



**REPORT OF**

**THE**

**STATE AUDITOR**

**Evaluation of Actions Taken on the  
1998 Colorado Water Conservation Board  
Construction Fund Loan Program Audit**

**As of December 1999**

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December 31, 1999

Members of the Legislative Audit Committee:

This report presents the results of our evaluation of the actions taken by the Colorado Water Conservation Board in response to our September 1998 performance audit of the Construction Fund Loan Program. The performance audit contained 18 recommendations, which are summarized in the Recommendation Locator. This report contains the original audit recommendations and agency responses, identifies actions taken to date by the Board, and communicates our evaluation of the Board's progress.

*J. David Barba*

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## RECOMMENDATION LOCATOR

### Office of the State Auditor's Evaluation of Actions Taken

### Recommendation Summary (From September 1998 Audit)

Rec. Page  
No. No.

1 3 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. In progress

2 5 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. In progress

3 8 Require applicants to provide evidence that they have explored alternative funding sources prior to approving the use of Construction Fund monies. In progress

4 9 Ensure projects receiving funding through the Program clearly adhere to the funding priorities now established by statute or seek statutory changes. In progress

5 11 Establish reasonable time limits for sponsors to expend project funding. In progress

6 13 Improve methods for ensuring the feasibility of a project prior to loan approval. Implemented

7 15 Identify all feasibility study loans made before 1993, determine their status, and initiate repayment processes if appropriate. In progress

8 17 Develop and implement a systematic method for quantifying and weighing the relative creditworthiness and financial need of potential loan recipients. In progress

## RECOMMENDATION LOCATOR

### Office of the State Auditor's Evaluation of Actions Taken

### Recommendation Summary (From September 1998 Audit)

Rec. Page  
No. No.

9	18	Ensure collateral for loans adequately protects the State's interests in the event of a borrower's default on its loan obligation.	In progress
10	20	Ensure that all security documents are filed in a timely manner, and develop reliable systems to monitor compliance with filing requirements.	In progress
11	21	Ensure that borrowers comply with requirements to carry general liability insurance.	In progress
12	23	Establish a process for reviewing each loan file prior to disbursing funds and periodically thereafter.	In progress
13	24	Improve procedures for maintaining loan records including developing a consistent, centralized filing system.	In progress
14	25	Ensure that borrowers receive bills that are timely and accurate.	In progress
15	27	Formally adopt policies and procedures for handling loan collection problems.	In progress
16	28	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.	In progress
17	30	Work with the Department of Natural Resources' Accounting Section to improve accounting procedures and to strengthen internal controls.	In progress
18	31	Consider staffing changes and other alternatives to correct accounting deficiencies.	In progress

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## **Colorado Water Conservation Board Construction Fund Loan Program Performance Audit, September 1998**

### *Evaluation of Actions Taken by the Board As of December 1999*

In 1998 the Office of the State Auditor conducted a performance audit of the Colorado Water Conservation Board's (CWCB) Construction Fund Loan Program. The purpose of the audit was to evaluate various aspects of the Program, including funding, loan application and review processes, accounting, and recordkeeping activities.

The September 1998 audit report included 18 recommendations. Below is a summary of the report narrative, the recommendations, the CWCB's original responses, the CWCB's discussion of actions taken since the audit, and our evaluation of those actions. Because many of the actions taken by the Board in response to the audit occurred in the fall of 1999, most of our recommendations have not been fully implemented. Of the 18 recommendations, 1 is implemented, and the remaining 17 are in progress. The Board has, however, made some notable progress in a couple of areas. For example, in Fiscal Year 2000 the Board received some additional funding to hire an accountant and a contract compliance officer. These additional staff should help the Board correct certain accounting and administrative deficiencies that were noted in the report. The Board also adopted several new policies in October 1999 in response to some of the issues brought forth by the audit report. The following sections provide more detailed information about the status of each individual recommendation.

### **Establish Goals and Objectives for the Program**

In the 1998 audit we identified a number of problems with how the Construction Fund Loan Program was managed and operated. Improvements were needed in loan processing, fiscal management, performance measurement, accounting, statutory compliance, contracting, and recordkeeping. We concluded that in order to improve program management, it was crucial for the Board to develop and report on the achievement of goals, objectives, and performance indicators for its day-to-day operations.

### **Recommendation No. 1 (September 1998):**

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's Report Response (September 1998):**

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.

**Implementation Date:** July 1999.

### **Water Conservation Board's Update (October 1999):**

*In progress.* The Construction Fund Program goals and objectives are outlined in the CWCB Long Range Plan that is revised periodically. The Program has developed a mission statement and individual performance objectives for each employee that follow the overall goals of the Program and are in line with the Colorado Peak Performance Program objectives. The CWCB staff delivers progress reports of program improvements at every CWCB Board meeting and regularly to the Colorado Water Congress and the Colorado Water Resource and Power Development Authority.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* We noted that the Board has recently made some progress in establishing shorter-term performance objectives for the Construction Loan Program. In its Fiscal Year 2001 budget request, for example, the Board reported on several new performance measures of a process-related nature (e.g., number of feasibility studies completed and reviewed, number of loan applications received and reviewed, and number of loans approved). Although formulating and reporting on these measures represents progress toward implementing the audit recommendation, further improvements are still possible. For example, the Board has not created any goals or objectives to illustrate its performance in certain business-related areas which are fundamental to the overall success of the Program

(e.g., number of loan payments received on time, number of requests for payment processed within a given time frame, percentage of loans in compliance with the Board's insurance requirements). The Board should consider adding performance measures such as these so that the General Assembly and other interested parties have a more comprehensive picture of how well the Program is operating on a day-to-day basis.

The Board has established mechanisms to monitor and report on the implementation of procedures intended to improve the Program. To date, however, the Board has monitored and reported only on the status of the 1998 audit recommendations. Although actions taken in response to the audit recommendations are intended to improve the operations of the Program, it is unknown whether the Board will continue its efforts to monitor and report on improvements related to the Program after the audit process is finished.

*Report to  
CWB at  
their bi-monthly  
meetings.*

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## Improve Methods for Estimating Fund Receipts and Disbursements

In the 1998 audit we found that a large cash balance existed in the Construction Fund during Fiscal Years 1994 to 1998. The average cash balance during this time was \$91.5 million. On the basis of several assumptions, we estimated that the Program could reasonably operate with a cash balance of about \$39 million. We concluded that the Board should consider either increasing its rate of disbursements or work with the General Assembly to use excess money in the Fund for other worthy pursuits.

In an effort to manage the cash balance in the Fund, the Board attempted to estimate the Fund's future cash balance, receipts, and disbursements over a ten-year period (Fiscal Years 1997 to 2006). Staff projected that the Fund's cash balance would be about \$8 million by Fiscal Year 2006. However, we found that some of the assumptions used by staff in conducting this projection were not accurate, resulting in an unrealistically low ending balance in Fiscal Year 2006. For example, the Board's revenue projection did not include severance tax monies. Using what we considered to be more realistic assumptions, we estimated that the cash balance would be \$148 million in Fiscal Year 2006, \$140 million more than the Board's projection. Further, we found that the Board had not adopted a formal marketing plan for the Program, which made it difficult to judge demand for construction funds.

### Recommendation No. 2 (September 1998):

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's Report Response (September 1998):**

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 House Bill 98-1288 (the proposed Water Resources Act of 1988, which was postponed indefinitely, but is expected back next session). The proponents of House Bill 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.

**Implementation Date:** January 1999.

### **Water Conservation Board's Update (October 1999):**

*In progress.* A revised Long-Term Financial Projection Model has been developed by Andersen Consulting that will be reviewed by the CWCB Board at its January 2000 Board meeting. The CWCB staff will convene regional water supply planning meetings during late 1999 and early 2000 to determine future water project needs. Information developed from these meetings will be used to determine the required cash balance of the Construction Fund.

## Office of the State Auditor's Evaluation of Actions Taken (December 1999):

*In progress.* In response to our audit recommendation, the CWCB developed a new financial projection model that allows the Board to modify the assumptions used to estimate the Construction Fund's future cash balances, receipts, and disbursements. We reviewed the model and found the following:

- **Severance Tax Receipts.** The CWCB has improved its financial projection model by including severance tax receipts in the calculation.
- **Interest Receipts.** The financial projection currently uses a 6 percent return rate, which is more reflective of actual returns on monies deposited at the State Treasury. Further, the model allows the interest rate to be modified as needed to reflect changing conditions.
- **Disbursements.** In the 1998 audit we found that the CWCB was using large plug figures to estimate disbursements from the Fund. In its latest projections, the Board has decreased the overall amount of plug figures from over \$41 million to \$1.5 million (for unspecified feasibility studies).

Finally, we found that although the CWCB has taken steps to determine the future demand for the Program and includes this information in its financial projections, the Board has not assessed the effectiveness of its marketing efforts. The Board should pursue such an evaluation to ensure it is doing all that is possible to market the Program.

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## Require Evidence That Other Financing Options Were Explored

According to statutes, project sponsors are required to explore all other means of financing before Fund monies can be used for a project. In our 1998 audit we found instances where the Board approved and sought legislative authorization for projects that did not need state financing. Specifically, we reviewed applications and feasibility studies for nine projects that were approved by the Board and later deauthorized because the projects were built using other funding. The applications for five of these projects identified other possible funding sources, but were approved anyway. In addition, applications for two of the nine projects indicated that no other funding sources had been explored, even though it is a statutory requirement.

### **Recommendation No. 3 (September 1998):**

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's Report Response (September 1998):**

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* [Section 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.

**Implementation Date:** August 1998.

#### **Water Conservation Board's Update (October 1999):**

*Implemented.* The CWCB has added to its Construction Fund loan application form the requirement that applicants provide evidence they have explored alternative funding sources.

#### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* In its loan application, the CWCB asks applicants to provide a "brief description" of other financing sources that have been or will be explored. This requirement, however, was in place at the time of the audit. To determine whether loan applicants are doing a better job of complying with the requirement since the audit, we reviewed nine applications submitted to the CWCB between June 1998 and September 1999. We found a number of problems with the responses provided by applicants, including missing or vague information and a general lack of documentation to substantiate the applicants' claims. We

identified only one application that provided a contact name at a bank where a loan had been sought but denied. Even though information was generally inadequate, seven of the nine applications were approved by the CWCB and authorized by the General Assembly. The two remaining applications were received recently and had not yet gone through the approval process.

The Board did establish an additional requirement in October 1999 which asks applicants to provide a "summary of the results of applications to all other lenders to which the project sponsor has applied for funding of the proposed project." This requirement could not be tested, however, because of its relative newness.

Overall, we believe that the Board needs to do more to ensure adherence to its application requirements. Simply instituting policies will not ensure compliance. The Board should consider the following: providing more guidance to applicants about its loan application requirements, rejecting incomplete applications and/or feasibility studies, and providing more training to the staff who review loan applications.

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## **Ensure Projects Adhere to Statutory Funding Priorities**

Statutes mandate the order in which monies from the Construction Fund should be spent. Specifically, the first priority goes to projects that will increase the beneficial consumptive use of Colorado's undeveloped, compact-entitled waters. The remaining funds should be applied toward projects that 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. In our 1998 audit we found a number of projects that were funded under the Program that did not appear to be consistent with these statutory priorities. For example, we found that the Board approved nine loans totaling \$9 million to refinance existing loans from the United States Bureau of Land Reclamation. We questioned whether these loans increased the beneficial consumptive use of Colorado's undeveloped waters or met any of the other statutory funding priorities.

### **Recommendation No. 4 (September 1998):**

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's Report Response (September 1998):**

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 [Section 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).

**Implementation Date:** February 1999.

## **Water Conservation Board's Update (October 1999):**

*In progress.* The Board has received advice from the Attorney General's Office (AGO) that the Board is acting lawfully in recommending Construction Fund loans to the Legislature for the purchase of water rights. Another follow-up opinion from the AGO is forthcoming regarding whether the Board is adhering to the funding priorities established by statute.

## Office of the State Auditor's Evaluation of Actions Taken (December 1999):

*In progress.* In August 1999 the Board received an Attorney General's opinion related to loans authorized for the purchase of water rights or existing wells. The Attorney General concluded that "the CWCB acted lawfully in making those loans." While perhaps "lawful," loans made for the purchase of water rights and/or existing wells do not *clearly* fit the statutory criterion of "increasing the beneficial use of Colorado's undeveloped water resources," neither do they *clearly* meet the other statutory spending priorities.

The Board has a responsibility to demonstrate that the loans it authorizes meet statutory intent. The Board needs to improve its documentation methods so that it can clearly show that loans of this type do indeed meet statutory intent and/or seek statutory changes that specifically authorize the use of funds for such purposes. Further, we still question the appropriateness of the Board's decision to authorize loans for the purpose of refinancing existing loans made by the United States Bureau of Land Reclamation. Again, it is incumbent upon the Board to prove that refinancing an existing loan furthers the attainment of existing statutory goals, or the Board should seek statutory changes that specifically allow this practice.

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## Establish Time Limits for Use of Construction Fund Monies

Once a project loan is approved through the Program, monies in the Fund are earmarked for the project and, therefore, are not available to finance other projects. If an authorized project is not pursued, the Board and/or the General Assembly will deauthorize the funds, which allows the money to be used for other projects. In the 1998 audit we found the Board did not always seek these deauthorizations in a timely manner. We also found this to be the case for completed projects with residual funds. For example, we identified about \$181,000 in leftover funds that were still authorized for projects that had been completed for some time. We also found that although the Board had established time limits requiring construction to be completed within two years of the signing of a contract, there was no time limit for starting construction in regard to the date of the project's approval.

## Recommendation No. 5 (September 1998):

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's Report Response (September 1998):**

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 the Department's 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.

**Implementation Date:** February 1999.

### **Water Conservation Board's Update (October 1999):**

*Implemented.* The CWCB Board adopted a policy titled *Construction Fund and Severance Tax Perpetual Base Account Project Time Limits* at its September 27, 1999, Board meeting that addresses the auditor's project time limit concerns and recommendations. Residual funds from completed projects are returned to the Construction Fund via funding contract amendments.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* In response to our audit, the CWCB created a policy that establishes time limits for project sponsors to use monies authorized from the Construction Fund. Under the policy the Board must review the status of all projects with contracts that have not been fully

executed within three years of the project's approval. At that time the Board may seek deauthorization for idle monies in the next annual construction fund bill unless the Board specifically approves a time extension. Although the new policy is a good start, we noted that it needs to be more comprehensive. Specifically, the policy addresses only those situations where absolutely no action has been taken on a project and is silent in regard to other situations that might also call for a deauthorization of funds (e.g., cases of completed projects with residual funding).

Because the policy became effective only on October 1, 1999, we were unable to test its use or effectiveness in every type of situation that might call for a deauthorization of project funds (e.g., cases where project funds remained idle for several years). However, we did review the Board's actions in regard to 14 projects that were finished between June 1998 and June 1999. Five of these projects had residual funding totaling nearly \$820,000. In each of these five cases, residual funding was unencumbered through a contract amendment reducing the final amount due. Thus, even though the new policy does not specifically address residuals, it appears that the Board is making efforts to ensure these situations are dealt with appropriately.

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## **Ensure Feasibility of Projects Prior to Loan Approval**

When an entity applies for a project loan, it must submit an application and conduct a feasibility study. Feasibility studies must be prepared in sufficient detail to allow the Board to make an informed decision about whether or not to fund a particular project. During the 1998 audit we found the Board approved many projects before a feasibility study was completed. Of the 54 project loans approved from March 1995 to January 1998, about 76 percent (i.e., 41 loans) did not have a completed feasibility study at the time they were approved. In addition, there were four cases in which a project feasibility study was completed after or during the same month that the project itself was completed. We also found that some completed feasibility studies did not contain key data on the applicant's ability to repay the loan.

### **Recommendation No. 6 (September 1998):**

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's Report Response (September 1998):**

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 all 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.

**Implementation Date:** Immediately.

### **Water Conservation Board's Update (October 1999):**

*Implemented.* The CWCB Board adopted a policy titled *Procedure for Ensuring the Completion and Approval of Adequate Construction Fund Project Feasibility Studies Prior to Contracting and Disbursement of Loan Funds* at its September 27, 1999, Board meeting that addresses the auditor's project feasibility study concerns and recommendations.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*Implemented.* In response to our audit, the CWCB developed a policy that requires a feasibility study to be completed prior to a loan's consideration by the Board. In cases where it is impractical to complete the study prior to Board approval and/or General Assembly authorization, the policy allows the Board to consider conditional approval—that is, approval contingent upon the completion of the feasibility study by a specified date. To ensure the feasibility studies contain sufficient information for the Board to assess the project's benefit and the applicant's ability to pay its loan obligations, the policy requires the studies be prepared following the Board's Construction Fund Guidelines. This policy became effective October 1, 1999.

Although the policy was not effective until October 1999, we reviewed the eight projects authorized by the General Assembly in Fiscal Year 1999 to determine if the Board had discontinued its practice of authorizing projects before a completed feasibility study was received. We found that seven of the eight projects did have a completed feasibility study before authorization. The remaining project's authorization was contingent upon the completion of the feasibility study. We also found that in all cases project sponsors provided the information required by the Guidelines and that this information was sufficient to assess the project's benefit and the applicant's ability to pay its loan obligations.

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## **Identify and Begin Collection of Payable Feasibility Study Loans**

In order to encourage entities to undertake water projects, the Board sometimes loans entities money for the purpose of conducting a feasibility study. Prior to 1993, contracts required entities that received feasibility study loans to pay them back if the project was started within ten years. If the project did not begin within the ten years, repayment was not required. At the time of the 1998 audit, we identified seven cases where the Board had no information about whether feasibility study loan recipients had started their projects and an eighth case where repayment of a \$42,000 feasibility study loan should have begun in 1996, but no payments had ever been requested or received.

### **Recommendation No. 7 (September 1998):**

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's Report Response (September 1998):**

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 are 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.

**Implementation Date:** June 1999.

### **Water Conservation Board's Update (October 1999):**

*Implemented.* The CWCB staff has identified 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. All borrowers with these loan types have been contacted and the loans have either been reverted to a grant or rolled into a construction loan, depending on the status of project construction.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* The CWCB reports that it reviewed all existing contracts to identify feasibility study loans containing the ten-year clause. In addition to the eight loans we identified in 1998, the Board identified six additional loans that had not been rolled into a construction loan or had not been written off due to the expiration of the ten-year period. The following table identifies the current status of the 14 loans.

<b>Status of Feasibility Study Loans With Ten-Year Clause</b>	
<b>Status</b>	<b>Number of Loans</b>
Ten-year period expired with no construction (i.e., loan repayment not required – loan written off)	4
Contract has not yet expired	3
In repayment or seeking repayment	2
Pending final review by CWCB to determine if project was constructed	5
<b>Total</b>	<b>14</b>
<b>Source:</b> Office of the State Auditor review of the Colorado Water Conservation Board's loan files.	

The Board should prioritize the loans pending final review and, if appropriate, initiate the repayment process as soon as possible.

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## **Quantify and Weigh Creditworthiness and Financial Need of Potential Loan Recipients**

Statutes specify that the Board participate in only those projects where the sponsor can repay its investment. Grants are not allowed unless specifically authorized by the General Assembly. As a result, before authorizing a loan the Board has a duty to find a way to systematically balance a potential borrower's financing needs and options with its creditworthiness. During the audit we found that the Board's lending policy focused primarily upon determining the borrower's need and its ability to access other forms of funding instead of rating creditworthiness or other measures of loan risk. We concluded that the Board needed to implement a systematic methodology for assessing risk to help reduce the possibility of delinquent and/or defaulted loans.

### **Recommendation No. 8 (September 1998):**

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's Report Response (September 1998):**

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.

**Implementation Date:** January 2000.

### **Water Conservation Board's Update (October 1999):**

*Implemented.* The CWCB Board adopted a policy titled *Construction Fund and Severance Tax Perpetual Base Account Borrower Creditworthiness and Financial Need Determinations*

at its September 27, 1999, Board meeting that addresses the auditor's creditworthiness and financial need concerns and recommendations.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* The CWCB has developed a method for evaluating the creditworthiness and financial need of potential loan recipients. This policy requires that applicants submit specific financial information, such as financial statements and the results of applications to other lenders, with their applications. In addition, CWCB has developed a rating system that it will use as a guideline to determine creditworthiness. The rating system assesses a variety of factors, including the ratio of operating revenues and expenses.

The policy became effective October 1, 1999, and appears to address our recommendation. Because of the policy's newness, however, we could not fully assess its use or effectiveness. We did find, however, that at least one aspect of the policy is not being followed. As was mentioned in Recommendation No. 3, we found that applications do not contain sufficient documentation that other financing sources have been explored. Simply instituting a new policy does not ensure compliance. The Board needs to take actions to ensure that its policies are being followed (e.g., providing training to staff, rejecting incomplete applications).

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### **Protect the State's Interests by Obtaining Sufficient Collateral**

At the time of the 1998 audit, we found the Board's collateral policies and practices allowed for a great deal of discretion when making decisions regarding the collateral required to secure a particular project loan. For example, policy and practice allowed the Board to accept anything from a certificate of deposit for one loan payment to a deed of trust for the project itself. When we reviewed 28 loans for projects completed in Fiscal Years 1997 and 1998, we found a great deal of variation in the types of collateral pledged for loans. We could not determine if the variation was reflective of differences in the relative creditworthiness of the borrowers or was the result of some other factor(s).

### **Recommendation No. 9 (September 1998):**

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's Report Response (September 1998):**

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.

**Implementation Date:** June 1999.

### **Water Conservation Board's Update (October 1999):**

*Implemented.* The CWCB Board adopted a policy titled *Collateral for Construction Fund and Severance Tax Perpetual Base Account Project Loans* at its September 27, 1999, Board meeting that addresses the auditor's project collateral concerns and recommendations.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* The CWCB developed a collateral policy that is based on the type of entity applying for project funding as well as the entity's creditworthiness, repayment capacity, and available assets. This policy became effective October 1, 1999. Our review of the policy found that it is comprehensive and appears to address our recommendation. However, because the policy had been implemented only recently, we were unable to evaluate its use or effectiveness.

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## **Ensure Security Documents Are Filed in a Timely Manner**

Board staff are required to file deeds of trust and security agreements (i.e., UCC-1 statements) when a borrower pledges certain types of collateral for repayment of a loan. The purpose of filing these documents is to provide public notice that a borrower has pledged its property as collateral. At the time of the 1998 audit we found the Board did not have a perfected security interest in collateral for loans totaling almost \$12 million. More specifically, when we reviewed 68 contracts, we found there



were 19 cases (28 percent) where a deed had never been filed, even though it was required. In addition, we found that a majority of the deeds were not filed within the Board's standard time frame of ten days from contract execution.

### **Recommendation No. 10 (September 1998):**

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's Report Response (September 1998):**

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, 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 Department submitting a decision item to add this staff capability.

**Implementation Date:** June 1999.

### **Water Conservation Board's Update (October 1999):**

*In progress.* Draft procedures have been developed to assure that all security instruments associated with Construction Fund loans are recorded in a timely manner. These procedures are currently being tested and should be implemented by January 1, 2000. All active loan files have been reviewed relative to collateral and all security instruments are being updated, filed, or re-negotiated.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* Effective September 1, 1999, the CWCB instituted procedures aimed at ensuring that all security instruments are prepared and recorded in a timely manner. Staff are provided with step-by-step procedures on how to submit a deed of trust to the appropriate county clerk for recording and how to amend a recorded deed of trust to reflect changes made in the contract. Instructions are also provided on how to prepare and file the appropriate UCC-1 documents with the Secretary of State.

One problem with the new procedure is that it does not provide specific guidance to staff in regard to what is considered a "timely" filing (ten days from contract execution was the informal deadline used at the time of the original audit). The Board should consider setting formal standards in this area so that staff can easily demonstrate they have met the Board's expectations. The informal ten-day deadline is probably appropriate, since a review of five recent loan files showed that the majority of security documents are filed within this time frame.

We also noted that through a recent file review, the Board identified 21 deeds of trust that still need to be prepared and recorded. Attending to these cases should be a priority for staff.

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### **Ensure Borrowers Comply With General Liability Insurance Requirements**

The CWCB requires that borrowers maintain general liability insurance from the time of contract execution until their loan is repaid. In addition, for contracts dated 1995 and after, the State must be named as an additional insured on any insurance policy. To comply with insurance requirements, borrowers must provide the Board with a certificate of insurance (including an additional insured endorsement) and documentation of policy renewal as needed throughout the life of the loan. For the 1998 audit, we reviewed the CWCB's 154 active loans and found that in 41 cases (27 percent) there was no evidence that the borrower had obtained the required liability insurance.

### **Recommendation No. 11 (September 1998):**

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's Report Response (September 1998):**

Agree. CWCB staff, in cooperation with the Department of Natural Resources, is in the process of reviewing the structure of similar programs at other public agencies 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.

**Implementation Date:** June 1999.

### **Water Conservation Board's Update (October 1999):**

*In progress.* Draft procedures have been developed to ensure that all borrowers comply with general liability insurance requirements. These procedures are currently being tested and should be implemented by January 1, 2000. All active loans have been reviewed relative to insurance requirements, resulting in a current 92 percent compliance rate. It has also been determined that 66 percent of the borrowers without specific contractual insurance requirements are currently fully insured.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* The CWCB has developed a procedure for handling general liability insurance requirements. The purpose of this procedure is to ensure that all construction loan borrowers maintain general liability insurance in accordance with the terms of the loan contracts. Under the procedure, when a contract is completed, the staff verify receipt of the insurance certificate and additional insured endorsement, and follow up on any information that is not received. This information is entered into the Construction Fund Database, and monthly reports are prepared to show which insurance policies are expiring so that the borrower and/or insurance agent can be notified.

The CWCB also provided us with a report that shows all loan contracts, their insurance requirements, and whether the requirements have been met. According to the report, the CWCB has received certificates of insurance for 132 of the 144 contracts with insurance requirements (92 percent). We also conducted our own review of nine files to determine their completeness with regard to documentation of general liability insurance. We found all nine files contained the appropriate documentation. Although compliance rates have improved, the Board should continue its efforts to obtain any missing documentation so that it can achieve a 100 percent compliance rate with its insurance requirements.

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## **Improve Loan Review and Recordkeeping Processes**

During our 1998 review of the Board's loan files we observed issues with the internal loan review process and recordkeeping. We found that many files were missing evidence that feasibility studies had been conducted or that sufficient liability insurance or collateral had been obtained. In addition, we found that the Board did not have a centralized filing system for its loan records. We observed that many of these problems could have been identified and corrected if the Board had an internal review process and better file maintenance procedures.

### **Recommendation No. 12 (September 1998):**

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's Report Response (September 1998):**

Agree. The Department of Natural Resources 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. These reviews will be completed by June 30, 1999.

**Implementation Date:** June 1999.

### **Water Conservation Board's Update (October 1999):**

*In progress.* Draft procedures have been developed to ensure that prior to disbursement of loan funds, the projects have completed and submitted all required documentation and met all other contingencies. The procedure includes convening a pre-construction meeting, after a loan contract is completed and prior to any loan disbursements, to verify that loan documentation and contingency requirements have been met. These procedures are currently being tested and should be implemented by January 1, 2000.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* In response to our audit, the CWCB initiated a new procedure for what it calls a "pre-construction meeting." The purpose of this meeting is to review the loan contract

once it has been completed and to verify that all loan and grant contract conditions have been satisfied prior to the disbursement of funds. The procedure specifies that the CWCB's contract administrator, contract compliance administrator, and accountant review several issues including any outstanding contract requirements and accounting issues. According to CWCB staff, these procedures are currently being tested and are due to be finalized by January 1, 2000. We also reviewed a sample of nine files and found that all nine showed evidence that a monitoring system is in place to ensure that required documents are present in the file. Although these procedures appear to address some of our concerns, we have not been able to evaluate their use or effectiveness fully, since they have not been formally implemented.

### **Recommendation No. 13 (September 1998):**

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

### **Water Conservation Board's Report Response (September 1998):**

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 have started populating the database and expect 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 Department 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 Department that have been approved by the Information Management Commission (IMC).

**Implementation Date:** June 1999.

### **Water Conservation Board's Update (October 1999):**

*In progress.* \$270,000 spending authority was provided to the CWCB by the Legislature in Senate Bill 99-173 for an electronic document imaging system for the Project Planning and Construction Section to be used in the documentation of Construction Fund files. The system hardware and software are currently being planned and designed and are scheduled for implementation in 2000. The CWCB staff have also developed the Construction Fund

Database that tracks every aspect of a project from application through repayment. The Database is continually being populated with historic and current project information.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* In response to our audit, the CWCB initiated two projects to help improve its procedures for maintaining loan records and to develop a consistent, centralized filing system. As mentioned previously, the CWCB developed the Construction Fund Database, which maintains and tracks various aspects of a project from application to repayment of the loan. We reviewed the information contained in the database and found it to be comprehensive. In addition, the CWCB plans to implement an electronic document imaging system that should improve its maintenance of loan records. According to CWCB staff, the system is currently in the design phase and is scheduled for implementation in 2000. Finally, we reviewed a sample of nine files to evaluate their organization and found that all nine were well-organized in a logical and efficient manner.

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### **Ensure Borrowers Receive Timely and Accurate Bills**

Project sponsors are obligated to begin payments on their loans one year after their projects are determined to be "substantially completed." Annual payments are due until each sponsor's loan is paid in full. In most cases this is for a period of 30 years but can range from 10 to 40 years. In our 1998 audit we identified weaknesses in the Board's billing procedures. Specifically, we found several instances where the Board sent borrowers bills that were either inaccurate or not timely.

### **Recommendation No. 14 (September 1998):**

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's Report Response (September 1998):**

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.

**Implementation date:** June 1999.

### **Water Conservation Board's Update (October 1999):**

*In progress.* Draft procedures have been developed to assure that borrowers receive billing statements that are timely and accurate. A review of all loan contracts was made to verify the payment due dates. All discrepancies of billing dates are currently being reconciled with the borrowers. The billing statement procedures are currently being tested and should be implemented by January 1, 2000.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* The Board's staff has started taking steps toward ensuring the accuracy and timeliness of bills sent to borrowers. We reviewed nine loan files and found evidence in seven of the files that showed bills were accurate and timely (i.e., payment histories). The remaining two files did not include this information, but this was expected, since the first payment on these loans had not yet come due.

We found that procedures have been established to provide borrowers with billing information such as payment due dates, loan amounts, payment allocation, and disbursements. The CWCB is currently in the process of reconciling any discrepancies between the Board's records and those of the borrowers with regard to payment due dates. Staff are using a spreadsheet to track the payment due dates for completed projects. Letters will then be sent to borrowers in October to verify the payment due dates as recorded by staff in this spreadsheet. Staff expect any discrepancies to be resolved by January 1, 2000.

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## **Adopt and Implement Policies to Handle Loan Collection Problems**

During the 1998 audit we found that about 35 percent of the annual loan payments required between Fiscal Year 1995 and 1998 were not received in a timely manner. These delinquent loan payments cost the State more than \$514,000 in lost interest revenue. We also identified a number of problems with how the Board handled late payments on loans. For example, the Board did not include a clause in contracts written prior to March 1998 that allowed it to impose late penalties or other sanctions against delinquent borrowers. We also found that no formal policies had been established detailing how staff monitor collections and, if necessary, how the Board could declare a loan a bad debt.

Improvements were also needed in the staff's communication with the Board regarding delinquent accounts.

### **Recommendation No. 15 (September 1998):**

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's Report Response (September 1998):**

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.

**Implementation date:** June 1999.

### **Water Conservation Board's Update (October 1999):**

*Implemented.* The CWCB Board adopted a policy titled *Construction Fund and Severance Tax Perpetual Base Account Loan Delinquency, Loan Restructuring and Collection* at its September 27, 1999, Board meeting that addresses the auditor's loan collections concerns and recommendations.



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### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* In response to our audit, the CWCB created a policy detailing how staff will identify, address, and report collections problems. It also includes criteria for declaring bad debts and referring these cases to the Central Collections and/or Attorney General's Office. This policy appears to address the concerns noted by the audit and was implemented October 1, 1999. Because this policy had been implemented only recently, however, we could not test its use or effectiveness.

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### **Improve Contract Development, Approval, and Amendment Processes**

During the 1998 audit we found the Board did not use standardized contracts with borrowers. This meant that unique contracts were created for each new loan, which required individual contracts to be reviewed and approved by both the Attorney General's Office and the State Controller's Office. We found that it took an average of two to eight months for a contract to be developed, reviewed, and approved. We also identified weaknesses in the Board's methods for ensuring that amendments and deauthorizations are processed in a timely manner.

### **Recommendation No. 16 (September 1998):**

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 Loan 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's Report Response (September 1998):**

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 No. 5.

**Implementation date:** June 1999.

### **Water Conservation Board's Update (October 1999):**

*In progress.* The CWCB staff continues to work with the Attorney General's Office, the State Controller's Office, and the Department's Accounting Section in the preparation of a standard construction fund loan contract. The two-phase contracting approach suggested by the auditor has been discounted by the above state agencies as too cumbersome and time consuming. The residual funds issue was addressed in our response to Recommendation No. 5.

### **Office of the State Auditor's Evaluation of Actions Taken (December 1999):**

*In progress.* In response to our audit, the CWCB developed a standardized contract for corporate (i.e., agricultural) users. According to CWCB staff, the contract has been reviewed and approved by the Attorney General's Office. Currently it is in the process of being reviewed by the Department's Accounting Section, and upon its approval, the contract draft will be submitted to the State Controller's Office for approval and for signature authority waiver. Once this occurs, the CWCB will be able to use the standardized contract to streamline its dealings with ditch and reservoir users. The CWCB's goal is to shorten contract processing time by two to four weeks.

The CWCB has also developed a database that tracks and reports on the status of all loans. According to CWCB staff, this system is used to monitor contracts to ensure they have been amended when necessary and that any residual funding has been deauthorized in a timely manner. Finally, CWCB staff have discussed the two-phase contracting process with the Department's Accounting Section and the Attorney General's Office and concluded that it is not practical to pursue at this time.

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### **Improve Accounting Procedures and Internal Controls**

During the 1998 audit, we identified a number of weaknesses in the CWCB's accounting procedures and internal controls, including its management of payment vouchers, cash receipt controls, and loan balance information. For example, we reviewed 187 loan balances maintained in the Board's loan files and found that 40 did not match the balances in the Department's accounting records. We also found that nearly one-third of the balances maintained in borrowers' records did not match the accounting records.

### **Recommendation No. 17 (September 1998):**

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's Report Response (September 1998):**

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 Department's Accounting Section staff by June 30, 1999.

**Implementation date:** July 1999.

### **Water Conservation Board's Update (October 1999):**

*In progress.* Since the time of the audit, the CWCB has hired an accountant and is in the process of hiring a contract compliance officer. The duties identified in the audit report are currently allocated between the accountant, a data entry position, and the contract compliance officer. All cash receipts and payout vouchers are currently approved in the Department's Accounting Section which lends itself to another level of review prior to payments being deposited or warrants being issued. Process reviews will continue as duties continue to be reassigned. Finally, both the CWCB and the Department's Accounting Section are working on reconciling the loan balances on COFRS.

## Office of the State Auditor's Evaluation of Actions Taken (December 1999):

*In progress.* On the basis of our review, it appears the CWCB has made improvements in its accounting procedures and strengthened its internal controls. Specifically:

- **Payment Vouchers.** The CWCB's accountant and the Department's Accounting Section review and verify payment vouchers. At both levels, requests for reimbursement are verified against the contract and documentation supplied to support the request. The COFRS paperwork and warrant are then reviewed for accuracy. In the 1998 audit we found that staff were reviewing only the COFRS paperwork, so this new procedure is an improvement.
- **Cash Receipts.** Cash receipt-related responsibilities have been reassigned to ensure that there is better segregation of duties and that cash receipts are properly recorded and deposited.
- **Loan Balance Information.** According to Department staff, both the CWCB and the Department's Accounting Section are in the process of reconciling loan balances to COFRS. Limited testwork showed that problems still exist (e.g., COFRS loan balances do not always match CWCB loan records or borrowers' records). We encourage further work in this area to ensure records are as accurate as possible.

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## Identify and Correct Deficiencies in Accounting Operations

Throughout the 1998 audit report, we identified a number of problems with the Board's accounting operations in areas such as billing borrowers, collecting loan payments, and recordkeeping. We attributed these problems to several causes, including inadequate supervision and weak or absent internal controls. We also found that the Program did not employ any staff who had accounting expertise. This resulted in the Department's Accounting Section duplicating some Board-level accounting tasks in an effort to improve the accuracy of loan records.

## Recommendation No. 18 (September 1998):

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's Report Response (September 1998):**

Agree. CWCB staff will explore and evaluate these and other options through a review of the program structure. 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 Department's Acting Executive Director as a decision item for the Fiscal Year 2000 budget and are pending review.

**Implementation date:** June 1999.

### **Water Conservation Board's Update (October 1999):**

*In progress.* As identified in Recommendation No. 17, the CWCB has hired an accountant and is currently in the process of filling the contract compliance officer position. As all current vacancies are filled, the CWCB and the Department's Accounting Section will continue to evaluate assigned duties to ensure accurate data are kept and reported to all involved in the program.

### **Office of the State Auditor's Evaluation of Action Taken (December 1999):**

*In progress.* After reviewing its accounting and administrative staff, the CWCB decided to increase its accounting staff to address deficiencies noted in the 1998 audit. The Board has hired both an accountant and a contract compliance officer as mentioned previously. According to Department staff we interviewed, the addition of these positions should improve the deficiencies identified in the CWCB's accounting functions. The addition of these staff should allow the Board to better segregate duties, increase monitoring and supervision, and improve internal controls. Until these staff are in place for a period of time, however, it is impossible to determine what effect they will have on correcting the problems noted by the audit.

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