



Water Infrastructure Finance Authority of Arizona
Janet Napolitano, Governor

April 21, 2003

Debra K. Davenport, Auditor General
Office of the Auditor General
2910 N. 44th Street, Suite 410
Phoenix, Arizona 85018

Ms. Davenport:

On behalf of the Board of Directors of the Water Infrastructure Finance Authority of Arizona (WIFA), I am pleased to submit the attached response to the Office of the Auditor General's WIFA Performance Audit Report. I am particularly pleased that the revised Performance Audit Report incorporated many of the conclusions from our April 4, 2003 meeting and incorporated many concerns within WIFA's April 8, 2003 correspondence.

I believe the tone of the Report is constructive, productive, and objective and will serve WIFA well as we continue to automate our internal financial management systems. We look forward to demonstrating our progress during follow-up reviews.

Sincerely,

Greg Swartz, Executive Director
Water Infrastructure Finance Authority

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*Arizona's Water
and Wastewater
Funding Source*



cc: Dale Chapman, Melanie Chesney, Andrea Leder, Bill Thomson, Jessica Tucker

**Water Infrastructure Finance Authority of Arizona
Response to Performance Audit Report**



Submitted to the Auditor General

April 21, 2003

Water Infrastructure Finance Authority of Arizona Response to Performance Audit Report

Introduction

The Performance Audit Report (henceforth, the “Report”) by the Office of Auditor General (OAG) includes three substantive components – ***Audit Findings, Other Pertinent Information, and Sunset Factors***. The Water Infrastructure Finance Authority (WIFA) will respond to OAG recommendations and issues by report component below.

WIFA’s Response to Audit Findings

The OAG identified and addressed one audit finding relating to the accuracy of priority scores within WIFA’s 2003 Funding Cycle project priority lists. The OAG recommended that WIFA implement policies and procedures to ensure accuracy of scores used to generate project priority lists.

It is essential and factual to note that scoring errors noted in the OAG Report concerned draft scores on draft priority lists for the 2003 Funding Cycle. WIFA’s Board of Directors adopts final priority lists following public and comment. Subsequently, WIFA’s Board of Directors considers and awards funding only after an applicant submits a detailed Project Finance Application and after staff complete a due diligence report on the applicant. In effect, there are multiple reviews and opportunities to correct omissions and errors prior to a Board action on a loan request.

Given the distinction between draft priority lists, final priority lists, and Board actions to award funding, WIFA contends that it is unlikely that draft scoring errors can translate into incorrect interest rates and subsidies within loan agreements. Regardless of the low probability of compounded errors, WIFA believes enhancing procedures to reduce errors will increase confidence in the process and outcome. Accordingly, ***the finding of the Auditor General is agreed to and the audit recommendation will be implemented*** as outlined below.

To enhance procedures for scoring projects on the draft priority list, WIFA will:

1. Clarify procedures to ensure consistent scoring. Implementation Deadline: September 30, 2003
2. As part of WIFA’s ongoing automation effort, automate priority list scoring process with business rules governing scoring separate from application data input. Implementation Timeline: November 30, 2003
3. Require staff to certify priority list scores. Implementation Timeline: November, 2003.
4. Require Project Priority Committee (subset of Board members) approval of draft priority lists prior to public review and comment. Implementation Deadline: November 30, 2003

WIFA’s Response to Other Pertinent Information

Within the Other Pertinent Information component of the Report, the OAG reported on three issues:

- Federal Clean Water (Revolving Fund) Allocation Formula
- New Arsenic Standard
- Concerns about WIFA Internal Controls

WIFA will separately respond to each of the three issues as detailed below.

Federal Clean Water (Revolving Fund) Allocation Formula

WIFA will continue to coordinate with the Governor's Office and the Congressional Delegation to encourage Congress to adopt a needs-based formula to allocate CWRP funding.

New Arsenic Standard

WIFA was pleased to assist the Arizona Department of Environmental Quality in generating the Arsenic Master Plan and looks forward to the challenge of providing financial assistance to those water systems affected by the new arsenic standard.

Concerns about WIFA Internal Controls

In accordance with state statute, WIFA must secure the services of an external auditor and generate annual audited financial statements. The OAG noted concerns about WIFA's Internal Controls based on statements from external auditors associated with the 2001 and 2002 audits.

It is essential and factual to note that WIFA's accounting system simply summarizes transactions initiated and occurring within accounting systems managed by the State of Arizona and WIFA's Trustee. Presently, WIFA has no authority to independently withdraw, deposit, or transfer funds outside of the State of Arizona and Trustee accounting systems. Furthermore, all withdraws, deposits, and transfers must conform to Federal, State, and WIFA Master Indenture requirements.

WIFA maintains a redundant "shadow" accounting system, including a general ledger, to summarize transactions controlled elsewhere, to categorize the data in a manner consistent with accounting standards, to compute net worth, and to facilitate reporting of the data. In effect, given the parameters under which WIFA operates, the possibility of fraud or deceit is very remote.

WIFA agrees it must continue to improve its internal financial controls through automation, retaining skilled, experienced, and motivated staff, and by adopting relevant policies and procedures. However, the concerns about internal controls and ability to meet reporting deadlines must be viewed within the context of the unique challenges facing WIFA's FY 2002 Audit.

Simply put, it is reasonable to view the FY 2002 Audit as an anomaly. More specifically, during the July 1 through December 31, 2002 period, the following concurrent events impacted WIFA :

- WIFA's Move to New Office Space
- Absence of Key WIFA Fiscal Personnel
- Implementation of a New General Ledger Accounting Structure
- New WIFA Controller (*In response to the FY 2001 Audit, WIFA's Board authorized the creation of a new Controller position in April, 2002 and management filled the position in July, 2002.*)
- New WIFA Environmental Manager and Environmental Coordinator (*Staff responsible for technical and environmental issues occupied their positions for less than six months with no prior priority list experience.*)
- 5 Year Rule Review (*WIFA analyzed its rules and made recommendations for improvements to comply with a December 31, 2002 deadline from the Governor's Regulatory Review Council.*)
- FY 2002 Financial Audit
- Sunset/Performance Audit
- Arbitrage Audit
- Ongoing Automation Efforts
- Change in Trustee

Simply put, during the period July through December, 2002, WIFA was overwhelmed and targeted

resources as best it could under unique circumstances. The unfortunate consequence – concerns about internal controls and ability to meet reporting deadlines – was the direct result of this overwhelming workload and reliance on new staff to perform unfamiliar tasks.

Given the above circumstances, WIFA’s Executive Director delayed the final audited financial statements to ensure financial accuracy, compliance with GASB 34, and to meet the higher standard resulting from WIFA’s financial statements becoming material, for the first time due to increasing fund balances, within the State’s Comprehensive Annual Financial Report.

Looking to the future, the need for comprehensive and integrated financial software applications constitutes the greatest challenge to improve WIFA’s internal controls and reporting capability. Accordingly, WIFA continues to design, implement, and deploy software applications to automate day-to-day fiscal and program functions.

Since July, 2002 until present, the Authority implemented the following fiscal software applications:

- Fixed Asset Management,
- Interim Loan Servicing (*interim until comprehensively integrated with all fiscal applications*),
- Federal Capital Contributions, and
- Grant Management

WIFA will implement the following critical and integrated fiscal applications by July 1, 2003:

- Deposits,
- Withdraws,
- Transfers,
- Investment Management,
- Debt Management,
- State Match Management,
- Accounting Structure (*governs and automates transactions within and between accounts*), and
- General Ledger (*vast majority of data reported within general ledger will be entered as transactions within other fiscal applications; direct general ledger entries will be limited to non-cash transactions and end of year adjustments such as bond cost amortizations*).

In conclusion, WIFA continues to make dramatic progress to implement customized fiscal software applications that interface within WIFA as well as with the State and Trustee accounting systems.

WIFA’s Response to Sunset Factors

In accordance with A.R.S. 41-2954, OAG reviewed¹² “Sunset Factors” and noted three issues:

- WIFA should renew its CWRP Operating Agreement with EPA.
- WIFA must enhance procedures for disclosing Board members conflicts of interest.
- WIFA must file required public meeting notice statement with the Secretary of State.

For each of the above, ***the finding of the Auditor General is agreed to and audit recommendation will be implemented*** (renew CWRP Operating Agreement) or has been implemented (disclose conflicts of interest and public meeting notice statement).