

# San Antonio Water System

Schedule of Expenditures of Federal Awards  
For the Year Ended December 31, 2016

## Contents

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RSM US LLP

**Report on Internal Control Over Financial Reporting and on Compliance  
and Other Matters Based on an Audit of Financial Statements  
Performed in Accordance With *Government Auditing Standards***

To the Board of Trustees  
San Antonio Water System

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the business-type activities and the aggregate remaining fund information of San Antonio Water System (SAWS) as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the basic financial statements, and have issued our report thereon dated May 31, 2017, which included an emphasis of matter about a restatement of the prior-year financial statements to reflect the merger of the San Antonio Water System District Special Project with SAWS, effective January 1, 2015.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered SAWS' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SAWS' internal control. Accordingly, we do not express an opinion on the effectiveness of SAWS' internal control.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of SAWS' financial statements will not be prevented or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described in the accompanying schedule of findings and questioned costs as finding 2016-001, which is considered to be a significant deficiency.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether SAWS' financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and the Public Funds Investment Act (PFIA), noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or PFIA.

**SAWS' Response to Finding**

SAWS' response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. SAWS' response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

**Purpose of This Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of SAWS' internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SAWS' internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*RSM US LLP*

San Antonio, Texas  
May 31, 2017



RSM US LLP

**Report on Compliance for a Major Federal Program, Report on Internal Control Over Compliance and Report on the Schedule of Expenditures of Federal Awards as Required by the Uniform Guidance**

To the Board of Trustees  
San Antonio Water System

**Report on Compliance for a Major Federal Program**

We have audited San Antonio Water System's (SAWS) compliance with the types of compliance requirements described in the *Office of Management and Budget Compliance Supplement* that could have a direct and material effect on SAWS' major federal program for the year ended December 31, 2016. SAWS' major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

**Management's Responsibility**

Management is responsible for compliance with the requirements of laws, regulations, contracts and grant agreements applicable to its federal program.

**Auditor's Responsibility**

Our responsibility is to express an opinion on compliance for SAWS' major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about SAWS' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for its major federal program. However, our audit does not provide a legal determination of SAWS' compliance.

**Opinion on the Major Federal Program**

In our opinion, SAWS complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2016.

## **Report on Internal Control Over Compliance**

Management of SAWS is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered SAWS' internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of SAWS' internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected and corrected on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses or significant deficiencies. However, material weaknesses or significant deficiencies may exist that have not been identified.

## **Purpose of This Report**

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

## **Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance**

We have audited the financial statements of SAWS as of and for the year ended December 31, 2016, and have issued our report thereon dated May 31, 2017, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis, as required by the Uniform Guidance, and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the financial statements as a whole.

*RSM US LLP*

San Antonio, Texas  
May 31, 2017

**San Antonio Water System**

**Schedule of Expenditures of Federal Awards  
For the Year Ended December 31, 2016**

Federal Grantor/Pass-Through/Grantor/Program Title	Federal CFDA Number	Program/ Grant Number	Total Program/ Grant Award	Expenditures
Environmental Protection Agency:				
Passed through the Texas Water Development Board:				
Capitalization Grants for State Revolving Funds (Clean Water State Revolving Fund):				
Series 2007 Junior Lien Revenue and Refunding Bonds	66.458	135700	\$ 8,070,000	\$ -
Series 2008 Junior Lien Revenue Bonds	66.458	L070028	30,000,000	-
Series 2010A Junior Lien Revenue and Refunding Bonds	66.458	L090013	17,930,000	-
Series 2012 Junior Lien Revenue Bonds	66.458	L110061	19,630,000	-
Capitalization Grants for State Revolving Funds (Drinking Water State Revolving Fund):				
Series 2013C Junior Lien Revenue Bonds	66.468	L1000196	26,370,000	2,141,053
Series 2014D Junior Lien Revenue Bonds	66.468	L1000303	22,400,000	9,777,764
Series 2015A Junior Lien Revenue Bonds	66.468	L1000354	75,920,000	14,421,467
Series 2016D Junior Lien Revenue Bonds	66.468	L1000547	12,500,000	<u>343,296</u>
Total expenditures of federal awards				<u>\$ 26,683,580</u>

See notes to schedule of expenditure of federal awards.

**San Antonio Water System**

**Notes to Schedule of Expenditures of Federal Awards  
For the Year Ended December 31, 2016**

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1. The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of SAWS and is presented on the accrual basis of accounting. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance). Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the financial statements.
2. SAWS is indebted to the Texas Water Development Board (TWDB) as a result of the issuance of the City of San Antonio, Texas Water System Junior Lien Revenue and Refunding Bonds, Series 2007 and 2010A and the Junior Lien Revenue Bonds, Series 2008, 2012, 2013C, 2014D, 2015A and 2016D. The bonds were sold under the federal cross cutter program for financing qualified SAWS improvements related to wastewater, recycled water and water delivery systems. The amounts reflected in the Schedule represents expenditures incurred during the year ended December 31, 2016. The following table contains information about these bonds.

Bond	Federal CFDA Number	Interest Rate	Term—Annual Maturities Through	Outstanding Balance at December 31, 2016 (in Thousands)
Series 2007 Junior Lien Bonds	66.458	1.70%-2.40%	May 15, 2027	\$ 4,830
Series 2008 Junior Lien Bonds	66.458	1.15%-3.95%	May 15, 2038	24,210
Series 2010A Junior Lien Bonds	66.458	0.00%-3.31%	May 15, 2040	15,040
Series 2012 Junior Lien Bonds	66.458	0.00%-1.85%	May 15, 2042	17,315
Series 2013C Junior Lien Bonds	66.468	0.00%-2.74%	May 15, 2033	22,720
Series 2014D Junior Lien Bonds	66.468	0.00%-1.96%	May 15, 2034	20,295
Series 2015A Junior Lien Bonds	66.468	0.00%-1.97%	May 15, 2045	73,740
Series 2016D Junior Lien Bonds	66.468	0.00%-1.53%	May 15, 2046	12,500

3. Of the federal expenditures presented in the Schedule, SAWS did not provide any federal awards to any subrecipients.
4. SAWS has elected to not use the 10 percent de minimis indirect cost rate allowed under the Uniform Guidance.



**San Antonio Water System**

**Summary Schedule of Prior Audit Findings  
For the Year Ended December 31, 2016**

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No findings reported in the prior year.

**San Antonio Water System**

**Schedule of Findings and Questioned Costs  
For the Year Ended December 31, 2016**

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I. Summary of Auditor's Results

A. Financial Statements

1. Type of auditor's report issued: Unmodified
2. Internal control over financial reporting:
- Material weakness(es) identified?  Yes  No
  - Significant deficiency(ies) identified that are not considered to be material weaknesses?  Yes  None Reported
3. Noncompliance material to financial statements noted?  Yes  No

B. Federal Awards

1. Internal control over major programs:
- Material weakness(es) identified?  Yes  No
  - Significant deficiency(ies) identified that are not considered to be material weakness(es)?  Yes  None Reported
2. Type of auditor's report issued on compliance for major programs: Unmodified
- Any audit findings disclosed that are required to be reported in accordance with Section 2 CFR 200.516(a) of the Uniform Guidance?  Yes  No

3. Identification of major programs:

CFDA Number	Name of Federal Program
66.468	Texas Water Development Board Capitalization Grants for Drinking Water State Revolving Funds

Dollar threshold used to distinguish between Type A and Type B programs: \$800,507

Auditee qualified as low-risk auditee?:  Yes  No

(Continued)

## San Antonio Water System

### Schedule of Findings and Questioned Costs (Continued) For the Year Ended December 31, 2016

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#### II. Financial Statement Findings

##### A. Significant Deficiency in Internal Control

###### **Finding 2016-001:** Accounting and Reporting for the Capitalization of Self-Constructed Assets

**Criteria:** Management is responsible for preparing financial statements in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). Management is also responsible for designing and implementing policies and procedures which document the controls and control objectives used in the process of capturing amounts reported in the financial statements, and such documentation should be readily available.

**Condition/Context:** SAWS has a capital program that includes accounting and financial reporting for self-constructed assets. In order to account for the capitalization of these costs, management has developed a process for tracking these internally accumulated ancillary costs. The process lacks written documentation and control procedures. A brief and high-level description of this process includes the following:

1. SAWS performs an assessment of every accounting group and the expected level of effort from each accounting group that is directly attributable to its self-constructed assets and documents the expected level of effort that is part of placing its assets into service.
2. The amounts captured as ancillary costs of self-constructed assets are captured in the system, supported by summarized spreadsheets. Such amounts are further assessed throughout the year where adjustments are made as the expected effort is informally verified and compared to actual by the finance department.

**Effect:** Although the process is detailed and extensive, the following was noted:

1. SAWS' current capitalization policy does not specifically address the accounting and financial reporting for self-constructed assets or the process currently in place.
2. There are labor costs being capitalized as part of self-constructed assets related to employees' time and effort spent on multiple construction projects, but there are no time sheets supporting the employee's time and effort being capitalized. The support for these labor costs was primarily based on the detailed and extensive process referenced above.
3. RSM US LLP reported a passed adjustment in the amount of \$5,283,189.

**Cause:** The matters noted above are the result of the process lacking written documentation of accounting policies and control procedures.

**Recommendation:** We recommend the capitalization policy include comprehensive guidelines and control procedures specific to the accounting and financial reporting of self-constructed assets. The policy should define ancillary costs, which include, at a minimum, direct labor and other direct costs, as well as define the level of supporting documentation required for each type of cost to allow for an enhancement in both accountability and consistency in the treatment of direct construction costs in accordance with U.S. GAAP.

Management's capitalization policy should also incorporate the use of periodic certification (monthly, quarterly), random moment time studies or time and effort tracking of each employee whose labor is being capitalized. The tracking procedure should include daily time and effort logs for employees whose majority of time is spent on capital projects and time studies for employees whose time on capital projects is not constant or significant.

**San Antonio Water System**

**Schedule of Findings and Questioned Costs (Continued)  
For the Year Ended December 31, 2016**

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***Views of Responsible Official(s) and Planned Corrective Actions:***

*Comment:* Management believes that SAWS capitalization policies are consistent with U.S. GAAP. Management will develop a more detailed capitalization policy that includes comprehensive guidelines and control procedures in order to provide better documentation and support for ancillary costs capitalized related to self-constructed assets. The policy will identify ancillary costs eligible for capitalization in accordance with U.S. GAAP, as well as define the level of supporting documentation required for each type of cost capitalized. This documentation will include periodic time studies and effort tracking for employees whose labor is being capitalized.

*Contact Person:* Mary Bailey, Vice President—Business Planning and Controller

*Anticipated Date of Completion:* December 31, 2017

B. Compliance Findings

No findings to report.

III. Findings and Questioned Costs for Federal Awards

A. Significant Deficiency in Internal Control Over Major Programs

No findings to report.

B. Compliance Findings

No findings to report.

**San Antonio Water System**

**Corrective Action Plan  
For the Year Ended December 31, 2016**

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Comment Number	Comment	Corrective Action Plan	Contact Person	Anticipated Date of Completion
<b>Findings for Financial Statements</b>				
<b>Significant Deficiencies</b>				
2016-001	Accounting and reporting for the capitalization of self-constructed assets	See corrective action plan at 2016-001.	Mary Bailey, Vice President— Business Planning and Controller	December 31, 2017

