

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, 2018



2018

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

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Principal Office

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Board of Directors

Daryl Nieto	Chairman
Austin Tunnell	Vice Chairman
Joe Carrick	Secretary/Treasurer
Gordon Raney	Director
Bert Scott	Director

Management

David Kimmel, PhD	Director of Operations
Marie Gibson	Controller

Elfrink & Associates, PLLC

3119 E 87th Street
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Members of the AICPA, OSCP, and GFOA

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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 have audited the accompanying financial statements of the Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma ("District"), as of December 31, 2018 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Basis for Qualified Opinion on Utility System Valuation and Related Note Payable to Developer

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

continued to serve as operational manager for the District for the majority of 2018. The utility system was purchased from the developer at a price determined by the developer by the issuance of a note to the developer. The District has not had sufficient operating income to amortize the note. 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. Consequently, we were unable to obtain sufficient audit evidence related to the capital assets and note payable; the effect on the financial statements has not been determined.

Qualified Opinion

In our opinion, except for the matters discussed in the “Basis for Qualified Opinion on Utility System Valuation and Related Note to Developer” paragraph, the financial statements referred to above present fairly, in all material respects the financial position of the Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma as of December 31, 2018, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management’s discussion and analysis on pages 4-6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 30, 2019 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
April 30, 2019

MANAGEMENT'S DISCUSSION AND ANALYSIS

The management of the Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma ("District") is pleased to provide this annual financial report to demonstrate its accountability and communicate the District's financial condition and activities as of and for the year ended December 31, 2018. Management of the District is responsible for the fair presentation of this annual report, for maintaining appropriate controls over financial reporting, and for complying with applicable laws, regulations, and provisions of grants and contracts.

FINANCIAL HIGHLIGHTS

- DISTRICT's total net position decreased by \$154,293 and the assets of the District exceeded its liabilities at December 31, 2018 by \$187,714 (net position). Of that, \$392,559 is invested in capital assets, net of related debt, leaving the District with a deficit unrestricted position of \$204,845,
- The District showed an operating loss of \$42,961, as operating expenses outpaced increases in utility revenues.
- During the year, the carrying value of utility systems and related equipment increased by \$7,785 which included lift station improvements in the amount of \$31,613 and capitalization of \$4,970 in engineering costs related to sewer improvements, partially offset by \$28,798 in depreciation.

ABOUT THE DISTRICT

The Rural Water and Sewer District No. 20, Pittsburg County was created August 15, 2012 under Title 82, Section 1324.1 of the laws of the State of Oklahoma.

The purpose of the District is to provide water, sewer, and trash services to the Town of Carlton Landing, a planned community in Pittsburg County, Oklahoma.

This annual report includes all activities for which District's Board of Directors is financially accountable.

FINANCIAL STATEMENTS

The District's activities are entirely business-type and are reported as an enterprise fund. Enterprise funds are proprietary funds used to report business-type services provided to the general public. Proprietary funds are reported using an economic resources measurement focus. For example, proprietary fund capital assets are capitalized and depreciated and principal payments on long-term debt are recorded as a reduction to the liability. The District reports under a full accrual basis of accounting, similar to a commercial enterprise.

The notes provide additional information that is essential to gain an understanding of the data provided in the financial statements and can be found on pages 10-15 of this report.

RURAL WATER AND SEWER DISTRICT NO. 20
PITTSBURG COUNTY, OKLAHOMA
ANNUAL FINANCIAL REPORT
As of and for the Year Ended December 31, 2018

Condensed Statement of Net Position - December 31

	<u>2018</u>	<u>2017</u>	<u>Variance</u>	<u>Var%</u>
Assets:				
Current and other assets	\$ 111,942	\$ 155,450	\$ (43,508)	-28%
Capital assets, net	<u>1,358,698</u>	<u>1,350,913</u>	<u>7,785</u>	1%
Total Assets	<u>1,470,640</u>	<u>1,506,363</u>	<u>(35,723)</u>	-2%
Liabilities:				
Current liabilities	299,787	186,817	112,970	60%
Long term liabilities	<u>983,139</u>	<u>977,537</u>	<u>5,602</u>	1%
Total liabilities	<u>1,282,926</u>	<u>1,164,354</u>	<u>118,572</u>	10%
Net position:				
Net investment in capital assets	392,559	384,774	7,785	2%
Unrestricted (deficit)	<u>(204,845)</u>	<u>(42,767)</u>	<u>(162,078)</u>	379%
Total net position	<u>\$ 187,714</u>	<u>\$ 342,007</u>	<u>\$ (154,293)</u>	-45%

More than all of the District's net position reflects its investment in capital assets, less any related debt used to acquire those assets that is still outstanding. The deficit unrestricted net position was higher by \$138,328 from the prior year due to lower operating income and an accrual for a penalty assessed by the Oklahoma Department of Environmental Quality (ODEQ).

For the year ended December 31, 2018, The District's net position decreased by \$130,543.

Change in Net Position - Year Ended December 31,

	<u>2018</u>	<u>2017</u>	<u>Variance</u>	<u>Var%</u>
Operating revenues:				
Charges for sales and services	\$ 216,132	\$ 194,474	\$ 21,658	11%
Tap fees	<u>72,037</u>	<u>106,680</u>	<u>(34,643)</u>	-32%
Total operating revenues	<u>288,169</u>	<u>301,154</u>	<u>(12,985)</u>	-4%
Operating expenses:				
Depreciation	28,798	28,674	124	0%
All other operating expenses	<u>302,332</u>	<u>180,900</u>	<u>121,432</u>	67%
Total operating expenses	<u>331,130</u>	<u>209,574</u>	<u>121,556</u>	58%
Operating income	<u>(42,961)</u>	<u>91,580</u>	<u>(134,541)</u>	-147%
Nonoperating expense:				
ODEQ penalty	63,025	-	63,025	
Interest expense	<u>48,307</u>	<u>48,307</u>	<u>-</u>	0%
Total nonoperation expenses	<u>111,332</u>	<u>48,307</u>	<u>63,025</u>	130%
Change in net position	<u>(154,293)</u>	<u>43,273</u>	<u>(197,566)</u>	-457%

Operating income for the year ended December 31, 2018 decreased by \$134,541 over the prior year due to lower tap fee receipts and operating expenses outpacing the increase in utility charges.

CAPITAL ASSETS

The District's investment in capital assets was \$1,358,698 net of accumulated depreciation, an increase of \$7,785 from the prior year. Significant capital asset activity during the year included:

- Engineering fees related to the design of a sewer package treatment plant in the amount of \$4,970
- Improvement to the sewer lift stations in the amount of \$31,613.

ECONOMIC FACTORS AND OTHER POTENTIALLY SIGNIFICANT MATTERS

OVERVIEW

The District is dedicated to providing water, sewer and sanitation services for a developing planned community on Lake Eufaula. As the community expands, the District is challenged with providing services to the new residents. Inherent is the need for additional capital for infrastructure expansion and to address several issues with the existing system. On December 26, 2018, the District entered into a revolving construction loan agreement with Core Bank, secured by collateral pledged by the developer. It is anticipated that higher utility rates will be required to amortize the debt.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma's finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

Marie Gibson
Controller
29 Water Street
Carlton Landing, OK 74332
918-452-2218
marie@carltonlanding.com

Statement of Net Position – December 31, 2018

ASSETS

Current assets:

Cash and cash equivalents	\$ 1,082
Cash and cash equivalents - reserve accounts	82,000
Accounts receivable	27,960
Inventory - water meters	900
	111,942

Noncurrent assets:

Capital assets, net of accumulated depreciation	1,358,698
Total noncurrent assets	1,358,698

Total assets	1,470,640
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LIABILITIES

Current Liabilities:

Trade accounts payable	37,986
ODEQ payable	63,025
Accrued interest - related party	198,776
Total current liabilities	299,787

Noncurrent Liabilities:

Meter deposits payable	17,000
Note payable - related party	966,139
Total Noncurrent Liabilities	983,139

Total liabilities	1,282,926
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NET POSITION

Net investment in capital assets	392,559
Unrestricted (deficit)	(204,845)
Total net position	\$ 187,714

See accompanying notes to the basic financial statements

Statement of Revenue, Expense and Change in Net Position – Year Ended December 31, 2018

Operating revenues:

Charges for sales and services:

Water	\$ 77,152
Sewer	73,246
Sanitation	65,734
Tap Fees	72,037
Total operating revenues	288,169

Operating expenses:

Costs of sales and services:

Water purchases	57,205
Sanitation contractor	37,860
Service contractor	9,480
Operations and maintenance	154,437
Management fees	39,650
Legal fees	3,700
Depreciation	28,798
Total operating expenses	331,130
Operating loss	(42,961)

Nonoperating expense:

Interest expense	48,307
ODEQ penalty	63,025
Total nonoperating expense	111,332

Change in net position (154,293)

Net position - beginning 342,007

Net position - ending \$ 187,714

See accompanying notes to the basic financial statements

Statement of Cash Flows – Year Ended December 31, 2018

Cash flows from operating activities:

Receipts from members	\$ 282,963
Payments to suppliers	(279,734)
	3,229

Cash flows from capital and related financing activities:

Interest paid on capital debt to related party	(10,000)
Purchase of capital assets	(36,583)
	(46,583)

Net decrease in cash and cash equivalents (43,354)

Cash and equivalents - beginning of year 126,436

Cash and equivalents - end of year \$ 83,082

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

Operating loss	\$ (42,961)
Depreciation	28,798
Increase in accounts receivable	(5,206)
Decrease in inventory	5,360
Increase in meter deposits payable	5,600
Decrease in accounts payable - related party	(11,100)
Increase in accounts payable - outside vendors	22,738
	\$ 3,229

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 five 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/Treasurer and two Directors.

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 penalties.

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, 2018, 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, 2018, capital asset balances changed as follows:

	<u>Balance 12/31/2017</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance 12/31/2018</u>
Capital assets not being depreciated:				
Construction in progress (sewer)	\$ 30,102	\$ 4,970	\$ -	\$ 35,072
Capital assets being depreciated				
Sewer System	846,104	31,613		877,717
Water System	587,578	-		587,578
Total capital assets being depreciated	<u>1,433,682</u>	<u>31,613</u>		<u>1,465,295</u>
Less accumulated depreciation	<u>(112,871)</u>	<u>(28,798)</u>		<u>(141,669)</u>
Net capital assets	<u>\$ 1,352,143</u>	<u>\$ 7,785</u>	<u>\$ -</u>	<u>\$ 1,358,698</u>

C. Long Term Debt

For the year ended December 31, 2018, there were no changes in the District's long-term debt:

	<u>Balance 12/31/2017</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance 12/31/2018</u>
Note payable	<u>\$ 966,139</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 966,139</u>

At December 31, 2018, 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

Although the District has made payments toward the accrued interest balance related to the note, there have been no principal payments.

Core Bank Note Payable

On December 26, 2018 the District entered in a loan agreement with Core Bank in the amount of \$1,500,000 to construct a waste water treatment plant, secured by collateral pledged by the developer. The District may make draws against the loan as needed. The related note provides for monthly interest-only payments at the Wall Street Prime Rate + 1%. At December 31, 2018, there were no draws or other financial activity related to the loan.

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 that was constructed by the developer was 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, 2018, management and service fees paid and/or accrued under these contracts were \$39,650. The District also made payments to the developer in 2018 in the amount of \$21,100 which was applied first to amounts due for prior year management fees and then to the accrued interest on the note payable discussed in Note 2.

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. To help mitigate this risk, the District carries the following insurance coverage:

<u>Coverage</u>	<u>Each Loss/Annual Aggregate</u>
Property (\$1,000 deductible)	\$25,000/\$1,000,000
Comprehensive General Liability	\$25,000/\$1,000,000
Errors and Omissions/Directors and Officers Liability	\$125,000/\$1,000,000
Employee Dishonesty and Crime	\$10,000

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. Subsequent Events

Oklahoma Department of Environmental Quality – Consent Order

On April 2, 2018, the District entered into a consent order with the Oklahoma Department of Environmental Quality (ODEQ) for various violations related to the sewer system. Under the consent order, the District was required to make certain improvements to the existing system and submit plans for a wastewater treatment system by August 1, 2018. The District did not meet all the tasks outlined in the consent order.

On March 19, 2019, the District agreed to a consent order that supersedes and closes the prior one and requires the District to complete the construction of a new waste water treatment plant and submit a lagoon closure plan for the total lagoon system by October 1, 2020. Management estimates the total cost of the new system to be approximately \$1.5 million. The ODEQ is authorized to seek penalties of up to \$10,000 per day for each violation of the Oklahoma Environmental Quality Code. The consent order assessed penalties of \$62,875 with the possibility of waiving \$23,600 of the penalties if certain benchmarks are met. Consequently, management has accrued a liability of \$39,275 in the current year.

On April 11, 2019, the District received a notice of an Administrative Compliance Order (ACO) from the ODEQ that assessed additional penalties of \$33,750 for discharging untreated wastewater through an unpermitted land application system. The ACO allows a waiver of \$10,000 of the assessed penalty if the District constructs an approvable land application system no later than May 1, 2019. \$23,750 of the assessed penalty has been recognized in the current year.

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.

Elfrink & Associates, PLLC

Member of the AICPA, OSCP, and GFOA

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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 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 Rural Water and Sewer District No. 20, Pittsburg County, Oklahoma ("District"), as of December 31, 2018 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 April 30, 2019. We qualified our opinion due to inability to certify the value of the fixed assets or the substance of the associated debt resulting from transactions initiated and executed by a related party at the formation stages of the District.

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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 have not been identified. However, as described in the accompanying schedule of findings and management responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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: [2018-01 and 2018-04].

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 2018-02, and 2018-03.

The District's Responses to Findings

The District's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The District's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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

Tulsa, Oklahoma
April 30, 2019

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.

2018-01 – 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. In November, 2016, we noted the implementation of a procedure to obtain authorization by email. Although a procedure has been put in place in 2017 to obtain Board approval of all payments, we noted only two of the eight invoices reviewed had approval by a board member documented prior to disbursement. Because of the lack of division of responsibility, internal control is determined to be weak. This is compounded by the fact that the administrative management of the District are employees of 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 continue to look for ways in which segregation of duties could be strengthened, such as working with the bank to modify the electronic payment process such that management can set up a payment but cannot actually transact the payment without an online approval by a Board member who is also a signer on the account. Management would not have the ability to both initiate and approve. Bank statements could be mailed directly to a Board Member.

MANAGEMENT’S RESPONSE: Management has revised the payment approvals and payments process; all invoices require two approvals, one from our Manager and the second and final from a Board Director. Checks are now written in the business office instead of the online payment system. A Director, who is an authorized signer on the checking account, comes to the business office to review and sign checks. Bank statements are received by the Controller and reconciled by an Accounts Receivable Administrative Assistant. Bank reconciliations are reviewed by the Controller and both parties sign the reconciliation as completed and reviewed. No one person is allowed to handle any transaction from beginning to end of a process.

2018-02 – Member (Customer) Files

CONDITION: A review of a random selection of eleven member (customer) files at the time of field work in April, 2019 indicated seven did not have an application/agreement for service on file. None of the members had been issued a 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. The District may not be complying with the requirements of membership designated by its chosen organizational form under Title 82 of the Oklahoma Statutes.

CAUSE OF CONDITION: The District did not have policies and procedures in place to require that a member file, application and agreement for service be maintained in 2018. The District is not issuing benefit unit certificates.

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. District management should become familiar with the procedures for issuing and transferring benefit units.

MANAGEMENT'S RESPONSE: We are now obtaining Member Applications during the property closing process when title to a property changes ownership. Applications are included with the property closing documents and the application fee is collected with the closing fees. We will actively continue to obtain the missing applications from previous accounts.

2018-03- Board of Director Meetings

CONDITION: As part of routine audit procedures, we requested copies of Board of Director meeting minutes held from January 2018 through March 2019. Although an annual meeting was held in November, 2018, the minutes from this meeting did not include approval of the District's annual budget. This is continued from 2017.

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 has been operating with a budget not approved by the Board of Directors.

CAUSE OF CONDITION: Management did not provide a budget for approval at an annual meeting.

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.

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.

MANAGEMENT'S RESPONSE: The District will hold an annual meeting once each year where a budget will be presented, approved, and signed for the subsequent year. The notice will be provided as a memo on the customer's monthly usage invoice.

2018-04- 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 25% of the purchased amount of water. This is continued from 2017.

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 No. 1 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 Rural Water District No. 1 as well as the amounts billed to members. Unusual fluctuations and/or discrepancies should be investigated.

MANAGEMENT'S RESPONSE: Management has implemented a system of daily readings taken from the Master Water Meter measuring amounts of water coming into the system being logged. The readings are compared on a daily basis with any jump in usage reported for leak detection. Possible leaks from usage jumps are addressed as soon as identified with corrective action taken when necessary. The total of the daily readings is compared against the billing coming from Longtown Rural Water District No. 1 to track the relationship between water purchased and sold.