

MEMORANDUM

Subject: VARTF Program Audit
To: Corps, DEQ, IRT members
From: Karen Johnson
Date: May 11, 2016

The Virginia Aquatic Resources Trust Fund's 2011 Program Instrument requires a third party audit at least every five years. This memo provides a summary of two independent audit reports, TNC's response to the reports' findings and recommendations, and additional review by TNC of certain items requested by the IRT.

The memo is divided into the following sections:

I. Introduction – Provides general purpose and goals of the Program and the audit, Conservancy's role and focus, and IRT direction and review.

II. Programmatic Audit Summary and Response – Provides summary information on the programmatic review conducted by the Environmental Law Institute and TNC's response to the audit's findings and recommendations.

III. Financial Audit Summary and Response – Provides summary information on financial review conducted by Hanztmon Wiebel and TNC's response the audit's findings and recommendations.

IV. TNC Review Items Summary – Provides summary information on the Advance Credit and Pricing review that TNC conducted.

V. References – Provides links to useful reference documents relevant to the program operation and audit review.

I. Introduction

The Virginia Aquatic Resources Trust Fund (Program or Fund) is an in-lieu fee program established to provide compensatory mitigation for permitted wetland and stream impacts in Virginia. The Fund is administered by The Nature Conservancy (Conservancy) in accordance with a Program Instrument (Instrument) approved on July 14, 2011 by the Norfolk District of the United States Army Corps of Engineers (Corps) and the Virginia Department of Environmental Quality (DEQ). The Instrument details the establishment and operational procedures for the Fund and supersedes and replaces the Virginia

Aquatic Resources Trust Fund Program MOU, dated December 18, 2003 (2003 Amendment), which had in turn amended the Virginia Wetlands Restoration Trust Fund Program Memorandum of Understanding dated August 18, 1995 (1995 MOU).

A. PURPOSE AND GOALS OF THE TRUST FUND

The purpose of the Fund is to provide a mechanism for compensatory mitigation for impacts to aquatic resources authorized by relevant federal and state laws and regulations, while maximizing the benefit to the aquatic environment and the public interest. The Program Instrument establishes guidelines, responsibilities and standards for the establishment, use, operation and maintenance of the Program in a way that complies with revised regulations, as set forth in 33 CFR Part 332, governing compensatory mitigation for activities authorized by Department of Army permits. According to the Instrument, the parties intend to achieve no net loss of existing wetland acreage and functions pursuant to Va. Code § 62.1-44.15:21(B), and to accomplish mitigation projects in Virginia efficiently, at meaningful scales, and in beneficial ecological contexts so as to provide for a significant net gain of aquatic resource functions and values wherever possible.

B. AUDIT SCOPE

The scope and elements to be reviewed within the audit are not outlined in the Program Instrument. In consultation with the IRT, the Conservancy determined that two separate audits were advisable: one covering the financial aspects of the Program, and one covering programmatic compliance. The IRT approved the scope for both audits as well as the expenditure of VARTF funds to cover the expenses of the evaluations on December 29, 2015. The IRT requested that the Conservancy review several additional items and submit that information along with the audits.

II. Programmatic Audit Summary and Response

The Conservancy contracted with the Environmental Law Institute (ELI) to conduct a thorough review of the VARTF activities subject to the 2011 Instrument, focusing on projects and requirements that have been initiated since the 2011 Instrument was signed to meet the terms and requirements of 2008 Federal Rule. Program activities conducted between July 14, 2011 and December 31, 2015 are included in this review. ELI completed its review and provided its report electronically on April 29, 2016. The ELI report is attached to this memo.

ELI investigated compliance of a number of elements related to the operation of the Program specifically related to projects, proposals and site development plans submitted since July 2011. A summary of these items is provided below:

Element Reviewed	Compliance	Non-compliance
Conformation of Mitigation Project service areas to applicable regulations and standards	X	
Compliance with the approved Compensation Planning Framework	X	
Documentation of approval of Mitigation Project Sites – submission of proposals	X	
Documentation of approval of Mitigation Project Sites – review and approval of proposals	X	
Documentation of approval of Mitigation Project Sites – approval of credit purchase	X	

Site Development Plans including all required elements	X	
Content of Monitoring Plans	X	
Long Term Management and Maintenance Plan	X	
Adaptive Management Plan	X	
Financial Assurance	X	
Recorded land protection documents	X	
Documentation of credit costs	X	
Maintenance of credit tracking system	X	
Accurate credit tracking – Credit sales from 2012-2015	X	
Accurate credit tracking – Revenue tab entered into individual project tab	X	
Accurate credit tracking – compared summary tables to 2015 Annual Report	X	
Compliance with Advance Credit requirements		X
Satisfaction of required reporting protocols	X	
Standard Operating Procedures	X	

Of the 19 elements that ELI reviewed, the Trust Fund was in compliance with all but one factor, implementation of improvements within three growing seasons of the first Advance Credit sale. ELI also offered several recommendations about the Program and future reporting or auditing considerations which are summarized below, along with TNC’s responses.

1. ELI finding: Advance Credit requirements (implementation by third growing season) – NOT in compliance.

TNC response: The Conservancy concurs with and is very concerned about this finding. Many projects have been identified, proposed and approved to meet the Advance Credit sale liabilities; however, movement of projects from IEL issuance to approved SDP is taking longer than anticipated. The Conservancy and the IRT will need to identify ways to streamline the review process for the multiple projects under consideration to meet the timelines required by the Federal Rule.

2. ELI recommendation: Provide written procedures documenting pre-Instrument liabilities are met prior to Advance Credit liabilities post-Instrument.

TNC response: The Conservancy concurs with this recommendation. We shall establish written procedures to document the process for fulfilling existing pre-Instrument liabilities prior to Advance Credit sales.

3. ELI recommendation: Corps and DEQ should consider reviewing their operating procedures and priorities to ensure timely review will occur as more site development plans enter the review and approval process.

TNC response: The Conservancy concurs with this recommendation. We encourage both the Corps and DEQ to evaluate their own internal procedures for management of VARTF, and identify opportunities for improving the review process of VARTF sites.

4. ELI recommendation: Clearer presentation in Annual Reports of outstanding liabilities – both pre- and post-Instrument.

TNC response: The Conservancy concurs with this recommendation. We will discuss with the IRT changes to the Annual Report format to incorporate suggestions made here, and will include in subsequent Annual Reports if the IRT deems this is beneficial.

5. ELI recommendation: Written standard operating procedures for tracking potential credits and written procedures on establishing ledger entries for projects going through the approval process.

TNC response: The Conservancy concurs with this recommendation. We will update the VARTF operation manual to include current written procedures for tracking potential credits and establishing ledger entries for projects in the approval process.

III. Financial Audit Summary and Response

The Conservancy contracted with Hantzmon Wiebel LLP, a certified public accountant firm in Charlottesville, VA to conduct the review of the VARTF finances. Hantzmon Wiebel reviewed the financial statements for the years 2012, 2013 and 2014, the complete calendar years subject to the 2011 Instrument. Hantzmon Weibel provided three documents as part of its report: VARTF Final Communication Letter, VARTF Final Management Letter, and VARTF Final Statements. These documents were provided to the Conservancy electronically on March 9, 2016, and are attached to this memo.

Hantzmon Wiebel's report noted the following findings:

- No transactions entered into by the Fund during the year for which there is lack of authoritative guidance or consensus;
- All significant transactions have been recognized in the schedules in the proper period;
- The schedules disclosures are neutral, consistent and clear;
- No significant difficulties in dealing with management in performing and completing the audit;
- Misstatements, errors identified in the account ledgers, were identified during the audit and VARTF staff has corrected all such misstatements;
- No disagreements arose with Management during the course of the audit.

Hantzmon Wiebel's recommendations, along with the Conservancy's response to those recommendations are as follows:

1. Hantzmon- Weibel recommendation regarding allocation tracking: While the Nature Conservancy does track allocations based on approved budgets, they do not actively track changes in allocations. This can cause a material misstatement in annual reports to the IRT. It is our recommendation that TNC begin to separately track allocations activity to be able to quickly identified available funds.

TNC response: The Conservancy concurs with this recommendation. We shall create and maintain an allocation-tracking system that not only records newly allocated budgets but also clearly tracks the re-allocation of budgets across basins and/or resources.

2. Hantzmon- Weibel recommendation general ledger reconciliation: While bank accounts are reconciled to TNC's accounting records, the Fund's ledger is not regularly reconciled to the

same records. This could cause activity to not be recorded and, therefore, not included in the annual report. We recommend that the Fund's general ledger be reconciled to statements on a monthly basis to ensure all activity has been correctly recorded.

TNC response: The Conservancy concurs with this recommendation. In the past, reconciliation between the Fund's general ledger and TNC's accounting records has been done on an annual basis. We shall proceed by reconciling these two records on a monthly basis.

3. Hantzmon- Weibel recommendation regarding general ledger review: The Fund's ledger is not regularly reviewed by a second individual to ensure all activity has been recorded correctly. This could cause activity to be recorded under the incorrect resources, which would cause annual reports to be misrepresented. We recommend the Fund's ledger be reviewed monthly by a second individual as well as having check figures in place within the ledger.

TNC response: The Conservancy concurs with the recommendation that additional check figures be incorporated within the financial ledger. Due to personnel and financial constraints, a monthly review by a second individual of all financial data may not be feasible or material. Alternatively, the Conservancy proposes to establish and maintain additional quality control and accuracy methodologies to identify data errors as they occur, and then make the necessary corrections. These quality control and accuracy methodologies shall be implemented and applied to recorded data on a monthly basis.

4. Hantzmon- Weibel recommendation regarding Annual Report review: The Fund's ledger is recorded on a cash basis, despite the fact that reimbursements cover multiple months and overlap years. This can cause significant activity to not be included in the annual reports. We recommend that reimbursement be done every quarter and that reimbursements are reviewed to ensure that expenses are included in the annual reports to which they belong.

TNC response: The Conservancy concurs with this recommendation. We shall establish and maintain a system by which reimbursements are recorded, at minimum, at the end of every quarter.

IV. TNC Audit Items Summary

The IRT requested additional review of the following three elements of the Program:

- Adequacy of Credit Fee Schedule: The IRT requests the internal VARTF analysis of its credit fee schedules to per credit project implementation costs for watersheds where projects have been implemented. TNC should provide this information, at least for projects under the 2011 Program Instrument.
- Adequacy of Advance Credits in Each Watershed: VARTF should provide analysis of advance credits and evaluate whether allocation of advance credits by type (wetland, stream) and watershed is adequate – in other words are there some watersheds where an increase in advance credits might be appropriate.

- VARTF should identify watersheds with pending credit need based on VARTF liability or meriting additional effort to secure compensation projects. Additionally, identify watersheds where mitigation obligations have not been addressed in the timeframe presented.

The analysis and discussion provided by TNC is attached to this memo and summarized below.

A. Adequacy of Credit Fee Schedule – Although the IRT asked for this analysis to be conducted for projects implemented under the 2011 Program Instrument. The Conservancy extended the analysis to all VARTF projects, as there are no projects yet implemented since the 2011 Instrument. TNC analyzed all of the existing approved projects – based on the credits proposed, or the credits that have been released from each site, in association with all of the expenses from the projects and the Program to provide full cost accounting.

In most areas, the Fee Schedule satisfactorily covers the expected or real costs of implementing the mitigation projects in all basins.

B. Adequacy of Advance Credits in Each Basin – The Conservancy has reviewed the existing Advance Credits limits in comparison to the current available Advance Credits, and the use of Advance Credits since the 2011 Instrument went into effect. There are five areas where there is little or no Advance Credit available, currently. These are areas that may benefit from expanding the Advance Credit limit. There are additional four areas that may also be considered, though they currently have Advance Credits available. Single, moderately sized projects could utilize the existing credits in these areas, leaving none available for other projects.

The Conservancy has not determined to request increase of the Advance Credit cap in any of these areas, but is willing to discuss the possibility with the IRT.

C. Watershed with Pending Credit Liabilities – The Conservancy analyzed the existing liabilities within each basin and resource type, with the full breakdown provided in the attached analysis. Most liabilities are being addressed, or will be with the approval and implementation of proposed/approved projects. There are seven areas where the Conservancy needs to focus additional efforts into securing suitable mitigation sites to offset the existing liabilities. All others will be addressed through existing or proposed projects once implemented and credits released. However, delays in the approval processes throughout the proposal and implementation of projects significantly hinders the Program's ability to offset liabilities in a timely manner.

V. Reference Documents

All of the following documents have been or will be posted on www.nature.org/varff, except for the one marked confidential.

Financial Report

- VARTF Final Communication Letter
- VARTF Final Management Letter
- VARTF Final Statements.

Programmatic Report

TNC Analysis - *confidential*

Trust Fund Instrument

- VARTF Program Instrument
- Exhibit A – Compensation Planning Framework
- Exhibit B – Advance Credits
- Exhibit C – Standard Ratios
- Exhibit D – Fee Schedule

Trust Fund Annual Reports and Supporting Documentation

- 2016 Main Report
- Supporting Documentation
 - Map of Virginia Aquatic Resources Trust Fund Project Sites
 - Summaries of Virginia Aquatic Resources Trust Fund Approved Projects by Major River Basins
 - Project Credit Balances and Service Areas within Major River Basins
 - Map of Chowan Conservation Corridor
 - Map of Dragon Run Conservation Corridor