



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

COMMUNITY AND ECONOMIC  
DEVELOPMENT DIVISION

B-208765

SEPTEMBER 7, 1982

The Honorable James G. Watt  
The Secretary of the Interior

The Honorable John O. Marsh, Jr.  
The Secretary of the Army

**Subject: Water Sales Contracts From Missouri River  
Reservoirs Need To Require Reimbursement  
for Operation and Maintenance Expenses  
(GAO/CED-82-123)**

During our ongoing review of water resources project operation and maintenance (O&M) cost recovery systems established by the U.S. Army Corps of Engineers and the Department of the Interior's Bureau of Reclamation, we identified a problem concerning the nonrecovery of O&M costs. Although we plan an overall report on our review, we are bringing this matter to your attention now so as not to delay your consideration of corrective action in ongoing contract negotiations for additional water deliveries.

In existing contracts as well as contracts currently under negotiation for the sale of surplus irrigation water from the Corps' Missouri River reservoirs, the Bureau is not seeking reimbursement of O&M expenses, as required by Bureau water marketing policy. The water, originally allocated to irrigation but in excess of projected irrigation needs to the year 2060, is being sold for municipal and industrial (M&I) purposes under interim water sales contracts. The Bureau maintains that O&M cost recovery is not being sought because (1) the Memorandum of Understanding between the Secretaries of the Army and the Interior did not address O&M cost recovery and (2) the Corps has never provided the Bureau with O&M cost data upon which to base O&M charges and subsequent reimbursement. The Corps is not allocating O&M costs to M&I water use because it was not an original project purpose. The Corps follows a policy of allocating O&M costs in accordance with the original irrigation project purpose even though the purpose of actual water sales may differ from that originally intended.

We believe the Bureau needs to include an O&M cost recovery provision in water sales contracts, notwithstanding the lack of specificity in memorandums of understanding or the lack of O&M cost data furnished by the Corps. We further believe that the Corps needs to allocate O&M costs on an actual rather than

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intended use basis. To do otherwise deviates from sound principles of cost recovery and precludes the reimbursement of O&M costs.

#### OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our mainstem Missouri River reservoirs review is to determine if reimbursable O&M expenses are being recovered. We reviewed applicable laws and analyzed the agencies' policies, procedures, and records pertaining to the marketing of water from these reservoirs. As part of this review, we examined the Bureau's industrial water sales contracts and analyzed the Corps' recording of O&M expenses. We discussed these matters with Bureau officials in Billings, Montana; Denver, Colorado; and Washington, D.C., and with Corps division officials in Omaha, Nebraska, and Washington, D.C. We also analyzed the source of the Corps' O&M expenses and the disposition of O&M reimbursement transactions through both agencies' accounting systems. The review was made in accordance with generally accepted Government audit standards.

#### REPAYMENT BY SOME PROJECT USERS IS REQUIRED

Federal law <sup>1/</sup> and policies generally require that the cost to maintain water projects be divided equitably among all purposes served and be repaid by certain users. Generally, Federal expenditures for project purposes such as power production, irrigation, and M&I water supplies are reimbursable and must be repaid in their entirety. On the other hand, project purposes such as flood control, fish and wildlife, and navigation are considered benefits accruing to the public at large and are generally nonreimbursable.

The Federal Government largely finances water projects through U.S. Treasury borrowing. It finances project construction and requires that the construction costs be repaid in installments over periods of up to 50 years until the obligation is repaid. The Government also annually provides funds for water project O&M, but the repayment obligation is treated differently from construction costs. While reimbursable construction costs are specifically addressed as a permanent liability, O&M costs are not. By policy determination and common practice over the years, if O&M costs funded annually by the Federal Government are not reimbursed by the users of the water in the year incurred, they are generally not repaid.

Such is the case with the six Corps reservoirs on the mainstem Missouri River where over \$25 million has accumulated in nonrecovered O&M expenses. Expenses for O&M (painting, security,

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<sup>1/</sup>The Reclamation Project Act of 1939, as amended.

roads, rip-rap repair, etc.) on the mostly earthen-filled facilities have not been recovered because irrigation has not developed as anticipated. The storage space in these facilities is largely set aside for irrigation usage. About 8 million acre-feet of water is available annually in excess of current use. Projected water needs to the year 2060 would use about 5 million of the 8 million acre-feet annually. The remaining 3 million acre-feet available each year is uncommitted and in excess of needs at least through the year 2060. The Bureau also has estimated that only about half of the 5 million acre-feet of water allocated for irrigation at these six reservoirs will be used by irrigators in the next 25 years.

Meanwhile, each year the Corps allocates its annual O&M expenses to this block of water originally intended for irrigation. In fiscal year 1981 alone, the Corps recorded \$2.2 million in non-recovered O&M costs.

The Departments of the Army and the Interior concluded that because the 3 million acre-feet annually of irrigation water from the reservoirs will not be required by irrigators for decades, 1 million acre-feet annually could be made available for interim M&I use. A water marketing program was established by the Bureau to sell water in the Missouri River Basin for M&I purposes, such as additional steam electric powerplants, coal gasification plants, and potential coal slurry pipelines.

On February 24, 1975, the Secretaries of the Interior and the Army agreed to a Memorandum of Understanding to establish jurisdictional responsibilities and administrative procedures for marketing the water. The memorandum provided that the Secretary of the Interior, through the Bureau, had authority to negotiate contracts for M&I water sales from the mainstem reservoirs. It also provided that all operational and managerial control over the reservoirs remain with the Secretary of the Army.

The Memorandum of Understanding expired on December 31, 1978; however, the roles of the Departments continued as set forth in the expired agreement. The Bureau reaffirmed its water marketing policies in a November 1980 memorandum to the Corps which stated, in part:

"\* \* \* we intend to continue water marketing activities from mainstem reservoirs on the basis that (1) further extension of the MOU [Memorandum of Understanding] is not needed, (2) follow the principles previously established in the MOU as identified above, (3) adopt the rate making procedure for all new and amendatory contracts that utilize the current cost of replacement power plus the return of assigned water supply (ultimately irrigation) capital costs with interest, annual operation, maintenance, and replacement costs \* \* \*."

The Bureau currently has two M&I water sales contracts for the sale of surplus irrigation water on the mainstem Missouri--one with Basin Electric Power Cooperative and the other with ANG Coal Gasification Company. The contracts entitle the companies to annually withdraw from Lake Sakakawea 19,000 and 17,000 acre-feet of water, respectively. The contracts are providing total revenues of \$72,000 a year to the Bureau and will provide revenues of \$720,000 annually when full water service is established.

The Bureau is currently negotiating with Energy Transportation Systems, Inc. (ETSI), to sell the right to divert 20,000 acre-feet of water from Lake Oahe and may receive \$600,000 annually when full service is established. The water will be used for a planned coal slurry pipeline from Gillette, Wyoming, to the middle Southern States. Eventually, ETSI may need an additional 50,000 acre-feet of water.

M&I WATER SALES CONTRACTS DO  
NOT PROVIDE FOR O&M COST RECOVERY

The Bureau has not included provisions to recover O&M costs in the two existing M&I water sales contracts nor have any of the collected revenues been applied or returned to recover the Corps' O&M costs. Further, the Bureau is not seeking such provisions in contracts currently under negotiation for additional M&I water sales. Bureau regional repayment and contract officials told us that these cost recovery provisions were not included in these contracts because (1) the Memorandum of Understanding between the Secretaries of the Army and the Interior did not specifically address O&M cost recovery and (2) the Corps had never furnished the Bureau with O&M cost data to use as a basis for seeking reimbursement. These officials did not know why the original Memorandum of Understanding did not address O&M cost recovery, even though Bureau policy is clear that water rates should recover reimbursable O&M costs. However, the Bureau's contracting officers told us that despite the absence of contract provisions for O&M expense, the contract water rates charged and proposed were sufficient to recover any applicable O&M expenses based on prevailing expenses at other facilities.

The rate may be sufficient to recover O&M expenses. However, the contract files contained no documentation or procedure to determine how much of an O&M cost component was associated with these contracts, and no contract provision specifically addresses the recovery of the Corps' actual O&M expenditures. Because O&M costs are not specifically identified and recovered as a separate element in the water service contracts, the Bureau does not allocate the contract revenues to the appropriate capital repayment and O&M cost recovery accounts.

Bureau regional contracting officials stated that they could offset the Corps' O&M expenses with contract revenues and were willing to do so, even in the absence of contract provisions.

However, the Corps has never furnished the Bureau with O&M cost data upon which to base O&M charges and subsequent reimbursement. A breakdown of the Corps' O&M costs would be needed before contract revenues could be applied to O&M cost recovery. Corps division officials stated that the Bureau has never requested O&M cost data and that the Corps has no requirement to notify the Bureau regarding the Corps' O&M costs.

The Bureau's Assistant Commissioner for Administration stated that recently a dialog has been initiated with the Corps addressing joint agency accounting for M&I revenues from mainstem reservoirs, but no procedure currently exists to determine an O&M cost component associated with these contracts and no mechanism exists to recover the Corps' O&M expenditures.

CORPS ALLOCATES O&M COSTS  
ON INTENDED RATHER THAN  
ACTUAL USE OF PROJECT WATER

Although water allocated to irrigation is being sold to industrial customers, the Corps is not allocating the appropriate share of O&M costs to this new purpose. The Corps continues to allocate O&M costs to the original irrigation function but accounts for them as nonrecovered because irrigation revenues have not developed as anticipated and are thus unavailable to offset these costs. This allocation follows existing Corps policy which does not require subsequent reallocation of costs to project purposes--M&I in this case--which were not originally authorized. As a result, costs are not being offset against actual water use, and reimbursement of these costs is being foregone.

We are not aware of any provision in law that precludes the reassignment of costs or any reason that the Chief of Engineers cannot direct a policy change to allow a reallocation of costs based on actual use.

CONCLUSIONS

Although Bureau water marketing policy requires reimbursement of an appropriate share of O&M costs from M&I users, the contracts used to sell surplus irrigation water to M&I users do not include O&M cost recovery provisions. Neither the original Memorandum of Understanding nor the proposed ETSI contract addresses O&M cost recovery. Neither agency has assumed responsibility for O&M cost recovery, and only limited communication has taken place regarding a decision to reallocate a portion of the O&M expenses to M&I use. The Corps and the Bureau need to assess, recover, and account for an appropriate share of O&M costs from current and future M&I water users.

RECOMMENDATIONS


To properly account for the recovery of O&M costs associated with sales of surplus irrigation water on mainstem Missouri reservoirs, we recommend that the Secretaries of the Army and the Interior require the Corps of Engineers and the Bureau of Reclamation to jointly

- establish a policy to reallocate an appropriate share of O&M costs to existing and future M&I water sales,
- direct that all future water service contracts specifically provide a contract provision for O&M cost recovery, and
- direct the necessary communication between the two agencies to establish the proper accounting for O&M cost recovery.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report. A written statement must also be sent to the House and Senate Committees on Appropriations with an agency's first request for appropriations made not more than 60 days after the date of the report.

Copies of this report are being sent to the Director, Office of Management and Budget, and to appropriate congressional committees.

Sincerely yours,

*for*   
Henry Eschwege  
Director