CENTRAL UTAH
WATER CONSERVANCY DISTRICT

Special Project
For the Period January 1, 2014 through January 30, 2018

Report No. CUWC-18-SP

OFFICE OF THE
STATE AUDITOR

AUDIT LEADERSHIP:

John Dougall, State Auditor
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CENTRAL UTAH WATER CONSERVANCY DISTRICT

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TABLE OF CONTENTS

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November 1, 2018

Board of Directors
Central Utah Water Conservancy District
355 W University Parkway
Orem, Utah 84058

Dear Board Members:

We have completed a limited review of certain aspects of Central Utah Water Conservancy District's (District) compliance for the period January 1, 2014 through January 30, 2018 unless otherwise noted. The purpose of these procedures is to evaluate compliance with relevant statutes, District policy, and best practices for procuring bond-related professional services. We performed the following procedures at the District:

1. We analyzed District documentation for the procurement of professional services related to bond issuances to determine compliance with statutes, policies, and best practices.
2. We researched prevailing best practices for procurement of professional services using a variety of sources. As part of this procedure, we surveyed twelve local government entities in Utah to determine their philosophy and practices in procuring these services. We also conferred with investment and procurement professionals and the Government Finance Officers Association.

Our procedures were more limited than would be necessary to express an audit opinion on compliance or on the effectiveness of the District's internal control or any part thereof. Accordingly, we do not express such opinions. Alternatively, we have identified the procedures we performed and the findings resulting from those procedures. Had we performed additional procedures or had we made an audit of the effectiveness of the District's internal control, other matters might have come to our attention that would have been reported to you.

Our findings resulting from the above procedures are included in the attached findings and recommendations section of this report.

By its nature, this report focuses on exceptions, weaknesses, and problems. This focus should not be understood to mean there are not also various strengths and accomplishments. We appreciate the courtesy and assistance extended to us by the personnel of the District during the course of the engagement, and we look forward to a continuing professional relationship. If you have any questions, please contact me at 801-538-1340 or jwrigley@utah.gov.

Sincerely,

Julie M Wrigley

Julie Wrigley, CPA, CFE
Audit Manager

cc: Gene Shawcroft, General Manager
Shawn Lambert, Chief Financial Officer

BACKGROUND

State and local government entities often take advantage of bond financing to fund capital improvements and other projects. A significant part of issuing new bond debt is to assemble a team of various professionals to help with the bond issuance process. The team may include a municipal or financial advisor, bond counsel, and underwriter(s).

Government bond issuers engage municipal or financial advisors to assist in the structuring and issuance of bonds, which includes the determination of whether to use a competitive or negotiated sale process.

The foremost responsibility of the underwriter in a negotiated sale is to market the government issuer's bonds to investors.

It is important to understand that the municipal or financial advisor has a fiduciary responsibility to the issuer, and that the roles of the municipal or financial advisor and the underwriter are separate, adversarial roles. While the advisor has a clear fiduciary duty to the issuer, the underwriter does not.

FINDINGS AND RECOMMENDATIONS

1. FINANCIAL SERVICES CONTRACTS DO NOT COMPLY WITH UTAH PROCUREMENT CODE

The contracts between Central Utah Water Conservancy District (District) and various businesses for the provision of financial services associated with bond issuance are not compliant with Utah Procurement Code. The contracts for financial advisor, bond counsel, and underwriter were awarded as sole source contracts, but do not meet the requirements for sole source contracts detailed in *Utah Code* 63G-6a-802(1). In addition, the contracts were awarded for an indeterminate period in noncompliance with *Utah Code* 63G-6a-1204(7), which states that a multiyear contract, including any renewal periods, may not exceed a period of 5 years unless certain requirements are met and documented in writing. The contracts do not meet the exceptions to the 5-year limit. These requirements in Utah Procurement Code are designed to increase competition and safeguard the integrity of the procurement process. Failure to adhere to Utah Procurement Code may increase the risk of higher costs for services due to the lack of adequate competition.

Recommendation:

We recommend that the District terminate their contracts with the financial advisor, bond counsel, and underwriter, and re-procure the contracts by going through a proper procurement process taking into consideration the best practice recommendations found in Finding No. 3. We also recommend that the District ensure contracts do not exceed a period of 5 years unless the contract properly meets an exception found in *Utah Code* 63G-6a-1204.

2. INADEQUATE PROCUREMENT POLICY

We performed a limited review of the District's procurement policy and noted the following problems:

- The District's Purchasing Policy (Policy) §89101.01(b) requires that sole source procurements over $75,000 be published, and less costly sole source procurements may be published in accordance with *Utah Code* 63G-6a-112 Required Public Notice. However, according to Utah Procurement Code (*Utah Code* 63G-6a-802(3)), sole source contracts greater than $50,000 must be published. Because the District is subject to Utah Procurement Code, the Policy should be changed to require publication of all sole source contracts greater than $50,000. The purpose of the publication is to increase transparency and accountability, and to promote oversight by the public to help prevent contract fraud, waste, or abuse.

- The District's Policy §8505.01 states that the small purchase threshold for professional services is a maximum amount of $200,000 per budget year. However, the threshold contained in Utah Administrative Code R33-5-108 is $100,000, and that used by other similar districts is $100,000 per year. While the District has some latitude in establishing the threshold for small purchases, the amount seems excessive when compared to Utah Administrative Code and other similar districts. Small purchases are not subject to the solicitation and public notice requirements to which larger purchases are subject. Therefore, care should be taken when establishing the threshold to ensure there is adequate transparency and accountability over small purchases.

We did not review the District's policy in its entirety; therefore, the District should review its policy to ensure compliance with Utah Procurement Code in all respects and to ensure that all amounts and thresholds are reasonable and aligned with best practice.

Recommendation:

We recommend that the District:

- **Change its policy to require publication of all sole source contracts greater than $50,000 as required by Utah Procurement Code.**
- **Lower its small purchase threshold for professional services.**
- **Review its purchasing policy to ensure compliance with Utah Procurement Code in all respects, and that all amounts and thresholds are reasonable and aligned with best practices.**

3. BEST PRACTICES FOR BOND SALES AND SELECTION OF UNDERWRITERS

The District contracted with an underwriter for an indeterminate period, which violates Utah Procurement Code (see Finding No. 1). Additionally, we question whether it is best practice to engage in a long-term contract with an underwriter—especially given that the District and the underwriter have competing interests, with the District seeking to minimize costs and the underwriter motivated to maximize its earnings. There is a risk that the underwriter may not be motivated to offer the lowest costs once it is engaged in a long-term contract with the District. We noted that the District has used the same underwriter for each of its bond issues for over 20 years. We also had concerns related to best practices for selecting the method of sale of bonds, which can be sold either through a competitive sale or a negotiated sale.

To address these concerns, we researched various publications, including Government Finance Officers Association (GFOA) best practice guides related to the sale of bonds[1], an audit report from the Missouri State Auditor[2], and an article by Mark D. Robbins and Bill Simonsen regarding the use of underwriters and the cost of borrowing[3]. We also conferred with various investment and procurement professionals and the GFOA. Finally, we performed a survey of 12 local government entities in Utah which have issued bonds within the last 4 years. None of the entities we surveyed engaged in long-term contracts with underwriters. In addition, the article by Robbins and Simonsen provided evidence that contracting long-term with an underwriter, or even using the same underwriter for consecutive years, can result in higher borrowing costs to the entity. From our discussions with industry professionals and the GFOA personnel, we concluded that it is generally not considered advantageous to enter into a long-term contract with a single underwriter. Typically, a truly open and competitive procurement process for services results in lower costs. Also, we determined that while there are advantages and disadvantages to both the competitive sale and the negotiated sale methods, there are some best practice recommendations an entity should implement when making the method of sale decision in order to achieve the lowest borrowing cost and increase transparency.

Recommendations:

In order to increase competition and potentially lower costs, we recommend that the District, with the assistance of its financial advisor:

- **Select a method of sale based on a thorough analysis of the factors affecting the proposed bond issue, and ensure the method selected is expected to achieve the lowest cost of borrowing.**
- **If a negotiated sale is advantageous, justify or document the reasons for foregoing a competitive sale in favor of a negotiated sale.**
- **For both methods of sale, select the underwriter through a formal request for proposal (RFP) process, and ensure the criteria and process for underwriter selection are adequately documented and publicly available.**
- **To address instances where time is of the essence, the District could utilize the request for statement of qualifications process outlined in Utah Code 63G-6a-410 to identify a pool of qualified underwriters to draw upon.**
- **Select the underwriter on a bond-issue by bond-issue basis, unless the District can demonstrate that contracting with an underwriter for a specified length of time saves taxpayers and rate payers money.**

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[1] Government Finance Officers Association (GFOA, 2014). *Selecting and Managing the Method of Sale of Bonds*. Available at http://www.gfoa.org/selecting-and-managing-method-sale-bonds and *Selecting and Managing Underwriters for Negotiated Bond Sales*. Available at http://www.gfoa.org/selecting-and-managing-underwriters-negotiated-bond-sales

[2] Missouri State Auditor (2005). *General Obligation Bond Sales Practices Follow-Up.* Report no. 2005-101. Available at https://app.auditor.mo.gov/Repository/Press/2005-101.htm

[3] Robbins, Mark D, and Bill Simonsen "Persistent Underwriter Use and the Cost of Borrowing." *Municipal Finance Journal,* Volume 28, Number 04, Winter 2008, pp. 1-13.