>24,949</u>	<u>(163,290)</u>
Total capital assets, being depreciated, net	<u>980</u>	<u>403,370</u>	<u>-</u>	<u>404,350</u>
Total capital assets, net	<u>\$ 181,972</u>	<u>\$ 403,370</u>	<u>\$ (180,992)</u>	<u>\$ 404,350</u>

*The July 1, 2009 balance of construction in progress was reduced by \$41,689 from the prior year to reflect a prior period adjustment. (Note 12)

Structure and improvement additions relate to the District's new water system components. (Note 3)

5. ACCOUNTS PAYABLE

The District's accounts payable balance is primarily comprised of the amount due to its contractor for work performed on the replacement of the District's water system. (Note 3)

6. EASEMENT LICENSE

Part of the District's water system is located on land that is subject to a license agreement with the US Department of the Air Force (the grantor). The license provides the District rights to utilize the grantor's land for five year terms. The current term remains in effect until April 30, 2013, however, the license may be terminated at will by the grantor. Furthermore, upon termination, the license terms and conditions require the District to remove all property and restore the lands to their original condition.

7. RISK MANAGEMENT

The District is exposed to various risks of damage to, and destruction of assets, injuries to employees, and general liabilities. These risks are mitigated through the District's membership in TWIW Insurance Services, a commercial insurance carrier.

8. CONTINGENCIES

The District recognized as revenue, Federal grant monies received as reimbursement of costs incurred in replacing the District's water system. The grant may be subject to financial and compliance audits by the granting agency. The amount, if any, of expenditures which may be disallowed by the granting agency cannot be determined at this time, although the District expects such amounts, if any, to be immaterial.

Additionally, during the fiscal year, a consultant was hired to evaluate the contracted services for the water system to determine compliance with the Federal grant. As of June 30, 2010, the consultant determined that \$75,212 of services were unallowable under the Federal grant terms and conditions. Subsequent to fiscal year end, the contractor reduced the outstanding balance to \$36,247 and revised the invoices to be contingent upon the District obtaining an alternative source of funding for the work performed.

9. RELATED PARTY TRANSACTIONS

The District sells a substantial portion of its water to the Hitching Post Restaurant (Restaurant), an entity in which a member of the District's board is the owner and the District's secretary, is affiliated. Furthermore, the District's secretary is an immediate family member of the Restaurant owner. The Restaurant is charged water rates consistent with all District commercial customers, amounting to \$9,963 during the fiscal year ended June 30, 2010. At June 30, 2010, the Restaurant had an outstanding current receivable balance of \$897 for water fees.

10. BUDGETARY INFORMATION

In accordance with California Government Code Section 61110, on or before September 1st of each fiscal year or, for districts using two one-year budgets or a biennial budget, every other year, the District must prepare and submit a board approved budget to the County Auditor. For the fiscal year ended June 30, 2010, a budget was adopted for the Enterprise Fund on a cash basis. Any changes in the annual budget must be changed by a vote of the District's Board of Directors.

11. DEPENDENCE ON ONE MAJOR SUPPLIER

The District is dependent on Casmite Corporation for its water supply. As water sales are the primary source of revenue for the District, the loss of Casmite Corporation as a principal supplier would have material adverse effects on the District's business, financial condition, and results of operations. Additionally, the District is dependent on the ability of the supplier to provide its product on favorable pricing terms.

12. PRIOR PERIOD ADJUSTMENT

An adjustment was made to the prior period to reduce the amount of construction in progress recorded by \$41,689 and accounts payable accrued by \$16,474. As a result of the adjustment, beginning net assets decreased by \$25,215.

13. SUBSEQUENT EVENTS

During fiscal year 2008, the District was awarded Proposition 50 (Prop 50) funds from the State of California in the amount of \$631,700. Due to a billing discrepancy which occurred during the fiscal year ended June 30, 2010, the State Department of Finance initiated a review of the District's Prop 50 funding which concluded on February 17, 2011. A copy of the report can be obtained on the State Department of Finance's webpage, http://www.dof.ca.gov/osae/audit_reports. The review contained recommendations to ensure corrective action.

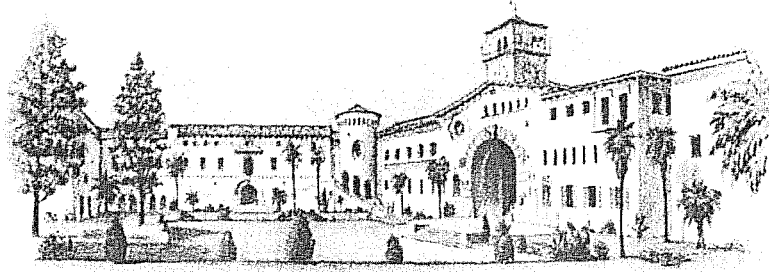
On July 20, 2011, the District entered into an agreement not to exceed \$64,950 for engineering services for the District's water tank replacement.

On August 9, 2011, the District entered into a Memorandum of Understanding (MOU) with the County of Santa Barbara Water Agency (County) regarding the Prop 50 award. Under the terms of the MOU, Prop 50 monies due for the District's water system and received on the District's behalf by the County shall be paid directly by the County to the contractor, design/engineering firm or other person or entity to whom payment is due.

COUNTY OF SANTA BARBARA

ROBERT W. GEIS, C.P.A.
Auditor-Controller

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OFFICE OF THE AUDITOR-CONTROLLER

September 9, 2011

To the Board of Directors of Casmalia Community Services District:

We noted certain matters involving internal control and other operational matters that are presented for your consideration. We will review the status of these comments during our next audit engagement. Our comments and recommendations are intended to improve the internal control or result in other operating efficiencies. We would be pleased to discuss these comments in further detail at your convenience, perform any additional study of these matters, or assist you in implementing the recommendations. Our comments are summarized as follows:

Finding 1: Accounting Function (Repeat Finding)

We identified material adjustments in the District's general ledger that were not initially identified by the District. As a result, the District does not have internal controls in place to prevent, detect, and correct material misstatements in the financial statements. This also demonstrates that the District does not have sufficient accounting expertise to prepare financial statements in accordance with generally accepted accounting principles. We noted the following items while reviewing the District's records:

- Prior year audit adjusting journal entries were not recorded.
- Customer deposits are not applied to delinquent accounts.
- Customer accounts had negative receivable balances for greater than 90 days.
- The District did not maintain bank reconciliations and prepare entries to adjust the cash balance for a reconciling item outstanding for 2 years.
- Capital asset additions were recorded as expenses instead of assets.
- The District did not record an allowance for uncollectible customer accounts.
- Accrual entries were not recorded for both revenue and expense accounts.
- Grant funds returned to the State were recorded as an expense instead of a reversal of revenue.

Recommendation

We recommend that the District contract with an accountant or an accounting consultant to review complicated transactions and help ensure that the financial statements are prepared in accordance with generally accepted accounting principles and governmental accounting codifications and standards. Additionally, we recommend that the District implement the following procedures:

- Annually record adjustments provided by auditors.

- Formally establish a policy for applying customer deposits to delinquent accounts.
- On a periodic basis, evaluate accounts receivable for collectability and record any necessary adjustments.
- Determine why the District has negative receivable accounts and whether money should be refunded to the customer.
- Maintain records of bank reconciliations performed and correct outstanding reconciling items.

Finding 2: Independent Contractor Status (Repeat Finding)

Currently, the District classifies a worker as both an employee and an independent contractor. We noted some deficiencies that may raise question to an individual's status as an independent contractor. For example, the District does not have a written contract with the independent contractor or submit a form 1099-MISC to the IRS. If someone treated as an independent contractor is judged by the IRS to be an employee, the District could be responsible for back payroll taxes, as well as interest and penalties.

Recommendation

We recommend that the District review the IRS regulations regarding the classification of workers as employees or independent contractors. If the District concludes that the worker should be classified as an independent contractor, take steps to comply with IRS requirements and to justify the District's conclusion. The following are some ways the District could help protect the individual's classification as an independent contractor:

- Segregate the duties performed by the worker as an independent contractor and an employee. If the duties performed by an employee are similar to those performed by the same individual working as an independent contractor, the IRS is likely to judge that the individual is not an independent contractor.
- Obtain a written contract with the worker that clearly defines his duties and fees as an independent contractor.
- Report payments made to the independent contractor by submitting a form 1099-MISC to the IRS.

Finding 3: Conflict of Interest

We noted a member of management and of the Board of Trustees that may have economic interests that could affect their ability to participate in rate setting or other potential areas of conflict.

Recommendation

We recommend that the District have an attorney evaluate management's economic interests to determine whether a conflict of interest exists.

Finding 4: District Treasurer

We noted that the District does not utilize the County of Santa Barbara as its depository. Pursuant to Government Code Sections 61050 and 61053, when an alternative depository is utilized, the District board of directors is required to appoint a District treasurer to serve in place of the county treasurer. Furthermore, the District's treasurer is required to be bonded. We noted that the staff member currently handling the District's finances was not formally appointed as the District's treasurer and is not bonded.

Recommendation

We recommend that the District formally appoint a treasurer for handling the District's finances. We also recommend that the District provide bond insurance to the appointed treasurer.

Finding 5: Supporting Documentation

The District did not retain construction documents related to the purchase of the 1983 water system. Therefore, the auditors could not accurately determine the cost of the original components that were not replaced by the new system.

Recommendation

We recommend that the District ensure that it retains adequate documentation to support financial statement accounts.

* * *

We believe that the implementation of these recommendations will provide the District with a stronger system of internal control while also making its operations more efficient.

This communication is intended solely for the use of the District Board and the District's management. However, this letter is a matter of public record and its distribution is not limited.

We thank the District Board and management for the opportunity to serve the District. We appreciate the courtesy and cooperation extended to us and would be pleased to discuss the contents of this letter with you.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "R. W. Geis". The signature is fluid and cursive, with a large initial "R" and "G".

Robert W. Geis, CPA
Auditor-Controller

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AUDITOR CONTROLLER

**CASMALIA COMMUNITY SERVICES DISTRICT
P.O. BOX 207
CASMALIA, CA 93429**

September 9, 2011

The Honorable Robert W. Geis
CPA Santa Barbara County
Auditor-Controller P.O. Box 39
Santa Barbara, CA 93102-0039

Dear Mr. Geis:


We are providing this letter at your request in connection with your audit of the financial statements of the Casmalia Community Services District ("CCSD") as of June 30, 2010, and for the year then ended for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Casmalia Community Services District and the respective changes in financial position and, where applicable, cash flows thereof in conformity with U.S. generally accepted accounting principles (hereinafter, collectively, "Financial Matters").

At the outset, it should be noted that the assertions/responses set forth herein are conditioned upon the fact that we are, in no way, professionally qualified to comment on the Financial Matters, including, but not limited to, the audit performed by you and the financial statements you provided to us. As you are likely aware, our knowledge of such matters is cursory at best. Indeed, we have no clear understanding of a myriad of the terms used in the financial statements and accompanying paperwork provided by your office, including, but not limited to, the following terms and phrases; "U.S. generally accepted accounting principles," "capital assets," "related depreciation," and "carrying value."

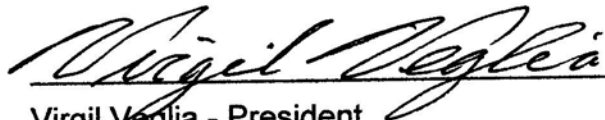
While we do not have the knowledge and/or resources to confirm and/or opine as to the legitimacy of most of the items presented in the Financial Matters, CCSD is able to assert, based on CCSD's information and belief, that you have been provided with all the documents in CCSD's possession that you have requested.

As always, thank you for your time and effort in this matter.

Sincerely,

A handwritten signature in cursive script, appearing to read "Terri Stricklin".

Terri Stricklin – Bookkeeper
Casmalia Community Services District

A handwritten signature in cursive script, appearing to read "Virgil Veglia".

Virgil Veglia - President
Casmalia Community Services District

February 17, 2011

Mr. Charles R. Hoppin, Chair
State Water Resources Control Board
1001 I Street, 25th Floor
Sacramento, CA 95814

Dear Mr. Hoppin:

Management Letter—State Water Resources Control Board, Review of Santa Barbara County Water Agency Grant Agreement 08-613-550

In accordance with our bond oversight responsibilities, the Department of Finance, Office of State Audits and Evaluations (Finance), initiated a fiscal compliance audit of a Proposition 50 (Prop 50) grant awarded by the State Water Resources Control Board (State Water Board) to the Santa Barbara County Water Agency (County Water Agency). The audit was to be conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain sufficient, appropriate evidence to support our conclusions.

Finance outlined the engagement in a letter dated February 25, 2010 and held an entrance conference on March 2, 2010. Because all disbursed grant funds were returned to the State Water Board, Finance changed its focus to a review of the County Water Agency's grant controls and monitoring processes. Accordingly, this letter summarizes the results and risks specific to the following:

- Information about the double billing incident identified by the State Water Board.
- Grant-related internal controls and oversight activities of the County Water Agency and other related parties, including controls that failed or were overridden.
- The County Water Agency's Corrective Action Plan (CAP) to determine if it is adequately designed to ensure an effective system of internal accounting and administrative controls over grant funds.

Various interviews of key personnel were conducted, and applicable policies, procedures, and documentation were reviewed to gain an understanding of relevant internal controls.

BACKGROUND

Under the Integrated Regional Water Management Grant Program, the State Water Board awarded the County Water Agency a \$25 million Prop 50 implementation grant (Prop 50 grant) in December 2008. This grant (Grant Agreement 08-613-550) is comprised of 14 separate project components.

Of the \$25 million awarded, \$631,700 was budgeted for the Casmalia Community Services District's (Casmalia CSD) Water System Retrofit Project (Project C4). Project C4's objective was to replace Casmalia CSD's leaking water storage tank, repair an access road leading to the tank, and replace service laterals connecting the tank to the Casmalia CSD's main water lines.

In September 2008, Casmalia CSD was also awarded a \$410,579 Community Development Block Grant (CDBG grant) from the United States Department of Housing and Urban Development (HUD). Both grants were awarded to improve the Casmalia CSD's water system. The County Water Agency administers the Prop 50 grant while the CDBG grant is administered by the County of Santa Barbara (County), HUD Unit (County HUD Unit).

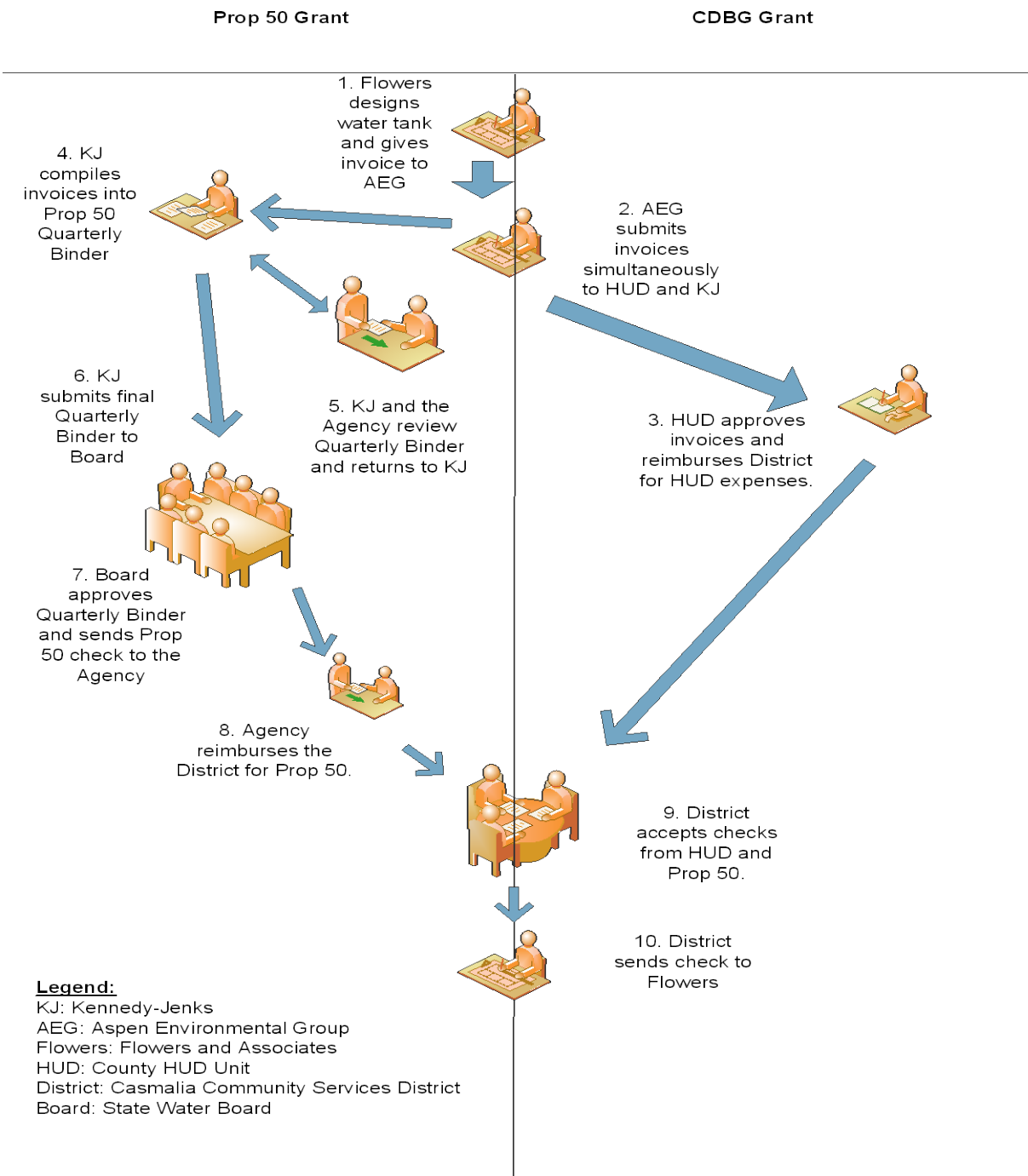
The Casmalia CSD selected Flowers and Associates (Flowers) to act as Project C4's prime contractor. Flowers also has a financial interest as a contractor in two other components—C1 and C2—which are not subject to this review. The key parties involved in Project C4's claims process are:

Figure 1: Key Parties Involved in Project C4

Flowers	<ul style="list-style-type: none"> • Prime Contractor for Casmalia CSD's water project; designed and engineered the project; hired subcontractors to perform labor, invoicing, and reimbursement claims; was awarded the original bid from the County HUD Unit and the Prop 50 bid due to already working on the CBDG Grant.
Aspen Environmental Group (AEG)	<ul style="list-style-type: none"> • Hired by Flowers and provided environmental design services; oversaw day-to-day project operations; prepared subcontractors' invoices; compiled supporting documents for the Prop 50 and CDBG claimed costs. AEG submitted data electronically to Kennedy Jenks for approval.
Kennedy Jenks	<ul style="list-style-type: none"> • Hired by the County Water Agency to review, compile, and report fiscal and project information submitted by AEG. Their web-based system allowed sub-recipients to upload images of financial and project reporting documents. Once the County Water Agency approved the Quarterly Binder, it was submitted to the State Water Board for final approval and reimbursement. The Quarterly Binder contains all invoices claimed for reimbursement for a particular quarter, including the supporting documentation.
County Water Agency	<ul style="list-style-type: none"> • The Prop 50 grantee who provided technical support to the sub-recipients, verified the mathematical accuracy of the information in the Quarterly Binder, and submitted approved Quarterly Binders to Kennedy Jenks.
County HUD Unit	<ul style="list-style-type: none"> • The CDBG grantor who provided technical support to Casmalia CSD to build a water tank and put in new laterals. Approved invoices from Flowers and paid Flowers for work completed.
County Auditor-Controller's Office	<ul style="list-style-type: none"> • Performed other administrative duties. Accounting Unit prepared the necessary accounting entries and the County Auditor-Controller's Office performed desk reviews of the Quarterly Binders for the County Water Agency.

In March 2009, Flowers—through its agent Aspen Environmental Group (AEG)—billed the Prop 50 grant using the same invoices previously submitted and reimbursed by the County HUD Unit. Figure 2 illustrates how Flowers was able to obtain duplicate payments.

Figure 2: Process Flowchart of Prop 50 and CDBG Claimed Costs



Although our review was limited to Project C4, our recommendations should be implemented to ensure the success of the entire \$25 million Prop 50 grant project.

RESULTS

Observation 1: Double Billing Occurred Due to Controls Being Overridden

In June 2009, AEG submitted a project scope change to the State Water Board. In July 2009, the State Water Board received a second letter stating “extra” funds were available, which drew attention to the CDBG grant. After the State Water Board researched the issue, it came to their attention a duplicate claim for Prop 50 reimbursement was already paid by the CDBG grant. The State Water Board demanded repayment and corrective measures be implemented. Funding for the entire project was halted.

In response to the State Water Board’s demands, the County Auditor-Controller’s Office conducted an investigation and confirmed the duplicate payment. The County Water Agency repaid the State Water Board \$131,371 in September 2009 and submitted a Corrective Action Plan (CAP) in January 2010 to address the State Water Board’s concerns. Further, the County Auditor-Controller’s Office referred the incident to the Santa Barbara County Sheriff’s Office for further investigation. Resumption of grant funding is contingent on the State Water Board’s approval of the CAP.

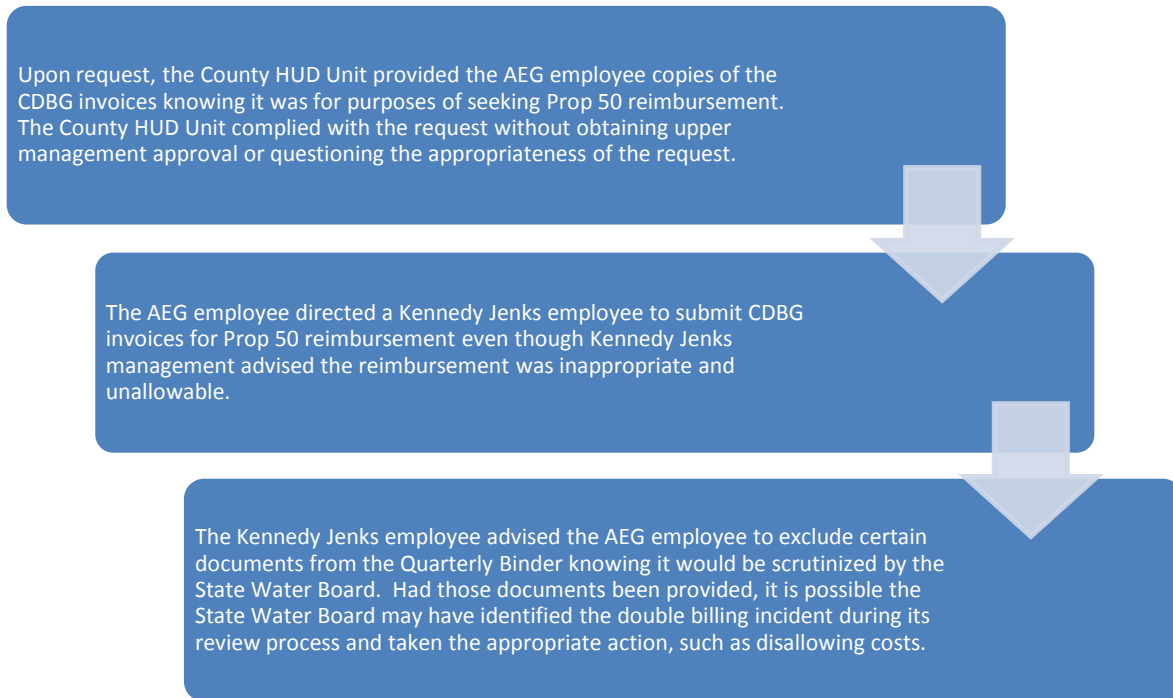
As stated in the *Background*, different parties are expected to perform distinct types and levels of review over claimed costs to ensure accuracy and propriety. However, weak implementation of certain controls permitted the double billing incident to occur.

Our interviews indicated Flowers had a closer working relationship with the County HUD Unit rather than the Casmalia CSD. This relationship may have impaired objective and independent project oversight. For example, the County HUD Unit performed duties for the CDBG grant that should have been performed by the Casmalia CSD, such as invoice preparation. The County HUD Unit compiled invoice information from Flowers, created the invoices, obtained the Casmalia CSD’s signature, and submitted signed invoices to HUD for reimbursement. This practice prohibits proper segregation of duties.

At times, Flowers would inquire directly with the County HUD Unit about payment information and funding opportunities. As the grantor, the County HUD Unit should be less involved with invoice preparation, and conduct oversight functions to ensure the project is within scope and cost. This County HUD Unit practice demonstrates a weak control environment.

AEG would receive invoices from Flowers and submit the invoices to both the County HUD Unit and to the County Water Agency on behalf of Flowers. Since Flowers employs AEG and guided their actions, it appears Flowers influenced the double billing incident. Based on our interviews, the following chain of events led to the double billing incident:

Figure 3: Chain of Events Leading to Double Billing Incident



Recommendations:

The State Water Board should ensure the County Water Agency:

- A. Provides ongoing training for key personnel to ensure local, state, and federal policies are followed, and to increase awareness on topics such as independence, conflicts of interest, unethical activities, and fiduciary controls.
- B. Re-evaluates the grant-related internal control structure to ensure adequate segregation of duties.

Observation 2: Grant Management Practices Require Improvement

As the administrator over grant funds, the County Water Agency should implement stronger grant management practices to increase its effectiveness. Based on our interviews, the County Water Agency and the County Auditor-Controller’s Office dedicated about three days to review a voluminous Quarterly Binder. The County Water Agency’s Grant Manager claims he spends approximately five hours to review Quarterly Binders, which provide the basis for all reimbursed claims. The Grant Manager’s review mostly consists of recalculations and a cursory review to ensure completeness. This level of project review is insufficient.

Given all parties have a large investment in this project, those charged with project oversight should be dedicated to monitoring the project to ensure it is within scope, schedule, and cost. An overall plan should be developed to address potential risks affecting the 14 components. Potential risks may be events or issues preventing the achievement of the project’s objectives. For example, disadvantaged communities with limited experience and knowledge in grant

management, such as the Casmalia CSD, may require the County Water Agency to provide a higher level of technical assistance and support.

Recommendations:

The State Water Board should ensure the County Water Agency develops:

- A. A project risk assessment/plan for the 14 project components to ensure limited resources are monitoring the higher risk components.
- B. Stronger grant management practices to increase its effectiveness by employing continuous interim monitoring. Such efforts could include regular communications with the sub-grantees, periodic site visits, and unannounced reviews of selected invoices. Documentation of such efforts should be maintained for audit purposes.

Observation 3: The Corrective Action Plan Appears Adequate if Implemented as Designed

The double billing incident demonstrates signs of ineffective communication and poor coordination among personnel charged with Prop 50 grant responsibility, and that grant management practices need to be improved. As a result, the County Water Agency submitted a CAP to demonstrate steps planned or taken with respect to administration of the Prop 50 grant and any future state grants.

If the CAP is implemented as designed, the County Water Agency's controls would improve. We provide comments with respect to certain Exhibits in the CAP:

- *Exhibit 1 (Listing of Invoices) and Exhibit 4 (Project Budget Sheet):* These documents will be submitted to the State Water Board along with the Quarterly Binder. However, the risk exists these Exhibits may not be completed uniformly. It is also unclear if supporting documentation for match and other funding source information will be submitted.
- *Exhibit 2 (Letter of Notification):* This letter explains the double billing incident and reminds all grant managers about their responsibilities. Based on our review, it appears Exhibit C, Items 13 and 15 of the Grant Agreement 08-613-550 are not being complied with; however, these provisions are not addressed in this Exhibit.
- *Exhibit 3 (Sub-Grantee Certification):* The certification includes a provision that the sub-grantee will submit their most recent audited annual financial statements to the County Water Agency prior to finalizing the grant agreement. However, no mention is made that invoices reimbursed with Prop 50 funds are subject to audit at any time. It is unclear if this certification is incorporated in the sub-grant agreements.

The CAP's Exhibits have since been completed by the County Water Agency and sub-grantees. Those documents were marked as "received" by the State Water Board.

Recommendations:

To ensure the CAP is implemented as designed, the State Water Board should:

- A. Continue to review the CAP on an ongoing basis. This can be performed in conjunction with other interim monitoring efforts, such as attending the quarterly meetings.
- B. Review the Exhibits submitted and, if necessary, provide guidance if they were not completed uniformly or consistently. In addition, provide clarity regarding the requirements of maintaining supporting documentation.
- C. Ensure the County Water Agency as well as sub-grantees are complying with the grant agreement.
- D. Include a provision in Exhibit 3 or amend the sub-grant agreements to include additional audit requirements. A common provision included in grant agreements is state funds are subject to audit at any time during the grant agreement period and for a defined time period after project completion (e.g., three years after final payment is made).

We appreciate the assistance and cooperation of all parties involved. If you have any questions regarding this report, please contact Frances Parmelee, Manager, or Rich Hebert, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

cc: Mr. Esteban Almanza, Deputy Director, State Water Resources Control Board
Ms. Laura McLean, IRWM Program Manager, State Water Resources Control Board
Mr. Doug Wilson, Interim Administrative Manager, State Water Resources Control Board
Ms. Kelley List, Engineering Geologist, State Water Resources Control Board