
**Thomas P. DiNapoli
COMPTROLLER**



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**OFFICE OF THE
NEW YORK STATE COMPTROLLER**

**DIVISION OF STATE
GOVERNMENT ACCOUNTABILITY**

**NEW YORK CITY
MUNICIPAL WATER
FINANCE AUTHORITY**

**SELECTED FINANCIAL AND
MANAGEMENT PRACTICES**

Report 2006-S-124

AUDIT OBJECTIVES

Our objectives were to determine whether the New York City Municipal Water Finance Authority (MWFA) has established adequate internal controls over its major financial operations and MWFA's Board of Directors (Board) has complied with State requirements for board governance.

AUDIT RESULTS - SUMMARY

MWFA is a public benefit corporation that was statutorily created in 1984 at the request of New York City to finance capital improvements in the City's municipal water and sewer system. As of October 17, 2006, MWFA had issued about \$28.8 billion in bonds to finance these capital improvements, of which about \$16 billion was outstanding.

MWFA typically receives, disburses, and invests hundreds of millions of dollars annually in connection with its bond issuance activities. Our review found some instances of non-compliance and several instances of technical or minimal compliance pertaining to internal control and board governance requirements. For example, we found MWFA has developed general guidelines for its investment activities and should develop written policies and procedures for its cash management and debt issuance activities. Establishing adequate written policies and procedures increases assurances that MWFA's activities are performed in accordance with requirements.

MWFA periodically awards millions of dollars in contracts with financial, legal, and engineering firms that play critical roles in its debt issuance process. However, we found MWFA needs to strengthen control by documenting why one firm is selected over another when a contract is awarded. For example, documentation should make clear

the various reasons why MWFA's auditing contract was awarded to a firm whose services were both more costly and less comprehensive than its competitors.

Similarly, documentation should support why MWFA repeatedly hired an engineering firm as an advisor without any competition, when other qualified engineering firms were available. According to MWFA, the firm is uniquely qualified to provide advice about New York City's water and sewer system, because of its extensive involvement in construction projects for the system. However, we question whether it is prudent for MWFA to rely exclusively on a single engineering firm for this advice and whether the firm's advice can be sufficiently disinterested, given its extensive involvement with the system.

In addition, MWFA needs to obtain the annual independent audit of its investments that is statutorily required.

MWFA is governed by a seven-member Board of Directors. We found certain improvements are needed in the Board's governance practices, and believe these improvements will help strengthen control. For example, two Board members had low attendance rates at Board meetings, and three members did not receive training in their legal, fiduciary, financial, and ethical responsibilities. Such training is required by the New York State Public Authorities Accountability Act of 2005. We also determined that the Board needed to approve MWFA's annual budget and monitor MWFA's financial activity against this budget.

Our report contains 18 recommendations for improving MWFA's financial and management practices.

MWFA officials disagreed with some of our conclusion. They agreed with certain of our recommendations indicating steps taken to implement them.

This report, dated November 7, 2008, is available on our website at <http://www.osc.state.ny.us>

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Office of the State Comptroller

Division of State Government Accountability

110 State Street, 11th Floor

Albany, NY 12236

BACKGROUND

The New York City Municipal Water Finance Authority (MWFA) is a public benefit corporation. It was created in 1984 by Article 5, Title 2-A, of the New York State Public Authorities Law. MWFA was created for the purpose of financing capital improvements in New York City's municipal water and sewer system (water system).

The capital improvements are made by the New York City Department of Environmental Protection (DEP), a City agency that is responsible for the operation and maintenance of the water system. The system itself is leased from the City by another public benefit corporation, the New York City Water Board (Water Board). The Water Board is authorized to establish rates and collect fees and charges adequate to pay the cost of operating and financing the system.

MWFA issues bonds or notes to finance the cost of the capital improvements. As of October 17, 2006, MWFA had issued a total of about \$28.8 billion in bonds, of which about \$16 billion was outstanding. MWFA issues commercial paper to provide interim financing for the capital improvements, and

this commercial paper is eventually redeemed by long-term debt (bonds).

The Water Board collects fees from the water system's customers and distributes the revenue to MWFA and DEP. Pursuant to a Financing Agreement among the Water Board, MWFA, and DEP, the Water Board first remits sufficient revenue to MWFA to meet its bond obligations and operating costs. It then remits revenue to DEP for that agency's operating costs, and it covers its own operating costs. If there is any revenue left over, the Water Board remits the surplus revenue to MWFA. MWFA may use this revenue toward its bond obligations or can choose to apply the funds to any purpose enumerated in the Financing Agreement.

For the year ended June 30, 2007, MWFA had an operating budget of \$20 million. About half of the budget represented fees that were to be paid to the New York State Environmental Facilities Corporation, which provides MWFA with low-interest debt financing. Most of the rest of the budget represented banking fees and a small portion for professional consulting services needed for bond issuances.

MWFA has only two full-time and two part-time staff. These four staff are sometimes augmented by staff from the New York City Office of Management and Budget (OMB). MWFA reimburses OMB for the cost of these additional part-time personnel. While MWFA is an independent public benefit corporation, it obtains office space and other types of administrative support from OMB.

MWFA is governed by a Board of Directors consisting of seven members. Four of the members are *ex officio*: the Commissioner of the State Department of Environmental Conservation, the Commissioner of New York City DEP, the Director of New York

City OMB, and the New York City Commissioner of Finance. Two of the three remaining members are appointed by the Mayor of New York City and one is appointed by the Governor.

AUDIT FINDINGS AND RECOMMENDATIONS

Internal Controls

We found MWFA needs to develop written policies and procedures for critical areas of its operations. We also identified opportunities for improvement in MWFA's controls over procurement and contracting, and in the controls over investments, employee hiring, and disbursements.

Policies and Procedures

As a standard business practice, an organization should have written policies and procedures in place to inform employees of their duties. These procedures provide operational guidance to employees and help the organization carry out its mission as intended.

We found that MWFA has prepared written policies and procedures in the areas of procurement, employee compensation, employee travel allowances, whistle-blower protection, acquisition and disposition of property, indemnification and defense of directors, and ethics. These policies and procedures were issued in November 2006 in response to requirements imposed by the New York State Public Authorities Accountability Act of 2005 (Act).

However, MWFA has not prepared written policies and procedures in the areas of debt issuance (its main function), cash management (including receipts and disbursements), or payroll; and has prepared

general guidelines only in the area of investment management (these general guidelines are discussed later in the section of this report entitled *Investments*). Establishing written policies and procedures for these areas increases assurances that MWFA's activities are performed in accordance with requirements.

MWFA officials stated that they established policies and procedures for all the areas specified in the Act. They added that, due to the small size of their organization and because of the experience and professionalism of their staff, they can function effectively and efficiently without written policies and procedures in the other areas. Nevertheless, they indicated they will consider developing additional policies and procedures for these areas.

We believe operational policies and procedures are necessary. For example, when we reviewed MWFA's debt issuance process, we found that the information used in determining MWFA's minimum cash balance requirements for its debt service payments came from 42 different sources, and only 1 MWFA manager knew the process. It is important that such critical processes be described adequately in formal procedures, in case current employees leave the organization and new employees become responsible for the processes.

Procurement and Contracting

Professional services contracts account for a significant portion of MWFA's total operating costs. To help ensure that the costs of such contracts are reasonable and the contracts are awarded in a fair and objective manner, the procurement process should be open and competitive.

We examined MWFA's procurement process and found that the process is not always as open and competitive as it could be. The procurement guidelines developed by MWFA do not sufficiently promote competition. In particular, they do not contain guidance for a number of common competitive practices. For example, while it appears that the guidelines state that requests for proposals (RFPs) can be used when professional services are needed, the guidelines provide no guidance for the development of such requests and no guidance for the evaluation of proposals received in response to such requests. The guidelines also contain no guidance for sole source procurements, price negotiations, or competitive sealed proposals.

We note that MWFA did not have procurement guidelines until November 2006, when its current guidelines were adopted pursuant to requirements contained in the Act. We question whether these guidelines (a mere two and one-half pages) satisfy the letter of the law. While we acknowledge that MWFA is not subject to the procurement guidelines issued by the New York City Procurement Policy Board (which sets procurement policy for all New York City agencies), we note that the Citywide guidelines are 169 pages long. While we would not expect the MWFA procurement guidelines to be as comprehensive as the City's, we would expect MWFA's guidelines to provide some specific guidance in the common critical areas of competitive procurement. MWFA officials stated that their procurement guidelines are adequate for an agency of its size and there is no need to amend them.

We reviewed a sample of contracts to determine whether they were awarded in an open and competitive manner. The period covered by our sample was July 1, 2003, through February 28, 2007. We reviewed the contracts relating to 6 of 14 requests for

proposals issued by MWFA for contracts that were active during that period. These contracts covered such services as bond underwriting, auditing, printing, and consultant engineering.

We found the contractor selection process was not documented adequately. As a result, we could not determine why MWFA selected one proposal rather than another when more than one proposal was submitted. We also found that one of the vendors (a consultant engineer) was repeatedly selected as a consultant without competition, even though other qualified engineering firms were available.

Three of the six requests for proposals that we examined related to a contract for bond underwriting services (the underwriters purchase the bonds from MWFA and re-sell them on the market for a commission). In this type of contract, MWFA designates one underwriter, from its pool of pre-approved underwriters, to function as the lead underwriter for a particular bond issuance. MWFA selects this underwriter on the basis of proposals that are submitted by the underwriters in the pool.

MWFA has a meeting to review the proposals and makes its decision. However, MWFA does not document the basis for this decision and thereby provide transparency and accountability for the decision. Moreover, MWFA has no written policies or guidelines governing the selection process.

MWFA officials told us that the selection of the lead bond underwriter is made in consultation with officials of the various New York City governmental financing agencies, and MWFA is not legally required to do any more than this. We acknowledge that MWFA is not legally required to do more, but we believe public accountability would be better

served if the basis for these decisions were documented and the decision process were subject to formal guidelines.

One of the requests for proposals that we examined related to a contract for consultant engineering services in connection with the debt issuance process. In this type of contract, an engineering firm is asked to provide an opinion on the engineering feasibility of the City's water system and the capital improvement projects.

We found MWFA has been using the same engineering firm for these services since it was created in 1984. MWFA does not seek proposals from other firms when it needs these services. Rather, it hires the one firm as a sole source vendor, claiming that the firm is uniquely qualified to provide the services because of its extensive experience with New York City's municipal water system. (Since 1983, the City has awarded the firm 31 contracts totaling \$185.7 million for design, construction, and other types of work on the system.)

We question whether this engineering firm is, in fact, a sole source vendor. Many other engineering firms perform similar work, and some of these firms have experience with New York City's water system. For example, DEP has pre-qualified 30 firms for its engineering needs (the firm used by MWFA and 29 others).

We also question whether it is in MWFA's best interests, or the best interests of the public, to always use the same firm without seeking proposals from other qualified firms. In the absence of a competitive selection process, MWFA has no assurance it receives these consulting services in the most economical manner.

We also note that, in light of the firm's extensive involvement with prior, ongoing and possibly future construction projects in New York City's water system, questions could be raised about the firm's independence in evaluating such capital projects for financing by MWFA. A recent audit by the Nassau County Comptroller identified an independence issue in a similar situation, as a long-term sole source engineering consultant for the Great Neck Water Pollution District was found to have both recommended (as the consultant) and performed (as the contractor) certain maintenance and repair projects for the District.

Another of the requests for proposals that we examined related to a contract for auditing services. A financial audit of MWFA must be performed each year. When MWFA issued a request for proposals in 2004 for a multi-year auditing contract, MWFA received six proposals and selected one. The selected firm cost more than most of the other firms submitting proposals, which is not necessarily inappropriate, because cost is not the only factor to be considered. However, there was no contemporaneous documentation showing why the firm was selected in spite of its higher cost.

For example, the selected firm bid \$243,000 for the 2006 audit, while four other firms (including two Big Four auditing firms) bid \$183,000 or less for that year. Moreover, two of these lower-bidding firms proposed to do more work for their lower prices, as they indicated that they would do their audits in accordance with generally accepted government auditing standards (GAGAS). The selected firm indicated that it would follow generally accepted auditing standards (GAAS), which are less comprehensive than GAGAS.

We note that the selected firm did not meet two important requirements when it performed its audits: (1) it did not provide MWFA with an annual investment report, even though such a report was explicitly required by the contract, and (2) it did not meet the City Comptroller's requirement that the audit be performed in accordance with GAGAS. These matters are discussed in more detail later in this report.

We also determined, during our review, that MWFA did not comply with the following contracting requirements:

- MWFA obtained printing services from a number of vendors that printed materials for bond issuances. However, MWFA did not enter into formal, written contracts with any of these vendors. Rather, according to MWFA officials, the vendors accepted the terms set forth in MWFA's request for proposals. MWFA officials advised that the acceptance of the RFP constitutes a formal contract, and no further action is needed. They added that the selection of the firm is evident from the name of the firm printed on the documents. To fully protect its interests, MWFA should enter into formal, written contracts in such instances.

(MWFA officials stated that when the costs associated with delivering consent letters in connection with the printing of official statements are taken into account, only two of the firms were less expensive than the one they selected. These officials then advised us why each of these two firms was unacceptable to them. Accordingly, MWFA officials assert that the firm selected was the best of the six that submitted proposals.

However, the officials could provide no documentation to support this position.)

- MWFA's procurement guidelines require compliance with the MacBride Principles Provisions for New York City contractors. The MacBride Principles, which were enacted into New York City's Administrative Code in September 1991, require contractors to address employment discrimination and freedom of workplace opportunities. However, we did not find any reference to the MacBride Principles during our review of MWFA contract files.

Investments

MWFA routinely invests millions of dollars annually in the course of meeting its long-term financial obligations. As of September 30, 2006, MWFA had about \$1.4 billion in investments.

MWFA is required by the New York State Public Authorities Law to prepare formal investment guidelines (i.e., general guidelines addressing such matters as the types of investments that are to be made in various circumstances) and obtain the annual approval of its Board of Directors for the guidelines. We found MWFA has prepared such guidelines and has obtained the annual approval of its Board for the guidelines.

MWFA's investment guidelines state that MWFA is to submit quarterly investment reports to its Board of Directors, obtain an annual independent audit of its investments, and make the audit available to the Board when it performs its annual review of the guidelines. We found MWFA has submitted quarterly investment reports for Board

review, as required. However, MWFA has not obtained an annual independent audit of its investments since at least 1998 (we did not review the records for earlier years). As a result, the Board has less assurance the quarterly investment reports have been accurate and the investment guidelines are adequate.

In addition, MWFA is required to submit an annual investment report to certain State and City oversight agencies (the Office of the State Comptroller, the Office of the Mayor of the City of New York, and the Office of the New York City Comptroller). This report is supposed to include an annual independent audit of MWFA's investments. Thus, in the absence of the audit, MWFA was unable to prepare the annual investment report and comply with the reporting requirement.

An independent auditor performs an annual financial audit of MWFA in accordance with the City Comptroller's Directive No. 22. As was previously noted, MWFA's contract with its auditor requires the auditor to prepare the annual investment report (and thus perform the annual investment audit). However, since 1998, none of MWFA's auditors has prepared the annual investment report, and MWFA has taken no action to enforce compliance with the contract terms. We recommend MWFA monitor its auditing contract more closely and make sure that required work is actually performed.

MWFA officials agreed with our findings and stated they would take corrective action. They stated they believed a separate audit of investments was not necessary, because MWFA received an unqualified audit opinion each year; and no management letter from its auditors has indicated problems with its investments. However, a separate audit of investments is necessary, because this type of audit includes a more thorough examination

of investments than the general type of audit that was performed by MWFA's auditors. MWFA's current auditor acknowledged that it did not do enough work to express an opinion on MWFA's investments. (MWFA officials stated at the closing conference that they did not pay for services that were not performed. However, the agreement for services includes certain services that must be performed "at a minimum." We note that one of those services is the Investment Report, which, as noted, was not done.)

We note that, while MWFA's investment guidelines provide general guidance to its employees, they do not describe the detailed procedures that are to be followed by the employees when they make various types of investments or take the other actions required by the guidelines. Consequently, these guidelines do not constitute formal investment procedures, as is noted earlier in the section of this report entitled *Policies and Procedures*. This is why we recommend that MWFA develop such procedures.

Hiring Policy

A 1994 agreement between MWFA and OMB states that MWFA will adopt OMB's personnel and human resources policies. OMB's Deputy Personnel Director told us that, under these policies, MWFA must advertise open positions on the OMB internal website for a minimum of two weeks. In addition, all candidates for the position must be interviewed and a record of the interviews must be forwarded to OMB's Human Resources Department. If no one is selected, then MWFA should advertise the position on the Internet until the position is filled. The successful job candidate should be approved by MWFA's Executive Director and Board Chairperson.

MWFA officials agreed that the provisions of the 1994 agreement apply and stated they generally follow OMB's personnel, payroll, and human resources policies. However, they further stated that they have some discretion when hiring senior-level employees. We question why senior-level employees would not be subject to the same personnel, payroll, and human resources policies as other employees. We note that OMB's personnel, payroll, and human resources policies make no such distinction.

We found that MWFA did not fully adhere to the OMB policies when it hired one senior-level employee, as follows.

There is no evidence that the Executive Director's position was advertised anywhere. Rather, it appears that the former Executive Director simply selected a replacement when he was promoted. The Board's approval was not obtained until after the individual was hired. According to MWFA officials, the new Executive Director was initially hired as an "employee" - with a salary commensurate with that of an Executive Director - and was not actually promoted to the Executive Director position until Board approval was obtained. MWFA also indicated that this process was resorted to after a nationwide search for an Executive Director resulted in the selection of an individual who resigned after less than one year. They added that advertising for open positions can be waived when the situation warrants.

In support of their views, MWFA officials provided an opinion from the City OMB. (See Appendix A, page 21.)

Financial Reporting Requirements

According to Article 2A, Section 1045-y, of the New York State Public Authorities Law, MWFA's accounts are subject to supervision

by the New York City Comptroller. Because it is part of the New York City reporting entity, MWFA is also subject to all of the City Comptroller's internal control and accountability directives. In addition, as a State-established public authority with at least one director appointed by State leaders, MWFA is subject to certain general sections of the Public Authorities Law that deal with reporting requirements, personnel, and investments.

We found that MWFA complied with some of these reporting requirements, but did not comply with others. For example, MWFA is supposed to file annual personnel and investment reports with certain State agencies. However, MWFA has not filed the annual personnel report or the annual investment report. The annual personnel report is supposed to describe the position, grade, salary, and title for each of MWFA's employees, while the annual investment report is supposed to describe MWFA's investment procedures and contain an independent audit of its investments, a record of its investment income, and a list of all fees associated with the investments. In the absence of these reports, MWFA is not being fully accountable to the public.

MWFA is also required by the City Comptroller's Directive No. 1, which was most recently updated in 1995, to complete an annual internal control questionnaire. However, MWFA had never completed this questionnaire. After we brought this matter to the attention of the City Comptroller's Office, MWFA was asked to complete the questionnaire for calendar year 2006.

After MWFA officials had completed the internal control questionnaire, we reviewed it and found it had not been fully completed, as MWFA had indicated that 523 of the 564 questions were not applicable because it

relied on OMB in these areas (which include payroll, personnel, and information systems). We believe MWFA still needs to ensure that these areas are controlled adequately (e.g., MWFA needs to ensure that a written information technology contingency and disaster plan has been prepared). We also note that OMB had not completed the internal control questionnaire, either. Accordingly, we recommend MWFA coordinate with OMB and ensure that the questionnaire is completed fully and adequately.

We also found that MWFA was not fully complying with a provision in the City Comptroller's Directive No. 22. This provision requires that an annual financial audit of the agency be conducted in accordance with generally accepted government auditing standards. MWFA has an annual financial audit, but the audit has been conducted in accordance with GAAS, which provide less comprehensive audit coverage than GAGAS.

Disbursements

MWFA sells bonds and notes to finance capital improvement projects for New York City's water system. MWFA makes these sales when the projects have been approved and their expected costs are known. MWFA then retains the proceeds from the sales until funds are requested by the City to pay for capital project costs. Generally, such requests are made on a monthly basis. Funds are to be provided to the City only to pay for costs that have actually been incurred, and the requests are to be certified by the City Comptroller.

It is MWFA's practice to disburse the amounts requested, as long as the requests have been certified by the City Comptroller. MWFA requests no additional supporting documentation for the amounts requested, such as invoices submitted to DEP by project

contractors. Rather, MWFA relies on City agencies, such as DEP, to review and validate the costs claimed by contractors. We recommend MWFA periodically obtain additional assurances about the reasonableness of these costs. We believe it would be prudent for MWFA, as an independent public benefit corporation with significant fiduciary responsibilities, to seek such assurances.

At the closing conference, MWFA officials stated that they are in compliance with their agreement with the City, which calls for them to sell bonds and to pay the City for amounts it has certified to reimburse the City for the capital costs of water projects. Therefore, they will not change their practice.

In addition, MWFA paid \$6,800 in 2005 for the purchase and use of eight cellular telephones. We attempted to review the documentation supporting these disbursements and found MWFA had no such documentation. However, OMB did have documentation for six of the eight telephones, and this documentation indicated that the telephones were purchased for OMB officials. No documentation was available for the other two telephones, which MWFA officials state were bought for its Comptroller and Assistant Comptroller. We recommend that the Authority charge OMB for devices attributable to OMB work.

Recommendations

1. Develop written policies and procedures for all operational activities.
2. Expand MWFA's procurement guidelines to include specific guidance on the use of common competitive practices such as requests for proposals, sole source procurements, price

negotiations, and competitive sealed proposals.

3. Ensure that the contractor selection process is documented adequately.
4. Seek proposals from more than one firm when consultant engineering services are needed in connection with bond issuances.
5. Enter into formal, written contracts with vendors that provide services.
6. Include a reference to the MacBride Principles in each MWFA contract.
7. Ensure that an annual independent audit of MWFA's investments is performed and made available to the Board of Directors when it performs its annual review of MWFA's investment guidelines.
8. Monitor the auditing contract more closely and pay only for work that is actually performed.
9. The recommendation has been deleted based on information provided in the response to the draft report.
10. Comply fully with all applicable State and City financial reporting requirements.
11. Obtain additional assurances periodically about the reasonableness of the costs claimed on capital improvement projects financed by MWFA.
12. Charge OMB for its share of telephone costs.

Board Governance

In 2004, the Governor's Office established a set of Model Governance Principles (Principles) to help improve oversight, accountability, and transparency at the public authorities operating in New York State. The Principles were based on best practices of corporate governance in the private sector, as well as the requirements of the Federal Sarbanes-Oxley Act of 2002. The Principles addressed board member training, the separation of oversight and executive functions, independence of board members, the establishment of audit and governance committees, and other areas of governance.

MWFA was not named specifically as one of the public authorities expected to follow the Principles, and MWFA made no changes to its governing practices at that time. However, in January 2006, the Public Authorities Accountability Act of 2005 effectively codified the Principles in New York State law, and thus required public authorities to implement the Principles and abide by them. MWFA was named as one of the public authorities required to comply with the Act, and it began to make corporate governance changes. MWFA's Board of Directors is also subject to the New York State Open Meetings Law.

We found certain improvements are needed in the governance practices of MWFA's Board of Directors.

Board Meetings

Proper direction and oversight of any public authority depends inherently on the active participation of the board members, since they are required to approve all major items of business, such as bond issuances and contracts. It is therefore important that they, or their delegates, attend scheduled board

meetings (*ex officio* board members are permitted by law to delegate a representative to act on their behalf in their absence).

However, we found that, during the period February 24, 2003, through December 31, 2006, two of MWFA's Board members missed a significant number of meetings, as follows:

- The two previous *ex officio* members from the State Department of Environmental Conservation did not attend any Board meetings. Both named delegates, but the delegates failed to attend several meetings. The delegate for the period February 2003 through November 2004 attended only 4 of the 9 meetings held during that period, and the delegate for the period February 2005 through November 2006 attended only 10 of the 17 meetings held during that period.
- One of the Board members appointed by the Mayor attended only 6 of the 26 Board meetings held between April 2003 and December 2006.

The Board is less able to function as the State Legislature intended when two of its seven members (or delegates) are absent on a regular basis. To encourage attendance, we recommend the Board perform formal, periodic assessments of each member's performance and use meeting attendance as one of the criteria for evaluating this performance. MWFA management stated they were considering including such assessments in the Board's new charter.

Board committees are considered public bodies that are subject to the New York State Open Meetings Law. The Open Meetings Law requires that the date and time of meetings be posted at least three days prior to

the meeting. MWFA posts the date and time of Board of Directors meetings, but not the meetings of the Board's audit committee and governance committee. To fully comply with the Open Meetings Law, MWFA should post the dates and times of these committee meetings.

MWFA officials do not believe they are legally required to provide public notice for the committee meetings, but agreed to do so in the future.

Governing boards are responsible for overseeing the work done by the executive staff they have selected to run day-to-day operations. It is inherent in basic governance principles that governing boards do not include members of the executive staff. The Model Governance Principles explicitly called for the separation of oversight and executive functions, and this kind of separation is also required by the Act.

We noted that the Executive Director was a member of the Board and voted on the Board, but this practice stopped when the Act was passed. As a result, board governance has been strengthened.

Board Member Training

The Act requires individuals appointed to a public authority's board of directors to participate in State-approved training regarding their legal, fiduciary, financial, and ethical responsibilities as board members. The training is to be provided within one year of an individual's appointment to the board.

The New York State Authority Budget Office (Budget Office) was formed to oversee public authorities on matters related to the Act. The Budget Office allowed existing board members one year from the start of their authority's fiscal year, between January and

December 2006, to receive the required training, but was willing to extend this deadline to the end of the authority's fiscal year in 2008, provided the board members made a "best faith effort" to satisfy the requirement.

The Budget Office states that it is the responsibility of each authority to maintain documentation of board member participation in required training. The documentation should include the names of board members who attended training, the date of the training, the location of the training, and the State-approved trainer who conducted the training. All of this information should be listed on the course completion certificate.

MWFA has seven Board members and an additional six individuals who serve as delegates for some of the Board members. All 13 of these individuals have been in their positions since June 2005. As a result, they should have received the required training by June 30, 2007. However, according to MWFA records, as of that date, only four of the seven board members and two of the six delegates had participated in a training program. MWFA provided training certificates for the six.

Seven of the 13 Board members/delegates had not participated in the training program. Three of these seven individuals told the Budget Office that they made a "best faith effort," but were unable to attend the training and would attend before the end of the year. However, there was no documentation explaining what these best faith efforts were. We recommend MWFA provide and document all Board members training in accordance with requirements.

At the closing conference, MWFA officials advised that the three *ex officio* Board members had completely delegated their

Board responsibilities to another individual and do not plan to attend any Board meetings. As a result, they (*ex officio*) do not have to attend training. MWFA officials provided the Authority Budget Office response to frequently-asked questions to support of the waiver for training for the three *ex officio* members. However, MWFA did not provide any documents from the three individuals. We question whether this meets the intent of the law because the experience and expertise of the *ex officio* members are not available when they effectively delegate their responsibilities and do not attend Board meetings.

Board Committees

The Act and Directive No. 22 of the New York City Comptroller require public authorities, including MWFA, to establish an audit committee with certain designated responsibilities. The Act also requires MWFA's Board to establish a governance committee. We found MWFA has had an audit committee for many years and it established a governance committee in 2006, after it was required to do so by the Act.

The Budget Office recommends that board committees have charters to govern their operation and detail how the committees help the board direct affairs. However, as of June 2007, MWFA had not established charters for either the audit or governance committees. MWFA officials advised that in October 2007, after our audit field work, both of these committees adopted a charter.

Directive No. 22, which was issued in 1995, requires audit committees to prepare minutes that document their activities and to prepare annual reports of their activities and decisions. However, MWFA keeps no minutes of the audit committee meetings and prepares no annual report of the committee's activities. According to MWFA officials, the

minutes and annual reports are not prepared because the audit committee does not make decisions but instead recommends actions to the full governing Board. The officials also stated they did not know that MWFA was subject to Directive No. 22.

Budgetary Oversight

Section 2801 of the New York State Public Authorities Law requires all authorities (including MWFA) to prepare an operating and capital budget, approved by the governing board, 90 days before the beginning of each fiscal year. As a matter of good business practice, the board of directors should periodically monitor actual financial activity against the budget; and such financial supervision should be noted in the minutes of the board meetings.

We reviewed MWFA's Board meeting minutes for the period January 2003 through March 2007. We found that the Board did not formally approve any annual budget during this period. In addition, there was no indication in the meeting minutes, or elsewhere, that the Board had monitored MWFA's actual financial activity against the budget. MWFA officials advised that, after our audit field work, the minutes reflect the Board's approval of the Authority's budget.

Recommendations

13. Perform formal, periodic assessments of each Board member's performance and use meeting attendance, by either the member or the member's designee, as one of the criteria for evaluating this performance.
14. Post the dates and times of all Board committee meetings publicly.

15. Ensure that all Board members and their designees receive the required training within the required time frames, and fully document this training. If any training requirements are not met, document the reasons why.
16. Establish charters for the audit and governance committees.
17. Prepare and maintain minutes of all Board committee meetings.
18. File annual audit committee reports as required by the New York City Comptroller's Directive No. 22.
19. Ensure that MWFA's budget is approved by the Board at least 90 days before the beginning of each fiscal year, and that the Board monitors MWFA's actual financial activity against the budget throughout the year.

AUDIT SCOPE AND METHODOLOGY

We conducted our audit in accordance with generally accepted government auditing standards. We audited selected financial and management practices of MWFA for the period April 1, 2004, through April 20, 2007. The areas of financial operation addressed by our audit included cash and investments, payroll, procurement and contracting, bond financing, and budgeting and expenditure control.

To achieve our objectives, we reviewed applicable laws, rules, and regulations; interviewed MWFA personnel; and analyzed documents. We also performed detailed reviews and analyses of records and reports relating to MWFA activities.

In addition to being the State Auditor, the Comptroller performs certain other

constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

AUTHORITY

The audit was performed pursuant to the State Comptroller's authority as set forth in Article X, Section 5, of the State Constitution, and Section 2803 of the Public Authorities Law.

REPORTING REQUIREMENTS

A draft copy of this report was provided to MWFA officials for their review and comment. Their comments were considered in preparing this final report, and are included as Appendix A.

Within 90 days of the final release of this report, we request that the Chairman of the New York City Municipal Water Finance Authority report to the Governor, State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons why.

CONTRIBUTORS TO THE REPORT

Major contributors to this report include Carmen Maldonado, Gerald Tysiak, Roger C. Mazula, Joseph Smith, Richard Moriarty, Nancy Zgaljardic, Robert Stevens and Dana Newhouse.

APPENDIX A - AUDITEE RESPONSE



New York City Municipal Water Finance Authority

75 Park Place, 6th Floor
New York, NY 10007
Tel. (212) 788-5889
Fax. (212) 788-9197
<http://www.nyc.gov/nyw>

June 27, 2008

Carmen Maldonado
Office of the State Comptroller
123 William Street, 21st Floor
New York, NY 10038-3804

Re: Draft Report on "Selected Financial and Management Practices"

Dear Ms. Maldonado:

The above-referenced draft report was received by the New York City Municipal Water Finance Authority (the "Authority") on May 29, 2008, following the conclusion of your audit which commenced in November 2006. As the report correctly notes, the Authority was created by New York State ("State") law in 1984 at the request of the City of New York (the "City"). Its powers and duties are limited to the financing of the City's water and sewer system (the "System") and are set forth in the New York City Municipal Water Finance Authority Act (the "Act").

The Authority is housed within the offices of the City's Office of Management and Budget ("OMB") and is overseen by a statutorily-created Board of Directors consisting of three *ex-officio* City officials, an *ex-officio* State official, two appointees of the Mayor of the City and one appointee of the Governor of the State. The Act effectively provides that no board action will be taken without the participation of at least two of the three City *ex-officio* board members. Pursuant to the Act, the Authority efficiently and cost-effectively manages the capital financing program of the System, which includes managing a portfolio of over \$19 billion of outstanding bonds and, for the current fiscal year, issuing over \$2 billion of bonds. The Authority has achieved a credit rating higher than that of the City of New York, which allows the Authority to issue bonds at lower interest rates, which is ultimately a savings for ratepayers. The Authority performs these services at minimal cost to the ratepayers and with limited overhead, including only five full-time-equivalent employees. We note however that, contrary to the assertions in your report, only a small portion of the Authority's operating budget is for professional consulting services. The majority of the budget is for fees to the New York State Environmental Facilities Corporation and to banks issuing letters of credit and liquidity facilities, in each case as required in connection with the issuance of Authority bonds. Additionally, we note that your report states that surplus revenues of the Water Board are to be used by the Authority towards its debt obligations. This is not accurate. While these funds may be used to pay debt service, pursuant to the Financing Agreement (incorrectly referred to in your report as the "Memorandum of Agreement") by and among the City, the Authority and the Water Board, the Authority can choose to apply the funds to any of the enumerated purposes set forth in the Financing Agreement, including pay as you go capital.

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* See State Comptroller's Comment, page 21

The following are our responses to your recommendations.

Policies and Procedures. The Authority is in the process of developing additional written policies and procedures for key operational areas, as your report proposes.

Procurement Guidelines. The Authority's procurement guidelines are appropriate for a small entity such as the Authority which enters into very few contracts each year. The Authority's procurement guidelines contain provisions covering requests for proposals, sole source procurements, price negotiations and competitive sealed proposals, contrary to the assertion in your report. The guidelines also set standards for small purchases. These guidelines are adequate to ensure proper procurement processes while allowing the Authority to carry out its procurements in an efficient manner. There is no need to amend our current procurement guidelines.

Documentation of Reasons for Contractor Selections. The Authority's contractor selections (except for small purchases) are made by a committee consisting of Authority staff and representatives of the City Comptroller and Mayor. Contracts are also approved by the Authority's Board of Directors. All of the Authority's contracts have been unanimously approved by all such parties, including representatives of the separately-elected officials. The Authority keeps records of all proposals submitted and has explained the rationale for each contractor selection about which you have inquired.

Written Contracts. The Authority always enters into written contracts with vendors, unless purchases fall within the small purchase category such as purchases of office supplies. Your report has identified one instance in which your report states, incorrectly, that the Authority did not enter into a written contract. In that case, your report states that the Authority obtained printing services "from a number of vendors that printed materials for bond issuances." The Authority selects only one financial printer following a request for proposals process. The Authority uses that printer for a period of years, after which a new request for proposals process is issued to select a printer for the subsequent period. The request for proposals includes a detailed scope of work and specifications along with terms and conditions for the completion of work. Proposers submit bids based on the specifications, terms and conditions within the request for proposals. When the Authority selects a printer, a legal and binding contract exists based on the detailed specifications, terms and conditions provided by the Authority and the fees bid by the printer. No additional writing is necessary to form a valid, legal and binding contract. Furthermore, because all of the terms of the engagement are spelled out within the existing documents between the parties, an additional document would be superfluous and would not provide any legal benefit to the Authority.

MacBride Principles. The Authority now includes the MacBride Principles as an attachment to its contracts.

Investment Compliance Reports. Your report states correctly that the Authority did not receive separate investment compliance reports that auditors were required to deliver under the Authority's auditor contract. The Authority has received that report for

fiscal year 2007 and will ensure that it continues to receive the report in the future. However, your report incorrectly states that the Authority was charged for the investment compliance reports when they were not delivered. The Authority paid its auditors only for the financial statement audit, which did not include the investment compliance report. Had the auditors completed that report, it would have been billed separately at the hourly rates specified in their contract.

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Hiring Policies. The Authority has agreed to comply with the personnel policies of OMB. Your report incorrectly states that the Authority did not comply with such policies in connection with the hiring of its Executive Director. Although OMB's personnel policies generally require that open positions be advertized, the agency has discretion to use other means of selecting a candidate when the situation warrants. In this case, less than one year prior, the Authority had conducted a nationwide search for an officer to assume primary responsibility for running the Authority. This search involved advertizing and interviewing many candidates for the position. Based on its experience with that recent search and after receiving new resumes from senior officials at State agencies, the Authority determined that it would not be fruitful to repeat a lengthy search process. The Authority interviewed two candidates and selected a highly-qualified individual with extensive experience at one of the largest municipal borrowers in the State. Therefore, this process complied with OMB policy and was appropriate under the circumstances. Please see the attached memo from OMB's Director of Personnel concurring that the hiring procedure followed by the Authority did not violate OMB's personnel policies.

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In addition, your report incorrectly states that the Executive Director was appointed prior to action by the Authority's Board of Directors. Although the candidate began working at the Authority as a staff member pending approval by the Board, he was not appointed Executive Director until the Board took action to appoint him.. Furthermore, his continued employment with the Authority was contingent on his appointment as Executive Director by the Board.

Directive 1 Questionnaire. Your report correctly states that the Authority did not complete the City Comptroller's annual questionnaire referred to as Directive 1 and that it did not file the required annual investment report and annual personnel report with the State. The Authority completed such questionnaire and reports commencing with fiscal year 2007 and will continue to do so in the future.

Project Cost Review. The Authority has entered into agreements with the City and the New York City Water Board that define the role of each party in connection with the operation and financing of the water and sewer system and the rate setting with respect thereto. Your report states incorrectly that the Authority's agreement with the City "only calls for the Authority to sell bonds." In fact, the Financing Agreement among the Authority, the City and the New York City Water Board sets forth in detail the duties and obligations of the Authority. Section 3.2 of that agreement requires that the Authority pay the City amounts that it has certified to reimburse the City for the cost of water projects. The Authority's staff is made up of finance professionals. The Authority

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* See State Comptroller's Comment, page 21

is not qualified, and under its agreement with the City is not permitted, to substitute its own judgment for that of the City as to whether the costs of water projects are reasonable. The Authority is entitled, and in fact is required, to rely on the professional determinations as well as the procurement, internal controls and accounting systems of the City of New York.

Telephone Charges. In 2005, the Authority purchased eight Blackberry devices for members of its staff and members of OMB staff who allocate time to work for the Authority. You requested authorization forms for those purchases and received such forms for six of the eight devices. The other two devices were for the Comptroller and the Assistant Comptroller of the Authority, positions at a level consistent with other personnel at the Authority and OMB that were entitled to receive Blackberry devices. The costs of the devices attributable to time spent by staff members on OMB matters has now been charged by the Authority to OMB. However, this represents only a portion of the total cost of \$6,800 for all the devices. Your suggestion that the entire costs of these devices be charged to OMB is inappropriate. The Authority will not charge OMB for devices that are not attributable to OMB work.

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Public Notice of Board Meetings. The Authority has always posted notice of Board meetings. The Authority now posts notice of all committee meetings as well, even when they are held in conjunction with Board meetings where a notice has been posted.

Board Member Training. The Authority Budget Office (“ABO”) was created by State law to oversee the implementation of the Public Authorities Accountability Act (“PAAA”), including the PAAA’s Board Member training requirement. ABO Policy Guidance No. 06-01 states that Board Members should participate in training by the end of the fiscal year beginning in 2006 (i.e., by June 30, 2007, in the case of the Authority). That Guidance further provides that, although the ABO expects that best efforts will be made to complete training by that date, it understands that full compliance may not be possible until, in the case of the Authority, by June 30, 2008. As of June 30, 2007, six of the required ten Board Members and delegates had completed training. The four who had not completed training by that date submitted letters to the Authority stating that they had made best efforts to attend training, but were unable to do so and further stated that they would attend training by the ABO-established deadline. All Board Members and delegates who are required to attend training have now completed the training, in advance of the June 30, 2008 deadline. *Ex-officio* Board Members are permitted by law to delegate their responsibilities to “a deputy or assistant in their respective departments or offices....” (Public Authorities Law Section 1045-c(4)). The ABO has determined that “[b]oard members are not required to participate in training only if they have effectively delegated their responsibilities as a board member to a designee.” (ABO “Frequently Asked Questions”) Therefore, it is the delegate, rather than the *ex-officio* Board Member who is required to attend training. The Authority does not take issue with the ABO’s conclusion; it seems appropriate that the individuals who are designated to attend board meetings would be the ones to participate in training.

* See State Comptroller's Comment, page 21

Audit and Governance Committees. The Authority established audit and governance committees when required under applicable law.

Minutes of Committee Meetings. The Authority has always prepared minutes of committee meetings in accordance with the New York State Public Officers Law. Minutes are not required when a committee takes no action.

Audit Committee Reports. The Authority's Audit Committee filed an annual report of its activities with the City Comptroller for calendar year 2007 and will continue to do so in the future.

Annual Budgets. The Authority's Board adopted budgets for fiscal years 2008 and 2009 and will continue to do so in the future.

Very truly yours,



Mark Page



The City of New York
Office of Management and Budget
75 Park Place
New York, NY 10007
(212) 788-5882

June 19, 2008

New York City Municipal Water Finance Authority
75 Park Pl.
New York, NY 10007

Ladies and Gentlemen:

I am writing to confirm that the process followed by the New York City Municipal Water Finance Authority ("NYW") in hiring its Executive Director complied with the personnel policies of the New York City Office of Management and Budget ("OMB"), in accordance with the agreement between OMB and NYW. Although it is generally the policy of OMB that open positions be advertised, that requirement may be waived when the situation warrants. Because the Authority had completed a nationwide search within the preceding year and because it had also received resumes and interviewed two highly-qualified individuals for the position, the OMB determined that an advertisement was not necessary in this case.

Very truly yours,

A handwritten signature in black ink, appearing to read "Carol DiDonna".

Carol DiDonna
Director of Personnel

* State Comptroller's Comment: The final audit report has been revised to reflect information provided in the Authority response to the draft audit report.