

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, 2022



2022

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

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Caleb Conner	Chairman
Ryan McGovern	Vice Chairman
Robert Scott	Secretary
Luke Harry	Treasurer
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

Opinion

We have audited the accompanying financial statements of the business-type activities of the Rural Water and Sewer District No. 20, Pittsburg County ("District") as of and for the year ended December 31, 2022, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

In our opinion, except for the matters discussed in the "Basis for Qualified Opinion" paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the District, as of December 31, 2022, and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States (*Government Auditing Standards*). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the District, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Matters Giving Rise to The Qualified Opinion

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 2019. The utility system was purchased from the developer at a price determined by the developer by the issuance of a note to 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. In addition, as discussed in footnote 2B, the District is in the process of building a new waste water treatment plant which is expected to replace a significant portion of the sewer system assets. No impairment for these assets has been recorded in the financial statements. 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.

Responsibilities of Management 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, and 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 fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the District's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 District's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the District's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

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 5-7 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 June 23, 2023, 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 23, 2023

Elfrink and Associates, PLLC

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, 2022.

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

- The District's total net position decreased by \$206,475 and the liabilities of the District exceeded its assets at December 31, 2022 by \$212,431 (deficit net position). Of that, \$303,584 is invested in capital assets, net of related debt, leaving the District with a deficit unrestricted net position of \$516,015.
- The District reported a net operating loss of \$42,423, which included non-cash expenses of depreciation (\$67,570) as well as amortization of the asset retirement obligation (\$187,000).
- During the year, the carrying value of utility systems and related equipment increased by \$1,426,810 which included continuation of construction of a new water treatment plant with additional capitalized costs of \$1,457,039 and sewer improvements of \$37,341.

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 11-16 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, 2022

Condensed Statement of Net Position - December 31

	<u>2022</u>	<u>2021</u>	<u>Variance</u>	<u>Var%</u>
Assets:				
Current and other assets	\$ 304,557	\$ 337,655	\$ (33,098)	-10%
Capital assets, net	4,408,858	2,982,048	1,426,810	48%
Total Assets	<u>4,713,415</u>	<u>3,319,703</u>	<u>1,393,712</u>	42%
Deferred outflows of resources:				
Related to ARO	<u>-</u>	<u>187,000</u>	<u>(187,000)</u>	-100%
Liabilities:				
Other liabilities	72,572	627,493	(554,921)	-88%
Asset retirement obligation	748,000	748,000	-	
Notes payable	4,105,274	2,137,166	1,968,108	92%
Total liabilities	<u>4,925,846</u>	<u>3,512,659</u>	<u>1,413,187</u>	40%
Net position:				
Net investment in capital assets	303,584	844,882	(541,298)	-64%
Unrestricted (deficit)	(516,015)	(850,838)	334,823	-39%
Total net position	<u>\$ (212,431)</u>	<u>\$ (5,956)</u>	<u>\$ (206,475)</u>	3467%

The District's net position reflects its investment in capital assets, less any related debt used to acquire those assets that is still outstanding and is offset by an unrestricted deficit net position of \$516,015. The \$748,000 estimated cost to reclaim the sewer lagoons is expected to occur in 2023.

For the year ended December 31, 2022, The District's net position decreased by \$206,475.

Change in Net Position - Year Ended December 31,

	<u>2022</u>	<u>2021</u>	<u>Variance</u>	<u>Var%</u>
Operating revenues:				
Charges for sales and services	\$ 683,581	\$ 692,657	\$ (9,076)	-1%
Tap fees	4,647	55,360	(50,713)	-92%
Total operating revenues	<u>688,228</u>	<u>748,017</u>	<u>(59,789)</u>	-8%
Operating expenses:				
Depreciation and amortization	254,570	254,560	10	0%
All other operating expenses	476,081	426,037	50,044	12%
Total operating expenses	<u>730,651</u>	<u>680,597</u>	<u>50,054</u>	7%
Operating income (loss)	<u>(42,423)</u>	<u>67,420</u>	<u>(109,843)</u>	163%
Nonoperating expense:				
ODEQ penalty	(23,730)	-	(23,730)	
Interest expense	(140,322)	(44,915)	(95,407)	212%
Total nonoperating expense	<u>(164,052)</u>	<u>(44,915)</u>	<u>(119,137)</u>	265%
Change in net position	<u>(206,475)</u>	<u>22,505</u>	<u>(228,980)</u>	1017%

The District reported an operating loss of \$42,423 which was net of depreciation and amortization of the asset retirement obligation in the amount of \$67,570 and \$187,000, respectively. Operating revenues decreased by 8% from prior year while operating expenses increased 7%.

CAPITAL ASSETS

The District's investment in capital assets was \$4,408,858 net of accumulated depreciation, an increase of \$1,426,810 from the prior year. Significant capital asset activity during the year included:

- Construction costs for the new water treatment plant, expected to begin service in 2023, in the amount of \$1,457,039.

ECONOMIC FACTORS AND OTHER POTENTIALLY SIGNIFICANT MATTERS

OVERVIEW

The District is dedicated to providing water, sewer and sanitation services for the Town of Carlton Landing, 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. The note was renewed on October 1, 2022, and is due January 1, 2023. As of December 31, 2022, \$3,181,259 of the available \$3,200,000 had been drawn against the note.

This is a summary of the note activity in the current year:

	Balance 12/31/2021	Additions	Deductions	Balance 12/31/2022
Note payable - related party	\$ 1,049,969	\$ -	\$ 125,954	\$ 924,015
Note payable - Core Bank	1,087,197	2,094,062	-	3,181,259
	<u>\$ 2,137,166</u>	<u>\$ 2,094,062</u>	<u>\$ 125,954</u>	<u>\$ 4,105,274</u>

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the District'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:

Caleb Conner
RW&SD #20, Pittsburg County
44 Water Street
Carlton Landing, OK 74332
325-315-7255
crconner@gmail.com

Statement of Net Position – December 31, 2022

ASSETS

Current assets:

Cash and cash equivalents	\$ 131,905
Cash and cash equivalents - reserve accounts	70,755
Cash restricted for debt service	977
Accounts receivable, net of allowance for uncollectible	96,195
Prepaid insurance	1,407
Inventory - water meters	3,318
	<u>304,557</u>

Noncurrent assets:

Capital assets, net of accumulated depreciation	<u>4,408,858</u>
Total assets	<u><u>4,713,415</u></u>

LIABILITIES

Current Liabilities:

Trade accounts payable	23,909
ODEQ payable	23,730
Note payable - Core Bank	44,077
Note payable - related party - current portion	924,015
Total current liabilities	<u>1,015,731</u>

Noncurrent Liabilities:

Meter deposits payable	24,933
Note payable - Core Bank	3,137,182
Asset retirement obligation - lagoon closure	748,000
Total Noncurrent Liabilities	<u>3,910,115</u>
Total liabilities	<u><u>4,925,846</u></u>

NET POSITION

Net investment in capital assets	303,584
Unrestricted (deficit)	<u>(516,015)</u>
Total net position (deficit)	<u><u>\$ (212,431)</u></u>

See accompanying notes to the basic financial statements

RURAL WATER AND SEWER DISTRICT NO. 20
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Statement of Revenue, Expense and Change in Net Position – Year Ended December 31, 2022

Operating revenues:

Charges for sales and services:

Water	\$ 369,858
Sewer	159,021
Sanitation	127,549
Tap Fees	4,647
Late fees	318
Miscellaneous	26,835
Total operating revenues	<u>688,228</u>

Operating expenses:

Costs of sales and services:

Water purchases	148,462
Sanitation contractor	73,047
Operations and maintenance	121,823
Management fees	127,599
Legal fees	5,150
Amortization (asset retirement)	187,000
Depreciation	67,570
Total operating expenses	<u>730,651</u>
Operating loss	<u>(42,423)</u>

Nonoperating expense:

Interest expense	(140,322)
ODEQ penalty	(23,730)
Total nonoperating expense	<u>(164,052)</u>

Change in net position (206,475)

Net position - beginning (deficit) (5,956)

Net position - ending (deficit) \$ (212,431)

See accompanying notes to the basic financial statements

Statement of Cash Flows – Year Ended December 31, 2022

Cash flows from operating activities:

Receipts from members	\$ 665,845
Payments to suppliers, net	<u>(1,066,930)</u>
Cash used by operating activities	<u>(401,085)</u>

Cash flows from capital and related financing activities:

Interest paid on capital debt	(223,654)
Principal paid on capital debt	(42,622)
Proceeds from capital debt	2,094,062
Purchase of capital assets	<u>(1,494,380)</u>
Cash provided by capital and related financing activities	<u>333,406</u>

Net decrease in cash and cash equivalents (67,679)

Cash and equivalents - beginning of year 271,316

Cash and equivalents - end of year \$ 203,637

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

Operating income	\$ (42,423)
Depreciation and amortization	254,570
Increase in accounts receivable	(34,581)
Increase in meter deposits payable	5,233
Decrease in accounts payable	<u>(583,884)</u>
Net cash used by operating activities	<u><u>\$ (401,085)</u></u>

See accompanying notes to the basic financial statements

Notes to the Basic Financial Statements

1. Summary of Significant Accounting Policies

The Rural Water and Sewer District No. 20 complies with accounting principles generally accepted in the United States of America (GAAP) as applicable to government units. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations). The more significant accounting policies established in GAAP and used by the District are discussed below.

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 Director.

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, Deferred Outflows, 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.

Deferred Outflow of Resources

In addition to assets and liabilities, the statement of financial position reports a separate section for deferred outflows of resources. These represent a consumption of net position that applies to a future period which will not be recognized as an outflow of resources until that time. At December 31, 2022 the District did not report a deferred outflow of resources related to its asset retirement obligation for the lagoon closure as the amount of the estimated liability had been fully amortized.

Long-term Debt

All long term debt is reported as the liability is incurred. The long-term debt is presently comprised of a note payable to the developer and a note payable to a commercial developer, pledged by certain assets of 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, 2022, all of the District's cash was held in demand accounts bearing no interest and was full insured by federal deposit insurance.

B. Capital Assets and Depreciation

For the year ended December 31, 2022, capital asset balances changed as follows:

	Balance 12/31/2021	Additions	Deletions	Balance 12/31/2022
Capital assets not being depreciated:				
Land	\$ 209,000	\$ -	\$ -	\$ 209,000
Construction in progress (sewer)	1,450,775	1,457,039	-	2,907,814
Total capital assets not being depreciated	1,659,775	1,457,039	-	3,116,814
Capital assets being depreciated:				
Sewer system	1,002,860	37,341	-	1,040,201
Water system	587,578	-	-	587,578
Total capital assets being depreciated	1,590,438	37,341	-	1,627,779
Less accumulated depreciation:				
Sewer system	(183,414)	(55,819)		(239,233)
Water system	(84,751)	(11,751)		(96,502)
	(268,165)	(67,570)	-	(335,735)
Net capital assets	\$ 2,982,048	\$ 1,426,810	\$ -	\$ 4,408,858

The District is in the process of building a new wastewater treatment plant, expected to become operational in 2023 at which time a significant portion of the current sewer assets will be phased out of operations. Management was unable to determine the remaining book value of the impaired assets related to this effort, but it could have a significant effect on the carrying value of the assets.

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C. Long Term Debt

The following is a summary of long-term debt transactions of the District:

	Balance 12/31/2021	Additions	Deductions	Balance 12/31/2022	Amount Due in Next Year
Note payable - related party	\$ 1,049,969	\$ -	\$ 125,954	\$ 924,015	\$ 924,015
Note payable - Core Bank	1,087,197	2,094,062	-	3,181,259	44,077
	<u>\$ 2,137,166</u>	<u>\$ 2,094,062</u>	<u>\$ 125,954</u>	<u>\$ 4,105,274</u>	<u>\$ 968,092</u>

Payment requirements to maturity:

Year ended December 31,	Core Bank Note		Humphreys 2009 Note	
	Principal	Interest	Principal	Interest
2023	\$ 44,077	\$ 211,356	\$ 924,015	\$ 92,402
2024	3,137,182	69,286	-	-
Total	<u>\$ 3,181,259</u>	<u>\$ 280,642</u>	<u>\$ 924,015</u>	<u>\$ 92,402</u>

At December 31, 2022, the District's long term debt consisted of the following notes:

Note payable – related party

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.

On May 29, 2020, the District issued a second amended and restated promissory note that increased the principal amount to \$1,019,889 and changes the interest rate to be a floating one at 0.50% per annum in excess of the Wall Street Prime Rate and grants the developer a priority security interest in the assets of the District.

On April 14, 2020, the District issued a third amended and restated promissory note to include \$100,000 for the purchase of a tract of land from the developer.

On January 21, 2023 the District issued a fifth amended and restated promissory note in the amount of \$924,015 to supersede all prior agreements and provides for interest at the rate of the Wall Street Journal Prime Rate plus 2.5%, payable in full by December 31, 2023. In the event of default, the note provide for a special assessment to the District Mambers in an amount adequate to fully retire all principal and interest related to this note and the CoreBank Note as well as all of the rights and remedies afforded by applicable law.

Although subsequent to the reporting period, this restated note was used to value amounts presented in the financial statements as it was deemed to be the most reliable source of this information.

\$924,015

The developer's note has been subordinated to the Core Bank Note shown below.

Core Bank Note Payable

On October 1, 2022 the District entered in a loan agreement with Core Bank in the amount of \$3,200,000 to construct a wastewater 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 payments at the Wall Street Prime Rate + 1% with the full amount payable on January 1, 2023. \$3,181,259

Total notes payable \$4,105,274

3. Related Party Transactions

The District was originally financed by and had significant transactions with the developer of the planned community it serves. 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. The District was managed by a company owned by the developer until December 2019 at which time management was assumed by OK Water, LLC, an entity that is independent of the developer.

4. Asset Retirement Obligation

The District has incurred certain asset retirement obligations related to the operation of its wastewater utility system. The estimated liability of the legally required closure costs for the wastewater utility system was \$748,000 as of December 31, 2022. This cost estimate is for reclamation of the three sewer lagoons as required by regulations promulgated by the Oklahoma Department of Environmental Quality. The District is currently constructing a wastewater treatment plant. Upon completion, the lagoons will no longer be used. The reclamation process is expected to take place in 2023. Consequently, the cost is being amortized over 4 years, with the final \$187,000 expensed in the year ended December 31, 2022.

5. Management Agreement

On October 1, 2019, the District entered into an agreement with OK Water, LLC of Oklahoma City, Oklahoma to operate and maintain its water and sewer systems. The agreement expired on October 31, 2022. On December 1, 2019, the District also entered into an agreement with OK Water, LLC to provide accounting and administrative services. This agreement expired on November 30, 2022. During the year ended December 31, 2022, the District paid \$127,599 related to these agreements. The District does not have employees.

6. 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

7. 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.

ODEQ Consent Order Case No. 21-019

On March 21, 2019, the District entered into a consent order with the Oklahoma Department of Environmental Quality ("ODEQ") regarding unpermitted discharges and operation and maintenance violations from the wastewater treatment system. The consent order called for a new wastewater treatment system to be constructed beginning February 2021 with an objective of three months compliance with the OPDES permit by June 2021.

On March 29, 2021, the District informed the ODEQ that it would not be able to meet the specified deadlines of the consent order due to global supply chain delays for construction materials. Consequently, on July 7, 2021, a revised consent order was entered into with a modification of the task deadlines to begin construction by October 2021 and attain six consecutive months of compliance with the OPDES Permit by September 2022. Failure to meet the specified task deadlines in the consent order could result in penalties not to exceed \$70,000.

On December 21, 2022, the District received a Notice of Noncompliance from the ODEQ that assessed penalties related to this consent order in the amount of \$23,730.

8. Subsequent Events

Core Bank Loan Renewal

On March 1, 2023, the District executed an agreement to renew the Core Bank Note in the amount of \$3,181,259 which was also the balance on December 31, 2022. The note bears interest at the Wall Street Journal Prime Rate plus one percent and becomes fully due and payable on March 1, 2024.

Humphreys Partners 2009, LLC Fifth Amended and Restated Promissory Note

On January 21, 2023, the District executed an agreement to restate the note to the developer in the amount of \$924,015. The note bears interest at the Wall Street Journal Prime Rate plus two and one-half percent and becomes fully due and payable on December 31, 2023. The terms of this note have been incorporated in the current year's financial statements at December 31, 2022 as it was deemed to be the most reliable source of information related to this indebtedness.

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 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, 2022 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 23, 2023. 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.

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 and, therefore, material weaknesses or significant deficiencies may exist that were not identified. We identified a deficiency in internal control, described in the accompanying schedule of findings and management responses as item 2022-04.

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, and contracts, 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

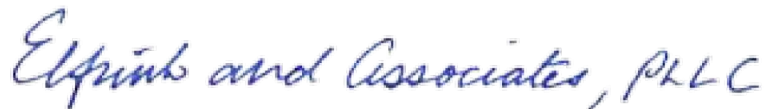
not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* described in the accompanying schedule of findings and management responses as 2022-01, 2022-02, and 2022-03.

The District's Responses to Finding

The District's response to the findings identified in our audit is described in the accompanying schedule of findings and management responses. The District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of 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.

A handwritten signature in blue ink that reads "Elfrink and Associates, PLLC". The signature is written in a cursive, flowing style.

Elfrink and Associates, PLLC

Tulsa, Oklahoma

June 23, 2023

SCHEDULE OF FINDING AND MANAGEMENT RESPONSE

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.

2022-01 – Member (Customer) Files

CONDITION: A review of 20 customer files at 12/31/22 showed that 4 still did not have applications or security deposits on file. Management reports that approximately 65 of the 307 current active customers did not have applications for service or security deposits on file.

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 has not consistently obtained a member file, application, and agreement for service from its members.

CRITERIA: 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 from/for all landowners.

MANAGEMENT’S RESPONSE: We are working with Title Companies to be notified as part of the Closing process to receive notification of a property changing hands, which will allow us to close an account and get final bill payment and obtain new owner information so they can apply for new account. For new housing construction, the District is working with the Town to get notified when a Certificate of Occupancy is issued. Internally, field staff will not install a new meter without a workorder, which will ensure there is an account set-up and the Benefit Unit and Deposit have been paid.

2022-02 – Cutoff Policy Enforcement

CONDITION: We noted that at the time of field work, 14 customers had current water service despite significant past due amounts. This included one customer with two active accounts which were 199 days past due at December 31, 2022, with a combined balance of \$3,887. The District transitioned to new management at December 1, 2022, and the new management plans to enforce the District’s policy to cut off service for accounts 30 days in arrears (60 days from the date of reading, since billing is 30 days in arrears), but at December 31, 2022 no actual cut offs are being performed.

POTENTIAL EFFECT OF CONDITION: The District may not generate sufficient cash flow to cover expenses and debt service without an additional rate increase. Other District customers could inadvertently subsidize the accounts that do not pay for services.

CAUSE OF CONDITION: The District is not enforcing its policy regarding cutoff for delinquent accounts.

CRITERIA: The Rules and Regulations for the District, dated May 24, 2014 state that:

Customers with unpaid bills on the first day of the month {following the billing month} who do not make arrangements to pay will be notified that water service is subject to termination. AND

The reconnection charge for restoration of service, if reconnection is authorized and approved under the provisions of the Bylaws of the District, after each suspension of service because of delinquent payment or for other infraction of these rules shall be the unpaid amount charged to date against the consumer's account plus ten percent (10%) interest, and a sum to cover the reasonable cost of labor necessary to make such reconnection.

RECOMMENDATION: The District should enforce its cutoff policy.

MANAGEMENT'S RESPONSE: Management will begin enforcing the cutoff policy.