

SPECIAL AUDIT

# CITY OF CHOCTAW

For the period January 1, 2009 through June 30, 2013



*Independently serving the citizens of  
Oklahoma by promoting the  
accountability and fiscal integrity of  
governmental funds.*



Oklahoma State  
Auditor & Inspector  
Gary A. Jones, CPA, CFE

**Audit Report of the  
City of Choctaw**

**For the Period  
January 1, 2009 through June 30, 2013**



# Oklahoma State Auditor & Inspector

2300 N. Lincoln Blvd. • State Capitol, Room 100 • Oklahoma City, OK 73105 • Phone: 405.521.3495 • Fax: 405.521.3426

November 14, 2013

TO THE CHOCTAW CITY COUNCIL

The following is our special audit of the City of Choctaw Town Square development, pursuant to your request. The objectives of our audit primarily included, but were not limited to the concerns noted in the audit request.

The goal of the State Auditor and Inspector is to promote accountability and fiscal integrity in state and local government and to maintain our independence as we provide this service to Oklahoma taxpayers.

This report is addressed to and intended solely for the information and use of the Mayor and City Council, and other state officials given oversight responsibilities, as provided by statute. This report is a public document pursuant to **51 O.S. § 24A.1, et seq.**

Sincerely,

A handwritten signature in blue ink that reads "Gary A. Jones".

GARY A. JONES, CPA, CFE  
OKLAHOMA STATE AUDITOR & INSPECTOR

**Executive  
Summary**

The Choctaw City Council requested that the State Auditor's Office review developer expenditures for its Town Square development in relation to its written agreement with the developer, Choctaw Town Square, LLC (CTS). Unfortunately, due to insufficient evidence supporting the developer's reported project expenditures, we were unable to conclude as to the overall allowability of development expenses. Only 32% of developer expenses submitted to the City of Choctaw were supported by detailed documentation.

We contacted CTS to request additional documentation and the opportunity for discussion, but this request was declined. During a review of the limited documentation provided, we noted several questionable developer practices, including providing inconsistent expenditure support, altering of an original invoice, and charging of unexpectedly high closing costs that may not have been in accordance with the parties' written agreement.

The City appeared to have entered into a broad based contract with no spending limits, giving the developer a wide berth of control over the project. As the Choctaw City Council approved the written agreement and the corresponding individual payments, the Council was ultimately responsible for committing public funds to any questionable expenditure.

**City of Choctaw Special Audit**  
**January 1, 2009 through June 30, 2013**

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**Introduction**

Pursuant to the request of the mayor of the City of Choctaw (City) and in accordance with 74 O.S. § 227.8, we performed a special audit associated with the joint development agreement between the City and Choctaw Town Square, LLC, concerning the allowability of developer expenditures related to the Choctaw Town Square development for the period January 1, 2009 through June 30, 2013.

In September 2010, the City<sup>1</sup> signed an agreement with Choctaw Town Square, LLC (CTS or “developer”) to construct a retail site called Choctaw Town Square to house an anchor store and other retail outlets. AK Enterprise of NWA, Inc. (AK Enterprise) was CTS’s general contractor. Both companies are headquartered in Bentonville, Arkansas and are owned, in part, by members of the Blackaby family. According to the mayor, the City was aware of these facts when it began doing business with CTS.

Early in the City’s relationship with CTS, the city manager at the time and at least one Choctaw City Council (Council) member questioned CTS business practices, such as marking up the contractor’s costs by 15% and submitting invoices without detailed supporting documentation. The full Council later joined this Council member and the city manager in expressing these concerns.

The city manager was subsequently terminated during 2012 and in January 2013 filed a lawsuit against the City and CTS, alleging wrongful termination related to his questioning of CTS activities. CTS requested reimbursement from the City for its legal costs related to the former city manager’s lawsuit, which the City did not reimburse on counsel’s advice. As a result, CTS filed a claim against the City for unpaid legal costs.

The City’s relationship with CTS was also complicated by the City’s repeated requests for additional supporting documentation as the project advanced, and subsequent questioning of certain CTS expenses. On February 13, 2013, CTS suspended work on the site.

Our procedures included interviewing relevant current and past City staff members and all Council members, reviewing the written agreements between the City and CTS, and reviewing all invoices, support, and related documentation provided to the City by CTS. Although we contacted CTS to request documentation and the

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<sup>1</sup> The Second Amended and Restated Joint Development Agreement dated February 23, 2012 also incorporated the Choctaw Utilities Authority. As a result, throughout the report references to the Choctaw City Council may also refer to Utility Authority trustees. The two bodies comprise the same members and meet on the same dates.

opportunity for discussion, our request was denied. As a result, all CTS-related documentation was obtained from the City and is management's representation of the full population of documentation provided by CTS. We also visited the development site, interviewed pertinent outside parties, and reviewed additional documentation such as correspondence and Council meeting minutes.

As our procedures do not constitute an audit conducted in accordance with generally accepted auditing standards, we do not express an opinion on the account balances or financial statements of the City of Choctaw for the period January 1, 2009 through June 30, 2013. Failure to report commendable features of the entity should not be interpreted to mean that they do not exist.

**Results**

Due to insufficient evidence supporting the developer's project expenditures and resulting payment requests, we are unable to conclude as to the overall allowability of development expenses. As discussed in detail later in this report, less than one third of developer expenses submitted to the City of Choctaw were supported with detailed documentation. We requested supporting documentation from the developer directly, which they declined to provide.

**Observations**

**Inadequate Developer Invoice Support**

According to City staff, between October 2010 and June 2012, CTS submitted invoices that were supported only by secondary invoices from AK Enterprise. The AK invoices included a cost total and 15% contractor's mark-up amount, and the cost total was supported only by what appeared to be a QuickBooks report listing vendors and dollar amounts, not by original invoices or detailed receipts.<sup>2</sup> The vendor names and purchase descriptions on these reports were often cut off. The following are examples excerpted from these reports.

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<sup>2</sup> CTS subsequently provided the City with additional expenditure documentation for the period October 2010 through June 2012, and this documentation was included in our review.

**City of Choctaw Special Audit**  
**January 1, 2009 through June 30, 2013**

<b>419 · Per Diem</b>				
Paycheck	6/6/2012	Choctaw Town Squ...		-40.00
Check	6/15/2012	Choctaw Town Squ...	Per Diem for Week End...	-120.00
Check	6/15/2012	Choctaw Town Squ...	Per Diem for Week End...	-120.00
Check	6/20/2012	Choctaw Town Squ...	Per Diem for Week End...	-80.00
Check	6/21/2012	Choctaw Town Squ...	Per Diem for Week End...	-68.57
Paycheck	6/22/2012	Choctaw Town Squ...		-51.43
Total 419 · Per Diem				-480.00
<b>425 · Out of Town/Housing</b>				
Check	5/30/2012	Choctaw Town Squ...	Out of Town Expenses	-1,934.32
Bill	6/11/2012	Choctaw Town Squ...	Out of Town Expenses	-161.22
Check	6/22/2012	Choctaw Town Squ...	Out of Town - Residenc...	-739.54
General Journal	6/22/2012	Choctaw Town Squ...	Out of Town Expense	-2,800.00
Total 425 · Out of Town/Housing				-5,635.08

<b>414 · Rental Equipment</b>				
Bill	5/31/2012	Choctaw Town Squ...	Kirby-Smith - R03008	-10,195.32
Bill	5/31/2012	Choctaw Town Squ...	Kirby- Smith - R03702	-16,856.25
Bill	5/31/2012	Choctaw Town Squ...	Kirby-Smith - R03006	-16,856.25
Bill	6/4/2012	Choctaw Town Squ...	Kirby-Smith - R03129	-2,773.13
Bill	6/5/2012	Choctaw Town Squ...	Nicoma - 10158536	-350.00
Bill	6/5/2012	Choctaw Town Squ...	Nicoma - 10159107	-1,417.60
Bill	6/5/2012	Choctaw Town Squ...	Nicoma - 10157838	-100.00
Bill	6/5/2012	Choctaw Town Squ...	Nicoma - C/M 45.75	45.75
Bill	6/7/2012	Choctaw Town Squ...	Kirby-Smith - R03391	-13,593.75
Bill	6/14/2012	Choctaw Town Squ...	Kirby-Smith - C97134	-1,218.30
General Journal	6/22/2012	Choctaw Town Squ...	Container Usage	-275.00
General Journal	6/22/2012	Choctaw Town Squ...	Disk Usage	-200.00
General Journal	6/22/2012	Choctaw Town Squ...	GPS Topcon/Bighorn U...	-4,800.00
General Journal	6/22/2012	Choctaw Town Squ...	Daihatsa Mini Truck Us...	-800.00
General Journal	6/22/2012	Choctaw Town Squ...	Skid Loader Usage	-2,800.00
General Journal	6/22/2012	Choctaw Town Squ...	Water Pump & Hose Us...	-250.00
Check	6/25/2012	Choctaw Town Squ...	Mobile Mini - 111323262	-321.59
Bill	6/25/2012	Choctaw Town Squ...	Kirby-Smith - C96005	-1,030.26
Total 414 · Rental Equipment				-73,791.70

According to one Council member, CTS responded to the City's requests for project documentation by questioning why the City needed such documentation and stating that development companies were not typically required to submit documentation regarding expenditure details or progress. Another Council member recalled that CTS justified their lack of invoice detail and support by saying it was not required by the joint development agreement. According to a city attorney, this may not have been specifically required in the agreement because it is typically understood that invoices are accompanied by adequate underlying documentation.

Despite the lack of detail and supporting documentation, the Council approved the requests for payment, including the contractor's 15% mark-up. According to one of the Council members, approximately a year into the development project a Council discussion was held that resulted in the contractor being allowed to charge this 15% mark-up on all project expenses, reportedly because CTS needed the funding to continue with the project. During our interviews, some Council members explained that they were unaware at the time that this mark-up was already applied to all project expenses.

Beginning in June 2012, the City made more adamant requests for supporting documentation. CTS initially denied these requests but later compromised, and in August 2012 a process was developed allowing the city manager to view, but not retain copies of, support for a selection of items from each invoice. According to the current city manager, in many cases the support was only a general journal entry in QuickBooks records. City officials stated that after litigation began between the City and CTS, the City was able to obtain additional support from the developer, but did not receive detailed support for all expenditures.

We obtained all developer invoices and related support collected by the City<sup>3</sup> and determined that of the \$5,345,120.13 invoiced<sup>4</sup>, it appeared that only 32% of costs were supported by documentation such as receipts from subcontractors or suppliers. Furthermore, as discussed in the

Only 32% of developer costs supported by detailed documentation

next section, some of this documentation may have been unreliable. As the documentation supporting the payments made to CTS is insufficient to judge the detailed nature and purpose of most expenses, we are unable to determine with any certainty whether many costs are truly “related to engineering and architectural work” specific to the Town Square project.

### Questionable Expenditures

While the supporting documentation provided by the developer was insufficient for us to conclude on the overall allowability of expenses, we were able to review the documentation available and determined that some specific issues and expenses should be included in our discussion. These items are presented with the intent of disclosing items that we believe the City Council, City residents, and general public would find of interest in the full disclosure of expenditures of a public entity of the State of Oklahoma.

*Inconsistent Expenditure Documentation*

During our review of available CTS invoice support, we noted an instance in which an altered invoice had been provided to the City. A local concrete contractor provided a handwritten invoice to CTS for

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<sup>3</sup> This documentation was obtained from City staff and is management’s representation of the full population of invoices and related support received from CTS related to the Town Square development project. As noted earlier, we requested all project-related invoices and support from CTS, but CTS declined to provide such documentation.

<sup>4</sup> This total includes the contractor’s 15% mark-ups, and *does not* include the closing costs discussed later in the report.





*Engineering  
Costs*

the supporting documentation available for review, many more developer expenditures were not supported with any detailed documentation and therefore may have included additional examples.

The mayor, city manager, and several Council members reported concerns related to engineering costs for this development project. We interviewed the project engineer, who stated that members of the Blackaby family owned 90% of Civil Design Consultants, LLC (CDC), which provided design and engineering services for the Choctaw Town Square development. CDC invoices were addressed to AK Enterprise, and were marked up by 15% along with the other contractor expenses.

City officials asserted that while working on the development, CTS purchased a house near the site, which it remodeled into an office building. The firm serving as project engineer then moved into this building and subsequently increased its hourly rates. Our review of available engineering invoices revealed a rate change between December 2011 and January 2012 in which the hourly rate for the Project Manager increased from \$150 to \$200, the Project Engineer rose from \$125 to \$150, and the Senior Technician increased from \$65 to \$70. The project engineer stated that a member of the Blackaby family purchased the house that served as CDC's office, and that the hourly rates were increased for each CDC employee in order "to stay in line with the competition." The City officials expressed concern that this rate increase may have been to cover the cost of the building purchase by CTS.

We reviewed all available copies of CDC's invoices, totaling \$274,829 in detailed invoices<sup>5</sup>, and noted that in one instance, the City reimbursed CTS for \$412 in engineering fees related to CDC's new office. The project engineer verified the City should not have paid these charges. In another instance, we noted the number of hours billed by the "project engineer" appeared unreasonable for one month's time; 290 hours in one month, as illustrated in the following invoices, would amount to 10-hour days for 29 consecutive days. When questioned about this figure, the project engineer

**City reimbursed  
engineering costs  
unrelated to Town  
Square development**

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<sup>5</sup> According to the invoice documentation submitted by CTS to the City, engineering costs totaled \$766,065. This amount includes \$110,074 for engineering charges that were invoiced by companies other than CDC, \$274,829 for which we were able to review detailed CDC invoices, and \$235,697 that was reported as CDC payments but for which detailed support was not provided. There were also four months during the audit period in which engineering expenses were reimbursed according to City staff notes, totaling \$145,465, but supporting documentation was so minimal that we were unable to determine the vendor. These figures do not include the contractor's 15% mark-up.

**City of Choctaw Special Audit  
January 1, 2009 through June 30, 2013**

stated that he and an unlicensed "engineer in training" were billing the City under this title at the same hourly rate.

*CIVIL* P.O. Box 1897 Choctaw, OK 73020  
*DESIGN* Telephone: 405-390-2500  
*CONSULTANTS, LLC* Fax: 405-390-0900

**INVOICE**  
FEI #27-3670634

March 26, 2012

Mr. Eldon Blackaby  
AK Enterprise of NWA, Inc.  
2201 East Central, Suite 9  
Bentonville, AR 72712

RE: **Project #10-090**  
**Choctaw Town Square; Choctaw, OK**  
Engineering Fee -02/26/2012-03/25/2012

Description	Hrs.	Hr. Rate	Total
Project Manager	6	200	\$1,200.00
Project Engineer	276.8	150	\$41,520.00
Senior Tech	37	70	\$2,590.00
Junior Tech	13	50	\$650.00
Clerical	58.5	35	\$2,047.50
Surveying			\$420.00
<b>Total Due</b>			<b>\$48,427.50</b>

Continue developing design plans for water, sanitary sewer, paving, grading, storm water, specifications, and various meetings.

*CIVIL* P.O. Box 1897 Choctaw, OK 73020  
*DESIGN* Telephone: 405-390-2500  
*CONSULTANTS, LLC* Fax: 405-390-0900

**INVOICE**  
FEI #27-3670634

March 26, 2012

Mr. Eldon Blackaby  
AK Enterprise of NWA, Inc.  
2201 East Central, Suite 9  
Bentonville, AR 72712

RE: **Project #12-004**  
**Henny Road Improvements; Choctaw, OK**  
Engineering Fee -02/26/2012-03/25/2012

Description	Hrs.	Hr. Rate	Total
Project Manager	0	200	\$0.00
Project Engineer	13.75	150	\$2,062.50
Senior Tech	8	70	\$560.00
Junior Tech	0	50	\$0.00
Clerical	0	35	\$0.00
Surveying			\$552.50
<b>Total Due</b>			<b>\$3,175.00</b>

Developing plans for lane improvements.

As with general project costs, we cannot conclude on the allowability of overall engineering costs due to the lack of complete supporting documentation. \$235,697 in payments, allegedly made by the contractor

to CDC, was not supported by detailed invoices. It appears that at least one engineering invoice submitted to the City by CTS was *not* related to the development project, and therefore CTS should not have been reimbursed for these charges.

*Closing Costs*

The closing of the City’s property sale to anchor store Walmart was held in mid-December 2012. City officials said they were surprised when, at the closing, CTS asked for a total of approximately \$1.9 million in closing costs. As explained by the mayor and city manager, these costs were related to CTS contractually serving as the City’s agent for the closing. The joint development agreement states that CTS is entitled to 15% on the purchase price of each lot *or* gross proceeds:

“Developer shall promote, market, advertise and solicit the sales of the platted lots on the Property, or shall cause such promotion, marketing, advertising and solicitation to occur, and in exchange for such services, Developer shall receive 15% of the total purchase price, *or* gross proceeds, of each such sale of each such lot.”<sup>6</sup>

According to the mayor and city manager, “gross proceeds” had been discussed but not formalized as a percentage of future sales tax, and CTS chose to charge the City using both measures. According to calculations performed by CTS and obtained by the City, these closing costs were calculated as follows:

	Proceeds		15% to CTS
Walmart Land Sale	\$ 500,000		\$ 75,000
Walmart Fuel Site Sale	380,000		57,000
		1.5% Sales Tax	
Projected Gross Sales for 7	Proceeds	on Proceeds	15% to CTS
Years, as estimated by CTS	\$ 801,278,973	\$ 12,019,185	\$ 1,802,878
Total CTS Closing Charges			<u>\$ 1,934,878</u>

The total was then adjusted to account for ground stabilization costs reimbursed to the developer directly by Walmart, bringing the final closing costs charged by CTS to \$1,617,044.

According to many Council members, no one on the Council was aware of the extent of the fee CTS expected to receive at closing. Most Council

<sup>6</sup> Excerpt from Article I of the Second Amended and Restated Joint Development Agreement between the City of Choctaw, Oklahoma, the Choctaw Utilities Authority and Choctaw Town Square, LLC, dated February 23, 2012. *Emphasis added.*

members and City staff feared that their deal with Walmart would fall through if they refused to meet the developer's demands. While the allowability of the closing charges may be questionable under the terms of the joint development agreement, it is important to note that the Council paid CTS.

**Potential Causes**

In an effort to understand why inadequate supporting documentation was provided by the developer and accepted by the City, we examined the written agreements between the two parties and reviewed the actions of the City Council.

**Broad Contract Terms Not in City's Best Interest**

The joint development agreement between the City and CTS appears to have been drafted by CTS representatives and reviewed by Choctaw's city attorney. At the time the agreement was presented to the Choctaw City Council for approval, the city attorney reportedly advised the Council that parts of the contract may not be in the City's best interest, and that the contract was "one-sided." One Council member later described the contract as "nebulous," suggesting it was fraught with loopholes that CTS was quick to exploit. However, the Council approved the contract.

While most projects of this scope would be subject to laws requiring competitive bidding, due to the fact that financing was provided through a Tax Increment Financing District and the City's portion of the projected development cost did not exceed 25% of the total project cost, this project

was exempt from such bidding laws according to the City attorneys. This exemption granted the developer full power in selecting subcontractors and suppliers.

Written agreement had no spending limit and gave subcontracting power to the developer

The initial agreement did not include an "amount not to exceed" for total project cost, and the later addition of a 15% mark-up for the contractor made this in effect a "cost plus" contract, in which the developer was entitled to reimbursement for project-related costs plus an added fee for profit. This type of contract does not limit total cost and logically does not incentivize efficiency on the part of the developer.

The agreement also did not include a statement of work or breakdown of construction phases related to the project. Two members of the Council

and the city planner at the time, all of whom have experience with project management, considered this aspect of the agreement out of the ordinary and questioned why CTS would not provide a customary statement of work, projected schedule, or progress reports. The Council as a whole reportedly had no prior experience with a large development project and, as a result, may have been unaware of the related planning documents that typically would be expected when implementing a project of this magnitude.

In January 2013, as available funds were diminished, the City requested assurance that CTS was focusing on Walmart-related or “Phase I” project costs. When the City requested that CTS break down its invoices into phases, CTS responded that such a requirement was unacceptable because it was not explicitly required in the written agreement.

The description of project-related expenditures to be paid by the City in the agreement is broad:

**Broad contract terms favored the developer**

“Developer shall perform or cause to be performed all of the engineering and architectural work and designing for the Property pursuant to such preliminary development plan. The City shall pay for all expenses and fees related to such engineering and architectural work.”

The contract also gives CTS wide control over design and construction, and the ability to hire or subcontract as desired:

“Developer shall construct or cause to be constructed all roads, infrastructure, properties, utilities and other improvements, including water, on the Property and shall have all necessary authority and discretion to hire or contract with third parties for such construction.”

“Except as expressly indicated otherwise in this Agreement, Developer shall determine and direct in its sole discretion the design, specifications, construction, subcontracting and all other work related to the Services rendered hereunder.”<sup>7</sup>

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<sup>7</sup> Contract excerpts are from Article I of the Second Amended and Restated Joint Development Agreement between the City of Choctaw, Oklahoma, the Choctaw Utilities Authority and Choctaw Town Square, LLC, dated February 23, 2012.

These descriptions appear to suggest a wide array of costs could be considered “allowable” as long as these costs are tied to the design and construction of the Town Square project. For example, some Council members expressed concerns about the extent and reasonableness of certain developer expenses, including land acquisitions, dirt work, out-of-town lodging costs, and the developer’s use of aircraft, each of which could be interpreted as allowable given the broad contract terms.

### City Council Approved Contract and Developer Payments

The Council was responsible for approving the joint development agreement, as well as successive amendments. During our interviews, multiple Council members referred to the contract as “confusing” or unfamiliar. According to one member, despite some concerns, the majority of the Council accepted statements from the owner of CTS that he would “do the City right.”

According to many accounts, the former city manager and one of the Council members expressed concern over the agreement and CTS charges from the beginning. As the project progressed, the full Council began requesting more detailed documentation related to CTS invoices. While the documentation provided by CTS was not always original or detailed, enough information was collected that the Council members began to seriously question certain expenditures.

City Council  
approved broad  
contract and  
developer invoices

We reviewed the Council meeting minutes and Choctaw Utility Authority meeting minutes from the audit period and noted that the vast majority of Choctaw Town Square-related discussions and decision making appears to have occurred during executive sessions. We were unable to obtain any notes or minutes reflecting the nature of activity in these executive sessions; therefore, we do not have a clear record of the topics and details discussed in each meeting, or the instructions or courses of action approved by the Council.

Overall, it appears that CTS was not forthcoming with documentation or information to support or explain its expenditures. However, responsibility for the approval of any questionable expenditure lies with the Council, which as a whole did not insist upon complete and consistent documentation and support from the project’s onset. By the time the Council obtained details regarding CTS’s use of these public

funds, the City had reimbursed CTS for many of the corresponding purchases.

Our interviews revealed several possible explanations for the Council's behavior. As discussed earlier, the Council members were inexperienced in dealing with a project of such large scope, and have been too trusting or fearful of the developer. As a result, they ceded control of the Town Square project to CTS. The overwhelming sentiment in our meetings with both Council members and City staff was one of resignation: despite the complications and financial burdens suffered during this development project, if Choctaw sees a Walmart built, everything has been worth it.

As stewards of public funds, the Choctaw City Council members should be held to the highest standard in their financial decision making. The fact that developer invoices were approved despite missing and vague supporting documentation significantly increased the potential for error, mismanagement, and fraud. Although we identified some issues with the developer's expenditures and practices, the Council approved the broad written agreement and the individual payments to the developer, and therefore was ultimately responsible for committing public funds to certain questionable costs.



APPENDIX A

The following are examples of specific developer purchases that do not appear to be directly related to the Town Square development project:

- \$250.00 for five “flight instructor hours” in conjunction with a plane rental on October 17, 2011.
- \$412.00 to CDC for engineering fees related to new office property in Choctaw (as discussed in the report) on December 11, 2011.
- \$39.75 to Crabby’s in Rogers, Arkansas for meals eaten by CTS owners with Mangold Burriss Architecture staff on March 1, 2012.
- \$177.62 to Nicoma Park Lumber Co. for an oscillating plastic sprinkler, 50 lb crossfire III fescue, Scotts Easyhand Spreader, surge outlet and protector, a large BRS twist hose nozzle, and a pulse lawn sprinkler, on multiple invoices from April 2012.
- \$19.53 to Mobile Mini, Inc. for late charges from invoice #111319284 during July 2012.
- \$254.96 to Sherwin Williams on October 5, 2012. A Sherwin Williams representative located the transaction through a receipt number and verified that the purchase was made at a store in Arkansas.
- \$65.01 to Mojo Sports, LLC in Midwest City, Oklahoma for two 9x12 plaques on January 18, 2013.
- \$160.00 to the Oklahoma Turnpike Authority for the period January 1 – 31, 2013, although PikePass charges for the month totaled only \$64.70.



**OFFICE OF THE STATE AUDITOR & INSPECTOR**  
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