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GAO

Report to the Ranking Minority Member,
Committee on Resources, House of
Representatives

May 1995

CENTRAL ARIZONA PROJECT

Costs and Benefits of Acquiring the Harquahala Water Entitlement



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United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-260349

June 5, 1995

The Honorable George Miller
Ranking Minority Member
Committee on Resources
House of Representatives

Dear Mr. Miller:

The Fort McDowell Indian Community Water Rights Settlement Act of 1990 (Title IV of P.L. 101-628) directed the Secretary of the Interior to acquire 13,933 acre-feet¹ of water to complete the settlement of the Fort McDowell Indian Community's (the Community) water rights claim against various Arizona parties and the federal government. In accordance with an option provided in the act, the Department of the Interior acquired the water from the Harquahala Valley Irrigation District (Harquahala), 1 of 10 irrigation districts that contracted for non-Indian agricultural water from Interior's Central Arizona Project (the project). As requested, we are providing you with information on how Harquahala became a source of water for the settlement, the federal government's costs to acquire the water, and the benefits accrued to the parties involved in the acquisition. The report also discusses the status of U.S. Department of Agriculture loans made to Harquahala landowners.

Background

The project was authorized under provisions of the Colorado River Basin Project Act of 1968 (Title III of P.L. 90-537). Interior's Bureau of Reclamation (the Bureau) began constructing the project in 1972 and estimates that it will be completed by 1999. The project's main components are a 336-mile aqueduct, water storage reservoirs, a pumping system, and an electric power generating plant. The project is designed to pump as much as 2.2 million acre-feet of water annually from the Colorado River on Arizona's western border and transport it as far south and east as Tucson. The project provides water to several cities, the 10 irrigation districts, and various Indian tribes in Arizona.

The Central Arizona Water Conservation District (the District) is responsible for operating the project and repaying to the federal government the reimbursable construction costs allocated to non-Indian agricultural, municipal and industrial water users, and electrical power

¹An acre-foot is the amount of water needed to cover 1 acre of land to a depth of 1 foot—or about 326,000 gallons.

generation. The District began operating the project in April 1993. The District collects revenue through a local tax and through project water and power sales.

The federal government has financed most of the \$3.2 billion spent to construct the project. Under the Colorado River Basin Project Act, project construction costs allocated to Indian irrigation water use are nonreimbursable, that is, they are borne by the federal government. The reimbursable costs allocated to municipal and industrial water use and power production are to be repaid with interest while those allocated to non-Indian agricultural water use are to be repaid without interest. Water users also pay for the operation and maintenance (O&M) costs incurred by the District in operating the project. In addition to their water use charges, the non-Indian agricultural water users are required by contract to pay the fixed O&M expenses associated with project water allocated to but not used by the Indian and municipal and industrial users, even if the non-Indian agricultural users choose not to use the water—the so-called “take or pay” provision.²

In 1908, the U.S. Supreme Court in *Winters v. U.S.*, 207 U.S. 564, declared that Indian reservations in the West had federal reserved water rights. The federal government, as the trustee for the nation’s Indian tribes, is responsible for ensuring that Indian water rights claims are settled in the tribes’ best interest. Disputes about the quantity of water covered by these rights have been resolved by court decrees, legislation, and agreements among the affected parties. The project has become a major source of water for settling Indian water rights claims in Arizona. These settlements, achieved in part through reallocations of the project’s non-Indian agricultural water to Indian use, decrease the reimbursable costs the District is required to pay to the federal government. The settlements are negotiated by Interior and authorized or confirmed by legislation.

Results in Brief

During the late 1980s, economic events led to the willingness of Harquahala landowners to sell their land and associated rights to project water. At the same time, the United States was interested in obtaining water to settle the Community’s long-standing water rights claims. The ensuing legislation and negotiations between the various parties allowed the Harquahala landowners to receive financial help and the federal government to acquire the needed water.

²In early 1995, the District and Interior reached tentative agreement whereby the take or pay provision will no longer be in effect.

The water acquisition will cost the federal government \$87.6 million in forgone receipts over the project's 55-year repayment period. Included in this cost are Interior's elimination of Harquahala's federal water distribution system debt, payment to Harquahala landowners for the project water entitlement, and a reduction in construction cost reimbursements from the District. Furthermore, the cost could increase to \$124 million, depending on water use. The cost estimates presented to the Congress were significantly understated because a cost element was omitted and two others developed subsequent to the estimates.

Many parties benefited from the acquisition. The federal government settled the Community's outstanding claims and acquired water for other settlements. The Community resolved its claims and obtained the water. The District's repayment obligation for project construction costs associated with the water was reduced. Harquahala landowners received a cash payment and debt relief for the sale of a water entitlement for which they paid nothing. The landowners continue to farm their land using project water obtained at a substantially lower rate than prior to the sale and delivered through their debt-free distribution system.

Interior did not adequately protect the federal government's financial interests with respect to federal farm loans held by several Harquahala landowners. Had the proceeds the landowners received from the sale of their project water entitlement been applied to these loans, a substantial amount of the delinquencies on these loans could have been made current.

How Harquahala Became Involved in the Fort McDowell Settlement Agreement

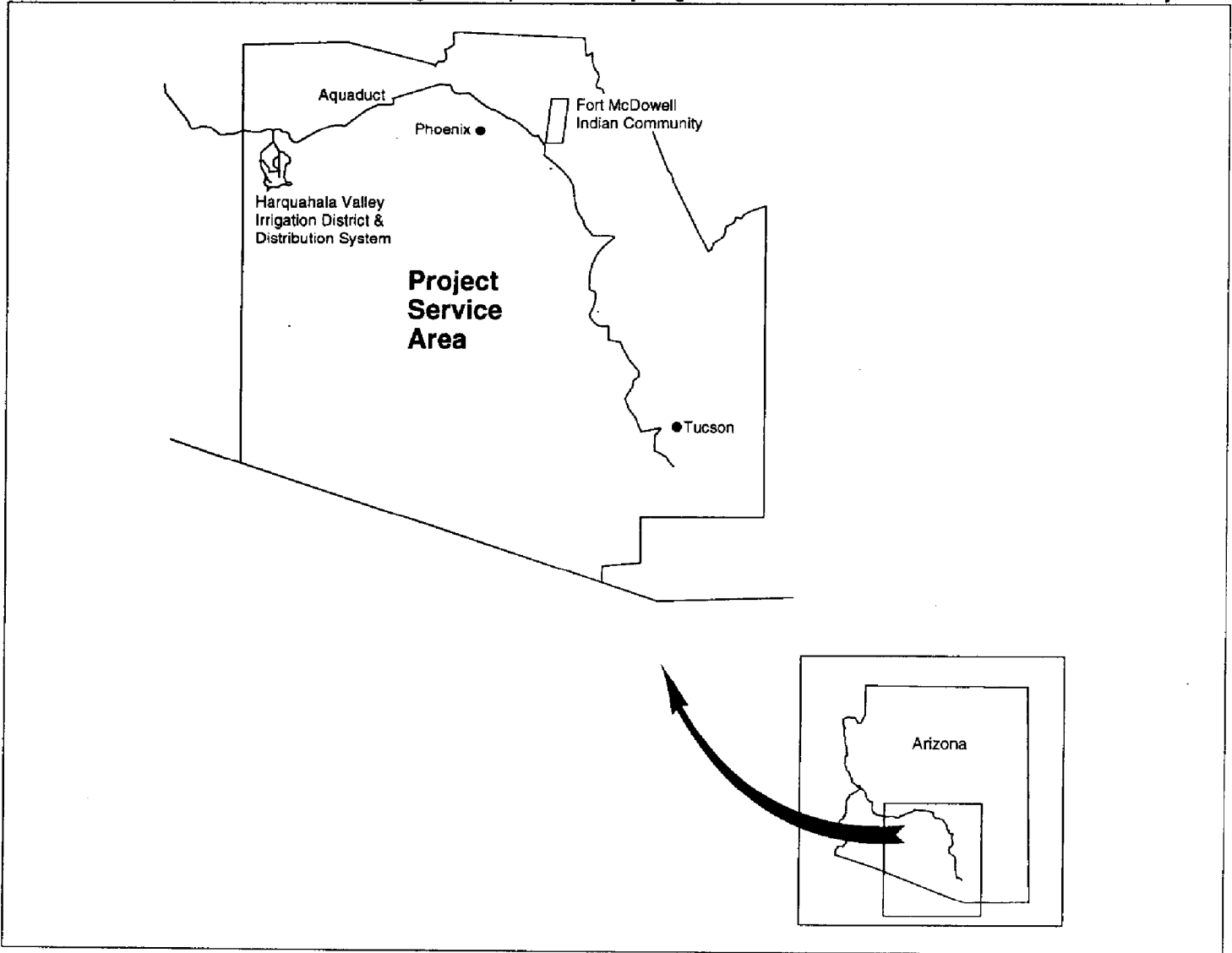
During the 1980s, Interior began negotiations to settle the Community's water rights claims and provide the Community with a secure source of water. By 1990, the various parties to the settlement had agreed on the amount of water due the Community and the contributions each party would make. Although the amount of water to be contributed by the federal government had been determined, the source of the water was uncertain.

Harquahala Valley Irrigation District—a Potential Water Source

Harquahala is located about 65 miles west of Phoenix. Harquahala comprises about 38,000 acres, approximately 33,000 of which are eligible to receive project water. (See fig. 1.) In 1983, Harquahala signed a contract with the Bureau and the District agreeing to pay the share of the project construction costs associated with an entitlement to 7.67 percent of the

project's annual non-Indian agricultural water supply.³ In 1984, Harquahala also contracted with the Bureau for the construction of a \$34.5 million distribution system to transport water from the project aqueduct to the farmers' fields. Construction was financed by a \$26.1 million noninterest-bearing loan from the Bureau and \$8.4 million in municipal bonds.

Figure 1: The Project Service Area Showing the Harquahala Valley Irrigation District and Fort McDowell Indian Community



³Because the repayment period was not scheduled to begin until more than a year after Harquahala sold its water entitlement to Interior, no payments were made.

Economic circumstances in the late 1980s led Harquahala landowners to consider selling their land and the accompanying groundwater. Many landowners were facing bankruptcy because of declining cotton prices, failing crops due to insect infestation, increasing project water costs, and debts associated with their land and the distribution system. To compound their problems, the landowners were faced with having to pay additional fixed O&M costs when the take or pay provision contained in their project water service contract took effect in January 1994.

In 1989, the District and several local municipalities were interested in acquiring land in the Harquahala Valley for use as a water farm—a tract of land acquired for its future use as a municipal groundwater supply. Aware that the federal government was interested in obtaining water for settling Indian water rights claims and recognizing the possibility of reducing its cost of acquiring the Harquahala land, the District joined with Interior to acquire Harquahala. In return for financially assisting the District in completing the acquisition, the federal government would obtain the rights to Harquahala's project water entitlement for use in settling Indian water rights claims. The proposal subsequently became the basis for the provision in the act designating Harquahala as a potential water source.

The Fort McDowell Indian Community Water Rights Settlement Act of 1990

The act confirmed an agreement between the Community, the federal government, the state of Arizona, and others for settling the Community's long-standing water rights claims. The agreement quantified the Community's right to an annual supply of 35,223 acre-feet of water in exchange for its waiver and release of all past, present, and future claims to water for its reservation lands. The agreement also identified the contributors and sources of the water supply, including 13,933 acre-feet to be contributed by the federal government.

The act directed Interior to acquire pursuant to contract the 13,933 acre-feet of project water permanently relinquished by Harquahala and/or the city of Prescott.⁴ The act also provided that if the water could not be acquired from these sources, Interior could acquire any water available in Arizona at its disposal.

The act did not appropriate funds to acquire Harquahala's project water supply. Instead, in consideration for the fair value of the relinquished water, the act authorized Interior to eliminate an appropriate share of

⁴The city of Prescott option refers to project water available to the city, two water companies, and two Indian tribes.

Harquahala's distribution system debt and, if the fair value of the relinquished water was greater than the debt relief, to credit the District's annual repayment obligation for the project's construction costs by that amount.

The act provided that Harquahala's non-Indian agricultural priority water could be converted to Indian priority water at the rate of 1 acre-foot for each Harquahala acre eligible to receive project water. This provision was necessary because non-Indian agricultural water deliveries are reduced or curtailed before municipal and industrial or Indian priority water deliveries if shortages occur in the project system. Interior officials believed that the Community would not have agreed to a settlement without the higher-priority water. The act also specified that any water acquired in excess of the amount needed to complete the Fort McDowell settlement could be used only for settling certain Indian water rights claims in Arizona.

After the act was passed, the District opted not to acquire the Harquahala Valley land as a water farm; therefore, Interior was unable to acquire Harquahala's project water supply as planned. Interior considered acquiring water from the city of Prescott as authorized in the act but concluded that due to environmental and financial factors, it would not be able to obtain the necessary water from this source. Interior then proposed to acquire Harquahala's project water entitlement without the District acquiring the land. Although no longer interested in buying Harquahala Valley land, the District agreed to provide the funds necessary to finance the federal acquisition of Harquahala's project water entitlement. Interior's Office of the Solicitor has concluded that the act provided sufficient authority for the District to advance the necessary funds to complete the transaction and in exchange to receive a credit against its annual repayment obligation. In effect, this interpretation allowed Interior to borrow the necessary funds from the District and to pay interest on them.

In December 1992, Harquahala agreed to relinquish its entire project water entitlement to the federal government for \$34.9 million. This yielded 13,933 acre-feet of water to complete the Fort McDowell settlement and an additional 19,318 acre-feet for use in settling other Indian water rights claims. In January 1993, the Fort McDowell Indian Community Water Settlement Agreement was signed by the various parties.

Cost of the Acquisition to the Federal Government

The Harquahala water acquisition will cost the federal government \$87.6 million in forgone receipts over the projects's 55-year repayment period.⁵ Interior's implementation of the act eliminated Harquahala's \$25.5 million debt for the water distribution system and in effect paid Harquahala \$28.7 million for its project water supply. The District's contractual project repayment obligation was reduced by \$30.5 million when the water was reallocated to nonreimbursable Indian use.⁶ Interior also incurred \$2.9 million in interest charges when the District financed the transaction. Furthermore, the cost could rise to \$124 million because Interior has tentatively agreed to incur \$36.4 million in fixed O&M costs associated with the Harquahala water. Table 1 shows the federal costs of the transaction, including the present value of each aspect of the transaction.

Table 1: Federal Cost of Acquiring Harquahala's Project Water Entitlement

Dollars in millions

Type of transaction	Cost	Present value
Elimination of Harquahala's distribution system loan	\$25.5	\$6.7
Payment to Harquahala by the District	28.7	28.7
Reduction in the District's repayment of project construction cost	30.5	6.7
Interest charged by the District on \$28.7 million payment to Harquahala	2.9	2.9
Total	\$87.6	\$45.0
Fixed O&M costs	36.4	12.3 ^a
Grand total	\$124.0	\$57.3

^aPresent value expressed in 1992 terms except the amount related to fixed O&M costs, which was calculated to 1995 present-value terms and adjusted for inflation back to 1992.

Distribution System Debt and Other Financial Considerations

In December 1992, Interior and Harquahala agreed that Harquahala would relinquish its entitlement to 33,251 acre-feet of project water for \$34.9 million. As authorized by the act, Interior deducted Harquahala's federal distribution system debt from the purchase price to determine how much additional compensation would be required to complete the transaction. Interior determined that Harquahala's \$25.5 million distribution system debt, which was to be repaid without interest over the succeeding 34 years, had a 1992 present value of \$5.8 million. Interior also

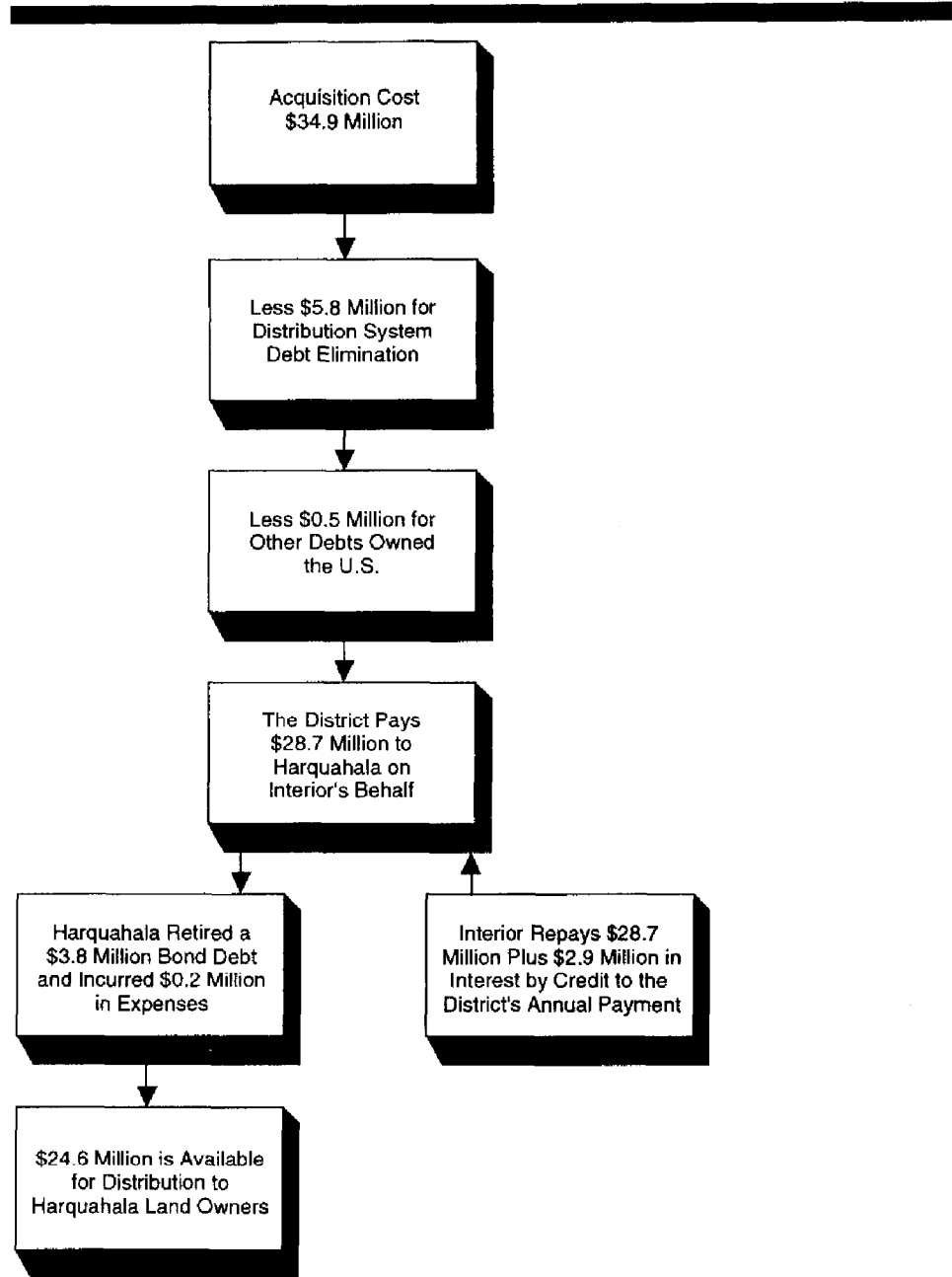
⁵This amounts to \$57.3 million expressed in 1992 present-value terms.

⁶The \$30.5 million reduction in the District's repayment obligation is the amount of the nonreimbursable project construction cost less the increased interest income. (See p. 11.)

deducted about \$0.5 million for miscellaneous expenses owed the government, leaving a balance of \$28.7 million due to Harquahala.

The District provided \$28.7 million to Harquahala to complete the transaction. A condition of the District's agreeing to finance the water sale was that it would not lose money on the transaction. The District charged Interior \$2.9 million to replace forgone investment income resulting from the payment to Harquahala. Interior credited the District's 1994 and 1995 project repayment obligations by a total of \$31.6 million that the District incurred for financing the transaction. Figure 2 shows the financing of the acquisition.

Figure 2: The Federal Government's Financing and Payments for Harquahala's Project Water Entitlement



Note: Numbers do not add because of rounding.

Inappropriate Discount Rate

In March 1994, Interior's Office of Inspector General reported that Harquahala's \$25.5 million distribution system debt was inappropriately discounted.⁷ The Inspector General determined the discounting to be inappropriate because (1) the act's legislative history raised concerns about the act's impact on the federal deficit and (2) general federal Reclamation law and Interior policy does not provide for discounting a stream of payments included in a repayment contract. The Inspector General also pointed out that the 8.5-percent discount rate applied to the distribution system debt was excessive.

We believe that the concept of discounting a debt that is to be repaid over time is appropriate. The act's legislative history indicates that discounting to obtain present value was considered a method that Interior could use. Deducting the present value of the distribution system debt from the purchase price would satisfy Interior's repayment obligation, provided the proper discount rate was used.

We agree with the Inspector General that the 8.5-percent interest rate used to discount the distribution system debt was excessive. We determined that a 7.5-percent rate better reflects the government's borrowing costs during the 1992 negotiation of the water entitlement acquisition. On the basis of this lower interest rate, we calculated that the present value of the \$25.5 million debt was \$6.7 million, or \$0.9 million more than computed by Interior. Had the 7.5-percent rate been applied, the cash required to pay Harquahala would have been less and would have reduced the amount borrowed from the District by \$0.9 million plus interest.

Interior officials told us that they were required to use the 8.5-percent rate because it was the fiscal year 1992 plan formulation and evaluation rate used in long-term planning of water projects. Our review showed, however, that Interior was not required by law or regulation to use this rate because the transaction in question did not involve the construction of a water project but rather the calculation of forgoing future streams of income from the repayment of existing debts. Also, the 8.5-percent rate did not reflect the long-term borrowing rate in effect at the time of the negotiations. Therefore, we believe that it would have been more appropriate to have used the 7.5-percent rate to calculate the present value of the distribution system loan.

⁷Acquisition of the Harquahala Valley Irrigation District's Water Allocation, Central Arizona Project, Bureau of Reclamation, Report number 94-I-424, Mar. 1994.

Project Repayment Obligation Reduced

The act authorized Interior to convert Harquahala's non-Indian agricultural priority water to Indian priority. Under the project's authorizing legislation, construction costs associated with water allocated to Indian irrigation use are nonreimbursable, that is, they are borne by the federal government. Bureau officials have calculated that as a result of the water-use conversion, \$67.8 million in construction costs became nonreimbursable. However, this reduction in reimbursable costs caused the District's project interest costs to increase by \$37.3 million over the project repayment period.⁸ The net effect of the water-use conversion is a \$30.5 million reduction in the District's repayment obligation to the federal government.

Fixed O&M Costs

By tentative agreement between Interior and the District, water reserved by Interior is assessed a fee for its share of the fixed O&M costs incurred by the District annually to operate the project. Under the tentative agreement, Interior will reserve 687,000 acre-feet of water. This amounts to 48.6 percent of the fixed O&M costs, or \$751.9 million in forgone receipts over the project repayment period. Currently, the 13,933 acre-feet of Community water and the 19,318 acre-feet of water Interior has available for future Indian water rights settlements are reserved. We calculate that \$36.4 million of the \$751.9 million represents the fixed O&M costs associated with the 33,251 acre-feet of water from the Harquahala acquisition. Should any of the reserved water be used, the water user would be responsible for paying the fixed O&M costs, and the federal cost would be reduced accordingly.

Cost of the Acquisition Was Understated to the Congress

The Congressional Budget Office's (CBO) and the Office of Management and Budget's (OMB) estimates of the cost of the Harquahala water option in the proposed legislation presented to the Congress were significantly understated. One cost was not included in the estimates, and two other costs did not become known until after the estimates were made. We calculate that these three costs represent \$69.8 million of the total \$124 million in forgone receipts associated with the Harquahala water acquisition, or \$21.9 million of the \$57.3 million expressed in 1992 present-value terms.

⁸While the conversion reduced the District's overall repayment obligation, it also reduced its annual payment and the amount applied to the interest-bearing portion of the repayment obligation. Over the project repayment period, Bureau officials calculate that this change will generate \$37.3 million more in interest because the interest-bearing portion of the District's repayment obligation is reduced at a slower rate.

While including some of the revenue losses associated with the acquisition, neither agency included the loss of federal receipts resulting from the conversion of the water from non-Indian agricultural use to Indian irrigation use. CBO and OMB officials said this cost element was omitted because Interior officials did not inform them of this cost or the need to include it in the estimates. The omission amounts to \$30.5 million in forgone receipts over the project's repayment period, or \$6.7 million expressed in 1992 present-value terms.

Subsequent to their estimates, two other costs arose that added to the cost of the transaction. First, the District charged Interior \$2.9 million in forgone receipts for interest. This cost was not included in the estimates because it had not been determined at that time that a finance charge would be applied to the transaction. Second, the federal government's share of the annual fixed O&M expense incurred by the District for the operation of the project subsequently became an issue. In early 1995, the District and Interior tentatively agreed that the federal government will be responsible for 48.6 percent of these expenses. On the basis of discussions with Interior officials, it is reasonable to attribute a proportional share of the fixed O&M costs to the acquisition cost of the Harquahala water. We calculate this cost at \$36.4 million in forgone receipts over the project repayment period, or \$12.3 million expressed in 1995 present-value terms adjusted for inflation back to 1992.

Many Parties Benefited From the Harquahala Water Acquisition

Interior's acquisition of Harquahala's project water entitlement provided the following benefits to various parties involved in the transaction:

- Interior obtained the water necessary to complete the Fort McDowell settlement, which was carried out on January 15, 1993. As part of the cost of the Harquahala transaction, Interior also acquired 19,318 acre-feet of high-priority project water for use in settling certain Indian water rights claims in Arizona.
- The Community obtained 13,933 acre-feet of project water from the Harquahala acquisition. When combined with the 21,290 acre-feet of water from other sources outlined in the settlement agreement, the Community obtained a firm annual water supply of 35,223 acre-feet, thereby resolving its long-standing water rights dispute.
- The District's contractual project repayment obligation was reduced by \$30.5 million as a result of converting Harquahala's non-Indian agricultural priority water to Indian priority.

- Harquahala landowners received multiple benefits for the sale of a water entitlement for which they paid nothing. After retiring \$3.8 million of municipal bond debt on its distribution system and other expenses associated with relinquishing its project water entitlement, Harquahala had \$24.6 million available for distribution to its landowners. As of October 27, 1994, 62 Harquahala landowners had received payments, ranging from \$2,116 to \$3,075,436, based on their share of project eligible acres.⁹ In addition, the landowners were relieved of their obligation to pay the federal distribution system debt and the additional fixed O&M charges associated with the take or pay provision. The landowners continue to own their land and the underlying groundwater resources and continue to use their debt-free distribution system. Due to the District's restructuring of its non-Indian agriculture water rates, the landowners now farm with project water purchased at prices significantly lower than what they paid prior to relinquishing their project water entitlement.¹⁰

Opportunity Missed to Apply Sale Proceeds Against Delinquent Federal Loans

Under the terms of the Harquahala transaction, \$24.6 million in sale proceeds were available for distribution to individual landowners. At the time of distribution, several landowners were overdue on millions of dollars of loans made by the U.S. Department of Agriculture's Farmers Home Administration (FmHA).¹¹ If applied to these loans, sale proceeds could have made current a substantial amount of these delinquencies. However, Interior did not consider the FmHA loans in its negotiations for the acquisition of the Harquahala water entitlement, and the majority of the delinquencies remain.

Since 1979, FmHA has made loans to various Harquahala landowners for rural housing, farm ownership, economic emergency, and natural disaster emergency purposes. According to FmHA officials, collateral for the loans generally was the Harquahala land, the value of which was based in part on the project water entitlement. As of October 28, 1994, 11 borrowers owed FmHA \$9.8 million. Our review of FmHA's records indicates that seven borrowers have past due payments totaling \$3.9 million on \$9 million in outstanding loans. These seven borrowers were eligible to

⁹Payments have been withheld from 10 landowners pending resolution of disputes between landowners, lienholders, and government agencies as to who is entitled to the proceeds.

¹⁰Harquahala landowners have access to other project agricultural water for as little as \$28 an acre-foot, or \$24 per acre-foot less than the \$52 an acre-foot charge imposed prior to the project water relinquishment.

¹¹In 1994, the responsibility for administering U.S. Department of Agriculture farm loans was transferred from FmHA to the newly created Consolidated Farm Service Agency. Because of the general familiarity with the agency's earlier name, we refer to FmHA in this report.

receive a total of \$4.5 million from the sale proceeds less deductions for overdue taxes. However, FmHA's records identify loan payments of only \$27,653 on the borrowers' various loans since the distribution of proceeds.¹²

FmHA officials consider Harquahala's sale of its project water entitlement as a disposal of FmHA's collateral for the \$9.8 million in loans. As such, the officials believe that the sale proceeds should have been applied to the borrowers' FmHA loans. The officials told us that had they known the details and timing of the acquisition, they could have taken actions to better protect FmHA's interest. For example, the officials said that they could have foreclosed on certain loans, thereby making FmHA the landowner of record at the time of the distribution of proceeds. A second option could have been for Interior to have required as a condition of the sale that the proceed checks be made payable to the landowner "and all lien holders." The officials said that such a payee stipulation would have put FmHA in a better position to require delinquent borrowers to bring their accounts current.

Interior officials told us that they were aware of the FmHA loans but did not consider them in their negotiations with Harquahala. While Interior negotiated a clause in the acquisition agreement requiring Harquahala to retire the municipal bond debt on the distribution system to protect the federal government's interest by having the water free and clear of this debt, no such action was taken to protect FmHA's interest. The officials said that in retrospect, they could have protected FmHA's interest by alerting FmHA to Interior's negotiations and by attempting to include a clause in the acquisition agreement that provided for applying the proceeds to borrowers' delinquencies.

Conclusions

Interior's acquisition of Harquahala's project water entitlement allowed the federal government to settle the Community's long-standing Indian water rights claims. However, the acquisition will cost the federal government \$87.6 million, and could possibly rise to \$124 million, in forgone receipts over the project's repayment period. This amount is significantly more than the amount estimated by CBO and OMB because of two factors. First, Interior did not provide the two agencies with

¹²In addition to the \$27,653, FmHA has also received \$1 million for releasing its liens to another creditor involved in bankruptcy proceedings against Harquahala borrowers. According to an FmHA official, the bankruptcy assets include some amount of water sale proceeds which would have been difficult for the federal government to successfully claim. After applying the \$1 million to the borrowers' \$5 million in outstanding loans, FmHA records show the borrowers' accounts remain \$2.3 million past due.

information on the costs of converting the water from non-Indian agricultural use to Indian irrigation use for inclusion in their estimates. Second, two other costs arose subsequent to the estimates. Thus, when the Congress passed the act, it was not made aware of the total federal cost of the acquisition. Whether the Congress would have acted differently if the conversion cost had been presented is unknown, but we believe that this additional information would have allowed the Congress to make a more informed decision on the legislation.

Many parties benefited from the Harquahala acquisition. The federal government settled the Community's outstanding claims and acquired water for other settlements. The Community resolved its claims and obtained the water. The District reduced its project construction repayment obligation associated with the water. Harquahala landowners received a cash payment and debt relief for the sale of a water entitlement for which they paid nothing. Also, the landowners continue to farm their land using the distribution system and to receive project water at a substantially lower rate than they paid prior to the sale.

Interior did not adequately protect the federal government's overall financial interests with respect to the FmHA loans held by several Harquahala landowners. The proceeds the landowners in effect received from Interior for the sale of what effectively was part of the collateral for their FmHA loans should have been applied to the delinquencies on these loans. Although Interior officials knew of the loans, they did not consider them in their negotiations with Harquahala and did not protect FmHA's interest as part of the acquisition process. As a result, the federal government lost an opportunity to make current a substantial amount of the \$3.9 million that was delinquent on the FmHA loans.

Recommendations

To ensure complete estimates of federal costs of future Indian water rights settlements that use Bureau of Reclamation project water, we recommend that the Secretary of the Interior and the Directors of CBO and OMB develop methodologies to ensure that all the known costs associated with any federal contribution of water are included in estimates provided to the Congress.

Because of the common link between land and water rights in Harquahala-type acquisitions and the need to ensure that the federal government's overall interests are protected in future Indian water rights settlements, we recommend that the Secretary of the Interior identify

other federal agencies' interests in these settlements and act to protect these interests in the negotiations.

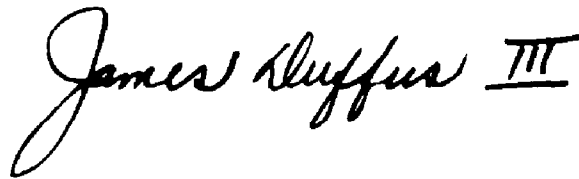
Agency Comments

We provided copies of a draft of this report to the Secretaries of the Departments of the Interior and Agriculture and the Directors of CBO and OMB for their comment. The Acting Deputy Administrator of FmHA, the Associate Director of OMB's Natural Resources, Energy and Science Division, the Counselor to the Secretary of the Interior, and a CBO Principal Analyst concurred in the report's findings and conclusions. While FmHA, OMB and Interior agreed with the recommendations, CBO considered the recommendation on including all costs in estimates provided to the Congress to be vague. We do not agree that the recommendation is vague. The recommendation specifies that all known costs, which would include the costs of converting the water, should be included. The recommendation also specifies the agencies that should be involved in implementing the recommendation but provides the agencies the flexibility of deciding the best means of achieving this. The agencies also made technical and editorial comments, and we made changes in the report, as appropriate.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies of the report to the appropriate congressional committees; interested Members of Congress; the Secretaries of the Interior and Agriculture; the Administrator, FmHA; the Directors of CBO and OMB; and other interested parties. We will also make copies available to others upon request.

Please call me at (202) 512-7756 if you have any questions about this report. Major contributors to this report are listed in appendix II.

Sincerely yours,

A handwritten signature in cursive script that reads "James Duffus III". The "III" is written in a stylized, slightly larger font than the rest of the name.

James Duffus III
Director, Natural Resources
Management Issues

Scope and Methodology

We conducted our work at the Department of the Interior's and Department of Agriculture's Washington, D.C., headquarters and at the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB). We also conducted our work at the Bureau of Reclamation's Lower Colorado Regional Office in Boulder City, Nevada, and its Arizona Project Office in Phoenix, Arizona; and at the District's headquarters in Phoenix, Arizona. At these locations, we interviewed Interior, Bureau, FmHA, the District, CBO, and OMB officials. We also interviewed members of the Harquahala Board of Directors and Harquahala's General Manager.

To determine how Harquahala became a source of water for the settlement, we examined the relevant legislation and supporting documents that authorized the acquisition. We then interviewed and obtained pertinent documents from Interior, Bureau, the District, and Harquahala officials who participated in the selection process and negotiation of the water acquisition. We also obtained a written response from the Solicitor's Office regarding legal issues raised by the use of Harquahala's project water entitlement in the settlement.

To estimate the federal government's cost of the acquisition, we reviewed the legislation that authorized the financing of the acquisition and obtained from CBO and OMB their respective budget estimates of the federal costs. We also interviewed and obtained documents from Interior, Bureau, the District, and Harquahala officials to determine each organization's role in the acquisition, the price paid for the water entitlement, the charges associated with the financing, and the post-implementation costs associated with the acquisition. In general, dollar figures have been rounded to the nearest hundred thousand.

To outline the benefits accruing to the parties involved in the acquisition, we talked with Interior, Bureau, the District, and Harquahala officials. We obtained pertinent documents from these officials to verify the amount of water Interior received to implement the agreement and future settlements, the elimination of Harquahala's distribution system loan, the amount of water sale proceeds made available to Harquahala landowners, the reduction in the District's project construction repayment obligation, and other benefits received by the various parties associated with the acquisition.

To determine the status of FmHA loans held by some Harquahala landowners and the water sale proceeds that could have been applied to their loan deficiencies, we talked with Interior, Bureau, FmHA, and

Appendix I
Scope and Methodology

Harquahala officials. The FmHA Arizona State Office and the St. Louis Finance Office provided us with information on Harquahala landowners' loan obligations and payments. We did not verify the FmHA source data for this information. We compared the FmHA loan information to sale proceeds data provided by Harquahala officials to determine the amount of proceeds that were due these borrowers versus the amount of loan payments made to FmHA.

We conducted our work between August 1994 and May 1995 in accordance with generally accepted government auditing standards.

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