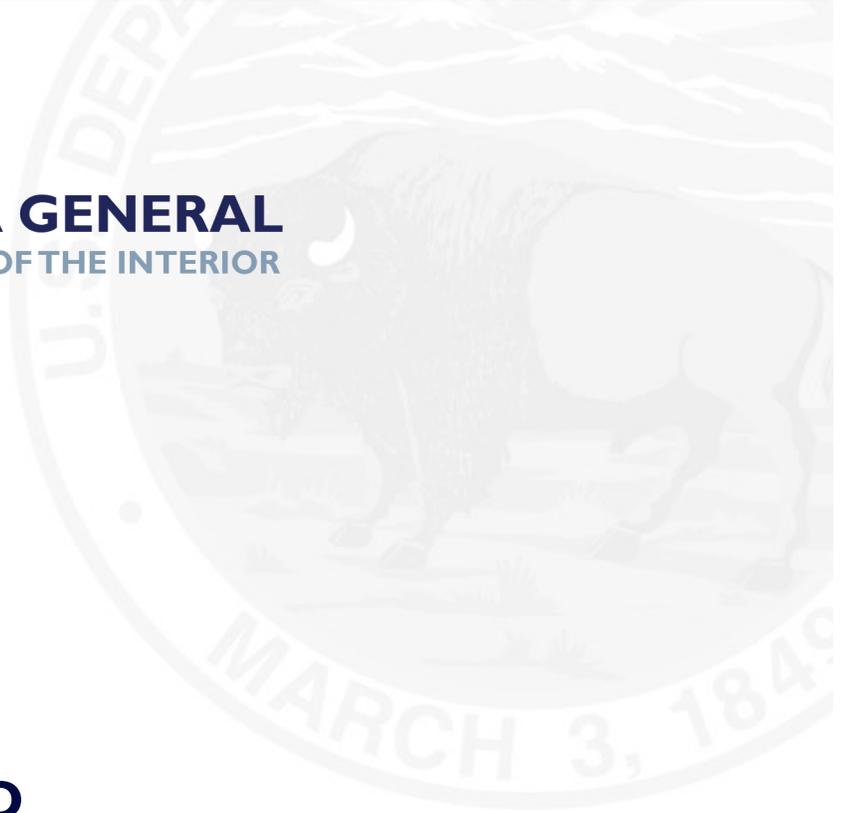




OFFICE OF
INSPECTOR GENERAL
U.S. DEPARTMENT OF THE INTERIOR



**OPERATIONS AND
MAINTENANCE COST ALLOCATION
FOR THE KLAMATH PROJECT
RESERVED WORKS**



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INSPECTOR GENERAL
U.S. DEPARTMENT OF THE INTERIOR

SEP 27 2016

Memorandum

To: David Murillo
Mid-Pacific Regional Director, Bureau of Reclamation

From: Michael P. Colombo 
Western Regional Manager for Audits, Inspections, and Evaluations

Subject: Management Advisory – Operations and Maintenance Cost Allocation for the
Klamath Project Reserved Works
Report No. 2015-WR-080-B

The U.S. Department of Interior, Office of Inspector General conducted an audit of the Bureau of Reclamation's (USBR) Klamath Basin Water User Mitigation Program (WUMP) to determine whether USBR had the legal authority for a cooperative agreement with the Klamath Water and Power Agency to administer the WUMP and whether related expenditures were allowable. During the audit, we found that USBR allocated 37.5 percent of the annual cost to operate and maintain the Klamath Project's reserved works to flood control and ceased collecting these costs from Project contractors.¹ This allocation does not conform with USBR policy that purports to be based upon applicable statutes. Because this matter is outside the objective and scope of our audit and will not be included in our final report, we are providing you with this management advisory so that you can fully review the matter and take corrective action.

Findings

Funds Allocated to Unauthorized Purpose

On January 28, 1975, representatives of six local irrigation and drainage districts responsible for paying the annual operation and maintenance (O&M) cost² of the reserved works wrote to USBR's Mid-Pacific Regional Director asking him to review and consider a "Flood Control Rationale for Reserved Works of the Klamath Project." This document acknowledged that the Klamath Project was authorized as a single-purpose irrigation development, but argued that because project operations also provided some flood control benefits, O&M costs incurred during the 5-month period between irrigation seasons should be allocated to flood control as a nonreimbursable expense. After further discussion and negotiations between USBR and the districts, the 5-month window was reduced to 4.5 months, or 37.5 percent of the year. In a memorandum dated July 11, 1975, the Mid-Pacific Regional Director accepted the districts'

¹ Reserved works are buildings, structures, facilities, or equipment that are owned by USBR for which Bureau employees or contracted entities perform operations and maintenance, regardless of the source of funding for the operations and maintenance.

² USBR defines operations as "activities related to the normal performance of the functions for which a facility or item of equipment is intended to be used." Maintenance is defined as the "upkeep of constructed facilities and structures and capitalized equipment that is necessary to realize the originally anticipated useful life of a fixed asset."

proposal that 37.5 percent of the annual O&M cost for the reserved works would be allocated for flood control and become nonreimbursable to the districts.

Reclamation Policy Manual PEC P07 addresses the allocation of operation, maintenance, and replacement costs for the purpose of establishing a consistent and legally sound methodology for these allocations. PEC 07 § 1 states (emphasis added):

Reclamation law requires the allocation of project costs, including operation, maintenance, and replacement (OM&R) costs, *to the various purposes as identified in project authorizing legislation.*

PEC 07 § 6 provides further clarification by stating:

Joint OM&R costs³ may be allocated to irrigation, M&I [municipal and industrial], power, flood control, recreation, F&W [fish and wildlife], and other purposes only on those projects or facilities where Reclamation is specifically authorized to allocate a portion of the construction costs to those respective purposes, or where minimum storage pools or operational requirements specifically serving those purposes have been established in project-specific legislation.

Also according to PEC P07, certain project costs, such as those for irrigation purposes, are considered fully reimbursable and are to be repaid by the project's designated beneficiaries. Other costs, such as those identified for flood control purposes, are considered nonreimbursable and are covered by Federal appropriations. Authorized by the Secretary of the Interior in 1905, under the provisions of the Reclamation Act of 1902, the Klamath Project was constructed as a single purpose irrigation development. During the first 70 years of operations, with minor exceptions, all annual O&M expenses incurred by USBR for the reserved works were paid by irrigation beneficiaries.

While Klamath Project operations do generate some flood control benefits for reclaimed lands within the Project, flood control itself is not an authorized purpose of the Project as authorized in the 1902 law. Thus, USBR's determination that 37.5 percent of the annual reserved works O&M costs were nonreimbursable and allocation of those costs to the purpose of flood control does not comply with USBR policy or Reclamation law and is not a proper use of appropriated funds. As a result, based on actual reserved works O&M expense information provided by USBR for the period from 1991 to 2015, we estimate that USBR did not collect a total of \$5.6 million in reimbursable O&M costs since the Regional Director's 1975 decision.

In addition, if USBR does not reverse the Regional Director's 1975 decision and begin collecting the entire amount of annual O&M costs, we estimate that approximately \$13.9 million

³ Joint OM&R costs are those project costs associated with facilities which serve multiple purposes and cannot be readily or logically assigned to a particular purpose from an operational perspective, e.g., normal reservoir operations, concrete repairs to a spillway, security guards and patrols, etc.

of additional revenues will not be collected over the next 30 years. The current estimated value of these foregone revenues is approximately \$8.1 million.

Unsubstantiated Basis of Allocation Rate

The percentage of O&M costs allocated to flood control as a nonreimbursable expense that was accepted by the Regional Director in 1975 (37.5 percent) appears to be excessive. The percentage was based on the 4.5 months of the year that water users thought were primarily for flood control activities. We noted that several Bureau officials at the time considered this rate to be excessive, especially during years of normal or less than normal rainfall. We found that droughts have been declared in Klamath basin during 5 of the past 10 years, indicating that little to no flood control would have been required during these years.

Recent efforts have been made to add flood control as an authorized purpose of the Klamath Project. The proposed Klamath Basin Restoration Agreement, which expired in December 31, 2015, after not being passed by Congress, proposed to add flood control as an authorized purpose of the Klamath Project. In the event that such efforts continue and future legislation authorizes flood control as a Project purpose, USBR should be prepared to refine and improve the method by which these costs are allocated.

Recommendation

We recommend that USBR comply with its policy and rescind the Regional Director's 1975 determination and immediately begin collecting 100 percent of annual O&M costs for the Klamath Project's reserved works from Project beneficiaries, unless the Office of the Solicitor can legally substantiate, in writing, that costs of an authorized, single-purpose irrigation project can be allocated to flood control.

Response to Report

Please provide us with your written response to this report within 30 days. The response should provide information on actions taken or planned to address the recommendation, as well as target dates and title(s) of the official(s) responsible for implementation. Please send your response to aie_reports@doioig.gov. If you have any questions regarding this report, please contact me at 916-978-5653.

The legislation creating the Office of Inspector General requires that we report to Congress semiannually on all audit, inspection, and evaluation reports issued; actions taken to implement our recommendations; and recommendations that have not been implemented.

We did not conduct this review in accordance with standards, such as Government Auditing Standards issued by the Comptroller General of the United States or the Quality Standards for Inspection and Evaluation issued by the Council of the Inspectors General on Integrity and Efficiency. We did, however, plan and perform work to obtain sufficient, appropriate evidence to provide a reasonable basis for our conclusions and recommendations.

