
SOUTH FLORIDA WATER MANAGEMENT DISTRICT



Audit Report on Comprehensive Everglades Restoration Plan (CERP) Financial Issues

Audit # 03-07

**Prepared by
Office of Inspector General**

**Allen Vann, Inspector General
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July 10, 2003

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RE: Audit Report on Comprehensive
Everglades Restoration Program
(CERP) Financial Issues #03-07

This audit was performed pursuant to the Inspector General's authority set forth in Chapter 20.055, F.S. The audit focused on assessing whether the District has systems and processes in place to ensure compliance with provisions contained in various authoritative documents relative to CERP. This report was prepared by Tim Beirnes.

Sincerely,

Allen Vann
Inspector General

AV/cf
Enclosure

c: Henry Dean
Alvin Jackson

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INTRODUCTION

The Water Resources Development Act of 1992 authorized a comprehensive study to reexamine the Central and Southern Florida Project (C&SF) to determine whether the South Florida ecosystem could be restored and provide for the future water needs of the region. This resulted in developing the Comprehensive Everglades Restoration Plan ("CERP" or the "Comprehensive Plan"), which was approved by the United States Congress through the Water Resources Development Act of 2000, Public Law 106-541 (WRDA 2000).

The Comprehensive Plan outlines the framework for restoring, protecting and preserving the water resources of central and southern Florida, including the Everglades. It contains over 60 projects including the creation of approximately 217,000 acres of new reservoirs and wetlands based water treatment areas. The projects will greatly increase storage and water supply for the natural system, as well as for urban and agricultural needs, while retaining original flood control features.



Implementation of the Comprehensive Plan is a joint venture between the State of Florida and Federal government and cost will be shared equally (i.e. 50/50). The entire project will be implemented and constructed over a 40 year period at an initial estimated cost of \$7.8 billion at October 1999 price levels; however, a majority of the projects will be completed within the first 20 years. U.S. Congress provided authorization for 6 pilot projects, 10 initial projects, and several additional projects through various Water Resource Development Acts. Subsequent projects require additional U.S. Congressional approval.

OBJECTIVES, SCOPE and METHODOLOGY

The objective of the audit was to determine whether the District has systems and processes in place to ensure compliance with provisions contained in various authoritative documents relative to CERP (See Criteria section, on page 3).

Specific objectives are as follows:

- Determining whether information systems, transactional processes, and account coding structures are adequate to properly account for and report on CERP activities.
- Reviewing the processes established for complying with various reporting requirements.
- Examining the District's indirect cost plan to determine whether it complies with Federal guidelines and offers the District the maximum benefit allowed.
- Evaluating in-kind credit arrangements.

The scope of the audit encompassed CERP activities from inception through the most current financial reporting period.

Methodology included:

- Reviewing numerous authoritative documents relating to CERP.
- Reviewing the accounting process.
- Interviewing various employees at the District and USACE.
- Performing other audit procedures as deemed necessary.

Our audit was conducted in accordance with generally accepted government auditing standards.

CRITERIA

The CERP program, like other government programs, was created by law and is subject to specific laws, regulations, and agreements between the parties. Accordingly, the audit was conducted based on the following criteria:

Federal Legislation

- Section 528 of the *Water Resource Development Act of 1996* (Public Law 104-303).
- Sections 101 and 208 of the *Water Resources Development Act of 1999* (Public Law 106-53).
- Section 601 of the *Water Resources Development Act of 2000* (Public Law 106-541).

US Office of Management and Budget Circulars

- OMB Circular A-87 - *Cost Principles for State, Local, and Indian Tribal Governments*.
- OMB Circular A-102 - *Grants and Cooperative Agreements With State and Local Governments*.
- OMB Circular A-133 - *Audits of States, Local Governments, and Non-Profit Organizations*.

US Army Corps of Engineers Regulations

- ER 405-1-12, USACE Regulations, Chapter 12, Section VII, *Credits for Land, Easements and Right-of-Way and Relocations for Cost Shared Projects*.
- ER 1165-2-131, *Water Resources Policies and Authorities - Local Cooperation Agreements for New Start Construction Projects*.

CERP Documents

- *Central and Southern Florida Project Comprehensive Review Study (the Comprehensive Plan).*
- *Master Program Management Plan (Master Plan) for the Comprehensive Everglades Restoration Plan (CERP) - Dated August 18, 2000.*
- *Program Controls Management Plan (PCMP) for the Comprehensive Everglades Restoration Plan - Dated December 12, 2000.*
- *Design Agreement Between the Department of the Army and the South Florida Water Management District for the Design of Elements of the Comprehensive Plan for the Everglades and South Florida Ecosystem Restoration Project - Dated May 12, 2000 (the Design Agreement).*

FINDINGS and RECOMMENDATIONS

EXECUTIVE SUMMARY

Financial Reporting Issues

We found that the accounting information system and account coding structures are adequate to properly account for CERP expenditures. However, the District needs to work with the USACE to improve financial reporting for the CERP program. In-kind Credit Request Reports have not been furnished to the USACE in a timely manner and Quarterly Financial Reports have not been exchanged by either party, as required. These reports are used to help track cost sharing requirements, manage projects, and manage the allocation of project responsibilities between the USACE and the District.

Financial reporting was given a low priority at the inception of the project; however, initiatives have been implemented to bring financial reports current. While separate In-kind Credit Request and Quarterly Financial Reports are required for each project, there is no report that rolls up all financial contributions from federal and non-federal sources. Thus, the USACE and District currently have no financial information showing where they stand regarding the 50/50 cost sharing requirement for the entire CERP Program. A five-year progress report required by Congress will require this type of financial data.

Direct and Indirect Cost Issues

The District's Indirect Cost Plan complies with Federal guidelines. However, based on our analysis, the District can receive close to \$1 million of additional in-kind credit per year by directly charging CERP salaries and other expenses for which it is entitled to under Federal cost principles.

Our audit identified several employees who dedicate 100% of their time to CERP initiatives who are included in the indirect cost pool instead of being charged directly to CERP. The District is forgoing approximately \$525,000 of in-kind credit annually because these employees are charged as indirect instead of as direct CERP expenditures.

Furthermore, we estimate that approximately \$150,000 of the Land Resources Group's operating costs could be allocated to CERP if there was a separate indirect cost pools for Land Resources. Currently, none of the overhead cost for this organizational unit is charged to CERP either directly or indirectly. Similarly, the District should obtain in-kind credit for approximately \$232,000 for a new real estate data management system under development. This represents our estimated allocable share of its \$365,000 in annual operation and maintenance expenses. While the CERP Master Plan provides for the District to receive in-kind credit for a portion of the systems' development cost it neglected to address in-kind credit for its annual operating and maintenance cost.

Land Acquisition Issues

With regard to in-kind credit issues, the District and USACE need to finalize an equitable methodology for determining the amount of in-kind credit the District will receive for land purchases. The District is purchasing land well in advance of future CERP project approvals, which entails a laborious process. While individual projects will not be approved for several years, over \$737 million has already been spent to purchase approximately 134,000 acres of land for the CERP program.

The advanced land purchase strategy complicates the in-kind credit process. The USACE is offering to provide credit for land at fair market value at the time the project is approved plus acquisition expenses. In order for the District to recover its total investment, we estimate that a property would have to appreciate at an annual compounded rate of between 6% to 11% just to breakeven. There is a risk that long-term property value trends may not support such rapid rates of appreciation. The difference in the appreciation needed to breakeven is primarily affected by the amount of premium paid above appraised value, which can be up to 30%. While the fair market value appears more attractive than cost, following the USACE's proposal for crediting land may result in unfairly penalizing the District for taking the initiative to minimize land cost.

**Audit Rights Need
To Be Exercised**

In the Master Plan the USACE and District agreed to reciprocal audit rights. The USACE plans to engage an accounting firm to audit the District's In-kind Credit Request Reports; however the District has not taken any similar initiative.

FINANCIAL REPORTING ISSUES

Background

CERP financial transactions are processed and recorded in the same accounting system with the same internal controls as all other District transactions. Separate account codes classify CERP expenditures and provide data needed by management and staff. The District's current accounting system is not capable of generating CERP financial reports in the format specified in CERP authoritative documents; hence, data is downloaded from the accounting system to desktop software applications in order to create reports.

There are specific financial reporting requirements contained in WRDA 2000, the Design Agreement with the USACE, and the Master Program Management Plan (Master Plan). The following reports are required:

- In-kind Credit Request Reports - These reports are used for reporting District project expenditures/costs to the Federal Government.
- Quarterly Financial Reports - The Master Plan requires the District and USACE to exchange quarterly reports, which show project actual expenditure information by quarter, fiscal year-to-date and project inception-to-date. These reports also are to include budget information and are intended to manage individual projects and monitor costs.
- Report to Congress - WRDA 2000 requires reports on the implementation of the Comprehensive Plan every five years beginning on October 1, 2005. The USACE and U.S. Department of Interior (DOI) have the lead responsibility for this report in consultation with other federal agencies and the State of Florida. This report will include a description of planning, design, construction work completed, the amount of funds expended during the period covered by the report, the work anticipated over the next five-year period, as well as certain scientific information.

The following sections discuss issues identified during the audit regarding each of the above mentioned reporting requirements.

In-Kind Credit Request Reports Not Submitted Timely

While criterion for when In-kind Credit Request Reports are due is not specifically spelled out, we noted that the first in-kind credit report was not submitted until November 2002, 3½ years after inception of the CERP program. Staff is currently in the process of bringing these reports current. From the District's vantage point, the In-kind Credit Request Report is the most critical financial reporting requirement contained in CERP authoritative documents. These reports are required to be submitted to the USACE for review and approval and collectively establish the dollar amount for determining the non-federal 50% cost share.

The 3½ year delay in submitting In-kind Credit Request Reports was due primarily to financial reporting activities being given a low priority when allocating CERP resources. Initially, two positions in the Accounting Department were designated exclusively for CERP. However, the positions were diverted to CERP project management (i.e. engineering) positions. Thus, the Accounting Department was left without the resources necessary to prepare these reports.

We identified the problem early during our audit fieldwork and immediately brought our concerns to management's attention. Management responded by issuing a work order contract under their program management contract with Jacobs/MWH Joint Venture to bring the reporting up to date. Currently, the In-kind Credit Request Reports are completed and submitted through September 30, 2002. Reports are substantially complete through March 31, 2003 and according to management will be submitted shortly.

So far, the In-kind Credit Request Report backlog has not had any financial impact on the District because no cash has changed hands between the District and the USACE for CERP projects. WRDA 2000 requires the USACE to monitor and manage the non-federal amount of cash, in-kind services, and land provided to CERP during each five-year period. The initial five-year period ends April 6, 2004. Current financial reports are essential to efficiently manage projects, effectively monitor cost sharing status, and equally allocate financial responsibilities between the District and USACE.

Quarterly Financial Reports Not Prepared

The USACE and SFWMD have not been exchanging quarterly financial reports as required by the Master Plan. The Master Plan requires the USACE and SFWMD to exchange quarterly financial reports that summarize all expenditures, budget projections and comparisons between budgeted and actual expenditures for each project. Expenditures must be presented in quarterly, yearly and inception-to-date formats and are due no later than the 30th day following the end of each quarterly reporting period.

Whereas the In-kind Credit Request Reports are used to account for actual cost, Quarterly Financial Reports provide the financial status of projects since they also include budget information. However, the actual historical expenditure information should be the same in both reports - especially since the USACE intends to use the Quarterly Financial Report as the basis for accounting for the Federal government's financial commitment.

Delay in submitting Quarterly Financial Reports is due primarily to the same reasons mentioned on page 8 regarding the In-kind Credit Request Reports. The District's consultant will also assist with preparing these reports.

The SFWMD currently has not issued any Quarterly Financial Reports for the CERP Program. Likewise, with the exception of some expenditure reports, the USACE has not provided any Quarterly Financial Reports to the District. Consequently, the State has not as yet received any official statement of the Federal government's financial commitments to date for CERP.

Since Quarterly Financial Reports are required to contain inception to date information, there is no benefit to creating Quarterly Financial Reports for prior periods; however, staff should start producing these reports as soon as possible and encourage the corps to provide us with their reports. The longer amount of time taken to start generating these reports may risk not including all expenditures from inception.

Congressional Reporting Issues

Since In-kind Credit Request Reports are prepared on a project by project basis, there is no single report that summarizes the entire District share of eligible CERP expenditures into one report. Furthermore, the In-kind Credit Request Reports do not include expenditures that have been incurred but are not yet eligible for in-kind credit-especially land purchases (See further discussion regarding land purchases under the section titled "Land Acquisition Issues.") Hence, there is currently no financial report that shows the District's total eligible CERP expenditures – including 1) those approved for in-kind credit and 2) those eligible for in-kind credit but not yet approved.

In order to accurately report to the U. S. Congress (and the Florida State Legislature) there must ultimately be a single non-federal amount of expenditures that is compared to a single federal amount of expenditures to determine where each party stands regarding the 50/50 cost share requirement. An expenditure rollup report should be a primary component in the Report to Congress. No such report currently exists. Hence, the cost sharing status of the entire CERP program is currently unknown. Although CERP authoritative documents do not require this additional information, it is essential in order to effectively monitor the 50/50 cost sharing status and report to congress. These reports must be completed at least every 5 years beginning on October 1, 2005 until October 1, 2036.

Although the District is not responsible for taking the lead role in preparing the Report to Congress, the District will need to provide a significant amount of information and data to the Federal agencies responsible for its preparation. Neither the District, nor the USACE have as yet assigned staff to coordinate the preparation of this report.

Although WRDA 2000 specifies a due date for the Report to Congress, it does not specify the reporting period cut-off date. However, there must be a period of time between the end of the reporting period and the report due date to allow time to prepare the report.

Recommendations

1. **Establish an action plan to have all In-kind Credit Request Reports and Quarterly Financial Reports up to date no later than April 6, 2004 - the end of the first five-year monitoring period.**

Management Response: The in-kind credit request reports are current through March 31, 2003. There have been three in-kind credit request reports submitted to the USACE. The first was submitted November 1, 2002 and covered the period from inception of the program through March 31, 2002. The second report was submitted January 31, 2003 and included the period from April 1, 2002 through September 30, 2003. The third report was submitted June 13, 2003 and covered the period October 1, 2002 through March 31, 2003. This last submittal brought the District current with the Design Agreement.

The quarterly financial reports are essentially the same as the in-kind credit request reports except for the budgetary comparison data. The plan is to use the budget values generated from the P3E project management software to generate quarterly financial reports. These values are not yet available. The USACE indicates it will be generating quarterly financial reports at some unspecified date in the future. Finance & Administration will coordinate with CERP managers to determine how budget values can be generated for the quarterly report.

Responsible Departments: Water Resources and Finance & Administration

Estimated Completion Date: The in-kind credit request reports are complete. Beginning with the September 30, 2003 quarterly report, Finance and CERP managers will determine 30 days prior to the end of each quarter whether budget values will be available to file the quarterly report.

2. **Work with the USACE in generating a rollup report of all CERP expenditures.**

Management Response: Management concurs that a consolidated financial report showing expenditures to all parties would be helpful in monitoring the cost-sharing status of the project. The USACE is the lead agency for financial reporting. The District will work cooperatively with the USACE to develop consolidated financial reports.

Responsible Department: Finance & Administration

Estimated Completion Date: Cannot estimate due to the fact that the USACE is the lead agency.

3. **Work with the USACE to establish a reporting period cut-off date for the Report to Congress.**

Management Response: Management concurs.

Responsible Department: Finance & Administration

Estimated Completion Date: Cannot estimate due to the fact that the USACE is the lead agency.

DIRECT AND INDIRECT COST ISSUES

Background

The allowability and allocability of expenditures for CERP are subject to Federal cost principles contained in OMB Circular A-87 (A-87). These cost principles address both direct and indirect cost criteria.

OMB Circular A-87 divides cost into two categories at the top level - allowable and unallowable. The second step is to divide allowable cost between direct and indirect. This framework is illustrated in the following Exhibit:

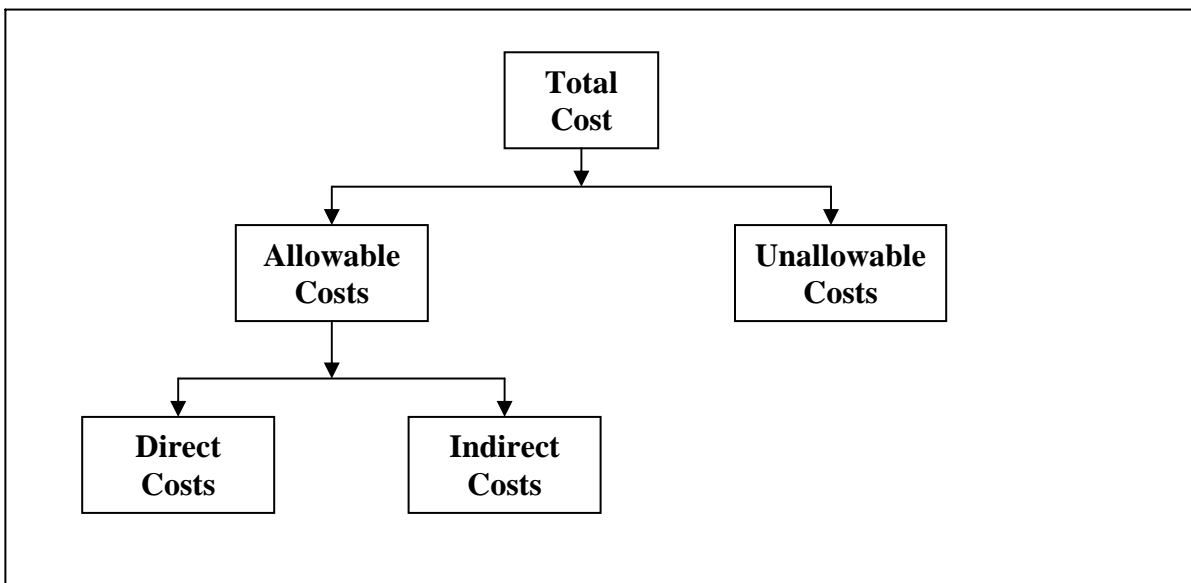


Exhibit 1

Unallowable costs must be totally excluded. They include such costs as interest, lobbying, fines and penalties, chief executive officer's salary, cost of investment counsel, and entertainment. After unallowable costs are excluded, costs are either classified as direct or indirect.

A-87 characterize *direct cost* as being identified with a particular final cost objective. They include: 1) employees' salaries for the time devoted and identified specifically to the performance of the program, 2) cost of materials, equipment and other capital expenditures, and 3) other direct expenses. Examples of final cost objectives at the District are Everglades Construction Project, Kissimmee River Restoration, Vegetation Management, etc. CERP qualifies as a final cost objective.

The general theme of A-87 regarding indirect cost is that they are costs incurred for a "common or joint purpose" and "benefiting more than one cost objective: not readily identifiable to a specific cost objective" (without an inordinate amount of effort). Also, a government organization can have more than one indirect cost pool. For example, a separate indirect cost rate is calculated for the Vegetation Management unit. There are no separate indirect cost pools used for CERP or any other Federal programs at the District. However, there is no limit on the number of indirect cost pools allowed.

There are no universal rules for classifying certain costs as direct or indirect; however, it is essential that each item of cost be treated consistently in like circumstances as either a direct or an indirect cost.

Full Time CERP Employees Are Not Being Charged Directly

Our audit revealed instances where employees in central service areas are exclusively dedicated to performing CERP activities. These employees have been directed by the Accounting Department not to charge their time directly to CERP because their costs are covered through the indirect cost rate. In contrast, District staff's U.S. Army Corps of Engineers counterparts are being charged directly to the CERP program.

Outsourced CERP activities that otherwise were previously conducted by central service groups at the District (and classified as indirect) are now charged directly to the program. For example, Office of Counsel handles eminent domain cases for CERP land acquisitions. District staff working on eminent domain cases were not permitted to charge their time directly to CERP because Office of Counsel is included in the indirect cost pool. When this activity was outsourced the cost was charged directly to CERP.

We identified one employee in the Information Technology Department and four employees in the Public Information Department that are dedicated exclusively to CERP activities. The Public Information Department employees are performing activities specifically mandated in WRDA 2000¹. These employees' salaries are costs clearly identifiable specifically with the CERP cost objective and are not incurred for a common or joint purpose, and clearly meet A-87's definition of a direct cost.

¹ Title VI of the Water Resources Development Act of 2000, Section (k) *Outreach and Assistance* (P.L. 106-541, Section 601).

We estimate that the District is foregoing approximately \$525,000 a year of in-kind credit by not charging these employees' salaries directly to the CERP Program.² The District could potentially forego approximately \$10,500,000 of in-kind credit over the life of the CERP Program (\$525,000 X 20 years³) by not charging these employees' salaries directly to CERP.

Establish a Separate Indirect Cost Pool for Land Resources

OMB Circular A-87 allows multiple cost pools. The District's current Indirect Cost Plan contains a central service cost pool and a separate cost pool for the Vegetation Management Program. These are the only cost pools currently used.

A separate indirect cost pool should be established for Land Resources. Approximately 61.5% of actual land purchases during FY '02 were for CERP projects and approximately 63% of the planned land purchases for FY '03 are for CERP projects. This trend is expected to continue for many years. Since a significant amount of Land Resource's activities are CERP related, it makes good business sense to create a separate cost pool for this organizational unit's overhead cost to better recoup (get credit for) their operating costs.

Land Resources' overhead cost is approximately \$480,000 annually consisting primarily of salaries, travel expenditures, and other administrative costs. The District is foregoing approximately \$150,000 per year of in-kind credit by not charging any of the Land Resource unit's overhead to CERP. This amounts to approximately \$3,000,000 of in-kind credit over the life of the CERP Program (\$150,000 X 20 years⁴).

² The District only receives in-kind credit of 16¢ for each dollar of base payroll expense when employees exclusively assigned to CERP activities are charged indirectly instead of directly to CERP. The District receives in-kind credit of \$2.06 per base pay dollar charged directly to CERP. (\$1.00 base pay + \$0.45 fringe benefits + \$0.61 indirect cost = \$2.06).

³ Although the CERP Program spans over a 40 year period, a large majority of the work will be completed within the first 20 years and most of these activity will likely be completed or significantly reduced from current levels at that point in time.

⁴ Although the CERP Program spans over a 40 year period, a large majority of the work will be completed within the first 20 years and most of these activities will likely be completed or significantly reduced from current levels at that point in time.

Allocate a Portion of the New Land Management Information System's Operating Cost to CERP

Land Resources is in the process of implementing a new computer information system for land acquisitions and land management activities. This new system, known as IRIS (Integrated Real estate Information System) is an enterprise system that will provide the following enhanced capabilities:

- A workflow application to improve productivity and data reliability.
- An interface to the GIS data to allow more efficient production of project maps showing the status of real estate acquisitions.
- A web-based interface to enable accessibility and information sharing among District, USACE, and external contractor users performing land acquisition activities.

During our audit we discovered that the Master Plan provides for charging a portion of this system's development cost to CERP. This was brought to management's attention during the audit. However, the Master Plan does not mention anything about providing in-kind credit for a portion of the ongoing operation and maintenance of the IRIS system. In accordance with the Federal guidelines contained in OMB Circular A-87 a portion of the ongoing operation cost for this system should also be allocated to CERP.

Cost allocation should be based on an equitable cost allocation method that reflects the relative benefit to the CERP Program, such as the number of acres purchased for CERP as a percentage of total acres purchased. The cost of implementing the IRIS system is estimated to be approximately \$1,328,000. The ongoing operation and maintenance costs are estimated to be approximately \$365,000 annually. We estimate that the District should receive in-kind credit of approximately \$843,000 for the one-time implementation cost and \$232,000 per year for the ongoing operation and maintenance costs - for a total of approximately \$5.5 million of in-kind credit over a 20-year period.⁵

⁵ While the estimated useful life of the IRIS system is likely less than 20 years, the assumption is that some other system would be installed in its place for which a similar portion would be charged to CERP.

Recommendations

4. Charge employees dedicated to performing CERP activities to CERP.

Management Response: Management concurs. The District has always been in compliance with federal guidelines for determining direct and indirect costs for the CERP program. As circumstances warrant, adjustments will be made in the budgeting and recording of costs to maximize the value of in-kind services expenditures. Where it can be demonstrated that personnel in direct and indirect cost units are spending 100% of their time on CERP activities, these resources will be treated as direct costs. Personnel in direct cost units will also be treated as direct costs even though they are not committing 100% of their time to CERP activities. Personnel in indirect cost units not contributing 100% of their time to CERP activities will be treated as part of the indirect cost pool.

Responsible Department: Finance & Administration

Estimated Completion Date: Ongoing.

5. Create a separate indirect cost pool for Land Resources.

Management Response: Management will study this recommendation to determine if the cost/benefit justifies a multiple pool approach. This recommendation will be discussed with the USACE to get their concurrence.

Responsible Department: Finance & Administration:

Estimated Completion Date: September 30, 2003

6. **Charge an allocable share of the operation and maintenance cost for the new land acquisitions computer information system to CERP.**

Management Response: Developmental costs for the new land acquisition computer information system have been submitted to the USACE for in-kind credit under the design agreement. Operation and maintenance for the computer system is budgeted for FY04 to be shared between all programs including CERP.

Responsible Department: Finance & Administration and Land Resources

Estimated Completion Date: Complete

LAND ACQUISITION ISSUES

Background

Land Acquisition Plans will be prepared for each CERP project and will be a component of each Project Implementation Report (PIR). Most CERP work to date has been preliminary design work performed under the Design Agreement as well as a significant amount of advanced land acquisition activity.

The Design Agreement provides a framework for performing preliminary design work and developing Project Implementation Reports for each project. Project Implementation Reports must receive U.S. Congressional approval before detailed design work, land acquisitions, and construction can be approved. Next, a Project Cooperative Agreement is signed which outlines the federal and non-federal responsibilities. In-kind credit is only approved for preliminary design activities until a PCA is executed. Hence, the District had not yet received in-kind credit approval from the USACE for any CERP land purchases. Exhibit 2 below illustrates the general project development process.

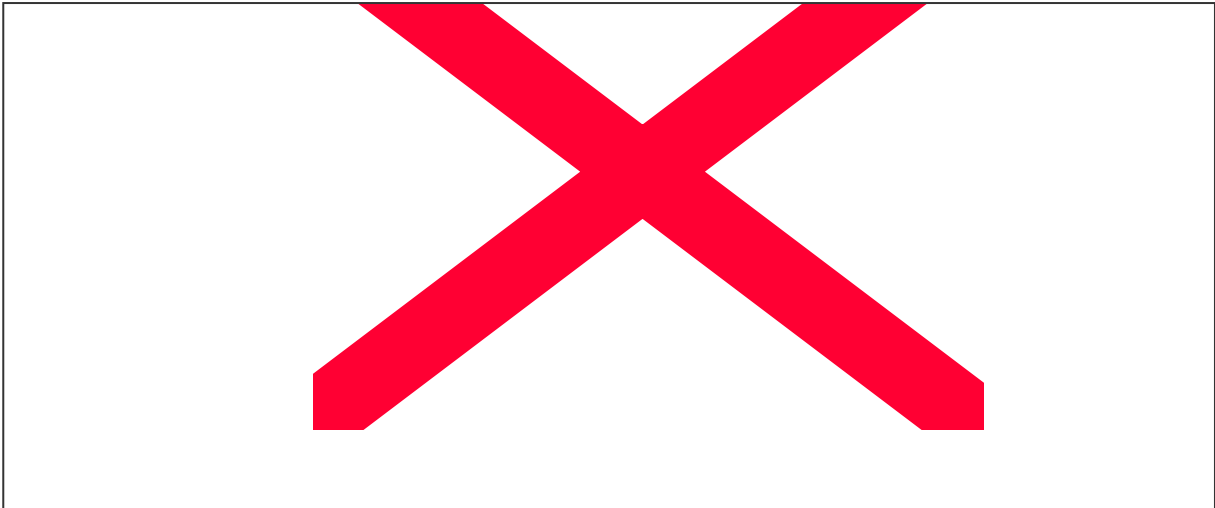


Exhibit 2 Source: Central and Southern Florida Project Comprehensive Review Study, Section 10.3.

The State and District have pursued a vigorous strategy of advanced land purchases in order to prevent development of certain parcels, pursue willing seller opportunities, and acquire land before values increased further - especially in rapidly appreciating areas. As of April 17, 2003, the District has expended approximately \$737 million to purchase approximately 134,000 acres of land for CERP projects.

Observations Regarding Proposed Land In-Kind Credit Methodology

The District and USACE have not finalized a methodology for determining the amount of in-kind credit the District will receive for land purchases. We reviewed the draft Master Project Cooperative Agreement (the "Master Agreement") that District staff is currently negotiating with the USACE. The Master Agreement will address the methodology for determining the amount of in-kind credit for CERP land acquired by the District both before and after a PCA is executed.

The District has embarked on an aggressive plan of obtaining land for CERP while needed properties are still available. The ultimate success of the program is dependent upon the availability of lands needed to build the projects on. Staff currently estimates that approximately 95% of all land will be acquired prior to executing project PCA's. Hence, the methodology for calculating in-kind credit for advanced land purchases is critical.

District staff proposed to the USACE that in-kind credit for land be based on the higher of fair market value of the land at the time of certification (i.e. when the land is needed for construction) or actual cost at the time of acquisition - which ever is greater. The USACE offered the District either fair market value at the time of certification or actual cost at the time of acquisition. The same methodology would be applied to all land parcels for every project.

District staff has tentatively accepted the fair market value approach believing that it represents the best alternative to maximize in-kind credit. We agree with staff. They concluded that land will appreciate in value from the time of acquisition to the time of certification and should adequately compensate the District even in those instances where the District has already paid above fair market value for properties.⁶

Staff is also correct in assuming that a pure acquisition cost approach would be disadvantageous to the District. For land purchased years before it is required, the State is losing the opportunity cost for such funds (i.e. interest earnings or the cost of not being able to use the funds for other programs). Using the cost approach for in-kind credit does not

⁶ The District often pays in excess of appraised value to entice a property owner to become a willing seller because this option may be less costly than acquiring the land via eminent domain. The price of property acquired through eminent domain process is usually determined by a jury or an out-of-court settlement and often results in paying substantially more than the appraised value.

consider the time value of money.⁷ However, under either alternative, in our opinion, there remains the risk that the District may not receive fair in-kind credit for these advanced purchases.

One problem with both the fair market value method and the cost method is that once the final project footprints are established, it is highly likely that some of the land purchased in advance will not be necessary for the project. Consequently the District will not receive credit for the cost of such land and will need to consider its disposition.⁸ It should be noted that many properties might have been purchased anyway under other programs in the absence of CERP.

Advanced land purchases also entail the cost of maintaining the property until it is needed for construction (e.g. controlling exotic plants, mowing, etc.). In many cases, the District has successfully leased land and transferred the maintenance responsibility to the tenants; as well as generate some income to help offset some of the maintenance costs.⁹ Land Resources does not compile the aggregate cost of maintaining land purchased for CERP projects and currently there is no provision to grant the District in-kind credit for land maintenance cost.

In summary, the total cost of CERP land is the aggregate amount of cash disbursed to acquire and maintain the property as opportunity cost. Hence, total investment in CERP land includes the sum of all the following cost components:

- Appraised value
- Premium paid above appraised value (if any)
- Acquisition expenses (e.g. appraisals, surveys, title policies, legal costs, etc.)

⁷ Due to the low interest rate environment over the past few years, the opportunity cost is abnormally low compared to that under normal economic conditions. However, interest rates are likely to return to long term historical average range of 5 to 6% when the economy strengthens. During the 1990's the District earned an average of approximately 5.5% on invested cash. (Currently, the District is earning only approximately 1.5% on its investments.)

⁸ See additional information in Audit No. 01-07, *Audit of Land Acquisitions*, issued November 6, 2001.

⁹ See additional information in Audit No. 02-21, *Audit of the Land Management Program*, issued January 27, 2003.

- Interim maintenance cost (e.g. mowing, exotic vegetation control, etc. - net of potential lease income).
- Cost of capital (i.e. foregone interest earnings) or opportunity costs.

In order for the District to recover its total investment in a tract of land, we estimate that a property would have to appreciate at an annual compounded rate of between 6% to 11%. There is a risk that long-term property value trends may not support such rapid rates of appreciation. The difference in future appreciation needed to adequately credit the State's financial contribution is primarily affected by the amount of premium paid above appraised value, which can be up to 30%. (See the Appendix for further details and assumptions.) While staff in negotiating with the USACE selected the best available alternative, the ultimate outcome of how much of the District's long term investment in CERP land will be recovered is unknown given the uncertainties of future values.

The fair market value approach is the normal method used for land in-kind credit in accordance with USACE regulations. USACE regulations also recognize there may be certain cases where the fair market value method may not fairly reflect the local sponsor's actual contribution of land interests.¹⁰ However, even in such situations, the value of land interests will be the sum of the actual purchase price paid by the sponsor, plus associated acquisition costs, including relocation costs. Hence, even the exceptions to the USACE's regulations do not recognize the interim maintenance expenses, cost of capital, and the premium paid above appraised value as creditable cost. Furthermore, acquisition expenses (surveys, appraisal, legal, etc.) are only creditable if the land interest was acquired within five years of certification.

One of the key reasons for purchasing land in advance is especially to acquire certain parcels that may potentially be developed. The District has taken the initiative to minimize this risk of substantially higher future cost by acquiring such tracts now. However, following the USACE's standard regulation for crediting land may result in unfairly penalizing the District for taking the initiative to minimize land cost by not adequately providing sufficient in-kind credit.

¹⁰ One example included in USACE regulations is where the sponsor demolishes improvements subsequent to purchase but prior to construction. Another example is situations involving rapidly depreciating land. Regulation reference: ER 1165-2-131 Section 12c(4), *Water Resources Policies and Authorities - Local Cooperation Agreements for New Start Construction Projects*.

Conclusion

Based upon our analysis the advanced land purchase program makes good sense. Given past land value trends, State funding availability, and the necessity of buying land for these projects while they are still available outweigh the uncertainty and risk of not receiving adequate in-kind credit especially if there is a downturn in future values. District staff has assured us that they are already making every effort to negotiate the best possible agreement with the USACE. Accordingly, we have no recommendation for this item that would mitigate the stated risks.

AUDIT RIGHTS NEED TO BE EXERCISED

The Master Plan (section 2.2.2.5) provides the USACE and District with reciprocal audit rights, which states:

"The Corps and SFWMD may request audits of either party's financial activities to ensure each party is following generally accepted accounting principles. Audits will be conducted by any mutually agreed upon entity, so long as the audits are conducted in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. The audits will ensure that each party maintains adequate internal controls over financial data to achieve effective and efficient operations, reliable financial reporting and compliance with applicable state and Federal laws and regulations. Costs of audits will be cost-shared in accordance with the provisions of the Design Agreement. Audits will be completed on a regular basis or as soon as a segment of work of reasonable quantity had been completed."

The USACE is in the process of engaging an accounting firm to perform annual audits of the District's in-kind credit reports. The District has not yet taken any similar initiative to exercise its audit rights regarding the USACE financial information.

Recommendation

- 7. Consider having the same auditor perform a combined audit covering expenditures of both entities or engage an auditing firm to audit the USACE's CERP expenditures.**

Management Response: A combined audit has been discussed with the USACE. Due to estimates of excessive cost and potential problems concerning the acquiring of an unqualified opinion, the initiative was never implemented. Management will discuss the possibility of having our auditors perform a limited scope engagement as a more cost effective method of reviewing USACE expenditures.

Responsible Department: Finance & Administration

Estimated Completion Date: June 30, 2004, pending available budgeted funds.

APPENDIX

Annual Appreciation Needed to Breakeven On CERP Advanced Land Purchases Assumming Various Premiums Paid Above Appraised Value

Premium Assumption	Annual Appreciation to Breakeven
0%	5.91%
5%	6.88%
10%	7.81%
15%	8.71%
20%	9.59%
25%	10.43%
30%	11.25%

Assumptions:

- 1) Premium paid is the amount paid above appraised value.
- 2) Acquisition costs are estimated to be 3% of appraised value.
- 3) Annual net maintenance cost is estimated to be 1% of appraised value.
- 4) Cost of capital is assumed to be 5% annually.
- 5) Holding period is assumed to be five years from acquisition to certification. A shorter holding period will increase the required appreciation rate, and vice versa. Also, under USACE Engineering Regulations, acquisition expenses are only reimbursable if the land was purchased within five years of certification.