

Rural Water and Sewer District No. 20

Pittsburg County. Oklahoma

Financial Statements and Independent Auditor's Reports

As of and for the Year Ended December 31, 2016



2016

**RURAL WATER AND SEWER DISTRICT NO 20
PITTSBURG COUNTY, OKLAHOMA**

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Jeff Click	Chairman
Joe Carrick	Director
David Kimmel	Director
Daryl Nieto	Director

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INDEPENDENT AUDITOR'S REPORT

To the Members of the Board
Rural Water and Sewer District No. 20
Pittsburg County, Oklahoma

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma ("District"), as of December 31, 2016 and for the year then ended, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to error or fraud.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with 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. Because of the significance of the matter described in the "Transactions with Related Parties" paragraph to the overall financial statement presentation, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Transactions with Related Parties

As discussed in footnote 3, the District was created to serve a startup planned community and was entirely financed by the developer who also served as the Chairman of the Board of Trustees until May, 2013 and continues to serve as operational manager for the District. Because of the startup nature of the entity and continuing management of the District, we were unable to determine that there was sufficient delineation between the District's transactions and those of the developer. As is often inherent with related party transactions, it may not be possible to determine whether a particular transaction would have taken place if the parties had not been related, or what the terms and conditions would have been. This includes the purchase of the utility system from the developer at a price determined by the developer. As discussed in footnote 6, the District was in the early stages of development and did not have the working capital to support operations without the financial support from the developer.

Disclaimer of Opinion

Because of the significance of the matters described in the Transactions with Related Parties paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Management's Discussion and Analysis Omitted

Management has omitted the management discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting and for placing the basic financial statements in an appropriate operational, economic, or historical context.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 28, 2017 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.



Elfrink and Associates, PLLC

Tulsa, Oklahoma

June 28, 2017

Statement of Net Position – December 31, 2016

ASSETS

Current assets:

Cash and cash equivalents	\$ 70,803
Accounts Receivable	28,527
Inventory - Water Meters	7,945
	<u>107,275</u>

Noncurrent assets:

Capital assets, net of accumulated depreciation	<u>1,352,143</u>
Total noncurrent assets	<u>1,352,143</u>

Total assets	<u>\$ 1,459,418</u>
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LIABILITIES

Current Liabilities:

Accounts Payable	\$ 8,168
Accounts Payable - related party	20,215
Advances payable - related party	8,416
Accrued Interest - related party	157,746
Total current liabilities	<u>194,545</u>

Noncurrent Liabilities:

Note payable - related party	<u>966,139</u>
Total Noncurrent Liabilities	<u>966,139</u>

Total liabilities	<u>\$ 1,160,684</u>
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NET POSITION

Net investment in capital assets	\$ 386,004
Unrestricted (deficit)	<u>(87,270)</u>
Total net position (deficit)	<u>\$ 298,734</u>

See accompanying notes to the basic financial statements

Statement of Revenue, Expense and Change in Net Position – Year Ended December 31, 2016

Operating revenues:

Charges for sales and services:

Water	\$ 64,259
Sewer	57,187
Sanitation	36,796
Tap Fees	96,359
Total operating revenues	<u>254,601</u>

Operating expenses:

Costs of sales and services:

Water purchases	29,820
Sanitation contractor	16,802
Operations and maintenance	60,181
Management Fees	36,000
Legal Fees	3,250
Depreciation	28,674
Total operating expenses	<u>174,727</u>
Operating income	<u>79,874</u>

Nonoperating expense:

Interest expense	48,307
Total nonoperating expense	<u>48,307</u>

Change in net position	<u>31,567</u>
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Net position - beginning*	267,167
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Net position - ending	<u><u>\$ 298,734</u></u>
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*Restated - see footnote 7

See accompanying notes to the basic financial statements

Statement of Cash Flows – Year Ended December 31, 2016

Cash flows from operating activities:

Receipts from members	\$ 230,460
Payments to suppliers	(149,177)
Cash provided by operating activities	<u>81,283</u>

Changes from non-capital financing activities:

Payments to related party	(30,000)
Cash used in non-capital financing activities	<u>(30,000)</u>

Cash flows from capital and related financing activities:

Purchase of capital assets	(2,661)
Cash used in capital and related financing activities	<u>(2,661)</u>

Net increase in cash and cash equivalents 48,622

Cash and equivalents - beginning of year 22,181

Cash and equivalents - end of year \$ 70,803

Reconciliation of operating income to net cash provided by operating activities:

Operating income	\$ 79,874
Depreciation	28,674
Increase in accounts receivable	(24,141)
Increase in inventory	(2,959)
Decrease in accounts payable	(165)
Net cash provided by operating activities	<u>\$ 81,283</u>

See accompanying notes to the basic financial statements

Notes to the Basic Financial Statements

1. Summary of Significant Accounting Policies

A. Financial Reporting Entity

The Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma ("District") was incorporated on August 15, 2012 under Title 82, Section 1324.1 as amended, of the laws of the State of Oklahoma. The District is exempt from Federal and State income tax. The purpose of the District is to provide water and sewer services to the owners and occupants of property located within the District which primarily includes the Town of Carlton Landing, and others as authorized by law.

The District is governed by a board of four directors, elected by a majority vote of the homeowners present at the meeting in which the vote is taken. Elected positions include Chairman, Vice-Chairman, Secretary, and Treasurer.

B. Basis of Presentation

The accounting policies of Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma conform to the basic principles of governmental accounting and financial reporting set forth by the Governmental Accounting Standards Board (GASB).

The District's fund is an enterprise fund. Enterprise funds are proprietary funds used to account for business-like activities provided to the general public. These activities are financed primarily by user charges and the measurement of financial activity focuses on net income measurement similar to the private sector.

C. Measurement Focus and Basis of Accounting

Measurement focus refers to how transactions are recorded within the various financial statements. Basis of accounting refers to when transactions are recorded regardless of the measurement focus applied.

The District's financial statements use the economic resources measurement. The District utilizes the basis of accounting generally accepted in the United States. Under this basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset is used.

D. Assets, Liabilities, and Net Position

Cash and cash equivalents

For the purpose of the statement of cash flows, the District considers all cash on hand, demand deposit accounts, interest bearing checking accounts, and time deposit accounts including certificates of deposit with maturities of three months or less to be cash and cash equivalents.

Capital Assets and Depreciation

Depreciable assets are recorded at cost when purchased or constructed. Improvements are capitalized; the cost of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life is not. Depreciation is calculated on a straight-line basis over the estimated useful lives of the depreciable assets.

Capital assets consist of utility infrastructure with an estimated useful life of 50 years. A capitalization threshold of \$2,000 is used to report capital assets.

Due to related party

The District was formed to provide services to a planned community in Pittsburg County, Oklahoma known as the Town of Carlton Landing. Startup expenses financed by the developer and working capital advances that are expected to be repaid from the District's resources are reported as liabilities on the statement of net position.

Note payable – related party

All long-term debt is reported as incurred and consists of a note payable to the developer of the planned community the District serves in exchange for assumption of ownership and operation of the water and sewer systems constructed by the developer.

Net position

Net position is divided into three components:

- a. *Net investment in capital assets* – Consists of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributed to the acquisition, construction, or improvement of those assets.
- b. *Restricted net position* – Consists of net assets with constraints placed on the use by 1) external groups such as creditors, grantors, contributors, or laws and regulations of other governments, or 2) law through constitutional provisions or enabling legislation.
- c. *Unrestricted net position*- All other net assets that do not meet the definition of "restricted" or "net investment in capital assets".

It is the District's policy to first use restricted net position prior to the use of unrestricted net position when an expense is incurred for purposes for which restricted and unrestricted net position are available.

E. Revenues and expenses

Operating Revenues – Operating revenues include activities that have the characteristics of exchange transactions, such as service fees.

Nonoperating revenues – Nonoperating revenues include activities that have the characteristics of nonexchange transactions such as grants from other governments, gifts and contributions, and other revenue sources that are defined as nonoperating revenue.

Operating Expenses – Operating expenses are those that are essential for delivery of services to the District's customers.

Nonoperating Expenses - Nonoperating expenses are those that relate to the financing of the District's activity, such as interest expense, and non-recurring and/or unusual expenses such as startup costs.

2. Detailed Notes on Transaction Classes/Accounts

A. Cash and investments

Deposits and investments - State statutes govern the District's investment policy. Permissible investments include direct obligations of the United States Government and Agencies; certificates of deposit of savings and loan associations, and bank and trust companies. Collateral is required for demand deposits and certificates of deposit for all amounts not covered by federal deposit insurance. Investments are stated at cost plus accrued interest.

Custodial Credit Risk – Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a written policy for custodial credit risk. At December 31, 2016, all of the District's cash was held in a demand account bearing no interest and was fully covered by federal deposit insurance.

B. Capital assets and depreciation

For the year ended December 31, 2016, capital asset balances changed as follows:

	Balance 12/31/2015*	Additions	Deletions	Balance 12/31/2016
Capital assets not being depreciated:				
Construction in progress (sewer)	\$ -	\$ 2,658	\$ -	\$ 2,658
Capital assets being depreciated				
Sewer System	846,104	-		846,104
Water System	587,578	-		587,578
Total capital assets being depreciated	1,433,682	-		1,433,682
Less accumulated depreciation	(55,523)	(28,674)		(84,197)
Net capital assets	\$ 1,378,159	\$ (26,016)	\$ -	\$ 1,352,143

*Restated from prior year for phase 3 contributed capital from developer - see footnote 7

C. Long Term Debt

For the year ended December 31, 2016, there were no changes in the District's long-term debt:

	Balance 12/31/2015	Additions	Deductions	Balance 12/31/2016
Note payable	\$ 966,139	\$ -	\$ -	\$ 966,139

At December 31, 2016, the District's long term debt consisted of the following note:

Note payable to Humphreys Partners 2009, LLC, dated September 10, 2013 in the original amount of \$1,361,000 and amended on August 15, 2015 to the amount of \$966,139 retroactively, with a fixed simple interest rate of 5.0%, and payable monthly in the amount equal to the excess of the District's monthly revenues less operating expenses, with payments beginning July 31, 2015. Payments may be waived at the option of the note holder; interest continues to accrue. The developer has waived payments through the date of this report

\$ 966,139

3. Related Party Transactions

The District was financed by and had significant transactions with the developer of the planned community it serves, Humphrey Partners 2009, LLC. In addition, the water and sewer system infrastructure was constructed by the developer and sold to the District at an amount determined by the developer.

Effective January 1, 2014, the District entered into agreements with Carlton Landing Enterprises, LLC, an entity owned by the developer, to provide various services, including providing support staff. During the year ended December 31, 2016, management and service fees paid and/or accrued under these contracts were \$36,000.

A member of the Board of Directors is a partner in a construction company that is a principal builder in the Town of Carlton Landing and is a common owner with the developer and the entity providing management services to the District.

4. Risk Management

The District is exposed to various risks of loss related to torts, errors, and omissions. At this time, the District carries no surety bonds or other types of insurance.

5. Commitments and Contingencies

The District is not involved in any legal proceedings, which normally occur in the course of operations, at this time. While legal proceedings cannot be foreseen, the District believes that any settlement or judgment would not have a material effect on the financial condition of the District.

6. Going Concern

The District continues in the early stages of operations as of December 31, 2016, and did not have the working capital to support operations. Management believes that, as new homes are built, the membership base and planned fee structure should be adequate to support ordinary operations, including amortization of debt.

7. Restatement of Beginning Net Position

Beginning net position has been restated to reflect contributed capital from the developer related to an expansion of the sewer and water system to accommodate additional residential services and reversal of accrued management fees that were determined to be overbilled in prior periods.

Restatement of Beginning Net Position:

December 31, 2015 net position as previously reported	\$ (149,648)
Add:	
Reversal of overbilled management fees	25,885
Phase 3 contributed capital from developer	390,930
January 1, 2016 net position as restated	<u>\$ 267,167</u>

8. Subsequent Events

Management has evaluated events and transactions that occurred after the balance sheet date for potential recognition and disclosure through the date on which the financial statements were available to be issued and has determined that no additional disclosures are required.

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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 Members of the Board
Rural Water and Sewer District No. 20
Pittsburg County, Oklahoma

We were engaged to audit the financial statements of the Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma ("District"), as of December 31, 2016 and for the year then ended, and the related notes to the financial statements, which collectively comprise the District's basic financial statements and have issued our report thereon dated June 28, 2017. We did not opine on the District's financial statements due to extensive related party transactions, an inability to certify the value of the fixed assets, and the lack of observable substance related to the sale of the infrastructure to the District by a related party, including an inability by the District to generate sufficient revenue to amortize the associated debt under the stated terms. Except as discussed in the preceding sentence, we conducted our audit procedures in accordance with 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.

Internal Control Over Financial Reporting

Management of the District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

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 the entity's 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. We consider the following deficiencies described in the accompanying *Schedule of Findings and Management Responses* to be material weaknesses: [2016-01, 2016-02, 2016-03, 2016-04, 2016-08, and 2016-09]. Given the above described limitations, other material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* described in the accompanying *Schedule of Findings and Management Responses as 2016-05, 2016-06, and 2016-07*.

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 the District's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Elfrink and Associates, PLLC

Elfrink and Associates, PLLC

Tulsa, Oklahoma
June 28, 2017

SCHEDULE OF FINDINGS AND MANAGEMENT RESPONSES

This schedule is presented as an addendum to accompany the *“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”*. Consideration of items listed should be made in conjunction with that report.

2016-01 – Related Party Transactions

CONDITION: The District is managed by the principal developer of a planned community who has also financed operating shortages. Expenditures are not approved by an independent Board prior to commitment or occurrence; no purchase orders are issued. The Board Chairman has a business affiliation with the developer.

POTENTIAL EFFECT OF CONDITION: Transactions may not be accurately reflected or may not reflect the true economic substance of the event. Errors or fraud may take place and be undetected.

CAUSE OF CONDITION: Since the District is a startup entity, it lacked sufficient working capital to cover necessary expenses without significant involvement from the developer.

CRITERIA: A related party relationship may result in transactions that would not ordinarily take place between unrelated parties or would be subject to different terms and conditions.

RECOMMENDATION: The District should increase efforts to assure that business is transacted in an independent and “arm’s length” manner. For example, the Board should have benefit of review of the support of a transaction prior to its payment, and the District should consider development of a policy to require expenditures above a certain amount be submitted to the Board for approval in advance of commitment.

MANAGEMENT’S RESPONSE: The District continues to recruit independent board members with no business connection to the Developer. Additionally, as revenue increases the District will be able to hire a manager and staff independent of the Developer. Until that day arrives, management believes the Developer is the best option to serve as Manager for the District.

2016-02 – Risk Management

CONDITION: As of the date of this report, the District did not have insurance in place that protected the district and the Board of Directors from risk of loss. This is continued from 2013.

POTENTIAL EFFECT OF CONDITION: The District or District Board members could be named as a party in a law suit that could be costly to defend and impair the District’s ability to continue to provide essential services to its members. The water and sewer system could be damaged by a natural disaster, accident, or other event that the District is not sufficiently capitalized to withstand.

CAUSE OF CONDITION: Since the District is a startup entity with limited financial resources, it did not have the capital necessary to fund the purchase of insurance.

CRITERIA: The District should have insurance policies in place that include fidelity bonds for anyone with access to cash, errors and omissions insurance for Board officers and members, general liability insurance, and property insurance for any property owned by the District.

RECOMMENDATION: The District should consult with its attorney regarding recommended protection and consider the need for insurance as described above.

MANAGEMENT'S RESPONSE: The District is in the process of acquiring appropriate insurance coverage. Quotes have been obtained from the Oklahoma Rural Water Association (OWRA). These will be evaluated by the Board at the July 2017 Board Meeting. Completion of this action is imminent.

2016-03 – Segregation of Duties

CONDITION: Duties are concentrated in the hands of a few individuals who are responsible for all phases of accounting functions. For instance, payments were being made electronically by the administrative assistant without review or knowledge of the Board Chairman who is the only authorized signer on the bank account. In November, 2016, we noted the implementation of a procedure to obtain authorization by email. Because of the lack of division of responsibility, internal control is determined to be weak, and in some instances, non-existent. This is compounded by the fact that the administrative manager of the District has common ownership with the developer. This is continued from 2014.

POTENTIAL EFFECT OF CONDITION: Errors or fraud could take place and be undetected.

CAUSE OF CONDITION: The District is small with limited staff that prevents segregation of duties that might be possible in a larger district and lacks the policies and procedures necessary to effect good controls.

CRITERIA: A good system of internal control requires a proper segregation of duties to prevent one person from being in a position to authorize, execute, and record the same transaction.

RECOMMENDATION: District management should establish and/or review existing internal control policies to look for ways in which segregation of duties could be strengthened, including a review of its documentation of proper authorization and review prior to initiating payments.

MANAGEMENT'S RESPONSE: In April 2017 management established a standard operating procedure regarding payments. Management believe this procedure should adequately mitigate this concern.

2016-04 – Member (Customer) Files

CONDITION: A review of a random selection of fourteen member (customer) files at the time of field work in June, 2017 indicated five did not have an application/agreement for service on file or benefit unit certificate. This is continued from 2014.

POTENTIAL EFFECT OF CONDITION: The terms and entitlement for service could be ambiguous and/or not consistently applied. The District may not be able to enforce collection of amounts due.

CAUSE OF CONDITION: The District did not have policies and procedures in place to require that a member file, application and agreement for service, or benefit unit certificate be maintained in 2016. In April, 2017, the District implemented procedures and is attempting to obtain applications from all members. At the time of field work in June, 2017, the District had received responses from 56 of the 168 landowners.

CRITERIA: Title 82 Chapter 18 Section 1324.12 of the Oklahoma Statutes requires each landowner within the district to subscribe to a number of such units in proportion to the extent s/he desires to participate in the benefits of the improvements. Good business practice dictates that an agreement for services be executed that outlines the terms of those services prior to the services being provided.

RECOMMENDATION: The District should continue its effort to obtain applications and agreements and issue benefit units from/for all landowners.

MANAGEMENT'S RESPONSE: The District will continue to actively obtain applications and agreements and issue benefit units from/for all landowners.

2016-05- Notes Payable to Humphrey Partners 2009 LLC

CONDITION: On August 15, 2015, the District amended its Note Payable to Humphrey Partners 2009, LLC to the amount due of \$966,639 with a fixed interest rate of 5.0%. Payments were scheduled to begin July 31, 2015 with monthly payments equal to the excess of the District's monthly revenues less operating expenses. No principal or interest payments were made during 2016 resulting in the Note being in default.

POTENTIAL EFFECT OF CONDITION: The District is in default with the payment terms as amended and restated in the outstanding Promissory Note Payable to Humphrey Partners 2009, LLC. Failure to adhere to the terms of the agreement may impair the substance of the agreement.

CAUSE OF CONDITION: The District purchased the Water and Sewer System assets from the Developer, Humphrey Partners 2009, LLC, in September 2013 and signed a Promissory Note Payable as payment for the acquisition. There has been insufficient effort to assure adherence to terms of the note.

CRITERIA: The first monthly installment payment of this Note was due on July 31, 2015. The amended and restated Promissory Note Payable requires monthly written waivers in the event of nonpayment. The District is in default with the terms and conditions of the Note Payable to Humphrey Partners 2009, LLC.

RECOMMENDATION: The District secure monthly written waivers of default from the lender, Humphrey Partner s 2009, LLC until such time funds are available to comply with the payment terms of the outstanding Promissory Note Payable.

MANAGEMENT'S RESPONSE: The District, Manager, and Developer will ensure this recommendation is implemented moving forward.

2016-06- Board of Director Meetings and Subsequent Minutes

CONDITION: As part of routine audit procedures, we requested copies of Board of Director meeting minutes held from January 2016 through May 2017. The District was not able to provide minutes from any meetings in 2016, however, we were able to review minutes and/or a draft of minutes for monthly meetings in January through May 2017. The minutes from these meetings did not include approval of the District's annual budget. In addition, the District was not able to provide the minutes or the meeting notices as the official records that an annual meeting of the members was scheduled and conducted.

POTENTIAL EFFECT OF CONDITION: The District could be in violation of Title 82, Section 1324.9 and the District's Bylaws Article XIII and the Oklahoma State Constitution Article II, section 534 regarding the Open Meeting Act. The District's has been operating with a budget not approved by the Board of Directors.

CAUSE OF CONDITION: The Board of Directors established a quarterly meeting schedule but has not adhered to the planned meeting schedule.

CRITERIA: The District's Bylaws Article XIII, Section 1 mandate, "the Board shall meet each year to adopt a budget for the following year." The District's Bylaws Article XII mandate, "The annual meeting of the participating members of the District shall be held at some suitable time at a location within

the District as designated by the Board and at a time and date designated by the Board. Notice of meeting shall be given by mail at least ten days prior to the meeting.” Additionally, Oklahoma Statute Title 82, Section 1324.9 requires that the governing board of Water Districts meet at least annually at the date prescribed by the bylaws. It is the duty of the secretary to maintain records showing all of its minutes, decisions and orders made.

RECOMMENDATION: The District hold an annual board meeting, including the required notice to all members, and approve the subsequent year’s budget as required by Article XIII, Section 1 of its Bylaws and per Oklahoma Statute Title 82; the District’s secretary maintain meeting minutes as official District records. The Minutes should be signed.

MANAGEMENT’S RESPONSE: The District holds Board meetings on the third Saturday of every month. Minutes of those meetings are recorded, signed, and filed. The District will hold an annual meeting once each year where a budget will be presented, approved, and signed for the subsequent year as recommended in this audit. All minutes will continue to be maintained as official District records.

2016-07- Purchasing Procedures

CONDITION: The District did not issue purchase orders in 2016.

POTENTIAL EFFECT OF CONDITION: The District could be in violation of the policy established by the Board and Oklahoma State Statute.

CAUSE OF CONDITION: The District management is not following the established policy.

CRITERIA: The Rural Water and Sewer District No. 20, Pittsburg County, established a purchasing policy in November 2014 that requires purchase orders to be issued prior to initial of a purchase.

RECOMMENDATION: The District management follow the policy as outlined by the Board of Directors.

MANAGEMENT’S RESPONSE: The District will issue purchase orders in accordance with established policy that will be incorporated either in an existing standard operating procedure (SOP), or one that is created for the purpose.

2016-08- Purchased Water Controls

CONDITION: The District is not tracking water purchases versus water usage. An attempt by management to measure the difference identified a possible shrinkage of 20% of the purchased amount of water.

POTENTIAL EFFECT OF CONDITION: A leak, unauthorized use of water, or billing error could go undetected.

CAUSE OF CONDITION: The District does not have sufficient master meters to be able to monitor water purchases or identify a possible leak, unauthorized use of water, or billing error.

CRITERIA: The District purchases water from Longtown Rural Water District and then resells it to its members. There is currently no capacity for water storage. Since the water usage is a principal driver of the billing calculations for both water and sewer, it is essential that a method is developed to track the relationship between water purchased and sold.

RECOMMENDATION: The District install a master meter and consider installation of meters for key distribution arteries. A log should be established to measure water purchases daily. The log should

be compared monthly to the purchased water bill from Longtown RWD as well as the amounts billed to members. Unusual fluctuations and/or discrepancies should be investigated.

MANAGEMENT'S RESPONSE: The District will install a reporting device that monitors the activity of the master meter and establish an SOP to log and reconcile water purchased and sold. As noted in the audit, the District currently receives a monthly report from the District's water supplier, Longtown No. 1, but is not able to detect, identify, and correct leaks with any level of immediacy. Until a reporting device can be installed that can provide daily or moment-by-moment reporting, the District is unable to detect unauthorized use of water or billing errors between RWD No. 20 and Longtown No. 1.

2016-09- Board Authorization for Payments to Developer

CONDITION: On June 30, 2016 the District made a \$30,000 payment to the developer to reduce the payable for advances made by the developer in previous years. We were unable to locate Board authorization for the payment.

POTENTIAL EFFECT OF CONDITION: Working capital could be constrained such that operations are impaired. The District could be in violation of its purchasing policy. Improper payments could be made.

CAUSE OF CONDITION: The District is managed by an owner of the development company. There are no controls in place that address payments to related parties that are approved and executed by that related party.

CRITERIA: The District's purchase policy requires two board member approvals for payments in excess of \$1,000. Given the structure of management by a related party, procedures should be in place that assure proper review and authorization for payments.

RECOMMENDATION: Irregular payments to the developer not previously approved by another authorization should be approved by the District's Board of Directors prior to being made. Management should retain approval of evidence of the payment of the transaction.

MANAGEMENT'S RESPONSE: . In the past, any payments from the District to the Developer were made in accordance with the terms of the Promissory Note which was accepted by the District Board. Earlier this year, the Board approved a policy for debt retirement which allows the District to establish operating reserves and capital expenditure reserves before making debt payments.