REPORT OF

THE

STATE AUDITOR

COLORADO WATER CONSERVATION BOARD CONSTRUCTION FUND LOAN PROGRAM DEPARTMENT OF NATURAL RESOURCES

PERFORMANCE AUDIT
SEPTEMBER 1998

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STATE OF COLORADO

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September 25, 1998

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the Colorado Water Conservation Board's Construction Loan Program. The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. This report presents our findings, conclusions, and recommendations, and the responses of the Water Conservation Board.

J. David Barba

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Colorado Water Conservation Board Construction Fund Loan Program Department of Natural Resources Performance Audit September 1998

Authority, Purpose, and Scope

This performance audit was conducted under the authority of Section 2-3-103, C.R.S., which authorizes the Office of the State Auditor to conduct performance audits of all departments, institutions, and agencies of state government. The audit was conducted in accordance with generally accepted government auditing standards. Our procedures included reviewing documentation, interviewing staff of the Colorado Water Conservation Board, and analyzing data. Audit work was conducted between December 1997 and July 1998.

The purpose of the audit was to evaluate various aspects of the Construction Fund Loan Program's:

- Statutory compliance
- Funding
- Loan application and review processes
- Accounting and recordkeeping activities

This report contains 18 recommendations for improving the Construction Fund Loan Program. We gratefully acknowledge the assistance and cooperation of staff at the Department of Natural Resources. The following summary provides highlights of the comments, recommendations, and agency responses contained in the report.

Overall Program Management Needs Improvement

The Colorado Water Conservation Board (the Board) is a Type 1 agency within the Department of Natural Resources. The Board is the State's primary water policy and planning agency. The statutory duty of the Board is to promote conservation of the State's waters in order to ensure their greatest utilization and to assist in flood prevention. One program that helps the Board meet its statutory duty is the Construction Fund Loan Program (Program). This important program was established in 1971 to help the Board meet its statutory responsibilities. The Program provides loans

For further information about this report, contact the Office of the State Auditor at (303) 866-2051.

for water projects that will either increase the beneficial consumptive use of Colorado's undeveloped compact-entitled waters and/or repair or rehabilitate existing water storage and delivery systems, maintain the State's satellite monitoring system, or promote efficient management and operation of agricultural and multipurpose water systems. Through our review of the Program's operations, we concluded that the Program needs to make operational improvements to ensure that state resources are being used effectively and efficiently. Problems exist in the Program's loan review, approval, billing, and collection processes. We also found problems in the areas of fiscal management, performance measurement, accounting, statutory compliance, contracting, and recordkeeping.

In addition, we found several projects that were completed using Board funding that may not be consistent with statutory funding priorities. For example, statutes require that project sponsors explore all other means of financing before Fund monies can be made available for a project. We found projects totaling $2.6 million that were approved by the Board and authorized by the General Assembly that were actually built using other funding sources. Further, we found an additional $9 million in loans that were made to refinance existing U.S. Bureau of Reclamation loans.

We recommend that the Water Conservation Board establish goals and objectives for managing the Construction Fund Loan Program and closely monitor progress toward improving program operations. In addition, the Board should ensure that all projects receiving funding through the Program clearly adhere to the funding priorities established by law, or it should seek statutory changes.

Resources May Exceed Demand Given Current Statutory Spending Priorities

The Construction Fund (Fund) has maintained a large cash balance (i.e., an average of about $91.5 million) over the five previous years. The majority of the cash balance is earmarked for specific projects; however, most of the cash balance is not immediately needed. In fact, we estimate that if the Fund stopped receiving all revenue as of June 30, 1997, (except for principal and interest payments on existing loans), and maintained the spending rate observed over the four previous years, the Fund would still remain solvent for over seven years.

Since this is a revolving fund that has both cash inflows and outflows, the level of cash in the Fund should be maintained so that it is high enough to absorb fluctuating revenues and disbursements but low enough to minimize the possibility of excessive amounts of idle funds. We estimate that the amount needed to pay for any anticipated disbursements for program activities and obligations on a day-to-day basis is about $38.8 million. Thus, given the Fund's $89.7 million balance at June 30, 1997, we estimate that the Fund has about $50.9 million that could be used for other purposes.

Not only is there more money in the Fund than is being used, the Board has additional funding available for financing water projects. Statutes give the Board the authority to use monies in the Severance Tax Perpetual Base Fund for making water project loans. On the basis of projections made by the Department of Local Affairs, by Fiscal Year 2006 the Board will have an additional $55 million in revenues from this source to spend on water projects.

Given the sizeable nature of the Fund's cash balance, it may be prudent for the Board to either increase its rate of disbursements or work with the General Assembly to free up funds for other purposes. We believe increasing disbursements may be difficult, however, because evidence suggests that the Board's current disbursement levels may be in excess of the demand for project funding. For example, we found that the Board has set aside large amounts of funds for projects that were never constructed and others that do not meet statutory spending priorities. We also could not find any evidence of a borrower's ever being denied funding for a water project that met the statutory funding parameters. In addition, there is no evidence of a potential borrower's applying for a loan and not receiving one because there were insufficient funds available.

The large cash balance in the Fund has resulted in the Board's recognizing the need to estimate cash balances and project its receipts and disbursements over the next ten years. On the basis of these estimates, staff projected the cash balance in the Fund to be about $8 million in Fiscal Year 2006. However, staff have used assumptions that do not reflect the Program's recent experience and, consequently, have forecasted an unrealistically low cash balance. Specifically, the staff did not include severance tax funds in the projections, used inaccurate interest rates, and used large plug figures. By changing three of the Board's assumptions for estimating receipts and disbursements to more accurately reflect prior experience, we estimate the Board will have about $148 million instead of the $8 million originally forecasted.

The Water Conservation Board should improve its methods for estimating the receipts and disbursements associated with the Construction Fund Loan Program and, if necessary, work with the General Assembly to make the changes needed to reduce the cash balance of the Construction Fund.

Many Project Loans Are Approved Without a Completed Feasibility Study

According to statutes and Board procedures, in order to obtain a loan, a project applicant must submit a completed feasibility study. We found that the Board approves many projects before a completed study is submitted. A completed feasibility study helps the Board make an informed decision about whether a project is technically feasible and whether the applicant has the ability to repay its loan.

Specifically, when we reviewed Board minutes covering the period March 1995 to January 1998, we found that 41 of the 54 project loans (76 percent) that the Board approved did not have a completed feasibility study. These loans totaled $16.8 million. Further, 13 of these project loans totaling almost $3.9 million still had no completed feasibility study at the time of our audit, even though some of the loans were approved over three years ago. We also found four cases where a project feasibility study was completed after or during the same month that the project itself was completed. In these cases the Board disbursed construction funds, even though there may have been incomplete information on the project sponsor's financial situation.

Some projects which lack a completed feasibility study when they are approved are later deauthorized, meaning that the project funds are never used. Specifically, 14 of the 16 loans (88 percent) that were deauthorized during Fiscal Years 1996 to 1998 did not have a completed feasibility study when they were approved. These loans totaled almost $8.8 million. **The Water Conservation Board should improve its methods for ensuring project feasibility prior to loan approval. This should include requiring projects to have a completed feasibility study before a funding request is considered. In those cases where this is impractical, the Board should grant conditional approval pending completion of a feasibility study by a certain date. In all cases the Board should ensure the study is completed before funds are disbursed.**

Significant Deficiencies Exist in Accounting Operations

We observed significant problems in the Board's accounting operations. These problems were apparent in nearly every functional area, including disbursing construction funds, billing borrowers, collecting loan payments, and recordkeeping. The problems we noted were generally attributable to one or more of the following causes:

- Inadequate supervision or monitoring processes.
- Lack of adherence to established policies and procedures.
- Weak or absent internal controls.
- Ineffective internal and external communication processes.

Good accounting practices are integral to the effective and efficient operation of a lending program. The weaknesses we observed may have serious ramifications for all Board operations. For example, weak internal controls or inadequate supervision may increase the risk of theft, fraud, or other types of inappropriate activities. We also noted that the Board does not currently employ any staff that have accounting expertise, even though accounting operations are an integral part of many of the Board's activities.

The Water Conservation Board, working with the Department of Natural Resources' Accounting Section, should perform a comprehensive review of its accounting functions to identify and correct deficiencies. Methods for addressing deficiencies should include, but not be limited to, outsourcing, moving all accounting responsibilities to the departmental level, and allocating FTE to the Board.

Summary of Responses to the Recommendations:

The Department of Natural Resources (the "DNR") and the Colorado Water Conservation Board (the "Board" or "CWCB") agree with the State Auditors' recommendations even though we do not agree with some of the associated findings.

The CWCB Construction Fund Loan Program has undertaken a significant transition during the last five years. With a small staff and a very expansive charge from the statute and the Board, we have increased the number of completed projects 56 percent in the last five years, from 110 to 172 projects, and increased the total value of completed projects 90 percent, from $65 million to $123 million. We have also increased the average number of projects completed annually between 86 percent between 1987-1993 and 1994-1998 while we increased the average value of projects completed annually by 176 percent between the same time periods. This increase in the number of communities, businesses and individuals we have assisted in recent years has tested our ability at the present level of staffing to assure accurate and timely monitoring of various loan compliance and record keeping activities. Therefore, we are evaluating programmatic reorganization opportunities to improve our effectiveness within existing resources and a decision item for Fiscal Year 2000.

In reinvigorating and expanding that Program, we have already alleviated several bottlenecks, first in the contracting process and then the feasibility study phase. With the support of this audit, our next focus is on our accounting and compliance responsibilities. We also acknowledge the ongoing need to continue improving the loan application review and approval process, including the documentation and analysis of key information provided by applicants and the assessment of collateral requirements. Complete documentation of the technical and financial feasibility of potential loan projects is important, and the well-established practice of making "conditional approvals" should be limited to a reasonable number.

The Board believes that its annual funding recommendations, and those added by the General Assembly, are consistent with the statutory purposes included in Section 119(1), which are very broad, and the Section 122(1) priorities. We have worked closely with the Governor's Office and General Assembly in the consideration of recommendations presented each year and do not agree with the State Auditor's suggestions that these recommendations represent present "statutory compliance" problems.

The Board has been adopting more "business-like" policies and procedures for the Construction Fund Loan Program, and the State Auditor's perspective is very helpful and supportive in this regard. However, we do not consider this simply a "loan program." From the beginning, the Program was intended to promote sound water resource development by providing easy access to below-market financing for projects that develop or improve the management of water supplies in Colorado. Concerns based upon the suggestion that the current rate of assistance may exceed current needs, and that there isn't evidence of loan applications being denied, reflect a difference in perspective concerning the purpose of the Construction Fund. This promotional policy guides much of the Board's effort to minimize bureaucratic requirements and emphasize maximum financial assistance to as many interested borrowers as possible.

RECOMMENDATION LOCATOR
Agency Addressed: Water Conservation Board

Rec. No.	Page No.	Recommendation Summary	Agency Response	Implementation Date
1	14	Set forth goals and objectives for managing the Construction Fund Program, closely monitor the progress of implementing procedures that will improve program operations, and make periodic reports on improvements to interested parties.	Agree	July 1999
2	19	Improve methods for estimating receipts and disbursements, assess the effectiveness of marketing strategies, and work with the General Assembly to make the statutory changes needed to reduce the cash balance of the Construction Fund.	Agree	January 1999
3	21	Require applicants to provide evidence that they have explored alternative funding sources prior to approving the use of Construction Fund monies.	Agree	August 1998
4	23	Ensure projects receiving funding through the Program clearly adhere to the funding priorities now established by statute or seek statutory changes.	Agree	February 1999
5	26	Establish reasonable time limits for sponsors to expend project funding.	Agree	February 1999
6	31	Improve methods for ensuring the feasibility of a project prior to loan approval.	Agree	Immediately
7	32	Identify all feasibility study loans made before 1993, determine their status, and initiate repayment processes if appropriate.	Agree	June 1999
8	35	Develop and implement a systematic method for quantifying and weighing the relative creditworthiness and financial need of potential loan recipients.	Agree	January 2000
9	38	Ensure collateral for loans adequately protect the State's interests in the event of a borrower's default on its loan obligation.	Agree	June 1999

RECOMMENDATION LOCATOR
Agency Addressed: Water Conservation Board

Rec. No.	Page No.	Recommendation Summary	Agency Response	Implementation Date
10	41	Ensure that all security documents are filed in a timely manner, and develop reliable systems to monitor compliance with filing requirements.	Agree	June 1999
11	42	Ensure that borrowers comply with requirements to carry general liability insurance.	Agree	June 1999
12	44	Establish a process for reviewing each loan file prior to disbursing funds and periodically thereafter.	Agree	June 1999
13	44	Improve procedures for maintaining loan records including developing a consistent, centralized filing system.	Agree	June 1999
14	46	Ensure that borrowers receive bills that are timely and accurate.	Agree	June 1999
15	50	Formally adopt policies and procedures for handling loan collection problems.	Agree	June 1999
16	52	Work with the Attorney General and State Controller to expand the use of boilerplate contracts, develop monitoring procedures to ensure contracts are amended in a timely manner, and consider adopting a two-phase contracting process.	Agree	June 1999
17	55	Work with the Department of Natural Resources' Accounting Section to improve accounting procedures and to strengthen internal controls.	Agree	July 1999
18	57	Consider staffing changes and other alternatives to correct accounting deficiencies.	Agree	June 1999

Description of the Water Conservation Board and the Construction Fund Loan Program

Overview

The Colorado Water Conservation Board (the Board) is a Type 1 agency within the Department of Natural Resources. The Board is the State's primary water policy and planning agency. The statutory duty of the Board is to promote conservation of the State's waters in order to ensure their greatest utilization and to assist in flood prevention. One program that helps the Board meet its statutory duty is the Construction Fund Loan Program (Program). This program provides loans for projects that will either increase the beneficial consumptive use of Colorado's undeveloped compact-entitled waters and/or repair or rehabilitate existing water storage and delivery systems. The Board, with approval of the General Assembly, authorizes loans to local governments, water districts, and private companies for a variety of projects that are important to water conservation in Colorado. Since inception of the Program in 1971, the Board has disbursed about $119 million for 159 water projects. See Appendix B for a list of completed project loans.

The Board is composed of 14 members. Nine members are appointed by the Governor to represent geographical areas of the State. There are also five ex-officio members: the executive director of the Department of Natural Resources, the Attorney General, the State Engineer, the director of the Division of Wildlife, and the staff director of the Board. The Board's staff includes the director and 30.5 FTE.

Funding Sources

The Administration and Construction Funds

The Board currently pays for its operations and construction loans from two primary funds. The Administration Fund receives annual appropriations from the General Fund, cash funding from various sources, and some federal funding.

The Construction Fund (Fund) is a continuing cash fund. Thus, balances do not revert to the General Fund at the end of the fiscal year. The Fund receives monies from the following sources:

- Principal and interest payments on loans
- Mineral lease fund distributions
- Interest earnings
- General Fund appropriations (upon occasion)

Expenditures and disbursements for the past four fiscal years from both the Administration and Construction Funds are shown in the following table:

Water Conservation Board Expenditures and Disbursements

Fiscal Year	Administration Fund	Construction Fund
1994	$2,480,000	$13,560,000
1995	$2,721,000	$16,787,000
1996	$2,931,000	$23,727,000
1997	$3,199,000	$15,531,000

Source: COFRS reports.

The Severance Tax Perpetual Base Fund

The Board also has another source of funds that is available for making loans for water projects. It is the Severance Tax Perpetual Base Fund, which is also a continuing cash fund. To date, no funds have been disbursed from this funding source. Revenues available from this fund over the past four fiscal years are shown in the following table:

Severance Tax Perpetual Base Fund Revenues	
Fiscal Year	**Total Revenues**
1994	$ 106,000
1995	$ 997,000
1996	$2,480,000
1997	$6,319,000
Source: Department of Local Affairs.	

Prior Audits of the Construction Fund Loan Program

The State Auditor conducted a performance audit of the Construction Fund Loan Program in 1993. Issues discussed in the 1993 report included establishing Program goals, developing a long-term financial planning process, and making changes to the Board's fiscal policies. The disposition of the 1993 audit recommendations is included in Appendix A of this report.

This audit report describes our recommendations to improve Program management, loan application and review, and loan administration.

Construction Fund Management

Chapter 1

Background

The Colorado Water Conservation Board's Construction Fund Loan Program (Program) was established by the General Assembly in 1971. This program provides loans for projects that will either increase the beneficial consumptive use of Colorado's undeveloped compact-entitled waters and/or repair or rehabilitate existing water storage and delivery systems. The first project funded through this program was completed in 1977.

Overall Management of the Program Needs Improvement

Through our review we concluded that the Program needs to make operational improvements to ensure that state resources are being used effectively and efficiently. Problems exist in the Program's loan review, approval, billing, and collection processes. Further, we found problems in the areas of fiscal management, performance measurement, accounting, statutory compliance, contracting, and recordkeeping. Our findings related to each of these areas are discussed in detail later in the report.

Since the Program started, the Board has approved loans totaling about $233 million for 360 projects and feasibility studies. However, we observed that many of these projects were never built at all or were built years after they were authorized at a much higher cost. In fact, we found that about one in four projects authorized by the Board has never been started. In addition, we found an instance where the Board had approved a loan in 1987 for $412,500 but had to increase the loan amount to $787,500 in 1998 because delays in the construction process led to increased project costs.

We are also concerned about approval of projects that may not be consistent with statutory intent. As stated above, statutes limit the use of Program funds to two types of water projects. We identified $9 million in projects that were funded (i.e., refinancing of existing U.S. Bureau of Reclamation loans) even though they may be inconsistent with these requirements. Statutes also require that project sponsors thoroughly explore other sources of financing before they are eligible for funding through the Program. We found that between Fiscal Years 1994 and 1998, the Board approved and the General Assembly authorized 14 projects for $2.6 million that were ultimately built using other funding sources.

Finally, we also observed problems that have resulted from management deficiencies in the Board's loan administration processes. Specifically, over a third of the borrowers were delinquent (i.e., 15 days or more overdue) in making their annual loan payments during Fiscal Years 1995 to 1998. This has resulted in the State's forgoing over $514,000 in interest revenue.

We reviewed the Board's annual reports, budget requests, and other key documents and found that there are no formal goals, objectives, and performance indicators for the day-to-day operations of the Program. Without this type of formal direction, it is unlikely that the Board will be able to make significant improvements in its management of the Program.

Recommendation No. 1:

The Water Conservation Board and its staff should set forth goals and objectives for managing the Construction Fund Loan Program and closely monitor the progress of implementing procedures that will improve Program operations. Also, the Board should make periodic reports on the progress of Program improvements to interested parties, including the members of the Legislative Audit Committee.

Water Conservation Board Response:

Agree. The Board has established programmatic goals and objectives for implementation of its Construction Fund Loan Program responsibilities in its Long Range Plan, and the staff presents increasingly better information to the Board at its regular meetings regarding implementation concerns. More extensive management goals and specific operational objectives will be developed by July 30, 1999, to provide better means to assure that the Program is operating within an appropriate framework. These new goals and objectives will be presented to the Board based upon 1) the review of workload allocation and priorities that is in progress within the agency, and 2) the comparison of the CWCB program structure with other State agencies with similar programmatic responsibilities.

Management of Construction Funds Needs Improvement

The Construction Fund (Fund) has maintained a large cash balance for the last five fiscal years. The majority of the cash balance is earmarked for specific projects; however, most of the cash balance is not immediately needed. We estimate that if all Fund receipts stopped as of June 30, 1997, (except for principal and interest payments on existing loans), and the Board maintained the spending rate observed over the four previous years, the Fund would still remain solvent for over seven years. Cash balances for the five previous fiscal years are shown in the following table:

Construction Fund Cash Balance	
Date	**Balance**
June 30, 1994	$ 82,400,000
June 30, 1995	$ 100,200,000
June 30, 1996	$ 90,000,000
June 30, 1997	$ 89,700,000
June 30, 1998	$ 95,100,000
Average	**$ 91,500,000**
Source: COFRS reports.	

Since this is a revolving fund that has both cash inflows and outflows, the level of cash in the Fund should be maintained so that it is high enough to absorb fluctuating receipts and disbursements but low enough to minimize the possibility of excessive amounts of idle funds. In order to determine the balance needed to pay for the day-to-day operations of the Program, we used the following assumptions:

- Cash in the Fund is earmarked upon approval of a project by the Board.
- Projects take an average of 3.3 years to complete from the date they are approved. (This estimate was derived from our review of all the projects authorized and completed since the Program's inception.)
- Average annual disbursements (including administrative costs) for the last four fiscal years were $17.4 million.
- Average annual receipts for the last four fiscal years were $18.6 million.

Using these assumptions, we multiplied the average disbursements ($17.4 million) by the average time to complete a project (3.3 years) to arrive at a total of $57.4 million. This represents the maximum amount of disbursements that the Fund could incur at any point in time. We reduced the $57.4 million by the average receipts ($18.6 million) to arrive at a final balance of $38.8 million. This figure represents the amount needed to pay for any anticipated disbursements on a day-to-day basis. Thus, given the Fund's $89.7 million balance at June 30, 1997, we estimate that the Fund has about $50.9 million that could be used for other purposes. This amount may be even higher given the increase in the cash balances as of June 30, 1998 shown above.

The Board Has Additional Funding Available for Water Projects

Not only is there more money in the Fund than is being used, the Board has additional funding available for financing water projects. Statutes establish the Severance Tax Perpetual Base Fund that receives a portion of state severance tax receipts. These monies are also available to the Board for making loans for water projects. As of the end of Fiscal Year 1997, the Perpetual Base Fund had a balance of $9.9 million, bringing the total funding now available for loans to almost $100 million. On the basis of projections made by the Department of Local Affairs, by Fiscal Year 2006 the Board will have over $55 million of additional severance tax receipts to spend on water projects.

Resources May Exceed Demand Given Current Statutory Spending Priorities

Between Fiscal Year 1994 and 1997, the Fund received about $74.3 million and spent about $69.6 million. Given the sizeable nature of the Fund's cash balance, it may be prudent for the Board to either increase its rate of disbursements or free up funds for other purposes authorized by the General Assembly in order to decrease the size of the Fund's cash balance. We believe increasing disbursements may be difficult, however, because evidence suggests that the Board's current disbursement levels may be in excess of the demand for project funding. For example, as stated previously, the Board has set aside funding for projects that were never constructed and others that did not meet statutory spending priorities. We also could not find any evidence of a borrower's ever being denied funding for a water project that met the statutory funding parameters. In addition, there is no evidence of a potential borrower's applying for a loan and not receiving one because there were insufficient funds available.

We also found that the Board has not established a formal marketing plan for the Construction Fund Loan Program. One of the Board's staff members performs some marketing functions, mostly consisting of soliciting potential borrowers on a one-on-one basis. However, the Board has not formally identified a pool of qualified, potential loan applicants as a precursor to developing a waiting list for funding. As a result, we could not assess whether the Board's current marketing activities are sufficient and effective or whether a more formal approach is needed.

The Board Has Recently Begun Conducting Forecasting Activities

The large cash balance in the Fund has resulted in the Board's recognizing the need to estimate cash balances and project its receipts and disbursements over the next ten years. On the basis of these estimates, staff projected the cash balance in the Fund to be about $8 million in Fiscal Year 2006. However, staff have used assumptions to produce this estimate that do not accurately reflect the recent experience of the Program, producing a forecast that projects an unrealistically low cash balance. By changing three of the Board's assumptions for estimating receipts and disbursements to more accurately reflect prior experience, we estimate the Board will have about $148 million instead of the $8 million originally forecasted. Specifically, we modified the following assumptions:

- Staff did not include severance tax receipts in their forecast. These receipts should be included because they are available for water project loans. From Fiscal Years 1997 to 2006, severance tax receipts are projected to be over $55 million.

- Staff calculated interest receipts on the basis of a 3.5 percent return rate when the actual return rate averaged about 6 percent between Fiscal Years 1994 and 1997. By applying this higher interest rate to the actual cash balance as of June 30, 1997, and to the projected cash balance for all subsequent years, interest receipts increase by about $58 million over Fiscal Years 1997 to 2006.

- Staff-estimated disbursements were based on plug figures (i.e. about $42 million) and other project costs that could not be substantiated. Using these figures resulted in a 28 percent increase ($5 million) in the Program's average annual disbursements. However, as discussed previously, we found no evidence that indicated that Board disbursements will increase at all in the future. Therefore, to estimate program disbursements, beginning with Fiscal Year 1997 we increased disbursements by 6 percent annually to allow for growth of the Program.

The Board's estimates and ours are shown in the table on the following page.

Colorado Water Conservation Board - revised March 1997
Long-Term Financial Projection
Cash Forecast (in Thousands)

	Estimated FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Beginning Cash Balance	$89,043	$84,571	$78,525	$60,155	$47,930	$38,895	$27,224	$19,682	$12,432	$10,011
Receipts:										
Principal and interest on loans	$6,001	$6,721	$7,824	$8,801	$9,882	$11,054	$12,063	$12,481	$13,041	$13,807
Mineral lease fund and other leases	$3,459	$3,286	$3,122	$2,966	$2,818	$2,677	$2,544	$2,417	$2,296	$2,181
Interest from the State Treasurer	$2,902	$2,726	$2,318	$1,807	$1,451	$1,105	$784	$537	$375	$303
Total Receipts	$12,362	$12,733	$13,264	$13,574	$14,151	$14,836	$15,391	$15,435	$15,712	$16,291
Disbursements	$16,834	$18,779	$31,634	$25,799	$23,186	$26,507	$22,933	$22,685	$18,133	$18,210
Ending Cash Balance	$84,571	$78,525	$60,155	$47,930	$38,895	$27,224	$19,682	$12,432	$10,011	$8,092

Office of the State Auditor
Long-Term Financial Projection - prepared July 1998
Cash Forecast (in Thousands)

	Actual FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Beginning Cash Balance	$90,030	$99,674	$106,849	$111,913	$118,004	$122,909	$130,931	$136,223	$140,083	$145,261
+Severance Tax Funds	$3,583									
	$93,613									
Receipts:										
Principal and interest on loans	$6,933	$6,721	$7,824	$8,801	$9,882	$11,054	$12,063	$12,481	$13,041	$13,807
Mineral lease fund and other leases	$3,858	$3,286	$3,122	$2,966	$2,818	$2,677	$2,544	$2,417	$2,296	$2,181
Interest from the State Treasurer	$4,482	$6,196	$6,563	$6,898	$7,227	$7,615	$8,015	$8,289	$8,560	$8,792
Severance Tax Funds	$6,319	$7,435	$5,006	$5,924	$4,585	$7,460	$4,701	$4,026	$6,035	$4,000
Total Receipts	$21,592	$23,638	$22,515	$24,589	$24,512	$28,806	$27,323	$27,213	$29,932	$28,780
Disbursements	$15,531	$16,463	$17,451	$18,498	$19,608	$20,784	$22,031	$23,353	$24,754	$26,239
Ending Cash Balance	$99,674	$106,849	$111,913	$118,004	$122,909	$130,931	$136,223	$140,083	$145,261	$147,802

Developing accurate forecasting methods is integral to managing the Program in an effective manner now and in the future. Estimating an ideal amount of cash for the Fund and maintaining a level where receipts equal the demand for project funding will allow the General Assembly to accurately assess the funding necessary to meet the needs of the Program.

Recommendation No. 2:

The Water Conservation Board should improve its methods for estimating the receipts and disbursements associated with the Construction Fund Loan Program. The Board should also assess the effectiveness of its marketing efforts and determine if the demand for the Program is being met with the existing level of receipts. If the demand is being met, the Board should work with the General Assembly to make the statutory changes needed to reduce the cash balance of the Construction Fund.

Water Conservation Board Response:

Agree. The CWCB staff will incorporate consideration of the Severance Tax funds and current interest rates in the next revision to the Long-Term Financial Projection by January 1, 1999. Although the basic methods used in estimating revenues, fund balance, and needs are sound, there are many assumptions and predictions that must be made in applying these methods (e.g., interest rates and construction schedules). These factors are expected to illuminate a variety of policy issues, including the desired duration of the funding assistance and the committed and uncommitted cash balance needed to serve the existing and future purposes of the Fund. These issues deserve further consideration by the Board and the interested constituencies before further legislative direction is considered. Revision of the Long-Term Financial Projection has been delayed for over a year based upon interest expressed by the Board and many legislators in conducting regional water supply planning meetings around the State to test our forecasting of future project needs.

It is important to note, however, that the demand for funding to develop Colorado's water resources is increasing. The future need for funds to develop Colorado's water resources is demonstrated by recent studies by the CWCB, the Colorado Farm Bureau, and the support for HB 98-1288 (the proposed Water Resources Act of 1988, which was postponed indefinitely, but is expected back next session). The proponents of HB 98-1288 estimated that as much as $100 million might be needed to motivate the necessary planning at the local or regional level. Local water providers and local governments will need a significant amount of additional funds to develop the water supply improvements and mitigate the impacts that are likely to be recommended in local plans.

Other Financing Is Available for Many Projects

The Board is approving and seeking legislative authorization for projects that do not need state financing. Statutes require that project sponsors thoroughly explore all other means of financing before Fund monies can be used for a project. We found:

- From Fiscal Year 1994 to 1998 the Board approved 14 projects totaling about $2.6 million that were actually built using other funding sources.

- In Fiscal Years 1988, 1989, 1996, and 1997 the Board approved nine loans totaling about $9 million to refinance loans from the United States Bureau of Reclamation.

In these cases there was obviously funding available from sources other than the Construction Fund.

The Board requests that project sponsors identify other financing sources in their project applications and feasibility studies. We examined applications and feasibility studies for nine projects that were deauthorized because they were built using other funding. We found that five of the nine project applications (56 percent) identified other possible funding sources. Two additional applications indicated that other possible sources of funding had not been pursued by the project sponsors. Nonetheless, in these cases the Board approved the loans knowing that alternative financing was either available or had not been pursued.

Requiring a potential borrower to examine its financing options before requesting a loan from the Board is not only required by statute, but is necessary to maximize the funding that is available to enhance Colorado's water resources. By limiting state funding to those projects that have fewer financing options, the Board can increase the total number of projects built in Colorado and increase the overall benefit of the Program.

Recommendation No. 3:

The Water Conservation Board should require applicants to provide evidence that they have explored other means of financing before approving the use of Construction Fund monies for a project.

Water Conservation Board Response:

Agree. The CWCB staff will insist upon evidence that applicants have explored other sources of funding in every loan application considered by the Board beginning immediately. The use of this information is expected to raise implementation issues that deserve further consideration by the Board and interested constituencies (e.g., what is the right balance between a borrower's need for state assistance and the assurance of timely repayment?).

There is no statutory requirement that the CWCB be a lender of last resort, although the statutes do provide that *all other means of financing shall be thoroughly explored before use is made of fund moneys* [37-60-121(b) (V), C.R.S.]. In order to protect the long-term integrity of the Construction Fund, the Board tries to maintain a balance between the more risky loans for borrowers that would not otherwise be able to borrow enough money to develop an adequate water supply, and investments in the more financially sound borrowers. In setting priorities, the Board's policy has been to give preference to projects that include other funding sources. Requiring the Fund to function only as a "lender of last resort" could undermine its integrity.

Water Projects May Not Be Consistent With Statutory Requirements

We found that projects have been funded that may not be consistent with statutes governing the use of the Fund. The statutory spending priorities are:

- The first priority goes to projects which will increase the beneficial consumptive use of Colorado's undeveloped compact-entitled waters. This is water that falls under one of the interstate river compact agreements. These agreements allocate water among Colorado and other downstream states. Undeveloped compact-entitled waters are those waters legally available to Colorado but not currently in use.

- The balance of the Fund is devoted to projects which repair and/or rehabilitate existing water storage and delivery systems, maintain the State's satellite monitoring system, or promote efficient management and operation of agricultural and multipurpose water systems.

The Board, with approval of the General Assembly, authorizes loans for a variety of projects that are important to water conservation in Colorado. However, it is not always clear that these projects are consistent with statutory spending priorities. For example, over its history, the Board has approved nine loans totaling $9 million to refinance existing loans from the United States Bureau of Reclamation. These projects were originally constructed with loans from the federal government and were subsequently refinanced to lower the project sponsor's interest rate. Refinancing an existing loan may not effect the consumptive benefit of Colorado waters or provide funding for the repair or rehabilitation of existing infrastructure.

Other Loans May Be Questionable Given Statutory Funding Parameters

There are additional projects that have received legislative funding where it is unclear whether statutory funding parameters were met. For example, we found loans that financed the purchase of existing water facilities (e.g., wells) and others that financed the purchase of water rights. These projects consisted of changing ownership of an existing asset and did not involve construction. We could not determine whether the purchase of an existing asset would result in an increase in the consumptive benefit derived from undeveloped waters. The projects we found that were questionable included:

- In 1997 the Board approved a loan for $900,000 to purchase five existing wells, the water rights associated with those wells, and the surrounding land.

- In 1996 and 1997 the Board approved two loans for $600,000 and $500,000, respectively, to purchase water rights.

- In 1995 the Board approved a loan for $3 million to purchase existing wells.

The Board justifies loans like these through a clause in its funding policy that states "when no project is proposed, the cost of acquisition of water rights is eligible for funding if the purchase is to satisfy an existing need or shortage, and not for future growth." We interpret this policy to apply to only those projects that address undeveloped waters and not those that propose repair or reconstruction of an existing structure, since these situations obviously involve a project. However, we could not always determine whether buying existing wells or water rights would increase the beneficial use of Colorado's undeveloped water resources. For example, if water rights or wells were being used equally before and after their purchase using Board funds, then these purchases do not satisfy either of the statutory spending priorities.

Loans made for the purposes described above may be important to fulfill a need; however, they do not appear to meet statutory intent. The Board should either ensure that all of the projects that receive funding clearly meet existing statutory funding parameters or seek changes in the law to expand the lawful uses of the Fund.

Recommendation No. 4:

The Water Conservation Board should ensure that all projects receiving funding under the Construction Fund Loan Program clearly adhere to the funding priorities established by statute. If the Board desires to expand the statutory funding priorities, it should work with the General Assembly to effect these changes.

Water Conservation Board Response:

Agree. The Board will review the need for revisions to the loan authorizing statutes and present recommendations to the Governor and the General Assembly by February 1, 1999.

The statutory priorities have been revised periodically (the last significant amendments were adopted in 1993 and 1994 legislative sessions). The annual review and approval of project recommendations by the Governor and the General Assembly has assured consistency with current state policy and statute.

The statutes are silent regarding use of funds for refinancing, purchasing of existing projects, and purchase of water rights [37-60-121, C.R.S.]. The Board's Guidelines, however, provide that *the costs of acquisition of land and water rights are not eligible for CWCB funding except as part of a project*. The Board has subsequently adopted additional policy at the January 1996 meeting that any purchase must be necessary *"to satisfy an existing need or shortage, and the purchase price must be supported by an appraisal."*

In 1993, a loan for the Conejos Water Conservancy District to purchase the Platoro Reservoir (an existing federal water project) was recommended by the Board and approved by the General Assembly in order to give Colorado water users much greater control over their water supply and save them significant expense.

The Board has pursued many ways of assisting towns, special districts, irrigation companies, and many others in financing their activities to meet their water supply goals, and has always coordinated closely with community leaders in recommending projects for funding. It is also significant that the General Assembly has consistently endorsed the Board's funding recommendations (last year's funding recommendations were reviewed and approved by two legislative committees in both the House and the Senate).

Project Funds Are Not Deauthorized in a Timely Manner

Each year the Board must obtain approval from the General Assembly for those project loans in excess of $100,000. Project loans under $100,000 do not require legislative approval and can be authorized directly by the Board. When a project is approved through either manner, monies from the Fund are earmarked. Once earmarked, these funds are not available to finance other projects. If a project is not constructed, the Board eventually deauthorizes the funds or asks the General Assembly to deauthorize them so that the money can be used for other projects.

We found that the Board is not seeking deauthorizations in a timely manner. Since 1980 the Board has sought deauthorizations of 59 projects totaling about $33 million. Many of these projects were authorized for five or more years before they were deauthorized, even though most successful projects are finished within 3.3 years. Specifically, 28 of these projects totaling $16.6 million were authorized for more than five years and 12 were authorized for more than ten years. Further, we noted that one $5.6 million project was authorized in 1983 and deauthorized 15 years later in 1998.

The Board also has many projects that are currently authorized that may need to be deauthorized. Specifically, there are over $26 million in project funds that have been authorized for over four years, but project construction still has not begun. Because the average time from approval to project completion is 3.3 years, at least a portion of the $26 million may be reserved needlessly. Some of these projects may have found funding through other sources, while others may have been abandoned altogether. For example, we identified one project that was authorized in 1983 for $8.5 million which is still authorized. Another project has been authorized since 1977 but has never been started.

Also, when a project requires fewer funds to construct than authorized, the excess amount should be immediately deauthorized to free up the money for other projects. This occurs fairly frequently because funds are earmarked on the basis of estimated project costs and not actual cost. We found that the Board has about $181,000 in residual funds that are still authorized for projects, even though the projects have been completed for some time.

Maintaining Project Authorizations Over Long Time Periods Has Little Benefit for the State

The benefit of allowing the projects to be authorized for excessive periods of time is unclear. For example, we found a $412,500 project that was originally authorized in 1987 that needed to have its loan amount increased to $787,500 in 1998 because the cost of the project increased by the time the construction was scheduled to begin. Ideally, in this case the original loan amount should have been deauthorized after three or four years to allow the funds to be used for other purposes. Then, if the project sponsor still needed funding at a later time, it should have reapplied.

The Board's current practice is to contact the project sponsor annually to determine if the project should be deauthorized. The Board seeks deauthorization of the funds only upon consent of the project sponsor. However, there is no motivation for project sponsors to allow deauthorization. This is because interest does not accrue on the loan proceeds until construction has started. Thus, maintaining authorization costs the sponsor nothing and allows funding to be available anytime should the project get started. For instance, the Board sent a letter in 1997 to a sponsor whose project had been authorized in 1983 for $8.5 million. Deauthorization was not approved because the project sponsor told the Board that construction might start in the next two years. Therefore, $8.5 million continues to be set aside for this project when it could be used for other projects.

The Board has recently established a time limit for spending construction funds. Project contracts have a requirement that construction must be completed within two years of signing the contract. However, there is no time limitation from the approval of the project to signing the contract and starting construction. We found three projects that started construction six years after approval of the project. Therefore, the construction funds were idle for over six years before starting construction.

Other states have time limits for using funds that have been approved for water projects. We found four states (i.e., Wyoming, Nebraska, Texas, and Utah) that provide loans for water projects through programs similar to Colorado's Construction Fund Loan Program. None of these programs allows continuous appropriation of project funds. Funding availability limits vary from one to four years. Also, in Colorado, monies appropriated to state agencies from the Capital Construction Fund that are not used or encumbered within a three-year period revert to the General Fund. Establishing time limits for spending project funds and seeking timely deauthorization of unspent funds will increase the benefit of the Program.

Recommendation No. 5:

The Water Conservation Board should establish reasonable time limits for project sponsors to use monies authorized from the Construction Fund. The time limits should be based on the average time needed to start a project. Upon expiration of the time limit, project deauthorization should be automatically sought unless the Board specifically authorizes an extension. Also, the Board should establish a process that ensures any residual funding is immediately deauthorized upon project completion.

Water Conservation Board Response:

Agree. The duration of funding assistance has been reviewed annually by the Board and the General Assembly. The Board has not considered rigid time limits for the Construction Fund loan approvals and, given the political nature of some projects, it seems appropriate to at least present and evaluate options to the Board before proposing an amendment to the statute or to the Board's Guidelines. The Board will present its assessment of this issue, along with any recommended action, to the Governor and the General Assembly by February 1, 1999.

The Board's Guidelines provide that, in September of each year, the Board will *review the status of all previously authorized projects which are as yet not started or are unfinished. The Board will review for reasonable progress on all projects which have (1) not started 24 months after authorization, and (2) projects still in process 36 months after authorization*

A number of funding authorizations (with both small and large funding residuals) have accumulated over the past 20 years and the CWCB and DNR Accounting Section staff have been working to identify those associated with completed projects. We will continue to rely upon the legislative process as we are able to determine that the remaining funds are not needed.

Loan Application and Review

Chapter 2

Background

Statutes and Board procedures outline the processes that entities, such as water districts, must use to apply for a project loan. The first step is submitting a loan application, which can be done at any time throughout the year. After the Board receives an application, it is reviewed and discussed with the applicant. The second step is conducting a feasibility study. These studies are usually performed by consulting firms selected by the applicant upon advice of the Board. The Board is also authorized by statute to provide funds to help applicants conduct feasibility studies. After completion and staff approval of the study, a formal request for funding is submitted to the Board. The Board then considers, approves or disapproves, and prioritizes each request for funding. Project loans under $100,000 can be authorized and funded by Board decision alone, whereas loans in excess of this amount must be authorized by the Board, the General Assembly, and the Governor before they receive funding.

Feasibility Studies Help the Board Make Informed Funding Decisions

Feasibility studies are required to be prepared in sufficient detail to allow the Board to make an informed decision about whether or not to fund a particular project. To support this objective, the Board's feasibility study guidelines require the applicant to:

- **Submit a feasibility study plan to the Board's staff.** The study plan outlines the major tasks that will be undertaken during the feasibility study and estimates the cost and time needed to complete the study. The study plan must be approved by Board staff before starting work on the feasibility study itself.

- **Conduct the feasibility study.** Statutes (Section 37-60-122, C.R.S.) require all projects funded through the Program to have a feasibility study. Studies must include a description of the project and the entity requesting the funding; various geographic, climatic, hydrologic, and water quality data;

maps; socioeconomic information; water demand estimates; cost estimates; loan repayment information; and project alternatives. The feasibility study also includes, at a minimum, a site inspection to verify topography, hydrologic features, and the location and condition of existing structures.

Many Project Loans Are Approved Without a Completed Feasibility Study

As part of our audit we reviewed the Board's guidelines for preparing feasibility studies and found them to be reasonable. Further, we concluded that if a project sponsor followed the guidelines, the resulting study report would provide adequate data for the Board to make an informed decision about whether to approve a project for funding. However, we found that the Board approves many projects before they have a completed feasibility study. We reviewed Board minutes covering the period March 1995 to January 1998 to determine how many new loans were considered for approval before staff had received a completed feasibility study. Of the 54 project loans that were approved during this time period, over 76 percent (i.e., 41 loans totaling $16.8 million) did not have a completed feasibility study at the time they were approved. In addition, we found that 13 of the 41 loans, totaling almost $3.9 million, still had no completed feasibility study at the time of our audit, even though some of the loans had received approval over three years ago. The information contained in a completed feasibility study is integral in helping the Board assess whether a particular project is technically feasible and whether a project sponsor has the ability to pay back a loan.

Further, many projects that received Board approval without a completed feasibility study are later deauthorized, meaning that the project funds were never used. Specifically, 14 of the 16 loans (88 percent) that were deauthorized during Fiscal Years 1996 to 1998 did not have a completed feasibility study when they were approved. These loans totaled almost $8.8 million. Setting aside funding for projects that may be impractical or financially risky wastes the time and effort of both the Board and the General Assembly and results in less funding being available for those projects which have proven viability.

Finally, we found four cases in which a project feasibility study was completed after or during the same month that the project itself was completed. In these cases the Board disbursed construction funds, even though there may have been incomplete information on the project sponsor's financial situation. Because of the timing of the legislative session, there may be situations where it is impractical to complete a feasibility study before a project is presented to the General Assembly for authorization. In these cases, the Board may want to consider conditional approval pending completion of a feasibility study by a certain date. In all cases, however, the study should be completed before the Board disburses funding in order to ensure the borrower has the means to repay its loan.

Studies Often Contain Incomplete Repayment Information

We also found that some projects with completed feasibility studies were approved by the Board, even though the studies were missing key information specifically related to the applicant's ability to repay the loan. We reviewed 34 feasibility studies that were completed between June 1992 and February 1998 and found that in nine cases key data on the applicant's ability to repay the loan were missing (e.g., information on the applicant's revenues, expenditures, or both). This type of financial information is needed for the Board to have a comprehensive picture of the applicant's creditworthiness.

Recommendation No. 6:

The Water Conservation Board should improve its methods for ensuring the feasibility of projects prior to loan approval by:

a. Requiring that projects have a completed feasibility study before a funding request is considered. In those cases where it is impractical to complete the study prior to approval and/or General Assembly authorization, the Board may want to consider conditional approval pending completion of a feasibility study by a certain date while ensuring the study is completed before any funds are disbursed.

b. Ensuring that all studies contain sufficient information upon which to assess the project's benefit and the applicant's ability to pay its loan obligations.

Water Conservation Board Response:

Agree. Beginning immediately, the CWCB staff will be more diligent in assuring that all pending and future feasibility studies are completed before the project is presented to the Board and that they contain the information needed to assess the applicant's ability to repay the proposed loan.

Requiring that <u>all</u> studies be completed before the Board can consider them may cause unreasonable delay for a limited number of projects. It might also prevent the General Assembly from adding projects during the legislative process. The Board has only recommended authorization for project loans without a completed study where there is adequate information available to be confident that the proposed project is feasible and where the borrower demonstrates sufficient interest in completing the studies. Review and acceptance of the completed study has been specified as a final condition of the funding in these cases.

Some Projects Receive Funding for Feasibility Studies

The Board occasionally makes a loan to an entity for the purpose of conducting a feasibility study. The Board finances feasibility studies as a means of encouraging entities to undertake water projects. Prior to 1993, entities that received feasibility study loans were required to pay them back if the project was started within ten years. If the project did not get under way within this time frame, the entity that received the loan was under no obligation to repay -- essentially turning the loan into a grant. In 1993 the Board discontinued its practice of funding feasibility studies in this manner. Funding for feasibility studies is now identified as either a grant or loan from the onset, regardless of when or if the project is built.

At the time of our audit the Board could not provide us with key information on the status of 19 feasibility study loans made under the pre-1993 funding system. For example, in seven cases the Board had no information about whether recipients of these feasibility study loans had started their projects. These loans totaled $273,475. Without information about whether these projects are under way, the Board cannot take the appropriate action (e.g., begin the repayment process or reclassify the loan as a grant if ten years have passed). We also observed one instance where repayment of a $42,000 feasibility study loan should have begun in 1996 because the project was completed, but no payments have ever been received. Board records did not indicate that funding for this feasibility study was owed, and subsequently, the borrower was never billed. The Board should identify all feasibility study loans made under the pre-1993 system to determine their status and then take appropriate action to either begin repayment or reclassify the loan as a grant.

Recommendation No. 7:

The Water Conservation Board should identify all feasibility study loans made before 1993 in order to determine whether these loans are payable under the ten-year clause or whether the loan has attained grant status. If payable loans are identified, the

Board should contact the borrowers to inform them of the obligation and make every effort to collect the amount due plus interest, if possible.

Water Conservation Board Response:

Agree. This process is in progress and the CWCB staff will identify and initiate collection of any unpaid obligations by June 30, 1999.

This requires not only that CWCB staff determine whether the project was constructed but also whether the funding agreement provides for the collection of interest. Some feasibility studies included more than one project, which will make it difficult to establish the amount of the repayment if some of the projects were not completed.

It may not be feasible to collect interest during the study period. In most cases prior to 1994, the Board's policies for implementing the Construction Fund Loan Program did not include charging interest during construction or during the feasibility study period. Since the State is interested in promoting a thorough analysis of water resource project options, funds spent on the evaluation of project feasibility are a wise investment and the State might choose to forgive some or all feasibility study loans or the interest during the study period.

Loan Interest Rates Are Established on the Basis of Several Factors

The Board's lending policy states that loan interest rates will be set according to several factors including the current annual yield on long-term municipal bonds, the type of entity seeking the funds (e.g., agricultural, municipal, or commercial enterprise), statutory limitations, the project sponsor's ability to pay, and the significance of the project in terms of statewide water needs. Interest rates by type of loan for the period 1973 to present are shown in the following table:

Thirty-Year Lending Rates Colorado Water Conservation Board					
Type of Loan	**1973-1992**	**1993-1995**	**1996**	**1997**	**1998**
Agricultural	5.00%	4.00%	4.25%	3.75%	4.00%
Municipal-Low*	5.00%	4.00%	4.25%	3.75%	4.00%
Municipal-Medium*	5.00%	5.00%	5.25%	4.75%	5.00%
Municipal-High*	5.00%	5.50%	5.75%	5.25%	5.75%
Commercial	5.00%	5.50%	5.75%	5.25%	6.25%

Source: Colorado Water Conservation Board.
*** Note:** Low, medium, and high designations are based on the median household income in the project sponsor's service area.

In 1993 the Office of the State Auditor recommended that the Board establish guidelines to tie its lending rates to market conditions. Before 1993 the Board charged all borrowers a flat 5 percent interest rate according to the statutory minimum that existed at the time. The Board has complied with this recommendation by establishing and adhering to a process that ties loan interest rates to the long-term municipal bond market. In addition, in March 1998 the Board decided that it will attempt to maintain an overall, long-term rate of return on loans of no less than 4 percent based on the aggregate amount of loans and grants made through the Fund. The purpose of this policy is to maintain the integrity of the Fund and to offset the long-term impacts of inflation on this funding source.

The Board's Lending Policy Does Not Systematically Assess the Relative Risk of Individual Loans

We believe that linking interest rates to the bond market is a good way to ensure that the State is getting a fair return on the money it loans for water projects. Setting a goal for the overall return on the Board's loan portfolio is also a sound management decision. However, further improvements are needed in the Board's processes for making key lending decisions. Specifically, the Board's current lending policy focuses primarily upon determining the borrower's need and its ability to access other forms of funding. For example, current policy states that agricultural and low-income municipal borrowers will receive lower interest rates and higher percentages of allowable costs (i.e., 90 percent of total costs instead of the standard 75 percent). These policies reflect the Board's statutory responsibility to be the lender of last resort for those entities that might have worthy projects but may have limited funding options because of their financial position. Although it is important that the Board be responsive to entities that have fewer funding options, there are additional factors that should be recognized when making lending decisions.

Being the lender of last resort is not, for example, the only statutory objective to which the Board must adhere. When making a loan, one of the most important considerations is evaluating credit risk (i.e., the borrower's ability and willingness to pay). Statutes clearly state that the Board shall participate in only those projects where the sponsor can repay its investment. Grants are not allowed unless specifically authorized by the General Assembly. The Board is not in the business of making loans to entities that have no intention or ability to repay the obligation. As a result, before making a funding decision, the Board has a duty to find a way to systematically balance a potential borrower's financing needs and options with its creditworthiness. Such a system should identify various factors that can be used to judge the relative risk of a loan and assess a borrower's creditworthiness (e.g., the borrower's credit history, financial strength, and/or revenue generation abilities). This information should then be used to establish the key components of each individual loan agreement.

The Board recently (November 1997) stated its intent to use measures of financial strength in its process for determining what percentage of total costs to pay for certain types of projects. We agree with this decision but believe the process should be expanded to include additional determinations such as interest rates, loan terms, overall loan amounts, and collateral requirements. By implementing a systematic methodology for assessing loan risk, the Board can reduce the possibility of delinquent and/or defaulted loans and can also maximize interest income which would then become available to fund additional projects.

Recommendation No. 8:

The Water Conservation Board should develop and implement a systematic method for quantifying and weighing the relative creditworthiness and financial need of potential loan recipients. This should include identifying relative measures of a borrower's creditworthiness and then using them to set various components of a loan agreement.

Water Conservation Board Response:

Agree. The CWCB staff will evaluate several options and present them for consideration by the Board and interested constituencies before presenting recommendations to the General Assembly. However, these options should be reviewed carefully with the appropriate constituencies, including the Colorado Municipal League, the Special Districts Association, the Colorado Water Congress, and Colorado Counties, Inc. The review of these options and development of recommendations for consideration by the Governor and General Assembly will be completed by January 1, 2000.

Statutes Require Borrowers To Collateralize Their Loans

Collateralization is important to ensure the State has some recourse in the event that a borrower cannot repay its loan. Section 37-60-120 (1), C.R.S., states that:

> The State of Colorado shall have the ownership and control of such portion of said projects, or shall take a sufficient security interest in property or take such bonds, notes, or other securities evidencing an obligation, as will assure repayment of funds made available by (the Water Conservation Board).

By way of implementing this section, the Board's loan policy states that project sponsors must provide adequate security to guarantee repayment of their loans. The security may be title to project property equal in value to the loan; a pledge of revenues or taxes; or bonds, notes, or other securities.

In practice, the Board generally requires borrowers to secure their loans by pledging:

- A certificate of deposit for one annual loan payment.

And/or:

- Security interest in the borrower's revenue stream. This type of interest is equivalent to one or two annual loan payments if the borrower were to go out of business or declare bankruptcy.

In the past it was common practice for the Board to take a deed of trust on the borrower's tangible property at the project site as collateral. Practices were changed because the Board believed that assets of a more liquid nature (e.g., certificates of deposit that could be easily converted to cash) offered them a better guaranty if the borrower defaulted.

The Collateral Obtained for Individual Loans Varies

As shown above, the Board's collateral policies and practices allow for a great deal of discretion when the Board makes a decision regarding the collateral that will be required to secure a particular project loan. For example, policy and practice allow the Board to accept anything from a certificate of deposit for one loan payment to a deed of trust for the project itself. Further, policy and practice allow the Board to require a borrower to provide collateral that consists of a single asset (e.g., a deed of trust to the project property) or a combination of assets (e.g., a certificate of deposit for one loan payment and security interest in a revenue stream).

To determine how the Board was applying both the written collateral policy and its stated practice for obtaining collateral, we reviewed the collateral pledged for 28 loans for projects that were completed in Fiscal Years 1997 and 1998. The loans for these projects totaled about $14.5 million. Collateral for 19 of the 28 loans (68 percent) consisted of a certificate of deposit and security interest in a revenue stream, which followed the Board's stated practice for obtaining collateral. In the remaining nine cases, the collateral obtained did not follow the Board's stated practice, although it did conform with the Board's collateral policy. Collateral for these nine loans consisted of the following:

- Deeds of trust for property and pledge of interest in a revenue stream (four cases).
- Pledges of water rights and an interest in a revenue stream (two cases).
- Security interests in a combination of various assets (e.g., water rights, property and other assets) (one case).
- Assignment of the proceeds from a contract with another entity and a pledge of interest in a revenue stream (one case).
- Certificate of deposit, pledge of interest in a revenue stream, and a deed of trust for property (one case).

Variation in the amount and type of collateral that is obtained from a borrower is expected and, to a certain extent, necessary. This is because different borrowers have different assets available to them to pledge for security for a loan. Further, the amount and type of collateral pledged for a loan should vary depending upon a borrower's credit history and other measures of the relative risk that the loan will not be repaid. Although we did observe a lot of variation in collateral pledged for the loans in our sample, we could not determine whether this variation was reflective of the relative creditworthiness of the borrowers or was the result of preferential treatment. By not explicitly linking collateral requirements to measures of risk, the Board may not be adequately protecting the State's interests in the event that a borrower defaults on its loan. Further, increasing or decreasing the amount of collateral that is required to secure a loan without showing some tie to the borrower's credit position may result in the appearance of preferential treatment.

Recommendation No. 9:

The Water Conservation Board should ensure its policies and practices for obtaining collateral for loans adequately protect the State's interests in the event of a borrower's default on its loan obligation. This should include specifically defining what constitutes sufficient collateral given the individual financial characteristics of borrowers and applying this definition consistently among loan applicants.

Water Conservation Board Response:

Agree. CWCB staff will develop a table that shows, depending upon the financial characteristics of each type of borrower, the range and type of collateral that would be "sufficient" for each category. The staff will present the proposed policy for consideration by the Board by June 30, 1999. There has been only one real default on a Construction Fund loan to date and that involved a project added by the General Assembly during the legislative process. The General Assembly also added and later forgave four project loans for oil shale projects.

Certain Security Documents Should Be Filed Upon Execution of a Contract

Board staff are expected to file various security documents when a borrower pledges certain types of collateral to secure a loan. These include:

- A deed of trust which is used to secure real property. This document is filed with the county clerk in the county where the property is located.

- A security agreement which is used to secure contract rights (e.g., pledges of revenue, equipment, shares of stock). Assignment of contract rights is accomplished by filing a Uniform Commercial Code (UCC)-1 statement with the Secretary of State's Office. These filings are valid for a period of five years, at which time it is the creditor's responsibility to refile if it wishes to retain security interest in the collateral.

The purpose of filing these documents is to provide public notice that a borrower has pledged its property as collateral to secure a loan. Once these documents are properly recorded, if additional creditors take an interest in the same property, their interests would be secondary to the State's.

Timely filing of deeds of trust and UCC-1 statements -- both at contract execution and at various times during the life of the loan -- is important to ensure the State's interests are being fully protected. Without proper and timely filing of these documents, the State may have no recourse in the event that a borrower declares bankruptcy and/or defaults on its loan. We found that the Board does not have a perfected security interest in its collateral for loans totaling almost $12 million. The following discussion provides highlights of the specific problems we found in this area.

The Board Is Not Filing Some Deeds of Trust as Required

We reviewed a sample of 68 contracts executed between 1975 and 1997 to determine whether deeds of trust and UCC-1 statements were being filed as required. Deeds of trust are filed at two times during the loan process. Deeds may be filed at contract execution if the collateral for a loan warrants it (e.g., the collateral is already in existence). A second filing process may be necessary at project completion if, for instance, part of the project is used to secure the loan.

We first reviewed documentation to determine whether all deeds were being filed as required, either at contract execution and/or at project completion. We found that the Board has no systematic process to ensure that deeds are filed as required. Specifically, in 19 cases (28 percent), we found that no deed had ever been filed, even though it was required. We then assessed whether the deeds that were filed as required were filed in a timely manner. We used the Board's standard of ten days from contract execution as a timely filing. We found that the vast majority of deeds were not being filed according to this standard, as shown in the following table. Late filing of a deed of trust could result in the State's interest in the collateral being relegated to a position lower than other creditors.

Timeliness of Filing Deeds of Trust	
Days	**Number of Deeds Filed**
0 to 10 days	5
11 to 30 days	3
31 to 60 days	5
61 to 180 days	7
over 180 days	62
Source: Office of the State Auditor analysis of Board data.	

The Board Needs To Continue Improving Its Filing of UCC-1 Statements

We also reviewed the Board's process for filing UCC-1 statements upon contract execution and then refiling them upon the five-year expiration date. In the past two years it appears that the Board has improved its efforts at filing initial UCC-1 statements. However, problems still exist. Specifically, when we reviewed a sample of 56 loans that required UCC-1 filings, we found that only two of these filings occurred within ten days of contract execution. The remaining 54 filings occurred anytime from three days to 18 years after contract execution. The Board also lacks a system for alerting staff when UCC-1 statements are about to expire. We found six instances where the UCC-1 statement was not renewed upon the expiration of the original filing.

The Board needs to take immediate action to correct the problems we observed. Specifically, the Board should implement an effective system for monitoring loans so that the appropriate security documents are requested, received, and filed as required. The Board also needs to review its active loans to identify missing or outdated documentation and then take the proper actions to perfect the State's security interests.

Recommendation No. 10:

The Water Conservation Board should ensure that all security documents (e.g., deeds of trust and UCC-1 statements) are filed in a timely manner when a loan is made (i.e., within ten days of the contract execution date) and as needed during the life of the loan (i.e., upon project completion and expiration of any previous UCC-1 filing). This should include developing a reliable system for monitoring loans to ensure the proper security documents are requested, obtained, and filed in a timely manner. The Board should also review all active loan files to determine which ones need to have security documents filed and then file the appropriate documents immediately. In instances where the Board may no longer have a senior position in the collateral, it should negotiate for this position to ensure the State's interests are protected to the fullest extent possible.

Water Conservation Board Response:

Agree. We will assess our current capability to pay sufficient attention to these responsibilities, especially in light of the size of the Fund and the increasing number of projects we are supporting each year. In addition to the discussions with other public agencies having similar responsibilities (described in the attached letter from the Acting DNR Executive Director), the CWCB staff is in the process of reevaluating Construction Fund Loan Program workload allocation and priorities. These reviews will be completed by June 30, 1999, and may result in a reallocation of staff assignments or in the Board and DNR submitting a decision item to add this staff capability.

A Reliable System for Tracking Compliance With Insurance Requirements Is Needed

Since 1987 the Board has required borrowers to maintain general liability insurance from the time of contract execution until their loan is repaid. Requiring borrowers to maintain liability insurance protects the State's interests should an unforeseen event at a project site impact a borrower's ability to pay its obligations. Board policy requires borrowers to have liability insurance that covers the management, operation, and maintenance of the project with minimum limits of $1 million per occurrence and $2 million in aggregate. In addition, for contracts dated 1995 and after, the State must be named as an additional insured, which gives the Board further protection.

To provide evidence that they have met insurance requirements, borrowers are required to provide the Board with a certificate of insurance including the additional insured endorsement. In addition, borrowers must provide the Board with documentation of policy renewal as needed throughout the life of the loan. We reviewed the documentation associated with insurance requirements for all of the Board's 154 active loans. For 41 loans (27 percent), there was no evidence that the borrower had obtained the required liability insurance. The outstanding balances of these loans totaled over $20 million. In addition, three loan files contained no evidence that the borrower had obtained the additional insured endorsement. These loans totaled $3,248,000. Without proper liability insurance, project sponsors may be endangering their ability to meet their loan obligations should the cost of an accident or other liability situation negatively impact their financial position.

Missing documentation appears to be attributable to the fact that the Board has no effective method for ensuring that borrowers comply with insurance requirements. Currently staff send a reminder notice to borrowers that proof of insurance and related documentation is due when their annual loan payment is due. Staff report that they follow up with noncompliers at a later date. Because of all the documentation problems we found, however, it appears that this system has not been effective. The Board should consider improvements to its system for obtaining proof that borrowers have the required liability insurance. This may include charging fees if borrowers do not provide proof of insurance in a timely manner.

Recommendation No. 11:

The Water Conservation Board should ensure that borrowers comply with general liability insurance requirements. This may include charging late fees if required documentation is not provided in a timely manner.

Water Conservation Board Response:

Agree. CWCB staff, in cooperation with DNR, is in the process of reviewing the structure of similar programs at other public agencies (see attached letter from the Acting DNR Executive Director) and reevaluating Construction Fund Loan Program workload allocation and priorities. We may submit a decision item to add this staff capability. These reviews will be completed by June 30, 1999.

Recordkeeping Needs Improvement

During our review of the Board's loan files we observed several recordkeeping issues. As mentioned previously, many loan files are missing evidence that feasibility studies were conducted or that sufficient liability insurance or collateral was obtained. Problems in these areas are discussed at length throughout this report. Obtaining proper documentation prior to disbursing funds is important to ensure that the State's interests are protected should repayment problems with a loan arise.

General file maintenance also need improvement. Specifically, we found that the Board does not have a centralized filing system for its loan records. Older loan records are kept in multiple binders, whereas a combined filing system is used for newer loans. Poor file maintenance may result in lost or misfiled documents. When developing ways to correct these problems, the Board should explore technological solutions (e.g., scanners).

An Internal Loan Review Process Would Identify Problem Areas

Many of the problems we observed could be identified and corrected if the Board had an internal loan review process and better file maintenance procedures. An internal loan review process could be conducted just prior to a loan approval to ensure that loan documents are complete and accurate prior to disbursing any funds. Such a review could be repeated periodically throughout the life of a loan to ensure that various loan maintenance issues were addressed. By conducting a periodic review process, the Board can determine whether:

- Contingencies, such as collateral that is expected to be obtained at project completion, were met. Reviews could also ensure that the State's security interest in certain collateral was perfected as required.

- Contract amendments were properly prepared and executed.

- Changes to loan conditions were documented and suitably reflected in the appropriate loan documents (e.g., amortization schedules, billings).

American Institute of Certified Public Accountants (AICPA) guidelines state that a loan review process is essential in assessing the quality of a lender's loan portfolio and may help identify weaknesses in the lending process or problems in the methods used to supervise and collect loans. The Board should also improve its file maintenance procedures to ensure that loan documents are properly filed and easily accessible.

Recommendation No. 12:

The Water Conservation Board should establish a process for reviewing each loan prior to disbursing project funds and at various times thereafter. The process should ensure that projects have sufficient collateral and liability insurance, evidence that the borrower has completed a feasibility study and met all other contingencies, correct amortization schedules, properly approved contracts, evidence of appropriate UCC-1 statement filings, and other required documentation.

Water Conservation Board Response:

Agree. DNR and CWCB staff are in the process of reviewing the structure of similar programs at other public agencies and reevaluating Construction Fund Loan Program workload allocation and priorities (see attached letter from the Acting DNR Executive Director). These reviews will be completed by June 30, 1999.

Recommendation No. 13:

The Water Conservation Board should improve its procedures for maintaining loan records, including developing a consistent, centralized filing system.

Water Conservation Board Response:

Agree. In response to the dramatic increase in the number of projects supported by the Program during the last five years, the CWCB staff has already contracted with a systems analyst graduate who has designed a sophisticated relational database for tracking and maintaining our loan records. CWCB staff has started populating the database and expects to complete the project June 30, 1999. We will also initiate a study of the feasibility of an electronic imaging system to improve the integrity and accessibility of the loan records to both CWCB staff and to the DNR Accounting Section staff. That feasibility study should be completed by February 1, 1999, so that a funding request may be proposed in the 1999 legislative session. Any proposed imaging system would, of course, be consistent with other imaging projects currently underway in the DNR that have been approved by the Information Management Commission (IMC).

Loan Administration

Chapter 3

Background

After a water project is finished and inspected by Board staff, a project sponsor is notified of its obligation to begin making loan payments. The first payment of the loan is due one year after the State determines that the project is substantially complete. Annual payments are then due until the loan is paid in full. Most loan terms are for a period of 30 years, but terms can range from 10 to 40 years. Annual payments on the principal and interest due on the Board's active loans currently range from about $325 to $1,153,400, with an average of $42,900.

Prior to the due date of the first payment, the Board sends the project sponsor a letter that includes information on the following:

- Interest payable that may have accrued during the construction phase.
- Amount of the first loan payment and its due date.
- Amortization schedules.
- Requests for proof of current liability insurance.

Because projects are finished at various times during the year, the Board receives payments throughout the year. Staff keep track of payment due dates by using a spreadsheet that shows the payments that are due each month. In addition, payments made on each loan are tracked in individual loan files by manually recording information on a ledger.

Billing Procedures Need Basic Improvements

Our review of the Board's billing procedures indicated a need for basic improvements. First, the Board sometimes sends bills to borrowers at the wrong time. We found six instances where a borrower was billed late and two where the borrower was billed early given the due date as noted on the loan contract. Billing borrowers in a timely manner is important to ensure that the interest due on a loan is accurately calculated. In the cases we observed, six borrowers were undercharged interest totaling almost $34,000, and two borrowers were overcharged interest of about $900.

Second, we found two instances where the Board sent information to a borrower that was inaccurate. In one case the Board sent a borrower a bill with the wrong payment amount. This resulted in the Board's receiving payments over a six-year period that were short a total of approximately $1,100. In another instance a borrower had skipped a payment but was sent an amortization schedule that showed the payment for $8,742 had been made. This statement also included another error that when combined with the former problem, may have led the borrower to conclude that the loan would be paid off five years before the actual full repayment date.

Staff may be sending bills at the wrong time because the spreadsheet they use to monitor billing dates contains inaccurate and incomplete information. Inaccurate billing information may be the result of the absence of a supervisory review of billing statements prior to their being sent. In addition, loan files have not been reviewed since 1993. Reviewing loan files periodically to ensure that billing, payment, and other information is accurate and up to date may help prevent the problems we observed.

Recommendation No. 14:

The Water Conservation Board should ensure that its borrowers receive bills that are timely and that contain accurate information. This should include a management review of the information contained in the billing statements and a periodic review of all loan files to identify and correct information that is inaccurate or out of date.

Water Conservation Board Response:

Agree. Billing information for all existing projects will be reviewed, verified, and incorporated into the loan project database by June 30, 1999.

Since about 1985, loan payment reminder letters have been prepared using a word processor and monthly merge lists, not a database.

Follow-Up on Late Payments Is Needed

We reviewed the payment histories associated with the Board's loans for the period Fiscal Year 1995 to 1998 to determine whether borrowers were making their annual payments in a timely manner. We found that during this period payments were not received in a timely manner about 35 percent of the time. We defined a timely payment as being received within 15 days of the payment due date. Our findings are shown in the following table:

Timeliness of Loan Payments
Fiscal Years 1995 to 1998

	Number of Payments Received					
Fiscal Year	0-15 days (timely)	16 to 30 days late	31 to 60 days late	61 to 90 days late	Over 90 days late	Total Loans
1995	61	28	13	2	7	111
1996	76	23	14	1	6	120
1997	100	22	10	1	5	138
1998*	74	27	5	2	4	112
TOTALS	**311**	**100**	**42**	**6**	**22**	**481**

Source: Office of the State Auditor analysis of Water Conservation Board records.
*** Note:** For Fiscal Year 1998 we reviewed only those loans with due dates of March 20, 1998, or earlier. The Board had an additional 40 loans that were active and due before the fiscal year-end.

Overall, delinquent loan payments have cost the State over $514,000 in lost interest revenue over this time period. We also found that one borrower has not made a payment in six years and owes approximately $40,500 in back payments.

Contracts written before March 1998 did not have a clause that allowed the Board to impose late penalties and other sanctions against delinquent borrowers. As a result, in nearly all of its active loan agreements, the Board has limited options for dealing with payment problems. If a borrower misses an annual payment, the Board does not assess a late penalty but merely adds an extra year to the borrower's repayment term. Further, in the past, management has viewed a payment made at any time during the year as "on time" and, thus, has not assessed a penalty as long as the payment is eventually received before the next one was due.

During the audit, staff began drafting provisions to insert into contracts and promissory notes that would allow the Board to:

- Charge a late fee on payments received more than 15 days after the payment due date. Late fees are 5 percent of the annual payment amount.

- Pay the late charges owed by the borrower before applying payment amounts to the interest and principal owed on the loan balance.

- Impose a variety of sanctions on the borrower if the loan should become delinquent (e.g., declare the entire balance of the loan immediately due, assess a new interest rate on the loan of 15 percent, make the borrower pay collection costs).

Changing loan provisions in these ways will bring the Program more in line with similar programs in other states. For example, Utah and Wyoming both impose interest-related penalties on late payments.

Although strengthening contractual provisions is a good start at improving the methods for dealing with delinquent loans, the Board needs to make additional improvements. For example, although the Board's contract administrator has written procedures for dealing with delinquent payments, these procedures have not been officially adopted by the Board. Also, staff have not established a formal process for monitoring collections and, if necessary, declaring a loan a bad debt. For instance, in the case noted above where the borrower had not paid its loan in six years, it may be necessary to write this loan off as bad debt and then take steps to try to collect the debt through other means (e.g., referring the debt to the Central Collections Unit at General Support Services and/or working with the Attorney General's Office to take legal action against the borrower).

The Board Needs More Complete Information on Collections Problems

In addition, we believe that staff needs to improve its communication with the Board regarding collections problems. For example, during Calendar Year 1997 only two borrowers were reported to the Board as being delinquent in their payments. However, when we performed a review of payment histories and prepared an aging schedule for this period, we found that the following information should have been reported to the Board:

Calendar Year 1997 Collections Problems - Aging Schedule					
Board Meeting	Number of Loans/Total Amount of Delinquent Payments				
	31-60 days late	61-90 days late	91-180 days late	181-365 days late	Over one year late
January 1997	0	0	3 loans for $342,373	2 loans for $17,135	1 loan four years behind for $25,860
March 1997	0	0	2 loans for $64,494	1 loan for $7,312	1 loan four years behind for $25,860
May 1997	0	0	1 loan for $60,592	2 loans for $11,214	1 loan four years behind for $25,860
July 1997	1 loan for $6,488	0	0	1 loan for $3,902	1 loan five years behind for $33,172
September 1997	1 loan for $2,725	1 loan for $9,823	1 loan for $7,312	1 loan for $2,402	1 loan five years behind for $33,172
November 1997	1 loan for $3,902	0	3 loans for $19,865	0	1 loan five years behind for $33,172 and 1 loan one year behind for $2,402

Source: Office of the State Auditor analysis.

Initiating a regular process for communicating collections issues to the Board, as well as making the other improvements noted, should help correct the problems we observed.

Recommendation No. 15:

The Water Conservation Board should formally adopt policies and procedures for handling loan collection problems and ensure that staff implement procedures that address the development of:

- Formal processes for identifying and dealing with collections problems.
- Criteria for declaring bad debt and procedures for referring bad debt to Central Collections and/or the Attorney General's Office to take appropriate legal action against the borrower.
- Regular and comprehensive reporting of collections issues to the Board.

Water Conservation Board Response:

Agree. The CWCB staff will develop proposed procedures, policies, and criteria for resolving loan collection problems for consideration by the Board by June 30, 1999.

The overall repayment record for CWCB loans is excellent. The number of loans which have encountered significant delinquency problems is minimal, and only one loan has formally been declared to have been in default. Even though the COFRS system does not support loan portfolio, the Board members indicate that they feel fully aware of every significant delinquency. Deferment of payments to help borrowers in financial hardship, however, differs from "delinquency," and there appear to be several deferred loan payments that are incorrectly being characterized delinquent because of irregular or late annual payments. Finally, the state collection process should be considered a means of last resort. The state collection process creates bad will among intended beneficiaries and is rarely cost effective for the Loan Program because half of the collected amount is retained by the collection agency.

Contracting Functions Need Improvement

The Board enters into a contract with each project sponsor, which specifies the terms and conditions of the loan agreement (e.g., repayment terms, interest rate, insurance and collateralization requirements). The same contract is used for both the project construction phase and the payback period of a loan. The Board prepares approximately 30 contracts each year, either in original form or in the form of amendments to existing contracts.

When we reviewed the Board's contracting functions related to the Program, we found several problems. Specifically, the Board's policies and procedures for writing, processing, approving, amending, and monitoring its contracts with borrowers all need improvement. Our findings in each of these areas are discussed below.

The Board Does Not Use Standardized Contracts

The Board does not use standardized contracts with its borrowers. As a result, staff must prepare a new contract for each new loan and then the Attorney General's Office and State Controller's Office must review and approve each contract individually.

State agencies that have numerous contracts of a similar nature can realize efficiencies and time savings by requesting the State Controller's Office and Attorney General's Office approve their use of one or more "boilerplate" contracts. A boilerplate contract is a preapproved, standardized contract that can be easily used in multiple circumstances. Since the bulk of the contract language is standardized and has already been approved, using a boilerplate contract can reduce the time needed to process contracts and may also reduce costs by eliminating the need for a separate legal/procedural review of every contract. The average time needed to develop, review, and approve an original contract is between two and eight months, which could be reduced if the Board used boilerplate contracts. Further, over the period Fiscal Year 1994 to 1997, the Board spent an average of approximately $220,000 annually on legal services. It is possible that these expenditures could be reduced if the Board standardized its contracts with loan recipients. The Board should work with the Attorney General's Office and State Controller's Office to identify possibilities for streamlining the contract development and approval processes.

Contracts Are Not Amended in a Timely Manner

Contracts with borrowers are frequently amended. This is mostly the result of the Board's practice of using one contract to cover both the construction phase of a project and the loan payback period. Because the loan amount that is written into a contract is based on an estimate and frequently includes an extra amount for contingencies, it is often necessary to revise the loan amount once the project is completed and all costs are known. This requires a contract amendment.

We found that contracts are not being amended in a timely manner. The Board provided us with a list of 22 existing contracts that needed amendments. We found that 15 of these contracts should have been amended over a year ago. In these cases the original contract amount overstated the amount of funding that was actually needed for the project. By not amending these contracts in a timely fashion, the Board tied up funding of almost $1.8 million that should have been deauthorized and made available for other projects. The Board should improve its methods for monitoring contracts to ensure amendments and any ensuing deauthorizations are processed in a timely manner.

The Board Should Consider Using a Different Contracting Approach

The commercial lenders we interviewed stated that they typically use separate contracts for the construction and payback phases of a loan. Once the construction phase is complete, a second loan contract is created which supersedes and replaces the first contract. Using two contracts instead of one may be beneficial for the Board. For instance, using a two-phase contracting approach would virtually eliminate the need to amend contracts for the purpose of adjusting the total loan amount. Further, drawing up a separate loan contract for the construction phase would give the Board an opportunity to segregate the higher risk associated with this part of the project and assign an interest rate accordingly. The Board should investigate the benefits of adopting a two-phase contracting process to address the problems we observed.

Recommendation No. 16:

The Water Conservation Board, working with the Attorney General's and State Controller's Offices, should explore the use of boilerplate contracts for the Construction Fund Program. In addition, the Board should develop monitoring procedures to ensure contracts are amended and any residual funding is deauthorized in a timely manner. The Board should also consider adopting a two-phase contracting process with its borrowers.

Water Conservation Board Response:

Agree. The CWCB staff has worked extensively with the Attorney General's Office to streamline the contracting process and the contracting process has already been vastly improved. However, the diverse character of the borrowers (ranging from individuals and homeowners associations to special districts and municipalities) has limited our opportunities; passage of the TABOR Amendment further complicated this effort. The CWCB staff will summarize these efforts and complications for consideration by the Board by June 30, 1999. The deauthorization and residual funding issues will be treated as indicated in our response to Recommendation 5.

Accounting Procedures and Internal Controls Need Improvement

During the audit we observed several problems with the Board's accounting procedures and internal controls. Specifically, we found problems in the areas of reviewing and approving payment vouchers and receiving cash. We also found that there is a need for improved internal communication between the Board's staff, the Department of Natural Resources' Accounting Section, and borrowers. Each of these issues is discussed in more depth below.

Stronger Controls Are Needed To Prevent Payment Errors

As explained in Chapter 2, during a project's construction phase, project sponsors send the Board requests for reimbursement of their construction costs. One staff member reviews requests to ensure that the costs are eligible for reimbursement and to apply any Board-imposed spending limits. Management staff then approve the transaction so that a state warrant can be prepared and sent to the project sponsor.

During the audit we found that a borrower had been paid twice for the same reimbursement request. This resulted in the project sponsor's being sent in error a warrant for over $1.1 million. We reviewed the documentation associated with this reimbursement request and found that it was the project sponsor who brought the error to the attention of staff. If the sponsor had not informed staff of the mistake, it is likely that this problem would have gone undetected. This is because management staff do not perform any in-depth review of the documentation associated with reimbursement requests (i.e., COFRS paperwork is reviewed and approved, but the actual reimbursement request and its supporting documentation are not reviewed). As such, the only control that could have stopped the warrant from being paid was if insufficient funds had existed in the project account. In this case ample funds were available to support processing of the duplicate payment. By modifying current procedure to provide a more detailed management review of disbursement requests, the Board can help ensure that payment errors of this type do not recur.

Controls Over Cash Receipts Are Inadequate

In Fiscal Year 1997 the Board received over $6.9 million in principal and interest payments on loans. Accordingly, we reviewed the Board's control procedures over cash receipts and found that there is inadequate segregation of duties. Specifically, the same individual who deposits cash receipts and enters the amounts into COFRS also has access to the logs for recording the payments received. A good system of internal controls would segregate cash receipt, data entry, and deposit functions. Without proper segregation of duties, there is an increased risk of theft and/or undetected errors. We also found that there is no reconciliation of the cash receipts to deposits with the State Treasurer's Office. Without this type of reconciliation, there is no way of ensuring that all receipts were actually deposited, which also increases the risk for theft or other problems.

Discrepancies Should Be Corrected

During the audit we compared information found in the Board's loan files with information in the Department of Natural Resources' accounting records. When we attempted to match loan balances, we found that 40 of 187 balances (21 percent) did not match. In total, the accounting records reported loan balances that exceeded the loan file records by over $1.5 million. We also attempted to confirm loan balances with borrowers and found that in 37 of 120 cases (31 percent), the borrowers' records did not match accounting records. Because accounting records are reconciled to COFRS, discrepancies such as these could result in misstatements in the State's financial statements. Further, without accurate information about loan balances, there is a greater risk that the State will not collect all the money it is due.

Many problems may have led to the differences that we observed. For example, we found instances where different amortization schedules were being used and where the Board had rolled an existing loan into a new loan and did not notify the

Accounting Section. Regardless of the reasons behind the problems, discrepancies such as these have been a long-standing issue. The Board and the Department's Accounting Section should immediately review all active loans, compare information, and then investigate and correct any discrepancies identified. Further, the Board should ensure that any periodic loan review process it adopts includes procedures to ensure that the Department's accounting records are accurate. Recommendation No. 12 discusses the need for a loan review process.

Recommendation No. 17:

The Water Conservation Board should work with the Department of Natural Resources' Accounting Section to improve its accounting procedures and strengthen internal controls. This should include:

- Strengthening management controls over the processing and review of payment vouchers to ensure proper processing.
- Reassigning various cash receipt-related responsibilities to ensure adequate segregation of duties and establishing procedures to ensure that cash receipts are properly recorded and deposited.
- Working with the Department to identify and correct loan balance information. The Board should also communicate the results of its periodic loan review process (see Recommendation No. 12) to the Department to ensure that loan information remains up to date and accurate.

Water Conservation Board Response:

Agree. The assignment of cash receipt-related responsibilities and stronger accounting controls are already in place. These procedural corrective measures will be documented and reported to the Board by February 1, 1999. Loan balances will be reconciled in cooperation with the DNR Accounting Section staff by June 30, 1999.

Significant Deficiencies Exist in Accounting Operations

As discussed throughout the report, we observed significant problems in the Board's accounting operations. These problems were apparent in nearly every functional area, including:

- **Billing borrowers** - We found that staff have sent bills to borrowers that contained erroneous information. We also found several instances where bills were not sent to borrowers in a timely manner.

- **Collecting loan payments** - We found that about a third of borrowers do not make their loan payments in a timely manner and that the Board does not have effective methods for handling delinquency issues. We also found problems with the processes used for receiving, recording, and depositing loan payments.

- **Recordkeeping** - We found many discrepancies among the records kept by Board staff, borrowers, and the Department's Accounting Section. In addition, we also observed several instances of inaccurate and/or misfiled records.

The problems we noted were generally attributable to one or more of the following causes:

- Inadequate supervision or monitoring processes.
- Lack of adherence to established policies and procedures.
- Weak or absent internal controls.
- Ineffective internal and external communication processes.

Good accounting practices are integral to the effective and efficient operation of a lending program. The weaknesses we observed may have serious ramifications for all Board operations. For example, weak internal controls or inadequate supervision may increase the risk of theft, fraud, or other types of inappropriate activities.

The Board Has No Staff With Accounting Expertise

We also noted that the Program does not currently employ any staff who have accounting expertise, even though accounting operations are an integral part of many of the Board's activities. This has created inefficiencies because staff in the Department's Accounting Section have begun duplicating some Board-level accounting tasks in an effort to improve the accuracy of loan records.

Because of the myriad problems we noted and the essential nature of the Board's accounting operations, we believe the Board, working with the Department's Accounting Section, should perform a thorough review of all accounting functions. This review should focus on identifying deficiencies and devising methods to correct the problems noted. These may include outsourcing all accounting functions, moving the responsibility to the departmental level, and/or allocating FTE to the Board so that it can hire qualified personnel to perform these tasks.

Recommendation No. 18:

The Water Conservation Board, working with the Department of Natural Resources' Accounting Section, should perform a comprehensive review of its accounting functions to identify and correct deficiencies. Methods for addressing deficiencies should include, but not be limited to, outsourcing, moving all accounting responsibilities to the departmental level, and allocating FTE to the Board.

Water Conservation Board Response:

Agree. CWCB staff will explore and evaluate these and other options through a review of the program structure (described in the attached letter from the Acting DNR Executive Director). The results will be presented to the Board for consideration by June 30, 1999. Any recommendations for legislative action will be presented to the Governor and the General Assembly by February 1, 1999.

The CWCB staff has already reviewed the tasks performed by its existing accounting and administrative staff. That analysis showed that, if we are to maintain the current level of service, 2 new FTE may be needed to perform the routine accounting and management functions. Two new positions, an accountant and a compliance officer, have been proposed to the DNR Acting Executive Director as a decision item for the Fiscal Year 2000 budget and are pending review.

Appendix A

Disposition of Prior Audit Recommendations

Overview

As part of our current audit we reviewed the implementation status of the recommendations made in the Office of the State Auditor's February 1993 Colorado Water Conservation Board Construction Fund Performance Audit Report. The recommendations, the Board's 1993 responses, and our current assessment of the status of the Board's implementation efforts are shown below.

Recommendation No. 1:

The Board should develop a formal, systematic program or process which provides a long- and short-term framework for the use of the Construction Fund consistent with the broader Departmental plan. This process should:

a. Identify critical water issues and develop broad policy statements.

b. Establish goals and implementation plans to meet these goals.

c. Develop performance measures which monitor the effectiveness of the activities sponsored through the Construction Fund.

Water Conservation Board Response:

Agree.

Office of the State Auditor Disposition:

Partially Implemented. See current Recommendation No. 1.

Recommendation No. 2:

The Board should develop and implement an effective process for long-term financial planning of Construction Fund monies. This process should include:

a. Establishing long-term funding needs for Board projects and activities: a ten- to twenty-year plan that includes projected funding required to develop and maintain the State's water resources.

b. Assessing current sources of funds and evaluating what can be done given the current sources: an assessment of funds currently available to the Board for accomplishing the long-term goals.

c. Identifying future sources of funding, as needed: a projection of additional funding requirements that may be needed to meet long-term goals. The evaluation should also include projections of the various funding mechanisms available to the Board.

Water Conservation Board Response:

Agree.

Office of the State Auditor Disposition:

Partially Implemented. See current Recommendation No. 2.

Recommendation No. 3:

The Board should establish guidelines for its loan rates to reflect market conditions. The guidelines should be reflected in the projects that will be authorized during the upcoming legislative session.

Water Conservation Board Response:

Partially Agree.

Office of the State Auditor Disposition:

Implemented.

Recommendation No. 4:

The Board should charge interest on cash disbursements made to project sponsors during the construction phase of projects. Interest charges could be added to the principal amount of the loan and financed over the term of the loan.

Water Conservation Board Response:

Agree.

Office of the State Auditor Disposition:

Implemented.

Recommendation No. 5:

The Board should improve its monitoring of project sponsors by:

a. Contacting project sponsors at least annually after authorization of funds to determine if project sponsors plan to proceed with the projects.

b. Documenting the responses from project sponsors, including requests to deauthorize projects.

c. Reporting the results of the contacts to the General Assembly on an annual basis.

Water Conservation Board Response:

Agree.

Office of the State Auditor Disposition:

Partially Implemented. See current Recommendation No. 5.

Recommendation No. 6:

The Board should develop and implement procedures which would:

a. Recover its share of feasibility study costs for projects that do not get constructed.

b. Evaluate options for the recovery of feasibility costs, including payback over a period of time.

c. Communicate the new policy and practice to project sponsors.

Water Conservation Board Response:

Agree.

Office of the State Auditor Disposition:

Partially Implemented. See current Recommendation No. 7.

Recommendation No. 7:

The Board should develop methods to demonstrate its compliance with procedures it has established, including:

a. Obtaining and filing documentation of all inspections, as appropriate.

b. Documenting all Board reviews and approvals.

Water Conservation Board Response:

Agree.

Office of the State Auditor Disposition:

Implemented.

Appendix B

Colorado Water Conservation Board
Water Project Construction Loan Program
Completed Project Loans

Borrower	Project Name	County	Div	Amount Loaned	Date Completed
Allenspark Water & San. District	Allenspark Water Project	Boulder	1	200,001	10/01/77
Gray Lakes Reservoir Company	Lake Canal	Larimer	1	160,000	06/21/79
Cache La Poudre Reservoir Co.	Cache La Poudre (Timnath) Res. Rehab.	Larimer	1	880,000	07/02/79
Town of Rico	Rico Water Supply System	Dolores	7	80,000	09/14/79
City of Delta	Delta Water System	Delta	4	450,000	10/11/79
Town of Dove Creek	Dove Creek Water System	Dolores	7	400,000	02/15/80
Trinchera Irrigation Company	Trinchera Canal Lining	Costilla	3	251,689	05/28/80
Town of Hayden	Hayden Water Supply System	Routt	6	300,000	11/17/80
Beaver Park Water, Inc.	Irrigation System & Water Rights (1)	Fremont	2	1,500,000	01/07/81
Town of Limon	Limon Water Supply System	Lincoln	1	750,000	02/02/81
Town of Ridgeway	Ridgeway Water Supply System	Ouray	4	175,000	02/10/81
San Luis Valley Irrigation District	Rio Grande Res. Emerg. Interim Repair	Hinsdale	3	90,000	07/28/81
Upper Yampa WCD	Yamcolo Dam	Routt	6	1,500,000	10/09/81
Town of Eagle	Eagle Water System	Eagle	5	250,000	10/19/81
Ft. Morgan Reservoir & Irrig. District	Fort Morgan Diversion Dam	Morgan	1	19,000	11/01/81
Lower Latham Ditch Company	Lower Latham Canal	Weld	1	20,000	11/01/81
Farmers Irrig. Ditch & Reservoir Co.	Diversion Dam and Canal	Larimer	1	109,000	02/01/82
Big Thompson Ditch Company	Div. Dam, Ditch, Pipeline, & Irrig. System	Larimer	1	193,170	02/01/82
Henrylyn Irrigation District	Prospect Dam Repairs	Weld	1	653,000	07/29/82
Town of Walden	Walden Water Supply System	Jackson	6	450,000	07/29/82
Ute Water Conservancy District	Pipeline and Storage Tank	Mesa	5	985,000	08/16/82
Beaver Park Water, Inc.	Brush Hollow Dam Rehab. & Canals (2)	Fremont	2	350,000	09/04/82
Winter Park Water & San. District	Winter Park Water Supply System	Grand	5	900,000	09/10/82
Terrace Irrigation Company	Terrace Reservoir Dam Outlet Rehab.	Conejos	3	608,600	09/22/82
Farmers Extension Ditch Company	Highland Lake Lateral 1	Weld	1	150,000	10/02/82
Town of Silt	Silt Water Supply System	Garfield	5	300,000	11/18/82
Town of Nunn	Nunn Water Supply System	Weld	1	209,000	11/18/82
City of Morrison	Morrison Water Supply System	Jefferson	1	350,000	02/28/83
Town of Hudson	Hudson Water Supply System	Weld	1	217,000	03/09/83
Town of Hotchkiss	Hotchkiss Water Supply System	Delta	4	60,000	03/31/83
City of Rifle	Rifle Water Supply System	Garfield	5	300,000	03/31/83
Farmers Irrigation Ditch Company	Diversion Dam	Larimer	1	63,000	04/11/83
Henrylyn Irrigation District	Horsecreek Dam Repairs	Adams/Weld	1	260,000	06/30/83
Mancos Water Conservancy District	Jackson Gulch Diversion Dam Repair	Montezuma	7	81,362	07/01/83
Blue River Water District	Blue River Domestic Water Supply	Summit	5	1,200,000	07/26/83
Brook Forest Water District	Maxwell Cr. Dam & Raw Water Pipeline	Jefferson	1	164,500	08/09/83
Town of Rangely	Rangely Water Supply System	Rio Blanco	6	150,000	08/03/83
City of Trinidad	Trinidad Water Supply System	Las Animas	2	465,000	08/17/83
Kelton Heights Water & San. District	Bancroft Water Delivery System	Jefferson	1	441,306	08/29/83
Beaver Park Water, Inc.	Irrig. System, Ditch Lining, & Pipeline (3)	Fremont	2	276,750	09/02/83
Cedar Mesa Ditch & Reservoir Co.	Cedar Mesa Reservoir Dam Spillway	Delta	4	12,000	10/17/83
Farmers Extension Ditch Company	Highland Lake Lateral 2	Weld	1	220,000	01/24/84
Town of Palisade	Cabin Reservoir Dam Reconstruction	Mesa	5	1,000,000	03/07/84
City of Canon City	Canon City Water System	Fremont	2	231,000	03/26/84
Brook Forest Water District	Maxwell Creek Dam, II	Jefferson	1	130,500	03/29/84
Ute Water Conservancy District	Water Supply System	Mesa	5	7,987,500	04/18/84
Town of Fruita	Fruita Water Supply System, I	Mesa	5	214,700	05/03/84
Town of Parachute	Parachute Water Supply System	Garfield	5	250,000	05/03/84
Sedgwick-Sand Draws WCD	Sedgwick-Sand Draws Land Acquisition	Sedgwick	1	33,000	05/08/84
San Luis Valley Irrigation District	Rio Grande Reservoir Enlargement	Hinsdale	3	515,000	06/18/84
Town of Basalt	Basalt Water Supply System	Eagle	5	226,975	07/01/84
Town of Starkville	Starkville Water Supply System	Las Animas	2	200,000	09/06/84

Borrower	Project Name	County	Div	Amount Loaned	Date Completed
Beeman Irrigation Company	Beeman Diversion Dam Improvement	Weld	1	92,512	09/28/84
Town of Manitou Springs	Manitou Spgs Water Supply System	El Paso	2	1,200,000	10/17/84
Kern Reservoir and Ditch Company	Kern Reservoir Dam Repairs	Weld	1	123,000	10/29/84
Town of Fruita	Fruita Water Supply System, II	Mesa	5	607,864	12/02/84
Ridges Metro District	Ridges Water Supply & Irrig. System	Mesa	5	1,916,092	12/02/84
Town of Wellington	Wellington Water Supply System	Larimer	1	1,140,000	12/19/84
North Poudre Irrigation Company	Fossil Creek Reservoir Dam Rehab.	Larimer	1	1,331,704	04/17/85
Paradox Valley Water Cons. District	Buckeye Res. Dam Rehabilitation	Montrose	4	100,000	08/15/85
City of Louisville	Harper Lake Dam	Boulder	1	1,588,271	10/28/85
Larkspur Homeowners Association	Larkspur Water System	Douglas	1	219,000	12/10/85
Town of Granby	Granby Water Supply System	Grand	5	405,000	12/17/85
Farmers Extension Ditch Company	Highland Lake Lateral	Weld	1	177,500	06/01/86
Town of Basalt	Basalt Water Supply Storage Tank	Eagle	5	221,107	07/01/86
Handy Ditch Company	Hertha Reservoir Dam Enlargement	Larimer	1	363,450	07/01/86
Farmers Extension Ditch Company	Highland Lake Lateral 3	Weld	1	177,500	08/18/86
Farmers Extension Ditch Company	Highland Lake Lateral 5	Weld	1	230,000	09/01/86
Beaver Park Water, Inc.	Irrig. Syst., Pipeline, & Ditch Lining (4)	Fremont	2	125,000	03/01/87
North Poudre Irrigation Company	North Poudre Dam #15 Rehabilitation	Larimer	1	1,152,908	05/11/87
Farmers Extension Ditch Company	Highland Lake Lateral 6	Weld	1	300,000	01/06/88
Stewart Ditch and Reservoir Co.	Stewart Ditch	Delta	4	157,133	01/29/88
Paradox Valley Water Cons. District	Buckeye Reservoir	Montrose	4	150,000	03/24/88
Grandview Irrigation Ditch Company	Grandview Siphon	Fremont	2	195,279	09/22/88
Overland Ditch Company	Overland Res. Dam Rehabilitation	Delta	4	850,000	11/30/88
San Luis Valley Irrigation District	Rio Grande Res. Dam Outlet Rehab.	Hinsdale	3	526,087	12/07/88
Grand Valley Water Users	Repurchase of USBR Loan	Mesa	5	100,000	12/31/88
Dolores Water Conservancy District	Cortez Water Supply Pipeline	Montezuma	7	1,244,142	01/03/89
Uncompahgre Valley WUA	Repurchase of USBR Loan	Delta/Mont.	4	2,060,805	05/01/89
Overland Ditch and Reservoir Co.	Repurchase of USBR Loan	Delta	4	541,947	06/01/89
North Poudre Irrigation Company	Repurchase of USBR Loan	Larimer	1	164,321	06/05/89
Fuchs Ranches	Fuchs Dam Spillway	Rio Grande	3	59,120	07/28/89
Orchard Mesa Irrigation Company	Repurchase of USBR Loan	Mesa	5	762,771	08/01/89
City of Ft. Collins	Repurchase of USBR Loan	Larimer	1	2,425,343	09/01/89
Orchard City Irrigation Company	Repurchase of USBR Loan	Delta	4	48,935	09/01/89
Ish Reservoir Company	Ish Dam Repairs	Boulder	1	17,000	11/15/89
Farmers Extension Ditch Company	Highland Lake Lateral 7	Weld	1	350,000	12/06/89
Summit Reservoir and Irrigation Co.	Summit Dam Repairs	Montezuma	7	26,383	03/14/90
North Poudre Irrigation Company	Clark Lake Dam Rehabilitation	Larimer	1	404,502	05/17/90
Beaver Park Water, Inc.	Irrigation System & Ditch Lining (5)	Fremont	2	125,000	07/09/90
City of Grand Junction	Juniata Pipeline	Mesa	4	195,930	08/25/90
Upper Yampa Water Cons. District	Stagecoach Reservoir Dam	Routt	6	7,900,000	09/19/90
Highline-Buzzard Ditch Company	Irrigation Pipeline	Mesa	5	65,000	11/16/90
Michigan River Conservancy District	Meadow Creek Dam	Jackson	6	1,103,200	02/21/91
Santa Maria Reservoir Company	Continental Reservoir Rehabilitation	Hinsdale	3	96,500	04/06/91
Santa Maria Reservoir Company	Santa Maria Reservoir Rehabilitation	Mineral	3	357,500	04/06/91
Bauer Lake Water Company	Bauer Res. No. 1 Dam Improvements	Montezuma	7	80,851	05/06/91
Lone Cabin Ditch and Reservoir Co.	Lone Cabin Reservoir Dam Repair	Delta	4	92,700	06/24/91
Windsor Reservoir Company	Douglas Dam Spillway and Repairs	Larimer	1	752,000	06/25/91
Town of Morrison	Morrison Consolidated Ditch	Jefferson	1	80,000	07/10/91
City of Greeley	Comanche Dam Rehabilitation	Larimer	1	1,100,000	10/15/91
Farmers Water Development Co.	Gurley Dam Repairs	San Miguel	4	828,401	11/07/91
Fruitland Irrigation Company	Onion Valley Dam Repairs	Delta/Mt/Gu	4	168,549	12/03/91
Coon Creek Reservoir & Ditch Co.	Coon Creek Res. No. 1 & 2 Dam Repairs	Mesa	5	55,000	04/09/92
Handy Ditch Company	Handy (Welch) Reservoir Dam Repairs	Larimer	1	304,000	05/01/92
North Poudre Irrigation Company	North Poudre Dam #2 Rehabilitation	Larimer	1	340,551	05/08/92
City of Longmont	McCall Lake Spillway and Repairs	Boulder	1	214,454	05/12/92
Lookout Mountain Water District	Upper Beaver Brook No. 3A Res. Enlarg.	Clear Creek	1	600,000	07/18/92
City of Greeley	Barnes Meadow Dam Spillway & Repairs	Larimer	1	313,424	09/18/92
Colorado Water Conservation Board	Union Avenue Boat Chute	Arapahoe	1	1,328,000	05/21/93

Borrower	Project Name	County	Div	Amount Loaned	Date Completed
Sanchez Ditch and Reservoir Co.	Sanchez Dam Repairs, Phase 1	Costilla	3	200,000	07/01/93
Clinton Ditch & Reservoir Company	Clinton Reservoir (Municipal Portion)	Summit	5	615,000	08/13/93
Clinton Ditch & Reservoir Company	Clinton Reservoir (Ski Area Note)	Summit	5	4,120,000	08/13/93
Conejos Water Conservancy District	Platoro Reservoir Purchase	Conejos	3	450,000	10/01/93
Sedgewick Sands Draw WCD	Phase II & III Flood Control Project	Sedgwick	1	130,027	11/01/93
Elmwood Lateral Ditch Company	Elmwood Lateral Ditch Rehabilitation	Mesa	5	80,000	09/01/94
Trinchera Irrigation Company	Mountain Home Reservoir Rehabilitation	Costilla	3	611,478	09/15/94
Summit Reservoir and Ditch Co.	Summit Reservoir Dam and Ditch Repair	Montezuma	7	33,000	11/01/94
Windsor Reservoir and Canal Co.	Poudre Valley Canal Slide Repair	Larimer	1	300,000	12/01/94
Town of Rangely	Rangely Raw Water Intake Rehab.	Rio Blanco	6	34,000	01/10/95
Town of Monument	Monument Well No. 2 Replacement	El Paso	2	94,000	02/01/95
Terrace Irrigation Company	Alamosa Creek Canals and Laterals	Conejos	3	1,650,000	04/15/95
Town of Erie	Erie Flood Control Levee	Weld	1	498,512	05/01/95
New Cache La Poudre Irrig. Co.	Diversion Structure Replacement	Larimer	1	450,000	05/01/95
Loloff Lateral Ditch Company	Loloff Lateral Ditch Replacement	Weld	1	71,500	05/01/95
North Poudre Irrigation Company	North Poudre Res. 5 & 6 Rehabilitation	Larimer	1	1,761,096	06/01/95
Hay-Bretherton Ditch Company	Lower Hay-Bretherton Ditch Lining	Rio Blanco	6	20,000	06/01/95
Castle Pines North Metro District	Well A-3 Rehabilitation	Douglas	2	100,500	06/30/95
Kings Row Homeowners Association	Irrigation System Improvements	Eagle/Garf.	5	75,000	09/01/95
Military Park Reservoir Company	Military Park Reservoir Dam Rehab.	Delta	4	29,515	10/15/95
Lloyd Ranch Limited Partnership	Rapid Creek Dams No. 1 & 2 Rehab.	Mesa	5	100,000	11/01/95
Ute Water Conservancy District	Colorado River Pumping Station	Mesa	5	400,000	11/01/95
Caryl Carroll	DD&E Wise Dam Rehabilitation	Rio Blanco	6	50,000	11/01/95
Town of Silt	Raw Water Irrigation System	Garfield	5	400,000	11/01/95
Divide Canal and Reservoir Company	Worster Dam Rehabilitation	Larimer	1	665,000	06/15/96
Appleton ML 350 Ditch Co., Inc.	Ditch Rehabilitation	Mesa	5	53,000	06/18/96
Town of Erie	NCWCD Southern Pipeline & Conn.	Weld	1	1,544,000	06/01/96
Rainbow Park Water Company	Rainbow Park Ditch Rehabilitation	Fremont	2	64,919	06/01/96
South Platte Ditch Company	Diversion Structure Rehabilitation	Logan	1	100,000	06/01/96
Colo. River Water Conservation Dist.	Wolford Mountain Reservoir	Grand	5	16,256,000	06/01/96
Morgan County Quality Water District	Hay Gulch Well Field Purchase	Weld	1	3,000,000	07/09/96
City of Greeley	Peterson Lake Dam Rehabilitation	Larimer	1	644,236	09/01/96
Tremont Mutual Ditch Company	Diversion Structure Rehabilitation	Morgan	1	45,000	09/01/96
Lower Arkansas Water Mgt. Assoc.	Well Augmentation Feasibility Study	Prowers	2	65,000	10/24/96
Castle Pines North Metro District	Rehabilitate Three 2,200 foot Wells	Douglas	1	255,804	12/01/96
City of Fort Lupton	NCWCD Southern Pipeline	Weld	1	4,233,000	01/01/97
City of Greeley	Hourglass Reservoir Rehabilitation	Larimer	1	206,351	01/01/97
Town of Hudson	NCWCD Southern Pipeline	Weld	1	1,273,000	01/01/97
City of Ft. Morgan	NCWCD Southern Pipeline	Weld	1	5,500,000	01/01/97
Town of Norwood	Norwood Raw Water Reservoir	San Miguel	4	950,000	01/01/97
West Divide Water Cons. District	Alsbury Dam Rehabilitation	Mesa	5	70,000	01/01/97
Bravo Ditch Company	Diversion Structure Rehabilitation	Logan	1	39,099	03/01/97
Consolidated Extension Canal Co.	Purgatoire River Siphon Rehabilitation	Bent	2	229,431	03/10/97
Orchard Mesa Irrigation District	Mutual Mesa Ditch Lateral Rehab.	Mesa	5	861,827	05/01/97
Vouga Reservoir Association	Vouga Reservoir Dam Rehabilitation	Saguache	4	600,000	05/08/97
Lower Arkansas Water Mgt. Assoc.	X-Y Ranch and Water/Manvel Shares	Prowers	2	3,688,368	05/28/97
Julesburg Irrigation District	Julesburg Res. Dam No. 4 Rehab.	Sedgwick	1	325,000	06/01/97
Town of Ignacio	Ignacio Outside Irrigation System	La Plata	7	180,000	06/01/97
Beaver Park Water Company	Brush Hollow Dam Rehabilitation	Fremont	2	975,000	06/30/97
TOTAL	159 Project Loans			$118,736,452	

Appendix C

STATE OF COLORADO

OFFICE OF THE EXECUTIVE DIRECTOR
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DEPARTMENT OF NATURAL RESOURCES

Roy Romer
Governor

Wade Buchanan
Executive Director

Ron Cattany
Deputy Director

September 25, 1998

Legislative Audit Committee

Dear Committee Members:

The Department of Natural Resources has reviewed the eighteen recommendations contained in the performance audit of the Colorado Water Conservation Board Construction Fund Loan Program. As you can see by the responses, the department agrees with all of the recommendations.

It is the intent of the department to consider the implementation of these recommendations very seriously. To that end, we will be pursuing two specific activities over the next several months.

First, we will review these recommendations in detail with the Colorado Water Conservation Board. Several of these recommendations relate to the clarity and intent of some of the policies of the Board. We feel it is important to discuss these recommendations with the Board and obtain their specific comments on how to address these concerns. Their responses will be useful in our implementation of these recommendations.

Second, it is our intent to review a variety of organizational structure options to administer this fund. The fundamental issue, which this audit has helped us understand, is that the Construction Fund Loan Program has grown considerably in recent years. While this is a measure of the program's success, it also may be appropriate to adjust our structure and procedures to keep up with this growth. I am in contact with the leadership of the Colorado Housing Finance Authority and other state programs that administer loan programs of this size and complexity to learn from them their administrative procedures and organizational structures. The information obtained in that review will also assist us in the implementation of these recommendations.

To that end, we have also reserved a decision item in the budget that the department has already submitted to the Governor's Office to address some of these implementation issues. Should our discussions with other state agencies result in proposed staffing changes that exceed our current staffing capabilities, we will translate those needs into a decision item. In addition, the agency will move forward this fall to hire a financial officer who will be involved with this and other activities within the Water Conservation Board. This will be accomplished by reprogramming an existing position.

As you can see, it is our intent to address the issues of this audit in both a short term and long term context. The short-term actions include the hiring of a fiscal officer, reviewing the recommendations with the board, and discussing organizational structure options with other relevant state programs. The long-term actions will be to implement an administrative structure that works for a program of this size and to pursue any relevant decision items necessary to further implement the recommendations contained in this audit. Our timeframe for these actions is this fiscal year, which will accommodate the every-other-month Board meeting schedule, the legislative session and the budget cycle.

Thank you very much for your accommodation of our timeframes as we attempt to address in a serious and compressive fashion the recommendations contained in this audit.

Sincerely,

Wade Buchanan

Wade Buchanan
Acting Executive Director

cc: Ron Cattany
Peter Evans
Patty Wells

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