



An Audit Report on

**The State Water Implementation
Revenue Fund for Texas
at the Water Development Board**

August 2016
Report No. 16-039



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Overall Conclusion

The Water Development Board's (Board) implementation of the State Water Implementation Revenue Fund for Texas (SWIRFT) and its provision of project financing through the State Water Implementation Fund for Texas (SWIFT) program substantially complied with state law, administrative rules, and Board policies and procedures. For example, the Board:

- Developed and adopted administrative rules for the implementation of the SWIFT program in accordance with statutory requirements.
- Implemented a process to prioritize and review applications for financing through the SWIFT program in accordance with statute and Board requirements.
- Implemented a process to issue SWIRFT revenue bonds and fund approved projects in accordance with statute and other requirements.

Background Information

In 2013, the 83rd Legislature:

- Established the State Water Implementation Revenue Fund for Texas (SWIRFT) and the State Water Implementation Fund for Texas (SWIFT), following the approval of a constitutional amendment creating those funds.
- Authorized a one-time, \$2 billion appropriation **from the State's Economic Stabilization Fund to the SWIFT.**

The Water Development Board (Board) administers the SWIFT program, which provides financing to political subdivisions of the State for projects in the state water plan. The SWIFT program includes both the SWIFT and SWIRFT funds. The Board issues revenue bonds and provides SWIFT program financing through the SWIRFT fund.

The Texas Treasury Safe Keeping Trust Company (Trust Company) is responsible for managing and investing the SWIFT. Funds from the SWIFT can be transferred to the SWIRFT no more than twice in any fiscal year. In November 2015, the Trust Company transferred \$108.2 million from the SWIFT to the SWIRFT. As of June 30, 2016, the balance of the SWIFT was approximately \$1.89 billion.

In the SWIFT program's first round of funding in calendar year 2015, the Board delivered \$899.7 million and committed an additional \$2.89 billion to 20 entities for 30 projects in the state water plan.

Sources: The Texas Constitution, the Texas Water Code, the Board, and the Trust Company.

Although the Board substantially complied with the requirements that auditors tested, it should improve certain controls and documentation for future rounds of SWIFT program funding. For example, the Board should:

- Implement a process to document the information used in its financial model for making SWIFT program policy and funding decisions. The Board could not provide sufficient documentation to support its decision-making process during the implementation of the SWIFT program and the first round of SWIFT program funding.
- Improve documentation of its prioritization and technical reviews of applications for SWIFT program financing. The Board could not always provide sufficient documentation to support its prioritization and technical review processes for applications for SWIFT program financing.

This audit was conducted in accordance with Texas Government Code, Sections 321.0131 and 321.0132.

For more information regarding this report, please contact Verma Elliott, Assistant State Auditor, or Lisa Collier, First Assistant State Auditor, at (512) 936-9500.

- Strengthen its supervisory review and monitoring process, and ensure that it has a consistent methodology for reviewing SWIFT program applications and project funding. The Board did not have an adequate review and monitoring process or a consistent methodology to ensure that its SWIFT program application review and project funding processes were accurate and complete.
- Strengthen access controls to its project tracking system (the Texas Water Information System Enhancement, or TxWISE) and its accounting system (Micro Information Products, or MIP). The Board did not appropriately restrict user access to those systems.

To minimize security risks, auditors communicated details about the user access weaknesses directly to the Board. Auditors communicated other, less significant issues to the Board separately in writing.

Table 1 presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 1

| Summary of Chapters/Subchapters and Related Issue Ratings | | |
|---|---|---------------------------|
| Chapter/ Subchapter | Title | Issue Rating ^a |
| 1-A | The Board Developed Administrative Rules and Offered Financing Options in Accordance with Statutory Requirements | Low |
| 1-B | The Board Used a Financial Model to Assist in the Development and Implementation of the SWIFT Program; However, It Should Improve the Documentation of Its Planning Process | Medium |
| 2 | The Board’s Review of SWIFT Program Applications Substantially Complied with Statutory and Board Requirements; However, the Board Should Strengthen Documentation and Certain Controls Over Its Application Review Process | Medium |
| 3-A | The Board’s Issuance of SWIRFT Revenue Bonds and Related Processes Complied with Statutory and Board Requirements | Low |
| 3-B | The Board’s Process for Releasing SWIFT Program Funds Substantially Complied with Board Requirements; However, the Board Should Strengthen Controls Over Its Review Process | Low |
| 3-C | The Board Should Improve Certain Procedures for Financial Monitoring of SWIFT Program Financing Recipients | Low |
| 4 | The Board Should Strengthen Certain Information Technology Controls | Medium |
| <p>^a A subchapter is rated Priority if the issues identified present risks or effects that if not addressed could critically affect the audited entity’s ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.</p> <p>A subchapter is rated High if the issues identified present risks or effects that if not addressed could substantially affect the audited entity’s ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.</p> <p>A subchapter is rated Medium if the issues identified present risks or effects that if not addressed could moderately affect the audited entity’s ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.</p> <p>A subchapter is rated Low if the audit identified strengths that support the audited entity’s ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity’s ability to effectively administer the program(s)/function(s) audited.</p> | | |

Summary of Management's Response

At the end of certain chapters in this report, auditors made recommendations to address the issues identified during this audit. The Board agreed with the recommendations in this report.

Audit Objective and Scope

The objective of this audit was to determine whether the Board's implementation of the SWIRFT and the provision of financial assistance provided through the SWIRFT comply with state law, administrative rules, and Board policy.

The scope of this audit covered the Board's implementation of the SWIRFT and all SWIFT program-funded projects as of December 31, 2015, including processes related to SWIFT program applications, SWIRFT revenue bonds, SWIFT program financing, and related information systems.

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Detailed Results

Chapter 1

The Board's Implementation of the SWIFT Program Complied with Statutory Requirements; However, the Board Should Improve Documentation of Its Planning Process

To implement the State Water Implementation Fund for Texas (SWIFT) program¹, the Water Development Board (Board) developed and adopted administrative rules and offered financing options in accordance with statutory requirements. In addition, the Board used a financial model to analyze different funding scenarios to achieve its goal of financing \$27 billion in state water plan projects during the next 50 years. During the planning process for the implementation of the SWIFT program and the first round of funding, the Board used that financial model to assist in the determination of the capacity of the SWIFT program and the amount of funds available. However, the Board should improve its documentation of its planning process for future rounds of SWIFT program funding.

Appendix 3 contains a list of the SWIFT program financing recipients during the first round of funding in calendar year 2015 and other information on that financing.

Chapter 1-A

The Board Developed Administrative Rules and Offered Financing Options in Accordance with Statutory Requirements

Chapter 1-A
Rating:
Low²

Texas Water Code, Section 15.439, required the Board to adopt administrative rules providing for the use of funds, including specifying the manner for prioritizing projects. In November 2014, the Board developed and adopted administrative rules for its prioritization of projects and use of SWIFT and State Water Implementation Revenue Fund for Texas (SWIRFT) funds, and those rules complied with the requirements in the Texas Water Code. The Board adopted those administrative rules in Subchapter M of Title 31, Texas Administrative Code, Chapter 363, related to the SWIFT and SWIRFT funds. That subchapter included information on the Board's

¹ The SWIFT program includes both the SWIFT and State Water Implementation Revenue Fund for Texas (SWIRFT) funds. The Board issues revenue bonds and provides SWIFT program financing through the SWIRFT fund.

² The risks related to the issues discussed in Chapter 1-A are rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

prioritization system to score and rank projects in accordance with the Texas Water Code.

For the first round of funding through the SWIFT program, the Board offered financing options in accordance with requirements in Texas Water Code, Sections 15.435 and 15.474. Specifically, it offered the following financing options:

- **Low-interest loans.** Long-term, fixed rate loans offered at below market-interest rates, with maturities ranging from 20 to 30 years. The interest rates were based on the Board's cost of funds, and they were further reduced by a subsidy that the members of the Water Development Board established for the first round of SWIFT program funding.
- **Deferred loans.** Loans for which the principal and interest is deferred up to eight years from the delivery date, or until the end of construction, whichever is sooner. The maturities for deferred loans range from 20 to 30 years.
- **Board participation.** Long-term, structured, fixed-rate financing provided through temporary Board ownership in a project. The Board's ownership interest in the excess capacity portion of the project is limited to 80 percent of the total project costs. The local sponsor of the project repurchases the Board's ownership interest under a repayment schedule that allows for the structured deferral of both principal and interest payments.

Management's Response

The Board appreciates recognition that it successfully developed and implemented a brand new program with accompanying rules, processes, prioritization criteria and technical review and delivered affordable financing to communities for implementation of water management strategies that will help meet the current and future water supply needs of the citizens of Texas.

The Board Used a Financial Model to Assist in the Development and Implementation of the SWIFT Program; However, It Should Improve the Documentation of Its Planning Process

Chapter 1-B
Rating:
Medium³

The Board contracted with external financial advisors that developed a financial model as a tool to assist in (1) implementing the SWIFT program, (2) achieving the SWIFT program's objective of funding the state water plan in the next 50 years, and (3) determining whether the \$2 billion SWIFT fund corpus (the amount initially placed into that fund) will be replenished over time (see text box for a description of the financial model).

Financial Model

The Board used a financial model to analyze the funding capacity of the SWIFT program and to assist in analyzing key policy and funding decisions, such as:

- The amount of funds to make available in each round of SWIFT program funding.
- The financing structures and terms to offer financing to recipients.
- The amount of interest subsidy to provide.
- The amount to transfer from the SWIFT to the SWIRFT.

The following inputs used in the financial model could affect the funding capacity of the SWIFT program but are not within the

Board's control:

- Market interest rates.
- Bond rating agency criteria.
- Investment return on the SWIFT fund.

Source: The Board.

The costs of all projects in the 2012 state water plan⁴ totaled \$53 billion. State financial assistance programs are expected to fund approximately \$27 billion of those costs. According to the Board, during the first decade of the SWIFT program, its goal is to provide approximately \$8 billion in SWIFT program funding.

The documentation the Board provided did not sufficiently demonstrate how it ensured that the financial model was reliable.

The Board asserted that its external financial advisors verified the reliability of the financial model and that the financial model was reviewed by both (1) financial advisor senior personnel with financial model development experience and (2) a second financial advisor. The Board provided documentation to support its assertions, such as invoices from its financial advisors; however, that documentation was not sufficient to validate the Board's assertions.

For future rounds of SWIFT program funding, the Board should implement a process to document the scenarios or inputs it uses in the financial model at key decision points.

The Board relied on the financial model as a tool to make key policy and funding decisions during the implementation of the SWIFT program and the first round of SWIFT program funding. According to the Board, it plans to continue using the financial model as a tool to analyze the funding capacity

³ The risks related to the issues discussed in Chapter 1-B are rated as Medium because they present risks or results that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level

⁴ The first round of SWIFT program funding was based on projects identified in the Board's *Water for Texas 2012 State Water Plan* (referred to as the 2012 state water plan); however, eligible projects for subsequent rounds of SWIFT program funding will be based on future state water plans. The Board adopted the 2017 state water plan in May 2016.

of the SWIFT program and determine the amount of funds available in each round of SWIFT program funding.

The Board was unable to provide sufficient documentation to support the different scenarios or inputs used in the financial model at key decision points. Because of the lack of sufficient documentation related to the different scenarios and inputs used, auditors were unable to verify how the Board used the financial model in its decision-making process during the implementation of the SWIFT program and the first round of SWIFT program funding. The Board asserted that it employed “active management” of the financial model to determine the effects of different scenarios on the SWIFT program through, for example, periodic meetings with its external financial advisors. The Board provided documentation of those activities, such as Board meeting materials and presentations to bond rating agencies; however, that documentation was not sufficient to demonstrate that the Board had a process to document scenarios or inputs it used in the financial model at key decision points.

The financial model is proprietary to the external financial advisors. In addition, according to the Board and its financial advisors, the model continually evolves, and historical copies of the model are not maintained. Not having a process to maintain documentation of significant historical information, such as different scenarios or inputs used in the financial model at key decision points, increases the risk that the Board may not be able to effectively use the financial model in its decision-making process for future rounds of SWIFT program funding.

Recommendation

The Board should develop and implement a process to document scenarios and inputs used in the financial model for the SWIFT program to make key policy and funding decisions.

Management’s Response

Recommendation

The Board should develop and implement a process to document scenarios and inputs used in the financial model for the SWIFT program to make key policy and funding decisions.

Management's Response

The Board agrees with the recommendation. While there was documentation of decisions made through the analysis, additional could be beneficial. We will develop and implement a process to provide additional documentation of scenarios and inputs used in the SWIFT program financial model.

While additional documentation may be beneficial, we do not agree with the statement that lack of "documentation of significant historical information, such as different scenarios or inputs used in the financial model at key decision points, increases the risk that the Board may not be able to effectively use the financial model in its decision-making process for future rounds of SWIFT program funding." The most effective use of the financial model is as a forward looking tool that replaces projected variables with factual data and is recalibrated constantly.

*Responsible party: Assistant Executive Administrator
Implementation date: December 1, 2016*

The Board's Review of SWIFT Program Applications Substantially Complied with Statutory and Board Requirements; However, the Board Should Strengthen Documentation and Certain Controls Over Its Application Review Process

Chapter 2
Rating:
Medium ⁵

The Board implemented a two-stage process to review applications for SWIFT program financing (see text box for more information about that process). Auditors reviewed both stages of the Board's application review

process and determined that the Board had processes and related controls to prioritize and perform technical reviews of applications for SWIFT program financing in accordance with statutory and Board requirements. However, the Board did not consistently document those processes and controls. In addition, the Board should strengthen its supervisory reviews and written procedures for those processes.

The Board implemented a process and controls to review SWIFT program applications in accordance with statute and Board requirements.

Prioritization. The Board received 48 abridged applications from 37 applicants⁶ during the first round of funding through the SWIFT program. For all 15 abridged applications tested, the Board accurately determined the applicants' eligibility to receive SWIFT program funding in accordance with the Texas Water Code. Applicants are eligible to receive SWIFT program funding if they are a political subdivision with a project in the state water plan.

The Board prioritized eligible abridged applications as required by the Texas Water Code and the Board's administrative rules. In addition, for all abridged applications scored, the Board's scoring documentation supported the prioritization results presented to the members of the Water Development Board.

The Two-stage SWIFT Program Application Process

The Board's SWIFT program application process includes two stages.

Stage 1. Prioritization of Abridged Applications. Applicants submit an abridged application (an abbreviated, short-form application) to provide information for the Board to determine the applicants' eligibility and prioritize projects based on criteria in the Texas Water Code and the Board's administrative rules.

After the Board verifies applicants' eligibility, it prioritizes (ranks) the abridged applications using criteria in the Texas Administrative Code and the Texas Water Code and presents the results to the members of the Water Development Board.

The members of the Water Development Board review the prioritization results when they establish the funding available by category, the structure of the financing, and the terms of the financing. For prioritized projects, the members of the Water Development Board then approve invitations to applicants to submit full financial assistance applications within the funding limits that the members of the Water Development Board established.

Stage 2. Technical Review of Full Financial Assistance Applications. Applicants submit a full financial assistance application (a longer, more detailed application) to provide information for the Board to perform its technical review. The technical review includes planning and conservation, environmental, engineering, financial, and legal reviews of the project and applicant. After the technical review process is complete, projects are submitted to the members of the Water Development Board for funding consideration.

Source: The Board.

⁵ The risks related to the issues discussed in Chapter 2 are rated as medium because they present risks or results that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

⁶ According to the Board, seven applicants that submitted abridged applications were not eligible for SWIFT program funding, and one applicant that submitted an abridged application withdrew its application. In addition, one applicant that submitted a full financial assistance application withdrew its application. Ultimately, 20 applicants received financing during the first round of SWIFT program funding. See Appendix 3 for more information regarding the SWIFT program financing recipients.

Technical review. The Board extended invitations to submit full financial assistance applications to 29 of the applicants that had submitted abridged applications; 21 of those applicants then submitted full financial assistance applications. For all 10 applicants tested, the Board completed the intake of the full financial assistance applications and substantially conducted technical reviews as required by the Board's administrative rules and written procedures. Additionally, the technical review information presented to members of the Water Development Board was generally supported by the Board's technical review documentation.

For future rounds of SWIFT program funding, the Board should improve documentation of certain areas of both stages of its application review process and ensure that it consistently evaluates applicants.

Prioritization. The Board did not have an adequate process to document its determination that applicants provided adequate and complete information to be considered for prioritization. As a result, for 1 (8 percent) of 12 eligible applicants tested, auditors were unable to verify that the applicant submitted all required information to be considered for prioritization. The Board asserted that applicant submitted adequate and complete

information; however, it was unable to provide documentation to support that assertion. To be considered for prioritization, Title 31, Texas Administrative Code, Section 363.1303(a), requires applicants to provide adequate information to establish that they qualify for funding, describe the project comprehensively, establish the cost of the project, and provide any other information requested by the Board's executive administrator.

Texas Water Code, Section 15.437, and Title 31, Texas Administrative Code, Section 363.1304, specify the prioritization criteria that the Board uses to prioritize abridged applications (see text box for additional details). The Board did not always use the same source of data or the same calculation methodology to evaluate applicants. Specifically, for 4 (33 percent) of 12 eligible applicants tested, the Board either (1) did not include all applicable population data or (2) used incorrect data when it calculated the population or the number of entities that the applicants' projects served.

Those inconsistencies affected 4 (40 percent) of the 10 prioritization criteria the Board used to prioritize applicants: serving a large population, assisting an urban

Ten Prioritization Criteria in
Texas Water Code, Section 15.437, and
Title 31, Texas Administrative Code,
Section 363.1304

The Board must consider the following prioritization criteria when scoring SWIFT program financing applications:

Highest consideration must be given to projects that will:

- Serve a large population.
- Provide assistance to a diverse urban and rural population.
- Provide regionalization.
- Meet a high percentage of water supply needs of users to be served by the project.

The Board must also consider the following additional criteria:

- Local contributions to the project, including federal funding.
- Financial capacity of the applicant to repay.
- Whether the project addresses an emergency need.
- Whether the project is ready to proceed with implementation or construction.
- Demonstration or projected effect of the project on water conservation, including preventing water loss.
- The priority ranking assigned to the project by the applicable regional water planning group.

Sources: The Texas Water Code and the Texas Administrative Code.

The Board's Financial Review Process

The Board's technical review of the full financial assistance applications includes a financial review to determine each applicant's financial soundness and ability to repay its commitments.

The Board's written procedures require staff to complete an evaluation criteria matrix using information the applicant provided to document its assessment of the financial soundness of the applicant; that matrix included the specific criteria used to evaluate applicants and related benchmarks to assess applicants' financial soundness and creditworthiness.

After completing the financial review, the Board assigns the following credit risk scores to the applicant (which indicate the Board's assessment of an applicant's financial soundness and ability to meet repayment requirements and other terms and conditions of the financing):

- Risk Score 1: The applicant's capacity to meet its financial commitments is extremely strong.
- Risk Score 2A: The applicant's repayment capacity is strong.
- Risk Score 2B: The applicant's repayment capacity is adequate.
- Risk Score 2C: The applicant's repayment capacity is sufficient to cover the existing and proposed debt.
- Risk Score 3: The applicant's capacity to meet principal and interest payments is predominately speculative.

Sources: The Board.

and rural population, providing regionalization, and meeting a high percentage of water supply needs. However, using an inconsistent methodology did not affect the overall scoring.

Technical review. Auditors tested 10 applicants to determine whether the Board accurately performed key calculations in its evaluation criteria matrix for the financial review. The Board did not always document its financial review using the evaluation criteria matrix or did not always document its calculations in the matrix (see text box for additional information on the financial review process). In addition, the Board did not always retain documentation of its financial review. As a result, auditors were unable to determine whether the Board consistently evaluated the applicants' financial soundness and ability to repay their commitments. For 5 (50 percent) of the 10 applicants tested, auditors could not recalculate the evaluation criteria the Board used to assess applicants. Specifically:

- For three applicants, the matrix the Board used did not include its evaluation criteria calculations.
- For two applicants, the Board could not provide any documentation of its financial review. Therefore, auditors were unable to determine whether the credit risk score the Board assigned was supported and accurately presented to the members of the Water Development Board.

For future rounds of SWIFT program funding, the Board should strengthen its supervisory reviews and monitoring for both stages of its application review process.

Prioritization. Auditors identified scoring errors for 5 (42 percent) of 12 abridged applications tested; however, those scoring errors affected the overall score for only one applicant. Although the Board provided evidence of supervisory reviews of the scoring results, those reviews were not effective in identifying and correcting those errors. In addition, the Board did not always document its supervisory reviews of the scoring results for prioritization criteria. Because the Board determined that funding was available for all eligible applicants that it prioritized, the error in the overall scoring for one applicant did not affect the Board's decisions regarding which applicants to invite to submit full financial assistance applications.

Technical review. Certain information related to financial reviews that was presented to the members of the Water Development Board was not always accurate or supported. For example, for 3 (30 percent) of 10 applicants tested, the applicants' credit risk score indicated that the applicants' capacity to meet their financial commitment was adequate; however, the credit risk was described as strong in the information presented to the members of the Water Development Board. Additionally, for one applicant tested, the Board inaccurately calculated one of the evaluation criteria assessed; that error, however, did not affect the credit risk score assigned because that calculation was within the Board's assigned benchmark. Although the Board provided evidence of supervisory reviews of the information presented to the members of the Water Development Board, those reviews were not effective in identifying and correcting those errors. In addition, the Board did not always maintain documentation of its supervisory reviews of its technical reviews.

The Board's written procedures require staff to complete checklists in the Texas Water Information System Enhancement (TxWISE, the Board's project tracking system); those checklists serve as the Board's method of documenting that the technical reviews of full financial assistance applications are complete and ensuring that applicants meet the Board's requirements. The Board did not have an adequate monitoring process to ensure that staff completed those checklists as required. For 6 (60 percent) of 10 applicants tested, staff did not always document their completion of those checklists or ensure that they completed all checklist items.

For future rounds of SWIFT program funding, the Board should strengthen written procedures for both stages of the application review process.

The Board did not have an adequate process to ensure that it updated its written procedures as needed. In addition, the Board's written procedures did not always provide clear guidance or reflect the Board's current processes. Outdated or inadequate written procedures increase the risk that the Board could evaluate SWIFT program applicants inconsistently or inequitably.

Prioritization. The Board's written procedures for its application prioritization process did not always provide clear guidance regarding source documentation and calculation methodologies or reflect the Board's actual processes for the prioritization criteria. The Board developed those written procedures for the first round of funding through the SWIFT program based on previous experience with other Board financial assistance programs. Additionally, the Board did not have written procedures for one prioritization criterion (preventing water loss); however, the Board had informational documents related to its calculation process for that prioritization criterion.

Technical review. The Board had adequate written procedures for the legal, environmental, and engineering review portions of its technical review process. However, its written procedures for the financial review and planning and conservation review portions of its technical review process did not accurately reflect the Board's current processes. The Board did not review or update its written procedures for both of those reviews within the required time frame or on a periodic basis. Specifically:

- The financial review procedures require staff to use the evaluation criteria matrix to complete the financial review; however, the Board asserted that staff could use other methods of documentation to complete that review and that staff were not required to assess all criteria in the evaluation criteria matrix. Additionally, the financial review procedures did not always reflect the Board's current process for calculating certain evaluation criteria.
- The planning and conservation review procedures require staff to complete TxWISE checklists as part of the review process; however, the Board asserted that, to avoid redundant data entry, staff did not complete TxWISE checklists for that portion of the technical review.

The Board should ensure that it enters accurate and complete project information into TxWISE.

For all 10 full financial assistance applications tested, the Board entered incorrect information into or omitted project information from TxWISE (for example, information such as the population served by the project or the applicant's address). Those errors occurred because the written procedures related to data entry of the project information were not adequate and the Board had not formally adopted those procedures. Although those errors did not affect the technical reviews tested, data entry errors or omissions increase the risk of inaccurate reporting from TxWISE and could lead to SWIFT program decisions being based on inaccurate information.

The Board should consider strengthening its conflict of interest policy.

The Board had a conflict of interest policy that required an employee to disclose a conflict of interest when the employee became aware of a potential conflict. That policy included all statutory requirements in Texas Government Code, Chapter 572. Additionally, executive management and members of the Water Development Board signed the required forms acknowledging the Board's conflict of interest policy and completed annual ethics training.

Although the Board had a conflict of interest policy, that policy did not require disclosure on a periodic basis regarding whether or not an actual

conflict exists. Not requiring members of the Water Development Board and executive management to disclose that information on a periodic basis increases the risk that disclosures may not be filed and that potential conflicts of interest affecting the SWIFT program funding decisions may not be identified.

Recommendations

The Board should:

- Improve documentation of its application review process for SWIFT program abridged and full financial assistance applications and ensure that it uses a consistent methodology to complete its prioritization and technical reviews.
- Strengthen and document its supervisory review and monitoring processes for SWIFT program abridged and full financial assistance applications to ensure that its prioritization and technical reviews are consistent, accurate, and complete.
- Improve its written procedures for processing SWIFT program abridged and full financial assistance applications to provide clear guidance for its prioritization, technical review, and data entry processes.
- Consider strengthening its conflict of interest policy to require periodic disclosure regarding whether or not an actual conflict exists.

Management's Response

Recommendation

The Board should:

- *Improve documentation of its application review process for SWIFT program abridged and full financial assistance applications and ensure that it uses a consistent methodology to complete its prioritization and technical reviews.*

Management's Response

The Board agrees with the recommendation. At inception of the SWIFT program, written procedures were developed outlining the methodology for prioritization and technical reviews of applications. As with any new program roll out, there are unanticipated issues and opportunities that cause changes mid-stream and decisions to be made ad hoc. From the onset, it was

recognized that initial procedures and documentation would need re-evaluating and updating and much of that has been done subsequent to the first round of SWIFT program funding.

Examples include re-evaluated methodology in the financial review of applications as well as revised methodology and documentation procedures, and peer review of the financial analysis of each project. This process was utilized for the SFY 2016 cycle of SWIFT program funding. Documented procedures for the peer review will be added for future SWIFT program funding cycles.

The Board will strengthen its documentation of the prioritization and technical review process, as well as note when alternative population data is used as part of abridged application scoring process.

At the conclusion of each funding cycle, processes and procedures are reviewed, updating where necessary to improve consistency. Annual reviews of SWIFT program procedures are proposed to be completed by December 1st of each year or prior to the opening of the solicitation period for abridged applications.

*Responsible party: Deputy Executive Administrator, Water Supply & Infrastructure (WSI)
Implementation date: December 1, 2016*

*Responsible party: Deputy Executive Administrator, Water Science & Conservation (WSC)
Implementation date: December 1, 2016*

*Responsible party: General Counsel, Office of General Counsel (OGC)
Implementation date: December 1, 2016*

Recommendation

The Board should:

- *Strengthen and document its supervisory review and monitoring processes for SWIFT program abridged and full financial assistance applications to ensure that its prioritization and technical reviews are consistent, accurate, and complete.*

Management's Response

The Board agrees with the recommendation and will continue to work on strengthening its review and monitoring processes for the abridged applications and full applications to ensure consistency, accuracy and

completeness of the prioritization process. At the conclusion of each funding cycle, staff will review processes and procedures updating where necessary to improve effectiveness and consistency. Annual reviews of SWIFT program procedures are proposed to be completed by December 1st of each year or prior to opening of the solicitation period for abridged applications.

*Responsible party: Deputy Executive Administrator, WSI
Implementation date: December 1, 2016*

*Responsible party: Deputy Executive Administrator, WSC
Implementation date: December 1, 2016*

*Responsible party: General Counsel, OGC
Implementation date: December 1, 2016*

Recommendation

The Board should:

- *Improve its written procedures for processing SWIFT program abridged and full financial assistance applications to provide clear guidance for its prioritization, technical review, and data entry processes.*

Management's Response

The Board agrees with the recommendation and has already begun implementation. Since the initial round of the SWIFT program, WSI has reviewed processes and procedures to ensure staff has clear guidance to document its review of the prioritization, technical and data entry processes and created a Business Process Manager with responsibilities for the annual review of Regional Water Planning & Development (RWPD) procedures for consistency and accuracy. The Reporting Manager will have oversight of data remediation and maintaining quality assurance and quality control of data including ensuring information is complete.

The Water Use, Projections, & Planning (WUPP) review process was assessed after the first round and updated accordingly. After the second round, the procedures will be updated again to ensure accuracy, better documentation, and enhanced efficiency.

WSC will develop and implement a work process document related to its activities that improves written procedures to provide clear guidance for the prioritization, technical review, and data entry processes related to abridged and full financial assistance applications.

*Responsible party: Deputy Executive Administrator, WSI
Implementation date: December 1, 2016*

*Responsible party: Deputy Executive Administrator, WSC
Implementation date: December 1, 2016*

*Responsible party: General Counsel, OGC
Implementation date: December 1, 2016*

Recommendation

The Board should:

- *Consider strengthening its conflict of interest policy to require periodic disclosure regarding whether or not an actual conflict exists.*

Management's Response

The Board appreciates the recognition of the current conflict of interest policy and controls in place and the compliance with state laws and regulations. In furtherance of continually evaluating potential ways to improve current procedures, OGC will consider additional and/or alternative conflict of interest policies and procedures, including that described through this audit report.

*Responsible party: General Counsel, OGC
Implementation date: Ongoing Consideration and Evaluation*

The Board's Process for Funding Approved Projects Substantially Complied with Statutory and Board Requirements; However, the Board Should Strengthen Its Review and Financial Monitoring Processes

The Board had a process and related controls to ensure that it issued SWIRFT revenue bonds⁷ and released funds to SWIFT program financing recipients in accordance with requirements. However, the Board should strengthen controls over its closing process to ensure that financing recipients provide required documentation in a timely manner, the Board completes required checklists, and the Board enters debt service information into TxWISE accurately. The Board should also improve procedures related to its financial monitoring of SWIFT program financing recipients.

Chapter 3-A

The Board's Issuance of SWIRFT Revenue Bonds and Related Processes Complied with Statutory and Board Requirements

Chapter 3-A
Rating:
Low⁸

Revenue bond issuance. The Board issued SWIRFT revenue bonds in accordance with requirements in the Texas Constitution, the Texas Water Code, Board policy, and the Board's bond indentures. For the first round of SWIFT program funding, the Board completed two SWIRFT revenue bond issuances totaling approximately \$810.4 million. For both issuances, the Board obtained the required approvals from the members of the Water Development Board, the Office of the Attorney General, the Bond Review Board, and the Legislative Budget Board. In addition, the Board registered the revenue bonds with the Office of the Comptroller of Public Accounts, as the Texas Water Code required.

The Board also complied with requirements specified in the bond indentures. For example, it delivered the following executed documents to the Board's trustee: bond indentures, an officer's certificate, written authorization to authenticate and deliver the bonds to the purchasers, bond counsel opinion regarding the authentication and delivery of the bonds, and the authorizing Board resolution certified by the Board's executive administrator.

Bond enhancement agreement. The Board directed the Texas Treasury Safekeeping Trust Company to enter into a bond enhancement agreement, which is a legal mechanism allowing for the transfer of funds from the SWIFT

⁷ The Board issues revenue bonds through the SWIRFT fund, and it provides SWIFT program financing using SWIRFT funds.

⁸ The risks related to the issues discussed in Chapter 3-A are rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

to the SWIRFT in support of the SWIRFT revenue bonds. The bond enhancement agreement complied with requirements in the Texas Constitution, the Texas Water Code, and the Board's bond indentures. The bond enhancement agreement resulted in a transfer of approximately \$108.2 million from the SWIFT to the SWIRFT.

The Board obtained the required approvals from the members of the Water Development Board, the Office of the Attorney General, and the Legislative Budget Board. In addition, the Board registered the bond enhancement agreement with the Office of the Comptroller of Public Accounts, as the Texas Water Code required. The Board also ensured that the bond enhancement agreement included required terms and provisions and that SWIFT program applicants submitted required documentation before the Board executed the bond enhancement agreement.

Use of revenue bond proceeds. The Board's use of revenue bond proceeds complied with requirements in the Texas Water Code, the Board's administrative rules, and the Board's bond indentures. For all 26 bond proceed disbursements tested, the Board used the funds to purchase political subdivision obligations or to pay costs associated with the issuance of the bonds (known as costs of issuance). All bond proceed disbursements tested also were supported with invoices or other supporting documentation. In addition, the Board obtained supervisory approval for all of the related payments. The costs of issuance, which totaled approximately \$1.1 million, included expenses such as legal services, travel costs, bond-rating fees, and financial advisory fees.

The Board's Process for Releasing SWIFT Program Funds

Substantially Complied with Board Requirements; However, the Board Should Strengthen Controls Over Its Review Process

Chapter 3-B
Rating:
Low⁹

Financing agreements. The Board had a process and related controls to ensure that SWIFT program financing agreements and local bond ordinances and resolutions included terms and provisions that conformed to the Board's administrative rules and the Board's authorizing resolution. For example, Title 31, Texas Administrative Code, Section 363.42, requires that, at the time of closing, financing agreements and local bond ordinances and resolutions include certain provisions, such as requirements related to a borrower's escrow account, use of project funds, accounting for project funds, and compliance with Board requirements. For all 15 funding commitments tested, the related financing agreements and local bond ordinances and resolutions contained the required language.

Closing and release of funds. The Board had a process and related controls to ensure that SWIFT program financing recipients substantially complied with requirements for closing and release of funds in the Board's administrative rules and resolutions.

However, the Board did not have a process to ensure that financing recipients provided transcripts of closing proceedings within the 60-day time frame required by Title 31, Texas Administrative Code, Section 363.42(b). For 7 (64 percent) of 11 commitments tested, financing recipients did not provide transcripts of closing proceedings within the required time frame. The Board received the transcripts for those 7 commitments between 18 and 85 calendar days after the required 60-day time frame.

Checklists. The Board did not have an adequate monitoring process to ensure that its review of compliance with SWIFT program closing and release of funds requirements was complete and accurate. Specifically, the Board requires staff to complete checklists in TxWISE to document that review; however, staff did not always complete those checklists or ensure that they completed all checklist items. For example, for 2 (13 percent) of 15 commitments tested, the legal review checklists related to the closing process had items that were not marked as completed.

In addition, for cases in which multiple entities each receive SWIFT program financing for the same project, the Board did not have a process to complete a separate checklist for each entity. Instead, the Board completed one

⁹ The risks related to the issues discussed in Chapter 3-B are rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

checklist for only one of the entities (the sponsoring entity). According to the Board, that was due to a database limitation in TxWISE. As a result, for 1 (10 percent) of 10 financing recipients tested, the Board could not demonstrate that it conducted its review of the requirements for release of funds. Not completing the required checklists for each entity funded increases the risk that the Board could close on its financing or authorize the release of funds to financing recipients that did not meet the Board's requirements.

Data entry. The Board had a process to enter SWIFT program debt service schedules into TxWISE. However, it did not always ensure that staff entered the correct debt service schedule into TxWISE. For 1 (7 percent) of 15 commitments tested, the Board did not enter the correct debt service schedule into TxWISE, resulting in a difference of \$104,062 between TxWISE and the financing recipient's correct debt service schedule. The Board asserted that it did not enter the final debt service schedule for that commitment into TxWISE. The Board's written procedures require staff to compare the schedule entered into TxWISE and the final debt service schedule included in the closing file; however, the Board did not perform that comparison, resulting in the error. The Board corrected the error in TxWISE after auditors brought it to the Board's attention.

The Board's trustee is responsible for collecting debt service payments; however, not entering correct debt service schedules into TxWISE increases the risk that the Board could rely on inaccurate information when it reports information using TxWISE.

Recommendations

The Board should:

- Develop and implement a process to ensure that SWIFT program financing recipients provide transcripts of closing proceedings within the required time frame.
- Strengthen its review and monitoring process to ensure that its review of SWIFT program closing and release of funds requirements is complete and that its entry of debt service schedules into TxWISE is accurate.

Management's Response

Recommendation

The Board should:

- *Develop and implement a process to ensure that SWIFT program loan recipients provide transcripts of loan closing proceedings within the required time frame.*

Management's Response

The Board agrees with the recommendation and that timely receipt of transcripts is important. It should be noted that the referenced transcript submittal requirement contained in 31 Texas Administrative Code Section 363.42(b) is a requirement of the recipient, not of the Board.

While there is a process for ensuring transcripts are received, which includes pursuing delinquent transcripts, the process is not documented. The process will be documented and formalized prior to the next round of SWIFT program loan closings.

*Responsible party: Chief Financial Officer, Finance
Implementation date: September 15, 2016*

Recommendation

The Board should:

- *Strengthen its review and monitoring process to ensure that its review of SWIFT program loan closing and release of funds requirements is complete and that its entry of debt service schedules into TxWISE is accurate.*

Management's Response

The Board agrees with the recommendation. In March 2016, the Board began a review of its closing process and has since made revisions in the closing checklist and process.

We will continue to review processes and procedures to ensure our checklists and milestones are completed in a consistent manner and control processes are in place to ensure TxWISE records are accurate at the time of closing.

*Responsible party: Deputy Executive Administrator, WSI
Fully implemented: August 1, 2016*

Responsible party: General Counsel, OGC
Implementation date: December 1, 2016

Responsible party: Chief Financial Officer, Finance
Implementation date: September 15, 2016

Chapter 3-C

The Board Should Improve Certain Procedures for Financial Monitoring of SWIFT Program Financing Recipients

Chapter 3-C
Rating:
Low ¹⁰

Financial monitoring procedures. **The Board had documented procedures to conduct financial monitoring of the entities that receive funding from any Board financial assistance program. It asserted that it would follow those same procedures to monitor SWIFT program financing recipients. However, those procedures did not reflect the Board's financial monitoring process. For example, those procedures described outdated processes related to an information system that the Board no longer used. The Board did not have an adequate process to update those procedures in accordance with the Board's required time frame for updating or when portions became obsolete due to the implementation of new systems. According to the Board's procedures, the Board should have reviewed the financial monitoring procedures in February 2013.**

Not having guidance or up-to-date procedures could lead to the Board not conducting financial monitoring of SWIFT program financing recipients in a consistent manner. Auditors did not test the Board's financial monitoring of SWIFT program financing recipients because the Board had not yet performed that financial monitoring. Financing for the first round of SWIFT program funding closed in November and December 2015; therefore, at the time of this audit, an insufficient time had passed to complete that monitoring.

Borrower repayments. **Auditors tested approximately \$6.1 million in borrower repayments for 11 commitments associated with 9 borrowers that were due to the Board as of March 31, 2016. For those commitments, the Board provided evidence that SWIFT program financing recipients made payments in accordance with their debt service schedules. However, the Board did not have a process to monitor borrower repayments by reviewing bank statements and reports from its trustee. Although the Board's trustee is responsible for receiving debt service payments and notifying the Board of**

¹⁰ The risks related to the issues discussed in Chapter 3-C are rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

receipt of payments, establishing a process at the Board to review borrower repayments would help to ensure that the Board is aware of borrowers' default risk and potential noncompliance with financing agreements; that review also would assist in evaluating the performance of the trustee.

Recommendations

The Board should:

- Update its financial monitoring procedures for SWIFT program financing recipients to reflect its current processes.
- Develop, document, and implement procedures to review trustee bank statements and reports to monitor SWIFT program financing recipient repayments.

Management's Response

Recommendation

The Board should:

- *Update its financial monitoring procedures for SWIFT program financing recipients to reflect its current processes.*

Management's Response

The Board agrees with the recommendation. Financial Compliance staff implemented updated procedures in May 2016. Updates to the procedures incorporated the impact of SWIFT program requirements, improved risk-based analyses and also TxWISE (automation) changes.

Responsible party: Team Lead, Financial Compliance

Fully implemented: May 2016

Recommendation

The Board should:

- *Develop, document, and implement procedures to review trustee bank statements and reports to monitor SWIFT program financing recipient repayments.*

Management's Response

The Board agrees with the recommendation and a process will be developed and implemented no later than December 31, 2016.

Responsible party: Director, Accounting

Implementation date: December 31, 2016

Chapter 4
Rating:
Medium ¹¹

The Board had information technology controls over its program and financial data; however, it should implement a process to update its information technology security policies and strengthen user access controls.

Auditors reviewed two information technology systems that the Board uses to manage program and financial data related to the SWIFT program:

- TxWISE (the Board’s project tracking system).
- Micro Information Products (MIP, the Board’s accounting system).

The Board had backup and recovery controls and adequate information technology security policies; however, it should implement a process to update those policies.

Backup and recovery. The Board had an adequate process and related controls to ensure that it protected its information assets in the event of an emergency or natural disaster. Auditors tested a sample of nine data backups for both TxWISE and MIP and determined that the Board ran those backups as scheduled. Additionally, the Board’s disaster recovery plan included all components that the Texas Administrative Code requires, and the Board regularly tested its disaster recovery plan.

Information technology security policies. The Board’s information technology security policies were adequate. The Board’s policies over passwords, employee system access, account management, backups, and disaster recovery were sufficiently detailed to identify employee responsibilities. Those policies also provided guidance for the overall direction and implementation of information technology security at the Board. However, the Board had not updated those policies in accordance with its policy on updating, which requires the Board to review those policies annually and to update them on an as-needed basis to comply with changes in law or administrative rules. For example, the Board had not updated its policies to reflect revisions made to Title 1, Texas Administrative Code, Chapter 202.

The Board should strengthen certain user access controls.

Although the Board had controls over logical access to its information technology systems, it should strengthen certain controls to ensure that access to TxWISE and MIP is appropriate. The Board did not adequately restrict the level of access granted to employees for TxWISE and MIP.

¹¹ The risks related to the issues discussed in Chapter 4 are rated as Medium because they present risks or results that if not addressed could moderately affect the audited entity’s ability to effectively administer the program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

However, the Board appropriately restricted access to the Board's network drives and cloud server management console. To minimize security risks, auditors communicated details about the user access weaknesses directly to the Board's management in writing.

Recommendations

The Board should:

- Implement a process to update its information technology security policies in accordance with its policy on updating.
- Strengthen access controls over TxWISE and MIP to ensure that access to those systems is appropriate.

Management's Response

Recommendation

The Board should:

- *Implement a process to update its information technology security policies in accordance with its policy on updating.*
- *Strengthen access controls over TxWISE and MIP to ensure that access to those systems is appropriate.*

Management's Response

The Board agrees with the recommendations. The Information Technology Division has started the comprehensive review and revision process for current security policies and procedures. This process will include review and revision of the agency's internal security policy review process to provide further clarity and guidance. The TxWISE access request policy has already been more clearly defined to align with current default access levels. Processes for review and verification of assigned roles, rights and levels of access for MIP will be reviewed and additional controls will be implemented as necessary to reduce the risk of future discrepancies.

Responsible party: Information Technology Director, Operations & Administration

Implementation date: May 31, 2017

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether the Water Development Board's (Board) implementation of the State Water Implementation Revenue Fund for Texas (SWIRFT) and the provision of financial assistance provided through the SWIRFT comply with state law, administrative rules, and Board policy.

Scope

The scope of this audit covered the Board's implementation of the SWIRFT and all State Water Implementation Fund for Texas (SWIFT) program-funded projects as of December 31, 2015, including processes related to SWIFT program applications, SWIRFT revenue bonds, SWIFT program financing, and related information systems.

Methodology

The audit methodology included collecting and reviewing documentation; conducting interviews with Board staff; reviewing Board policies and procedures; testing documentation related to the implementation of the SWIRFT, SWIFT program application review, bond issuances, and closing processes; and analyzing and evaluating the results of audit tests.

Sampling Methodology

Auditors selected a nonstatistical, stratified random sample of SWIFT program full financial assistance applications and a random sample of abridged applications submitted to the Board during the 2015 round of SWIFT program funding. Auditors tested all of the closed funding commitments and the related bond proceeds disbursements associated with the sample of full financial assistance applications selected. Auditors also selected nonstatistical, random samples of user access forms and data backups for the Texas Water Information System Expansion (TxWISE) and Micro Information Products (MIP). Those samples were designed to be representative of the population and results may be extrapolated to the population, but the accuracy of the extrapolation cannot be measured.

Auditors tested all bond issuances, bond enhancement agreements, and costs of issuance related to the bond issuances for the 2015 round of SWIFT program funding. In addition, auditors tested all SWIFT program borrower

repayments for the 2015 round of SWIFT program funding that were due as of March 31, 2016.

Data Reliability

Auditors used the Board's program and financial data in TxWISE and MIP. To determine the reliability of the data from those systems, auditors reviewed the accuracy and completeness of the data by (1) conducting interviews and observations with Board staff, (2) performing a high-level review of data fields and contents for appropriateness, (3) reviewing data query language and report totals, (4) testing general controls, and (5) relying on previous State Auditor's Office work on general controls over TxWISE and MIP. Auditors determined that the data in those systems was sufficiently reliable for the purposes of this audit.

Auditors used prioritization and closing transcript data maintained in the Board's manual spreadsheets. To determine the reliability of the data from those spreadsheets, auditors tested access to the network folders that house those spreadsheets and determined that access to those folders was appropriate.

- For the spreadsheets containing prioritization data, auditors recalculated information in the spreadsheets and compared the data to source documentation. Auditors determined those spreadsheets were sufficiently reliable for the purposes of this audit.
- The spreadsheet containing the closing transcript data was the only source of evidence available for testing. Auditors determined that spreadsheet was of undetermined reliability.

Information collected and reviewed included the following:

- Board policies and procedures.
- SWIFT program data from TxWISE.
- SWIFT financial data from MIP.
- Board documentation such as abridged applications, full financial assistance applications, closing files, review checklists, bond documents, accounting entries, and internal memos.
- Minutes and resolutions from meetings of the members of the Texas Water Development Board.
- System backup and recovery documentation.

- User access lists for TxWISE, MIP, and the Board's network drives.

Procedures and tests conducted included the following:

- Interviewed Board management and staff to identify the Board's processes related to the SWIRFT.
- Reviewed the administrative rules the Board developed and adopted and the financing options the Board offered during the 2015 round of SWIFT program funding for compliance with state law.
- Reviewed documentation related to the implementation of the SWIFT program and the Board's financial model.
- Tested a sample of abridged applications to determine whether the Board prioritized applicants in accordance with state law, administrative rules, and the Board's policies and procedures.
- Tested a sample of full financial assistance applications to determine whether the Board completed technical reviews in accordance with administrative rules and the Board's policies and procedures.
- Tested documentation to determine whether prioritization and technical review information presented to the members of the Water Development Board was accurate and complete.
- Tested the Board's SWIRFT bond issuances, bond enhancement agreement, and use of bond proceeds to determine compliance with statute, administrative rules, Board policies, and bond indentures.
- Tested documentation related to SWIFT program borrower repayments to determine whether borrowers made repayments on time and in the correct amount.
- Tested documentation to determine whether the Board entered information into key information systems accurately and completely.
- Reviewed the Board's conflict of interest policy to determine compliance with state law.
- Reviewed selected information technology access and security controls.

Criteria used included the following:

- Board resolutions, policies, procedures, and guidelines.
- Board bond indentures.

- Texas Constitution, Article III, Sections 49-d-12 and 49-d-13.
- Texas Water Code, Chapters 15 and 17.
- Texas Government Code, Chapter 572.
- Title 31, Texas Administrative Code, Chapter 363.
- Title 1, Texas Administrative Code, Chapter 202.
- Department of Information Resources' *Security Control Standards Catalog*.

Project Information

Audit fieldwork was conducted from January 2016 through July 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

- Sonya Tao, CFE (Project Manager)
- Tammie Wells, CIA, MBA (Assistant Project Manager)
- James Collins
- Kyle Ketry
- Alexander Sumners
- Quang Tran, CFE
- Mary Ann Wise, CPA, CFE (Quality Control Reviewer)
- Verma L. Elliott, CPA, CIA, CGAP, MBA (Assistant State Auditor)

Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; noncompliance with state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 2 provides a description of the issue ratings presented in this report.

Table 2

| Summary of Issue Ratings | |
|--------------------------|---|
| Issue Rating | Description of Rating |
| Low | The audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited. |
| Medium | Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level. |
| High | Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity. |
| Priority | Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity. |

Recipients of SWIFT Program Financing During Calendar Year 2015

Table 3 lists the recipients of State Water Implementation Fund for Texas (SWIFT) program financing during calendar year 2015 and provides associated project and funding information (see Figure 1 following this table for a map of the regions specified in this table).

Table 3

| Recipients of SWIFT Program Financing During Calendar Year 2015 | | | | |
|---|--------|--|-------------------------|--|
| Responsible Authority (Financing Recipient) | Region | Project Name | Total Funding Committed | Amount of Funding Closed in Calendar Year 2015 |
| Tarrant Regional Water District ^a | C | Integrated Transmission Pipeline Project | \$440,000,000 | \$440,000,000 |
| Bedford | C | Conservation - Water Distribution Improvements and Automatic Meter Readers | 90,000,000 | 30,000,000 |
| Fort Worth | C | Conservation - Advanced Metering Infrastructure Project | 76,000,000 | 13,000,000 |
| Upper Trinity Regional Water District | C | Lake Ralph Hall Reservoir | 44,680,000 | 44,680,000 |
| Greater Texoma Utility Authority (Tom Bean) | C | Tom Bean Supplemental Water Well and Appurtenances | 1,210,000 | 1,210,000 |
| El Paso Public Service Board | E | Bone Spring - Victorio Peak Aquifer Land and Water Rights Acquisition | 50,000,000 | 50,000,000 |
| Marfa | E | Additional Water Well | 705,000 | 705,000 |
| Lone Star Regional Water Authority | G | East Williamson County Regional Water Transmission System | 27,640,000 | 27,640,000 |
| Palo Pinto County Municipal Water District # 1 | G | Turkey Peak Reservoir | 17,100,000 | 17,100,000 |
| North Harris County Regional Water Authority | H | Northeast Water Purification Plant Expansion (Luce Bayou source water) | 551,760,000 | 8,160,000 |
| West Harris County Regional Water Authority | H | Second Source Transmission Line (Luce Bayou source water) | 325,440,000 | 3,100,000 |
| West Harris County Regional Water Authority | H | Northeast Water Purification Plant Expansion (Luce Bayou source water) | 306,200,000 | 4,740,000 |
| North Fort Bend Water Authority | H | Second Source Transmission Line (Luce Bayou source water) | 304,000,000 | 7,570,000 |
| Coastal Water Authority | H | Luce Bayou Interbasin Transfer of Surface Water from Trinity River to Lake Houston | 300,000,000 | 66,565,000 |
| North Fort Bend Water Authority | H | Northeast Water Purification Plant Expansion (Luce Bayou source water) | 251,845,000 | 1,100,000 |
| North Harris County Regional Water Authority | H | Second Source Transmission Line Phase I (Luce Bayou source water) | 222,135,000 | 58,125,000 |
| Houston ^b | H | Northeast Water Purification Plant Expansion (Luce Bayou source water) | 183,635,000 | 0 |
| West Harris County Regional Water Authority | H | Internal Distribution | 180,500,000 | 10,900,000 |

Recipients of SWIFT Program Financing During Calendar Year 2015

| Responsible Authority (Financing Recipient) | Region | Project Name | Total Funding Committed | Amount of Funding Closed in Calendar Year 2015 |
|--|--------|--|----------------------------|---|
| North Harris County Regional Water Authority | H | Second Source Transmission Line Phase II (Luce Bayou source water) | 135,385,000 | 10,900,000 |
| Houston | H | Second Source Transmission Line Phase I (Luce Bayou source water) | 112,490,000 | 25,915,000 |
| North Harris County Regional Water Authority | H | Internal 2020 Distribution | 44,125,000 | 3,250,000 |
| Brazosport Water Authority | H | Brackish Groundwater Reverse Osmosis Water Treatment Plant and Water Wells | 28,300,000 | 5,605,000 |
| Central Harris County Regional Water Authority | H | Northeast Water Purification Plant Expansion (Luce Bayou source water) | 22,655,000 | 5,510,000 |
| Central Harris County Regional Water Authority | H | Second Source Transmission Line Phase II (Luce Bayou source water) | 9,515,000 | 1,670,000 |
| Central Harris County Regional Water Authority | H | Second Source Transmission Line Phase I (Luce Bayou source water) | 9,460,000 | 3,625,000 |
| Canyon Regional Water Authority | L | Wells Ranch Phase II - Well Field and Transmission Line | 42,000,000 | 42,000,000 |
| Hays Caldwell Public Utility Agency | L | Phase 1A Transmission Line | 7,490,000 | 7,490,000 |
| Guadalupe Blanco River Authority | L | Integrated Seawater Desalination and Power Plant Project | 2,000,000 | 2,000,000 |
| Hidalgo County Irrigation District # 1 | M | Agricultural Irrigation Conveyance System Improvements | 7,100,000 | 7,100,000 |
| Totals | | | \$3,793,370,000 | \$899,660,000 |

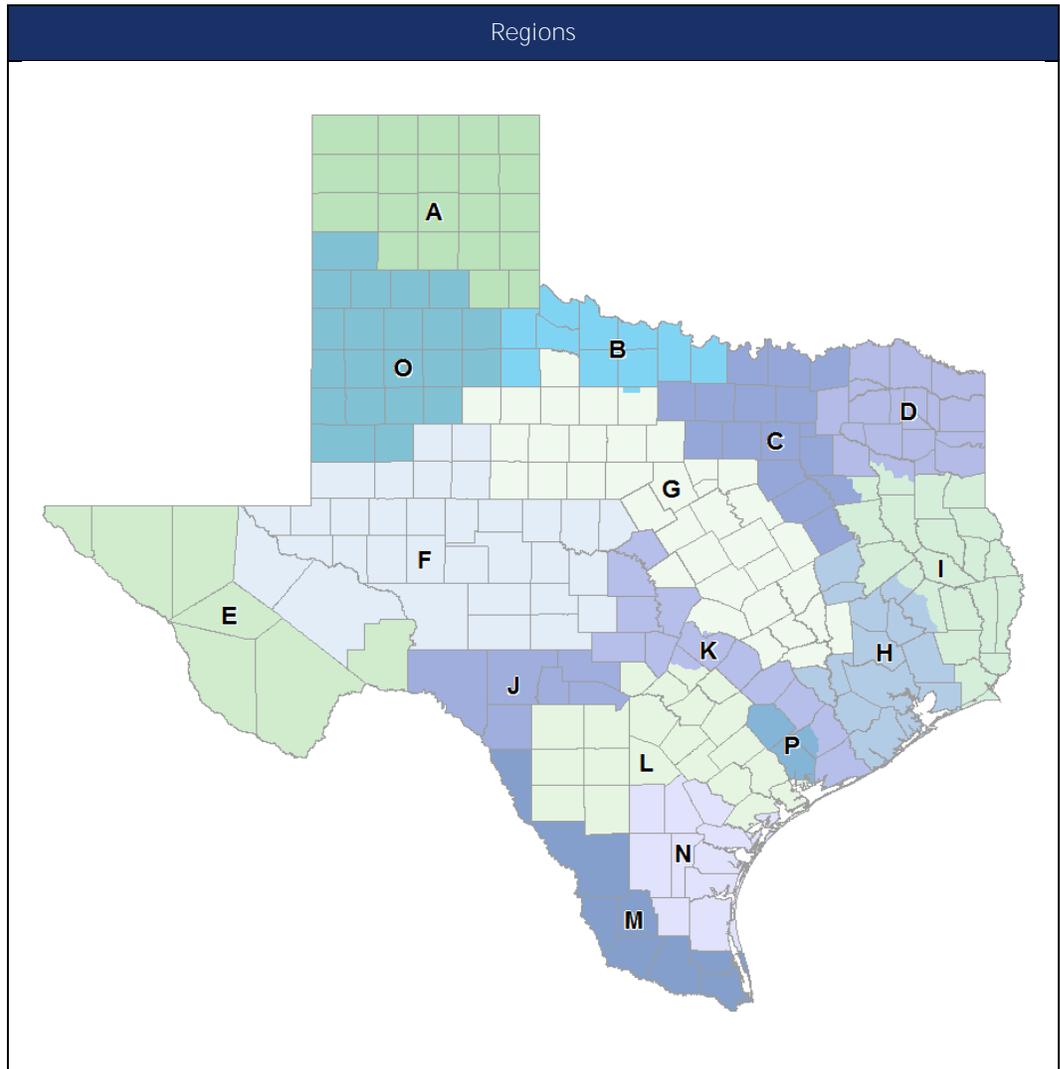
^a This funding commitment is for two projects in the 2012 state water plan under the Tarrant Regional Water District and the City of Dallas Water Utility. However, financing for both projects was provided solely to the Tarrant Regional Water District.

^b Houston's request for funding for that project was committed in 2015; however, funding will not begin to close until 2016.

Source: The Water Development Board.

Figure 1 shows the location of the regions specified in Table 3.

Figure 1



Source: The Water Development Board.

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The Honorable Dennis Bonnen, House Ways and Means Committee

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The Honorable Greg Abbott, Governor

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Members of the Water Development Board

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Ms. Kathleen Jackson

Mr. Peter Lake

Mr. Jeff Walker, Executive Administrator



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