



Audit of the Alternative Water Supply Program's Funding Process

Report # 07-08

Prepared by
Office of Inspector General

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SOUTH FLORIDA WATER MANAGEMENT DISTRICT

October 9, 2007

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Re: Audit of the Alternative
Water Supply Program's
Funding Process
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This audit was performed pursuant to the Inspector General's authority set forth in Chapter 20.055, F.S. The audit focused on determining whether funding for alternative water supply projects are awarded in accordance with the State's Water Protection and Sustainability Program and the District's Governing Board's guidelines. Our objectives also determined whether the contract agreements are adequately monitored. This report was prepared by Jankie Bhagudas and Tim Beirnes.

Sincerely,

John W. Williams, Esq.
Inspector General

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BACKGROUND

In accordance with the Office of Inspector General's Fiscal Year 2007 Audit Plan, we conducted an Audit of the Alternative Water Supply Funding Process.

The District's Water Supply Department (Water Supply) is situated within Water Resources Management. Its mission is to provide for reasonable and beneficial uses of water for agricultural and urban demands while protecting and restoring the environment and water resources of the region. This mission is partly accomplished through the Alternative Water Supply Funding Program (AWS), which provides funding assistance mainly to local governments and utilities for project support where future water needs will primarily be met through the development of alternative water sources. Alternative water supply includes saltwater; brackish surface and groundwater; water captured predominately during wet-weather flows; sources made available through the addition of new storage capacity; reclaimed water; stormwater; and any other water supply source designated as nontraditional in a regional water supply plan.

The District has been funding alternative water supply projects for over 10 years. In 2005 the Florida Legislature revised state law and created the Water Protection and Sustainability Program (Senate Bill 444). The alternative water supply portion of this program (codified in Section 373.1961, Florida Statutes) places great emphasis on the development of alternative water supplies and provides for significant recurring State funding of alternative water supply projects. This program also changed the role and content of the regional water supply plans. Specifically, the District's four regional water supply plans had to be updated to include specific water supply and water resource projects that can produce sufficient water supply to exceed the estimated demands of the year 2025. The plans have to be updated every five years. In addition, local governments are required to be more involved in the water supply planning process than they have been in the past.

The Legislation established a recurring annual source of state funding for alternative water supply projects, which is required to be matched with District funds. Prior to the Water Protection and Sustainability Program, the only source of funding for alternative water supply projects was the District's ad valorem tax revenue because the

District did not receive any State funding. During FY 2001 to FY 2005, the District funded over \$17M to alternative water supply projects. Annual District funding ranged from \$500,000 to \$6M during this period.

The District received \$30M in FY 2006 and \$18M in FY 2007 for alternative water supply projects from the State's Water Protection and Sustainability Program Trust Fund and satisfied the matching requirements in both years. Further, it is anticipated that the District will receive another \$18M to fund FY 2008 alternative water supply projects; however, future funding amounts are not guaranteed. It should be noted that the District is required to encumber State funding within 19 months of receipt. In order to retain State funding, unused funds must be certified forward and reallocated to other alternative water supply projects. The table below illustrates the amounts allocated to funding alternative water supply activities for FY 2006 and FY 2007.

FY 2006 AWS Funding	
State Funding	\$30,000,000
District Match (Exceeded matching requirement)	30,827,594
Total	60,827,594
FY 2007 AWS Funding (As of April 2, 2007)	
State Funding	\$18,000,000
District Match - Ad Valorem Funds Budgeted to AWS Projects**	18,000,000
Big Cypress Basin - Ad Valorem Funds Budgeted to AWS Projects	2,100,000
Unused and Unallocated State Funding Carried Forward from FY 2006 (Due to Contract Cancellations and Amendments)	3,485,584
Big Cypress Basin Funding Carried Forward from FY 2006	270,000
Total AWS Fund Budgeted/Allocated for FY 2007	\$41,855,584

** - As of April 2, 2007, \$16,625,916 of the District's \$18M has been allocated to AWS projects and \$1,374,084 is unallocated.

As of April 2, 2007, \$26,222,016 of the \$30,000,000 in State FY 2006 funding was either expended or allocated to specific alternative water supply projects; \$3,485,584 was unused and unallocated (due to contract cancellations and amendments) and rolled forward to FY 2007 projects to comply with funding requirements; and \$292,400 was encumbered but not spent in FY 2006 and is expected to be spent in FY 2007. The District's match of \$30,827,594 consisted of funds allocated to new and on-going

alternative water supply projects, conservation efforts and water resource development projects. Specifically, \$13,209,464 of the District's match was allocated to alternative water supply construction activities and \$16,873,125 was allocated to other water supply projects. The remaining \$745,005 represents FY 2006 funds that were rebudgeted in reserves for future use.

The District provides funding on an annual basis and funds are required to be expended by grant recipients in the fiscal year awarded. In FY 2006, the District received 119 applications and funded 80 projects, of which 71 projects were completed and 133 million gallons per day of water was made available from alternative sources. In FY 2007, the District received 73 applications and funded 62 projects that will increase water availability by 65 million gallons per day.

OBJECTIVES, SCOPE, and METHODOLOGY

Our objectives focused on determining whether funding for alternative water supply projects is awarded in accordance with the State's Water Protection and Sustainability Program and the District's Governing Board's guidelines. Our objectives also determined whether the contract agreements are adequately monitored.

To accomplish our objective we obtained an understanding of the Alternative Water Supply Program by interviewing key personnel in the Water Supply Department and reviewing relevant policies and procedures, (e.g., State's Water Protection and Sustainability Program and District guidelines). We determined whether fiscal year 2007 funded projects were included in the appropriate regional water supply plan. We also examined the fiscal year 2007 funding process to determine whether funds were being allocated in accordance with State and District funding guidelines. In addition, we selected a sample of contract agreements and determined whether the agreements were adequately monitored.

Our audit was conducted in accordance with Generally Accepted Government Auditing Standards. These 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.

AUDIT RESULTS

Executive Summary

Overall, our audit revealed that the District's Alternative Water Supply Program is being administered in compliance with State laws and District guidelines. Water Supply staff did an excellent job of implementing new alternative water supply statutory requirements that took effect in FY 2006 and made several improvements in the FY 2007 funding process. In addition, the FY 2008 funding process has been further enhanced, as the funding process is still evolving.

Our review also disclosed that the District's four Regional Water Supply Plans have been updated and the alternative water supply projects funded in FY 2007 were included in the Regional Water Supply Plans in accordance with State statutes. Further, pursuant to Section 373.1961(3) significant weight must be given to certain factors when determining the projects that will be selected for funding and no one factor is designated as a precondition for funding assistance. The legislature did not give specific directions on how the different factors should be weighed. The Governing Board decided to fund projects that met the definition of an alternative water supply project and certain other District criteria.

We also noted that the FY 2007 projects were funded in accordance with State and District guidelines. However, based on the funding guidelines, four of the 55 District projects were entitled to receive between \$3,500 to \$21,000 more in funding assistance but did not due to calculation rounding. We also noted that Water Supply's Division Director of Implementation was the only one responsible for calculating the funding amounts and recommend that all calculations be verified by another Water Supply employee. Our review also disclosed that a project received about \$36,000 more in funding than it was entitled to under the Governing Board's guidelines because it was designated a "Special Merit" project. Special Merit was a category created by the Governing Board for certain exemplary projects and the funding amounts were at the Governing Board's discretion; funding amounts usually exceeded the funding guideline amounts. However, we noted that adequate documentation was not maintained to

identify the project as a Special Merit project and indicate that the funding amount exceeded the funding guidelines.

Based on our review of seven sampled FY 2006 alternative water supply contract files, we concluded that contracts are adequately monitored. However, we noted that improvements are needed over the payment process. Specifically, we noted that three of the seven payments examined either lacked adequate supporting documentation or were not carefully reviewed by the project manager. In one of these three instances, a grant recipient received about \$190,000 in excess funding because supporting documentation was not closely reviewed.

FY 2007 Funded Projects Included in the District's Regional Water Supply Plans

Based on the Water Protection and Sustainability Program, 80% of alternative water supply funding must be allocated to projects identified in the regional water supply plans and 20% may be allocated, at the discretion of the Governing Board, to alternative projects that are consistent with, but not specifically listed in, the plans. Thus, in order to be eligible for cost share funding, most alternative water supply projects must be identified in the appropriate regional water supply plan. However, inclusion in a plan does not guarantee funding. Our audit disclosed that almost all the alternative water supply projects funded in FY 2007 were included in the District's Regional Water Supply Plans. It is important to note that the funded projects not included in the plans still met the criteria to qualify as alternative water supply projects and the total amount of funding awarded to such was minimal.

The District's four Regional Water Supply Plans were updated in 2005 and 2006 to comply with the new statutory requirements, which required the inclusion of specific alternative water supply projects intended to meet water needs until year 2025. Prior to this requirement, the plans identified demands and sources of water. Specific projects to meet future demands did not have to be identified. To comply, the District performed extensive outreach and requested water users and water suppliers to complete project questionnaires identifying water supply projects intended to meet water needs through the

year 2025. It should be noted that stakeholders were involved in the planning process to discuss water demand projections and coordinate planning processes.

During our review to locate the FY 2007 funded projects in the plans, we noted that all projects were not readily identifiable in the plans; however, with the assistance of Water Supply's planning staff all projects included in the plans were identified. To ensure that funded projects are included in the plans, the FY 2008 Alternative Water Supply Funding Application requires applicants to submit a copy of the page from the plan that lists the project for which funding is being requested. Further, Water Supply's funding staff stated that planning staff will be involved in the FY 2008 evaluation process to ensure that eligible projects will be funded.

Funding Awarded to FY 2007 Projects Met District Criteria

Overall, our audit disclosed that Water Supply complied with the State and District guidelines when determining the projects eligible for alternative water supply funding. Based on statutory factors, the Governing Board is responsible for determining which projects are funded and can establish conditions for funding. However, significant weight must be given to certain factors when determining the projects that will be selected for funding and no one factor is designated as a precondition for funding assistance. Specifically, Section 373.1961(3) requires that significant weight to given projects that:

1. Provide substantial environmental benefits by preventing or limiting adverse water resource impacts.
2. Reduce competition for water supplies.
3. Replace traditional sources and help implement a minimum flow or level (MFL) or reservation.
4. Will be implemented by a consumptive use permittee that has achieved the targets contained in a goal-based water conservation program approved pursuant to Section 373.227.
5. Favorably compares water quantity to project cost.

6. Deliver reuse water to end users.
7. Are implemented by a multi-jurisdictional water supply entity or regional water supply authority.

In addition to the above, other factors can also be considered in determining funding. Examples of the factors are as follows:

- Whether there are uniform rates for customers in a multi-jurisdictional entity.
- Whether a subsequent phase of the project is underway.
- Whether the project can be implemented within the time provided in the water supply plan.
- The percentage of the project to be funded by the water supplier or water user.

To ensure compliance with the statutory requirements, the District incorporated the above factors in its alternative water supply funding application and Water Supply staff evaluated the responses. However, our review disclosed that the results for items #1, #2, and #3 listed on page 7 were not documented.

The legislature did not give specific directions on how the different factors should be weighed, however, the results are used for other water supply reporting purposes. The Governing Board decided to continue funding projects that met the definition of an alternative water supply project and certain District criteria; for example, projects must be ready to be constructed in the fiscal year in which funds are awarded, and funding amounts are awarded based on Governing Board approved guidelines and directions. Further, Water Supply staff stated that all alternative water supply projects inherently satisfy the statutory requirements.

Our review disclosed that based on Water Supply's evaluation of the FY 2007 alternative water supply funding applications, 11 of the 73 proposed projects were not funded mainly because the projects did not meet the definition of an alternative water supply project or the project had already been constructed.

Funding Amounts Determined in Accordance With Statutory and District Guidelines

Overall, FY 2007 projects were funded in accordance with State and District guidelines. Based on the Water Protection and Sustainability Program, funding must be used only for construction purposes; however, the Governing Board has the discretion to fund some non-construction activities, such as feasibility studies and programs related to water resource and water supply development. Further, Section 373.1961(3)(e) requires fund recipients to provide a minimum of 60% of the capital cost of the project (i.e., the District can fund a project for up to 40% of the capital cost depending on fund availability and the project must be ready to construct). The Governing Board has the authority to waive the 40% requirement for financially disadvantaged small local communities.

In addition to the above, the Governing Board wanted to ensure that funding will be distributed equitably among eligible applicants. As a result, several additional funding criteria were developed by Water Supply staff and approved by the Governing Board for funding FY 2007 projects. For example,

- Guidelines were developed to award funding based on the amount of water made available by the type of alternative water supply project (reclaimed water, brackish water, and aquifer storage and recovery projects). It should be noted that funding amounts per the guideline are compared to 40% of eligible construction costs to ensure that funding does not exceed the 40% statutory threshold.
- Previous funding amounts are taken into consideration to ensure maximum funding amounts are not exceeded.
- Contract deliverables must be completed within the year funding is awarded. Resubmitted projects may be subjected to a reduction in funding where agreed upon work was not completed under a prior contract. Resubmitted projects are funded at the lower of 75% of funding per funding guidelines or 40% of current year's construction.

As part of our tests, we recalculated the FY 2007 funding amounts awarded to the 55 alternative water supply projects funded with District ad valorem revenue and

concluded that funding amounts were being determined in compliance with the Governing Board's and management's direction and/or funding guidelines. However, based on the funding guidelines four projects were entitled to receive anywhere from \$3,500 to \$21,000 more in funding assistance. Water Supply's Division Director of Implementation explained that the differences were due to rounding. It should be noted that the Division Director was the only one responsible for calculating the funding amounts. In the future, funding amounts should be rounded to the nearest hundred dollar to ensure a more equitable distribution of funding among applicants and all calculations should be verified by another Water Supply staff and be determined in a more accurate manner.

Our review also disclosed that a project received about \$36,000 more in funding than it was entitled to under the Governing Board's guidelines. Water Supply staff stated that the project was a "Special Merit" project. Special Merit was a category created by the Governing Board for certain exemplary projects and the funding amounts were at the Governing Board's discretion; funding amounts usually exceeded the funding guideline amounts. However, we noted that adequate documentation was not maintained to identify the project as a Special Merit project and indicate that the funding amount exceeded the funding guidelines. Adequate documentation should be maintained to substantiate the process for establishing the funding amounts for all projects in order to provide an audit trail.

**Adequate Monitoring of Contract Agreements;
Improvements Over Payment Approvals Needed**

Based on our review of seven sampled FY 2006 alternative water supply contract files, we concluded that contracts are adequately monitored. Project managers conducted site visits at the beginning and at the end of the projects and ensured that contractors submitted the status reports specified in the project deliverables. However, our review disclosed that improvements are needed over the payment process. Specifically, we noted that three of the seven payments lacked adequate supporting documentation, for example, a utility submitted two separate pay requests and both requests included the same vendor invoice (in the amount of \$149,800) as proof of expenditures. We informed the project manager that the second pay request was being substantiated by a duplicate

invoice and upon our request the project manager contacted the utility for an explanation. After several requests and discussions, the utility acknowledged that they submitted a duplicate invoice. However, other expenditures had been incurred which were eligible for reimbursement. The utility provided supporting documentation for these additional expenditures and thus was ultimately entitled to receive the funds.

In another instance, the District funded \$500,000 of the estimated \$1,267,000 to complete the installation of a reverse osmosis expansion facility, which was within the District's 40% maximum funding criteria. However, based on our review, we concluded that funding exceeded 40% of actual construction costs of \$775,000 incurred during FY 2006. This is due to the fact that this project was initiated prior to FY 2006 and the supporting documentation showed cumulative project costs; it did not separately identify the costs incurred during FY 2006. It should be noted that based on the Governing Board's funding guidelines and the contract agreement, funding should be for costs incurred during the year the funds are awarded. As a result of our review, the project manager requested additional documentation and met with the utility staff to determine the actual FY 2006 costs incurred by the utility to complete the installation of the reverse osmosis expansion facility. The project manager concluded that the actual FY 2006 construction costs totaled about \$775,000 which means the grant recipient was entitled to about \$310,000 (40% of \$775,000) in funding, not the \$500,000 paid by the District. Thus, it appears that the recipient received about \$190,000 in excess funding. As a result, we recommend that management seek reimbursement of funds from the utility for the overpayment made by the District for the unallowable expenditures

RECOMMENDATIONS

- 1. Ensure that all evaluations of statutory requirements are adequately documented.**

Management Response: Management agrees with the recommendation. The legislative factors evaluation process already has been enhanced to ensure that all

reviewer comments are gathered and documented and maintained in a single spreadsheet file.

Responsible Department: Water Supply Department

Estimated Completion: October 2007

2. **Require that funding calculations be doubled checked by another staff and rounded to the nearest hundred dollar.**

Management Response: Verification of funding amounts calculated by the Water Supply Implementation Division Director by multiple staff has been our practice and we plan to continue this in the future. A process to further document this verification has been implemented with the FY 2008 process. Management agrees with the recommendation that funding amounts be rounded down to the nearest \$100 to improve accuracy.

The Water Supply Implementation Division Director is the responsible person for developing and presenting the recommendation of the qualified projects and funding amounts to the Governing Board using the guidelines and other direction received from them. The Implementation Division Director works closely with many staff to confirm and verify the information and calculations used in formulating his recommendation are correct, including the Supervisor for the AWS program and a Lead and Senior Engineer, all of which have extensive experience in alternative water supply projects, process, and funding. In addition, a comprehensive and detailed spreadsheet is used to inventory project information and document how funding levels were determined.

Responsible Department: Water Supply Department

Estimated Completion: October 2007

- 3. Instruct project managers to ensure that fund recipients submit adequate supporting documentation and carefully review the documentation to ensure that payments by the District are adequately substantiated.**

Management Response: Management agrees with this recommendation. The invoice review and approval process has been enhanced to further ensure that expenditures are appropriate and adequately substantiated. Written procedures are available for District project managers clearly indicating the documents required for approval of a final invoice and closure of a project. Instructions are provided on how to review this information to ensure compliance with program mandates. These procedures have been and will continue to be discussed at periodic District project manager meetings along with the audit findings to highlight their relevance and importance. Furthermore, in addition to the District project managers and Water Supply Business Operations staff, the invoice review chain now includes a reviewer responsible solely for checking each invoice for compliance with these requirements. Finally, it was agreed during discussions with procurement and District legal staff earlier this year that future invoice packages from grant recipients should be certified by the grantee's chief financial officer in addition to the grantee's project manager in order to increase accountability and improve the quality of information received from the grant recipient. Procurement will also be consulted as to what information needs to be submitted with the invoice.

Responsible Department: Water Supply Department

Estimated Completion: October 2007

- 4. Ensure there is sufficient documentation to substantiate the process for establishing funding amounts for all projects.**

Management Response: Funding amounts are based on the funding guidelines table approved by the Governing Board for use starting with FY 2007 projects and other direction from the Governing Board. Significant staff time is spent to ensure recommended funding amounts are consistent with these guidelines and directions,

taking into account previous funding and percentage of work to be completed in the fiscal year with multi-year projects. A comprehensive and detailed spreadsheet is used to inventory project information and document how funding levels were determined. A process to further document, substantiate and verify established funding amounts is being implemented with the FY 2008 AWS funding process.

Responsible Department: Water Supply Department

Estimated Completion: October 2007

5. Seek reimbursement of funds from the utility for the overpayment made by the District for the unallowable expenditures.

Management Response We contacted the utility regarding the findings of this audit. A letter was mailed on August 8, 2007, to the grant recipient requesting documentation to support this entity's original certification. A response was received stating the entity's FY 2006 certification was for a single project that spanned three years. FY 2006 was the first year of the revised AWS Funding Program, which incorporated the new statutory direction (SB444). The time period covered by our grants also changed in FY 2006 from 3 years to 1 year. This project created 1.7 MGD of alternative water supply from the brackish Floridan Aquifer and had a total cost of \$3.3 million. The District awarded grants in FY 2004, FY 2005 and FY 2006 totaling \$900,000 for the project. The District's funding, as well as the entity's funding, were for construction of facilities directly related to development of the project and all are eligible for cost-sharing under the District's AWS Program. All three grants preceded establishment of funding guidelines in FY 2007, and the District's contribution is \$350,000 less than the current funding guidelines for a project of this type and size. The District's funding is 27 percent of the overall project cost, less than the 40 percent maximum cost-share allowed by Statute. This project meets the intent of the AWS legislation passed in 2005 and implements and furthers the goal of the District's AWS Funding Program to provide financial incentives to help water suppliers develop alternative sources. This project developed the brackish Floridan Aquifer, diversifying this entity's supply sources that supports the Strategic Plan's

Water Supply goal to ensure an adequate supply of water for all uses while sustaining water resources for future generations, and is also consistent with the direction established in the Lower East Coast Water Supply Plan.

In summary, this project meets the intent of the legislature and the District's AWS program, 100 percent of our funding went towards construction (implementation) as required, the District's total funding is within the 40 percent maximum cost-share allowed by Statute and is less than our current guidelines. Construction of some deliverables funded in FY 2006 occurred outside the fiscal year in conflict with current program guidance. However, we have had conversations with the entity regarding the requirements of the current program. Based on the above, we recommend not pursuing reimbursement.

We would like to offer additional clarification on this particular finding. In order to receive final payment, AWS grant recipients are required to certify that work has been completed in accordance with the executed agreement and that the reported expenditures are correct. The final FY 2006 invoice package for the referenced project certified that the actual construction cost for the project phase was well above the proposal amount. Based on their certification and other information they submitted, the project manager approved payment of the invoice. Additional information requested during the audit indicated they did not have the invoices to support their certification of FY 2006 expenditures.

Responsible Department: Water Supply Department

Estimated Completion: October 2007