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An Audit Report on

# The Kinney County Groundwater Conservation District

January 2006  
Report No. 06-021



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### Overall Conclusion

Significant deficiencies in the Kinney County Groundwater Conservation District's (District) financial operations prevent the District from ensuring that it (1) has timely, complete, and accurate financial information for decision making; (2) is able to meet its financial obligations; or (3) protects against violations, abuse, and fraud. In addition, the District's Board has not demonstrated the financial oversight of the District that is required by Texas Water Code, Section 36.057(a). The lack of proper financial oversight by the Board has contributed to the weaknesses in the District's accounting procedures and controls.

#### Background Information

House Bill 3243 (77th Legislature) created the Kinney County Groundwater Conservation District (District) effective September 1, 2001.

The District, whose office is located in Brackettville, Texas, issues permits for wells located in zones of the Edwards Trinity Aquifer, the Edwards Aquifer, and the Austin Chalk Aquifer.

A lack of accounting procedures, controls, and oversight significantly increases the potential for errors, theft, and fraud to occur. Auditors did not identify fraud during testing of the District's revenue and disbursements. However, we cannot provide assurance that fraud has not occurred. The District should act immediately to address serious financial issues and implement a long-term financial remediation plan.

The District complied with 26 (70 percent) of the 37 statutory requirements tested; however, it did not comply with 12 (46 percent) of the 26 District rules tested. The most significant examples of noncompliance were in the areas of well permitting; Board oversight and delegation of authority to the District's general manager; disbursement of District funds; and acceptance of grants, gratuities, advances, or loans. For example:

- In the area of well permitting, the District scheduled three applicants for permit hearings prior to determining whether the applications were administratively complete. According to Texas Water Code, Section 36.114, and District Rule 9.01, these applicants should not have been scheduled for hearings until the District determined that their applications were administratively complete.
- In the areas of Board oversight, delegation of authority, and disbursement of funds, the District's general manager signs District checks and executes contracts on behalf of the District. However, the District was unable to provide

*This audit was conducted in accordance with Texas Water Code, Section 36.302.*

*For more information regarding this report, please contact Nicole Guerrero, Audit Manager, or John Keel, State Auditor, at (512) 936-9500.*

a Board resolution authorizing the general manager to carry out these duties as required by Texas Water Code, Sections 36.057(f) and 36.151(b).

Compliance with statute and District rules in these areas is critical to the District's achieving its objectives to conserve, preserve, and protect groundwater and prevent waste.

The District achieved a majority of the objectives in its groundwater management plan and, therefore, it is operational. However, the District neither prepared nor submitted an annual report for 2004 to its Board as required by its groundwater management plan, which was adopted by the District's Board and approved by the Water Development Board.

## Key Points

Significant deficiencies in the District's accounting procedures and controls increase the risk of errors, theft, and fraud.

The District does not have timely, accurate, and complete financial information for making management decisions. The District's 2004 Statement of Revenues, Expenditures, and Changes in Fund Balance contained a material omission because it did not include \$78,542 in legal and consulting expenses. In addition, the District (1) did not correctly record the year-end adjustments to its accounting records for 2004 that its external auditor provided and (2) did not always correctly record accounting transactions.

The 2004 audited financial statements that the District's external audit firm prepared also showed that the District had a \$58,195 deficit. (Correctly reporting the \$78,542 in legal and consulting expenses discussed above would have increased this deficit.) The external audit firm's audit report for 2003 (the prior year) showed that the District had a \$129,804 deficit, and that report raised substantial doubt about the District's ability to continue as a "going concern" (see text box on page 3).

The District's Board has not demonstrated the financial oversight of the District that is required by Texas Water Code, Section 36.057(a). The lack of proper financial oversight by the Board has contributed to the weaknesses in the District's accounting procedures and controls.

### Information from the District's 2004 Audited Financial Statements

#### Balance Sheet

Total Assets	\$162,765
Total Liabilities	\$220,960

#### Statement of Revenues, Expenditures, and Changes in Fund Balance

Total Revenue (Property Taxes and Fees)	\$168,040
Total Expenditures	\$ 96,432

The amounts above are from the District's external auditor's report and do not include \$78,542 in legal and consulting expenses. See Appendix 2 for excerpts from the District's 2003 and 2004 audited financial statements, which were prepared by the external auditor.

The lack of accounting procedures and controls and inadequate physical security over the District's assets put the District at risk for errors, theft, and fraud. For example, state auditors observed that the District's checkbook was left unsecured, unendorsed checks that the District had received were left unsecured on the general manager's desk, and checks that the District received from its customers were placed in file folders indefinitely.

In addition, state auditors determined that one of the District's employees has a felony criminal record, which reinforces the significance of strong accounting controls.

Tests of District revenue and disbursements also indicate that the District lacks certain accounting procedures and controls. For example, the District did not collect any or all the required fees for 8 (14 percent) of the 56 permits for historic, existing, and new wells tested. The District also collected \$4,250 more in application fees from permit applicants than the applicants owed. In addition, state auditors could not locate in the District's bank statements or accounting records a \$550 application fee that District records indicated the District has received.

**The District did not always comply with statute or its rules.**

The District's well-permitting files were not always complete, but the documentation available in these files indicated that the District did not comply with important well-permitting requirements in areas such as reviewing permit applications for completeness and well permit hearings. None of the 27 permit files auditors tested contained information regarding the actual dates that (1) the District initially reviewed the applications for completeness or (2) determined whether the applications were "administratively complete."

The District scheduled three applicants for permit hearings prior to determining whether their applications were administratively complete. The District subsequently passed \$7,657 of its legal and consulting expenses for the hearings on to these applicants. According to Texas Water Code, Section 36.114, and District Rule 9.01, these applicants should not have been scheduled for hearings until the District determined that their applications were administratively complete.

The District's Board has not specifically authorized the District's general manager to engage in certain activities for which statute requires formal authorization, but the general manager has exercised full authority in the management and operation of the District. For example, the general manager has executed seven contracts on behalf of the District for professional and consulting services; however, the District was unable to provide the statutorily required Board resolution delegating this authority to the general manager.

The District's Board has not accepted or rejected two donations made to the District as required by statute. In one case, an organization paid \$17,500 for legal fees the District owed to a law firm.

**The District achieved a majority of the objectives in its groundwater management plan; therefore, it is operational.**

No earlier than one year after the certification of a district's groundwater management plan, the State Auditor's Office is required by Texas Water Code, Chapter 36, to audit the district's operational status. A district is operational if it has achieved a majority of the objectives in its groundwater management plan.

In fiscal year 2004, the District achieved six (75 percent) of the eight objectives in its groundwater management plan. In fiscal year 2005, the District achieved seven (78 percent) of the nine objectives in its groundwater management plan. Because it achieved the majority of the objectives in its groundwater management plan, state auditors determined that the District is operational.

### ***Subsequent Events***

Following the completion of audit work, in January 2006 a state district judge ruled against the District in a lawsuit filed by 13 permit applicants. The judge ruled that (1) the District was improperly billing permit applicants for costs of attorneys and experts the District hired for its hearings and (2) that the amount of the production fees the District charges permit applicants is incorrect because that amount is based upon the amount of water claimed by applicants.

It was unclear whether the District intended to appeal this ruling. However, this matter could further put the District's ability to continue as a going concern at risk.

### ***Summary of Management's Response and Auditor's Follow-Up Comment***

Management's responses state that "with few exceptions, the District agrees with the recommendations." However, in several instances, the District states that it believes its current practices already address the issues auditors identified.

This audit's scope, methodology, and criteria were objective and thorough and provided sufficient evidence to support the issues in this report. None of the information the District provided in its responses, or at any time during this audit, changes the issues and recommendations in this report.

The District's responses are presented in their entirety in Appendix 5.

## ***Summary of Objectives, Scope, and Methodology***

The audit objectives were to determine whether the District:

- Has accounting procedures and controls that ensure accurate, timely, and complete financial information is available for making management decisions; ensure it is able to meet its financial obligations; and protect against violations, abuse, and fraud.
- Achieves its management goals and objectives as outlined in its management plan.
- Complies with applicable statutes, rules, and regulations.

The audit scope covered the District's operations from September 1, 2001 (when it was created by House Bill 3243, 77th Legislature, Regular Session), through August 31, 2005.

The audit methodology included conducting interviews; collecting and reviewing information; and performing tests, procedures, and analyses against predetermined criteria. This audit did not include a review of information technology.

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# Detailed Results

Chapter 1

## ***Significant Deficiencies in the District's Accounting Procedures and Controls Increase the Risk of Errors, Theft, and Fraud***

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Significant deficiencies in the Kinney County Groundwater Conservation District's (District) financial operations prevent the District from ensuring that it (1) has timely, complete, and accurate financial information for decision making; (2) is able to meet its financial obligations; or (3) protects against violations, abuse, and fraud. A lack of accounting procedures, controls, and oversight significantly increases the potential for errors, theft, and fraud to occur.

The District's Board has not demonstrated the financial oversight of the District that is required by Texas Water Code, Section 36.057(a). The lack of proper financial oversight by the Board has contributed to the weaknesses in the District's accounting procedures and controls. In addition, the District's 2004 audited financial statements contained a material omission because \$78,542 in legal and consulting expenses were not included on those statements. As a result of the lack of accounting procedures and controls, lack of oversight by the Board, and difficulty in getting access to information, state auditors cannot provide assurance that the District's records of revenue and disbursement amounts are complete and accurate.

The weakness described above—coupled with additional weaknesses in physical security and the fact that the District uses numerous manual processes and employs an individual with a felony criminal record—significantly increase the potential for errors, theft, and fraud. State auditors did not identify fraud during testing of the District's revenue and disbursements. However, we cannot provide assurance that fraud has not occurred.

**The District does not have timely, accurate, and complete financial information.**

The District does not have timely, accurate, and complete financial information for making management decisions. The expenditures reported on the District's 2004 Statement of Revenues, Expenditures, and Changes in Fund Balance contained a material omission because it did not include \$78,542 in legal and consulting expenses. Rather than correctly reporting that amount as an expenditure on the Statement of Revenues, Expenditures, and Changes in Fund Balance, the District reported that amount only on its balance sheet as pass-through expenses to existing and historical permit applicants. State auditors were unable to determine why the external audit firm that prepared the District's 2004 financial statements and conducted the



District's 2004 audit did not identify this discrepancy because the external audit firm did not allow state auditors to speak to the firm's auditor who conducted this work.

**Information from the District's 2004 Audited Financial Statements**

Balance Sheet

Total Assets	\$162,765
Total Liabilities	\$220,960

Statement of Revenues, Expenditures, and Changes in Fund Balance

Total Revenue (Property Taxes and Fees)	\$168,040
Total Expenditures	\$ 96,432

The amounts above are from the District's external auditor's report and do not include \$78,542 in legal and consulting expenses. See Appendix 2 for excerpts from the District's 2003 and 2004 audited financial statements, which were prepared by the external auditor.

The District's external audit firm also did not provide state auditors with the specific standards that it used to prepare the District's financial statements. However, the external audit firm's audit report specified that:

- The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.
- The financial statements were prepared in conformity with generally accepted accounting principles.
- The District's expenses are recorded when a liability is incurred.
- The District did not have any changes from the prior

year in its accounting methods. (However, state auditors noted that the presentation of legal and consulting expenses in the 2004 financial statements was different from the presentation of those expenses in 2003.)

According to GASB Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments:

Governments should report all expenses by function.... As a minimum, governments should report direct expenses for each function. Direct expenses are those that are specifically associated with a service, program, or department and thus are clearly identifiable to a particular function.

Therefore, because the District's legal and consulting expenses are a direct expense that the District has incurred, the \$78,542 in legal and consulting expenses should have been included on the Statement of Revenues, Expenditures, and Changes in Fund Balance. Although the District passes legal and consulting expenses for permit hearings on to permit applicants, it is the District that has a contract for these services and is obligated to pay these expenses, not the applicants. In other words, if the applicants do not pay the costs that the District has passed on to them, the District is still obligated to pay for those services.

In addition to the discrepancy involving legal and consulting expenses described above, the District's accounting records also were not complete and accurate because the District (1) did not correctly record the year-end

adjustments to its accounting records for 2004 that its external auditor provided and (2) did not always correctly record accounting transactions. As a result, the District's financial information provided to the Board is not reliable for decision making.

The District experienced deficits in 2003 and 2004, which puts its ability to continue as a going concern at risk.

The 2004 audited financial statements that the external audit firm prepared show that the District had a \$58,195 deficit. Correctly reporting the \$78,542 in legal and consulting expenses discussed above would have increased this deficit. The external audit firm's audit report for 2003 (the prior year) showed that the District had a \$129,804 deficit and expressed concern about the fact that the District's liabilities significantly exceeded its assets. The 2003 external audit report raised substantial doubt about the District's ability to continue as a going concern (see text box). The 2003 audit report specified that the District "overexpended several expenditure categories by a total of \$196,490 of its budget."

**What Is a Going Concern?**

An entity is a "going concern" if it has the ability to pay its debts when they are due and, therefore, can continue to operate.

The District's legal and professional expenses were more than half of its total expenditures for 2002, 2003, and 2004. The District spent \$389,909 in legal fees from its creation by the Legislature in September 2001 through August 31, 2005. Attorneys were paid to develop the District's bylaws, management plan, and rules, as well as to develop permit hearing procedures, attend all permit hearings, and, more recently, represent the District in litigation. In a survey of 23 other groundwater conservation districts in Texas, state auditors determined that other districts were not routinely using attorneys in their permit-hearing processes. Although the other districts reported that they use a judicial process for permits, these districts' board presidents act as hearing officers, and these districts reported they use attorney services only when needed.

**Statutory Responsibilities of Boards that Oversee Groundwater Conservation Districts**

Texas Water Code, Section 36.057(a), specifies that boards of groundwater conservation districts:

...shall be responsible for the management of all the affairs of the district. The district shall employ or contract with all persons, firms, partnerships, corporations, or other entities, public or private, deemed necessary by the board for the conduct of the affairs of the district, including, but not limited to, engineers, attorneys, financial advisors, operators, bookkeepers, tax assessors and collectors, auditors, and administrative staff.

The District's Board does not demonstrate proper oversight of the District's financial affairs.

The District's Board has not demonstrated the financial oversight of the District that is required by Texas Water Code, Section 36.057(a) (see text box). The lack of proper financial oversight by the Board has contributed to the weaknesses in the District's accounting procedures and controls. Specifically:

- Although District staff asserted that Board members review District invoices when corresponding disbursement checks are signed, auditors found no evidence of Board member review on the invoices associated with 85 disbursements tested.

- The District's general manager exercises full authority in the management and operation of the District. For example, the general manager signs District checks and executes contracts on behalf of the District. However, the Board has not authorized the general manager to carry out these duties in the manner required by statute and Board bylaw. Specifically, Chapter 36 of the Texas Water Code and the District's bylaws allow the Board, by resolution, to delegate authority to sign disbursements and execute contracts. The District was unable to provide a Board resolution that delegates this authority. In addition, District Bylaw 9.1 further requires that executed contracts be attested to by the Board secretary and approved by general counsel and that any contract not approved in accordance with these requirements is void.

Auditors identified only seven contracts for professional and consulting services. None of the contracts was attested to by the Board secretary or approved by general counsel as required by District Bylaw 9.1. The District's general manager executed all of these contracts. Although there was no evidence of a Board resolution delegating this authority to the general manager as required by statute and District bylaws, the Board did approve two of these contracts at a Board meeting prior to the general manager's signing the contracts. In five cases, the general manager signed a contract prior to obtaining the Board's approval of that contract. One of these five contracts was a "quick start" contract in the amount of \$19,777, plus additional expenses, and did not specify the services that the contracted consultant would provide to the District. The contract also provided payment to the consultant for any services performed even if the Board did not later approve the contract.

Texas Water Code, Section 36.057 (c), and the District's Code of Ethics, Travel, Professional Services, and Management Policies also require that consultants be selected based on their qualifications and experience. In addition, District Bylaw 6.3 requires the District's general manager to compose a written policy (to be approved by the Board) concerning the selection, monitoring, review, and evaluation of consultants who provide professional services. However, auditors found no evidence of an assessment of the qualifications of the consultant the District contracted with or the required policy for consultant selection, monitoring, review, and evaluation.

- Minutes from Board meetings show that the District's Board adopts an annual budget. (Typically, developing a budget helps in planning, monitoring, and controlling disbursements.) In addition, District staff assert that Board members are provided with financial statements.

However, auditors did not find consistent evidence in the Board minutes that the Board has used the information described above to discuss or monitor the financial affairs of the District. (The Board has not held

regular meetings since August 2004.) Instead, minutes from 2004 and 2005 Board meetings and hearings show that the Board focuses its attention on permitting. This lack of financial oversight may have contributed to the District's accumulating \$135,873 in legal expenses that it could not pay (which constitutes a violation of District Bylaw 9.5) and its having to agree to a payment plan to pay the District's legal fees.

The District's lack of accounting procedures and controls and its inadequate physical security over assets increase the risk of errors, theft, and fraud.

A lack of accounting procedures and controls and inadequate physical security over the District's assets put the District at risk for errors, theft, and fraud.

Auditors observed the following:

- The District's checkbook was left unsecured in the office or an unlocked file cabinet.
- Unendorsed checks that the District had received when customers paid fees were left unsecured on the general manager's desk.
- Checks the District received from its customers were placed in file folders indefinitely. Specifically, auditors observed two instances in which the District had received checks from customers, did not restrictively endorse the checks, and left them in files indefinitely. One of these checks was one year old when auditors observed it.
- Checks for District disbursements that were awaiting a signature were left pinned to the general manager's note board.

In addition, auditors determined that one of the District's employees has a felony criminal record, which reinforces the significance of strong accounting controls. This employee works alone in the District's office on certain days and has access to the District's accounting and permit records. According to the District's general manager, this employee is not allowed to accept any fees from customers and is required to contact the general manager when a customer brings fees to the office.

Although the District had a compensating control to mitigate some of the risks associated with revenue collection, it has not used that control since September 2004. From August 29, 2003, through September 8, 2004, the District's former general manager used a prenumbered receipt book to record fees and deposits collected. However, auditors had difficulty obtaining this receipt book during this audit.

Throughout this audit, auditors repeatedly asked the current general manager if the District had a receipt book for the collection of fees and deposits, but the general manager informed auditors that there was no receipt book. After interviewing the former general manager, auditors again asked the current general manager for the District's receipt book and explained that the former

general manager stated that a receipt book had been used and that it was located in the District office. At that time, the current general manager located the receipt book without difficulty and without searching any of the District's files. The receipt book contained 43 entries totaling \$35,418.71, and the current general manager's initials were on the last two receipts in the book.

The District also does not consistently ensure that checks are signed by two individuals. Eight (9.4 percent) of the 85 checks tested had only one signature. In addition, auditors noted that, of checks on which there were two signatures, one of the signatures on the checks was that of the general manager. As noted above, the Board has not, by resolution, given the general manager authority to sign checks. Furthermore, in a sample of 15 payroll disbursements tested, the general manager provided the second signature on two of her own paychecks.

Tests of District revenue and disbursements indicate that the District lacks certain accounting procedures, controls, physical security, and oversight.

Audit tests of District revenue and disbursements identified errors that, although not material, are indicative of a lack of accounting procedures, controls, physical security, and oversight. For example:

- The District did not collect either any or all the required fees for 8 (14.29 percent) of the 56 permits tested for historic, existing, and new wells. For three of those eight permits, auditors found no indication that the District had received any application fees. In addition, for two of those eight permits, the District did not have any record of receiving the 2003 groundwater use fees. District Rule 14.03 prohibits the District from scheduling and holding permit hearings for any applicants who have not paid all fees due to the District.
- The District collected \$4,250 more in application fees from permit applicants than the applicants owed. Although the District asserts that \$3,500 of that amount was collected for permit hearing costs but was incorrectly recorded, it could not provide evidence to support this assertion.
- Auditors could not locate in the District's bank statements or accounting records a \$550 application fee that District records indicated the District has received. The receipt of the \$550 was recorded on a spreadsheet that the District uses to calculate the amount of permit hearing costs it bills to permit applicants.
- In 5 (9.43 percent) of the 53 historic, existing, and new well permits tested, revenue was posted to the wrong account.
- Fourteen (16.47 percent) of the 85 disbursements tested were not processed in compliance with statute or the District's Bylaws or were not

recorded to the correct expense account. Specifically, of the 85 disbursements tested:

- ♦ Eight (9.4 percent) lacked the proper signatures on the checks as required by Texas Water Code, Section 36.151 (b) and District Bylaw 9.3 (A).
  - ♦ Five (5.9 percent) lacked proper supporting documentation as required by the American Institute of Certified Public Accountants' Statements on Auditing Standards 31. (One of these five disbursements was also unallowable, as discussed below.)
  - ♦ Two (2.4 percent) were unallowable because the District did not obtain Board approval for the disbursements as required by District Bylaw 9.8.
- One (6.67 percent) of the 15 payroll disbursements tested was not recorded to the correct account and lacked proper supporting documentation.

### Recommendations

The District should act immediately to address its serious financial issues. Specifically, the District should:

- Set and follow a standard for documenting all financial decision making.
- Develop and implement policies and procedures to govern financial activities.
- Properly segregate financial duties.
- Implement a purchasing approval and receipt process for goods and services.
- Safeguard assets.
- Comply with rules, contracts, and laws.

To fully address and resolve its financial issues, the District also should implement a long-term financial remediation plan to ensure that its financial management system supports:

- Management's and Board members' fiduciary roles.
- Compliance with legal, regulatory, and other requirements.
- Fiscal management and associated decision making.

- Ongoing fiscal monitoring.
- The District's groundwater management plan.
- Contract management.
- The safeguarding of resources against waste, loss, and misuse.
- Generation of reliable financial data.
- Communication of useful financial information in a timely manner.

The success of the financial remediation plan will depend, in part, on the manner in which it is executed. For that reason, it is critical that the District:

- Clearly define the financial remediation plan's objectives.
- Specify time lines, benchmarks, and projected outcomes for each portion of the plan.
- Assign responsibility for corrective actions to specific staff and hold them accountable for carrying out their responsibilities.
- Implement a mechanism for regular review of plan implementation status.

At a minimum, the District's financial remediation plan should include the following:

- Development of a sound budgeting process that incorporates reasonable forecasting techniques, reliable financial data, and adequate staff input.
- Development of a cash management plan that allows the District to better anticipate its financial condition.
- Regular tracking of the costs associated with conducting business.
- Proper negotiation of contracts.

## *The District Did Not Always Comply with Statute or Its Rules*

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The District complied with 26 (70 percent) of the 37 statutory requirements tested from Chapter 36 of the Texas Water Code; however, it did not comply with 12 (46 percent) of the 26 District rules tested. The most significant examples of noncompliance were in the areas of well permitting; Board oversight and delegation of authority to the District's general manager; disbursement of District funds; and acceptance of grants, gratuities, advances, or loans (see Appendix 3 for the detailed information on the District's compliance with statute and rules). Compliance with statute and District rules in these areas is critical to the District's achieving its objectives to conserve, preserve, and protect groundwater and prevent waste.

The District's well-permitting files were not always complete, but the documentation available in these files indicated that the District did not comply with important well-permitting requirements.

Auditors cannot provide assurance regarding the completeness and accuracy of the District's well-permitting files because the permit files that auditors attempted to test contained duplicate information, did not always have information regarding the dates that applications or supplemental information was received, and did not always contain the date the District took action. The lack of documentation in these files can lead to delays in decisions regarding well permits and prevents the District from demonstrating compliance with statute and its own rules. (See Appendix 4 for detailed information on the amount of water the District permitted from August 12, 2004, through April 23, 2005.)

Auditors attempted to test 27 permit files, each of which contained one or more well-permit applications from a single applicant. Each of these 27 files contained a letter dated August 3, 2005, that specified (1) the Board's final decision; (2) the Board's intent to issue the permit(s); and (3) the amount of water to be granted (permitted). The August 3, 2005, letters also specified that the permits that were to be issued would expire on December 31, 2005. However, as of auditors' last visit to the District on November 17, 2005, the District had not yet issued any of these permits. According to the District, it has not yet issued permits because the applicants had not yet paid the required fees or the wells had not been inspected to ensure that meters had been installed and were operational as required by its rules.

Auditors' tests of documentation in these 27 permit files identified significant noncompliance with statute and District rules regarding well permitting. For example:

- None of the 27 files tested contained information regarding the actual dates that (1) the District initially reviewed the applications for completeness or (2) determined whether the applications were



“administratively complete.” The only documentation in the files consisted of letters from the District (all dated February 28, 2004) requesting supplemental materials needed to complete the applications. In addition, none of the files contained information that indicated precisely when the District received that information. Therefore, auditors were unable to determine whether the District complied with statute or its own rules.

This is important because District Rule 9.01 D(1) requires an initial review of the application for administrative completeness within 45 business days of receipt. In addition, Texas Water Code, Section 36.114, requires groundwater districts to “promptly consider and act on each administratively complete application for a permit.” The statute further requires that, if a groundwater district does not act on or set a hearing on an application within 30 days after it is deemed administratively complete, the applicant may petition the district court to compel the district to act on the application or set a date for a hearing on the application.

- The District scheduled three applicants for permit hearings prior to determining whether their applications were administratively complete. The District subsequently passed \$7,657 of its legal and consulting expenses for the hearings on to these applicants. According to Texas Water Code, Section 36.114, and District Rule 9.01, these applicants should not have been scheduled for hearings until the District determined that their applications were administratively complete.

The notice of hearing in the July 1, 2004, issue of *The Brackett News* specified that these three applicants would not receive permits due to insufficient information. One applicant was later able to provide sufficient information during the hearing process to obtain a permit; however, the other two were denied permits due to insufficient information.

In addition, all of the applicants for the 27 permit files tested received a letter stating that their applications were administratively incomplete. This may be due in part to District Rules 9.09 and 9.10, which specify that (1) historic and existing use permits applicants must apply for a permit and pay the prescribed fees on or before December 1, 2003, and (2) failure to apply for a permit and pay the prescribed fees will preclude owners from making any future claims or applications and that owners will forfeit their rights and ability to operate the wells.

- None of the 27 files tested contained information regarding the dates that the District’s technical review was completed. District Rule 9.01 D(2) requires a technical review to be conducted within 30 calendar days after an application is administratively complete.

Auditors estimated that the applications in the 27 permit files tested expired on May 28, 2004. However, the only dates in these files that

related to the District's technical review were on letters to all applicants dated June 28, 2004 (31 days after the applications expired).

- The District held the initial permit hearing for all 27 applicants 42 days after the hearing date was set; however, Texas Water Code, Section 36.114, and District Rule 9.01 D(2) require that hearings be held within 35 days after setting that date.

Auditors were unable to determine whether the District acted on the applications in the 27 permit files within 35 days after the date of the hearing as required by Texas Water Code, Section 36.114. In addition, statute does not clearly define what is meant by "action taken." However, auditors did calculate the length of time between the date of the Board's final decision and the date on the official letter of notification to all 27 applicants. All of the notification letters were dated August 3, 2005, and those letters included information regarding the amount of water granted (permitted) by the Board. In addition, 25 of the 27 letters included the date of the Board's final decision. Of those 25:

- ♦ Twenty-four showed that the Board's final decision was made from 41 days to 11 months before the official notifications were sent to applicants on August 3, 2005.
- ♦ One had an official notification letter that was sent prior to the expiration of the motion for rehearing, which indicates that the Board had finalized its decision prior to the time frame prescribed by District rules.

All applicants were scheduled for an initial hearing on August 12, 2004, but they did not receive official notice of the Board's decision until August 3, 2005, approximately one year later.

**The District's Board has not authorized the District's general manager to perform certain duties for which statute requires such authorization.**

The District's Board has not authorized the District's general manager to engage in certain activities for which statute requires formal authorization. Texas Water Code, Section 36.056 (and District Rule 3.01), specifies that boards of groundwater districts may delegate full authority to manage and operate the district subject only to orders of the board. In addition, Texas Water Code, Section 36.057, allows boards by resolution to authorize the general manager to execute documents on behalf of the district and makes boards responsible for the management of all district affairs.

Although auditors found no evidence that the District's Board granted the general manager this authority through board order or resolution, the general manager has exercised full authority in the management and operation of the District. For example, the general manager has executed contracts on behalf of the District for professional and consulting services. In one case, the

general manager signed a contract prior to obtaining the Board's approval of that contract. The "quick start" contract in the amount of \$19,777, plus additional expenses, does not state what services will be provided to the District. The contract also provides payment to the contractor for any services performed if the Board does not later approve the contract. (See Chapter 1 for more information regarding the District's financial operations.)

The District has not complied with statute regarding the disbursement of funds.

Texas Water Code, Section 36.151, requires groundwater districts to disburse money only by check, draft, order, or other instrument. This statute also requires that disbursements be signed by at least two board members unless the board, by resolution, allows certain employees to sign disbursements. However, 8 (9.4 percent) of the 85 District disbursements that auditors tested were not signed by two individuals. In addition, although the general manager signs checks, the Board has not delegated this authority to the general manager by resolution. (See Chapter 1 for more information regarding District disbursements.)

The District's Board has not accepted or rejected grants offered to the District.

Texas Water Code, Section 36.158, allows groundwater districts to accept grants, gratuities, advances, or loans. However, the District's Board has not accepted or rejected two donations made to the District. In one case, an organization paid \$17,500 for legal fees the District owed to a law firm. When District staff became aware of this payment, it did not present the payment to the Board for discussion or acceptance of the payment in a Board meeting. Establishing a process for the Board to accept or reject such payments and other grants, gratuities, advances, or loans would help the District to identify potential conflicts of interest or the appearance of conflicts of interest.

## Recommendations

The District should:

- Develop procedures to ensure that it complies with Texas Water Code and District rules.
- Develop record keeping and retention procedures to ensure that District records are complete, accurate, and available for public inspection as required by Chapter 36 of the Texas Water Code and District rules.
- Create a process for handling objections to hearing reports as a part of its permit process.
- Create a process for accepting or rejecting grants, gifts, donations, or gratuities made to or on behalf of the Board. This process will allow the

District to reject any grants, gifts, etc., that present a conflict of interest or may provide the appearance of conflict of interest.

The Board should:

- Determine what authority is to be delegated to the general manager and provide this authority by resolution of the Board.
- Provide more oversight of the District.

## *The District Achieved a Majority of the Objectives in Its Groundwater Management Plan; Therefore, It Is Operational*

In fiscal year 2004, the District achieved six (75 percent) of the eight objectives in its groundwater management plan. In fiscal year 2005, the District achieved seven (78 percent) of the nine objectives in its groundwater management plan. Because it achieved the majority of the objectives in its groundwater management plan, auditors determined that the District is operational.<sup>1</sup>

However, the District neither prepared nor submitted an annual report for 2004 to its Board as required by its groundwater management plan, which was adopted by the District's Board (see text box for additional details). The Water Development Board approved the District's groundwater management plan in February 2004; therefore, the District operated under an approved groundwater management plan for approximately seven months during fiscal year 2004.

**Annual Reports Required by the District's Groundwater Management Plan**

Section VI of the District's groundwater management plan requires the District to prepare and submit an annual report to its Board. The annual report must include an update on the District's performance in achieving its goals and objectives. The District must present the annual report to its Board within 90 days of the end of the fiscal year. The Board will adopt the annual report and maintain a copy for public inspection.

The District provided an annual report for 2004 to auditors, but that report was not a formal report and instead was the District's written testimony before the House Natural Resources Committee during the 79th Legislative Session. In addition, that report was neither presented to nor adopted by the District's Board as the District's groundwater

management plan requires.

Table 1 presents the status of the District's performance in meeting its objectives in fiscal years 2004 and 2005.

Table 1

District Performance in Meeting Its Groundwater Management Plan Objectives			
Objective	Was Objective Met?		Auditor Comments
	Fiscal Year 2004	Fiscal Year 2005	
Each year, the District will require all new exempt or permitted wells that will be operated within the boundaries of the District to be registered or permitted in accordance with District rules.	Yes	Yes	

<sup>1</sup> Texas Water Code, Chapter 36, requires districts to develop groundwater management plans. These plans must contain certain goals (if applicable) outlined in the Texas Water Code. Districts must submit their groundwater management plans to the Water Development Board for certification. No earlier than one year after the certification of a district's groundwater management plan, the State Auditor's Office audits the district's operational status. A district is operational if it has achieved a majority of the objectives in its groundwater management plan.

### District Performance in Meeting Its Groundwater Management Plan Objectives

Objective	Was Objective Met?		Auditor Comments
	Fiscal Year 2004	Fiscal Year 2005	
Each year, the District will regulate the production of groundwater by maintaining a system of permitting of the use and production of groundwater within the boundaries of the district in accordance with the District rules.	Yes	Yes	
Each year, the District will make an evaluation of the District rules to determine whether any amendments are recommended to decrease the amount of waste of groundwater within the District.	Yes	Yes	
The District will annually apply a water use fee structure to the permitted use of groundwater in the District to encourage the elimination and reduction of waste of groundwater.	Yes	Yes	
Each year, the District will participate in the regional planning process by attending at least 25% of the Region J Regional Water Planning Group (Planning Region) meetings to encourage the development of surface water supplies to meet the needs of water user groups in the District.	Yes	Yes	
Quarterly, the District will download the updated Palmer Drought Severity Index (PDSI) map and identify periodic updates to the <i>Drought Preparedness Council Situation Report</i> (Situation Report) posted on the Texas Water Information network Web site <a href="http://www.txwin.net">www.txwin.net</a> .	No	No	According to the District's general manager, the PDSI maps are downloaded annually. Auditors observed one download dated September 19, 2005, in the District's files. However, the District has not prepared biannual reports regarding drought assessment.
The District will annually submit an article regarding water conservation for publication to at least one newspaper of general circulation in Kinney County.	No	No	According to the District's general manager, the District is unable to comply with this objective because the local newspaper declines to publish conservation articles. However, the District was unable to provide evidence that it attempted to submit an article for publication. Other newspapers in Uvalde, Del Rio, and San Antonio also circulate in Kinney County.
The District will develop or implement a pre-existing educational program for use in the schools located in Kinney County to educate students on the importance of water conservation by January 1, 2005.	Not Applicable	Yes	
Each year, the District will include an informational flier on water conservation within at least one mail out to groundwater use permit holders distributed in the normal course of business of the District, or otherwise make such an informational flier on water conservation available for distribution to permit holders at the district office.	Yes	Yes	

## Recommendations

The District should:

- Consistently prepare required annual reports and submit them to its Board as required by its groundwater management plan. The Board should then adopt the annual reports. The submission and approval of annual reports should be documented in the Board's meeting minutes.
- Comply with its groundwater management plan objectives to:
  - ♦ Download PDSI maps on a quarterly basis and prepare a biannual drought assessment report.
  - ♦ Annually publish an article regarding water conservation in any of the newspapers that circulate in Kinney County.

# Appendices

Appendix 1

## ***Objectives, Scope, and Methodology***

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### Objectives

The audit objectives were to determine whether the Kinney County Groundwater Conservation District (District):

- Has accounting procedures and controls that ensure accurate, timely, and complete financial information is available for making management decisions; ensure it is able to meet its financial obligations; and protect against violations, abuse, and fraud.
- Achieves its management goals and objectives as outlined in its management plan.
- Complies with applicable statutes, rules, and regulations.

### Scope

The audit scope covered the District's operations from September 1, 2001 (when it was created by House Bill 3243, 77th Legislature, Regular Session), through August 31, 2005.

### Methodology

The audit methodology consisted of conducting interviews; collecting and reviewing information; and performing tests, procedures, and analyses against predetermined criteria. This audit did not include a review of information technology.

Information collected and reviewed included the following:

- Interviews with management of the District
- Interviews with the District's external auditor
- Interviews with staff at the Water Development Board and the Texas Commission on Environmental Quality
- Survey of 23 Texas groundwater conservation districts
- Documentary evidence such as:
  - ♦ Applicable state statutes and guidelines



- ♦ District bylaws, rules, and the management plan
- ♦ District policies and procedures
- ♦ Independent audit reports for 2002, 2003, and 2004
- ♦ The District's contracts for professional services
- ♦ The District's financial records and fee schedules, as well as Board notices, agendas, and minutes

Procedures and tests conducted included the following:

- Observed the District's processes for collecting fees and deposits and disbursing funds
- Reviewed and analyzed statutes and District bylaws, rules, the management plan, and policies and procedures
- Reviewed and analyzed the District's independent audit reports for 2002, 2003, and 2004
- Reviewed and analyzed Board meeting notices, agendas, and minutes
- Reviewed and analyzed the District's receipt book for collection of fees and deposits (August 29, 2003, through September 8, 2004)
- Surveyed a sample of 23 single-county groundwater conservation districts (of the 82 confirmed Texas groundwater conservation districts) with activities similar to those of the District to obtain information about their processes related to district operations, including permitting and financial processes
- Surveyed a judgmental sample of professional services vendors to verify the amount for services billed and owed
- Surveyed a judgmental sample of Kinney County landowners and permittees to verify the amount of fees and deposits paid
- Compared the District's revenues in the independent audit reports for 2002, 2003, and 2004 to its accounting software (QuickBooks) records
- Traced revenue collected and disbursements by check to the District's bank statements
- Tested the District's compliance in 2004 and 2005 with all of the objectives and performance standards in its groundwater management plan
- Tested compliance with selected sections of Texas Water Code, Chapter 36, and related District rules

- Tested a judgmental sample of 27 of the District's 41 permit files for compliance with Texas Water Code, Chapter 36, and related District rules
- Tested all District tax revenue (which totaled \$190,474 and represented 53.57 percent of the District's total revenue) received from the Kinney County Tax Assessor Collector from fiscal year 2003 through August 30, 2005
- Tested all District's groundwater use fees, registration fees, and application fees (which totaled \$161,331 and represented 45.37 percent of the District's total revenue) collected from fiscal year 2003 through August 30, 2005
- Tested a judgmental sample of 15 District personnel disbursements
- Tested a judgmental sample of 85 District disbursements for legal and professional, hearing, office, insurance, and education expenses

Criteria used included the following:

- Texas Water Code, Chapter 36
- House Bill 3243, 77th Legislature, Regular Session
- Governmental Accounting Standards Board (GASB) Statement No. 34
- American Institute of Certified Public Accountants' Statements on Auditing Standards 31
- The District's bylaws, rules, management plan, and fee schedules
- The District's code of ethics, travel, professional services, and management policies

### **Other Information**

Audit fieldwork was conducted from October 2005 through December 2005. This audit was conducted in accordance with generally accepted government auditing standards.

The following members of the State Auditor's staff performed the audit:

- Kimberlee N. McDonald (Project Manager)
- Anthony T. Patrick, MBA (Assistant Project Manager)
- Joseph K. Mungai, CIA
- Rachel A. Snell, MPA

- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Nicole M. Guerrero, MBA, CGAP (Audit Manager)

## Excerpts from the District's 2003 and 2004 Audited Financial Statements

Below are the District's (1) combined balance sheet and (2) combined statement of revenues, expenditures, and changes in fund balance for 2003. These statements were audited by the District's external auditor, and the State Auditor's Office did not express an opinion on them.

KINNEY COUNTY GROUNDWATER CONSERVATION DISTRICT      2			
COMBINED BALANCE SHEET -			
ALL FUND TYPES AND ACCOUNT GROUPS			
SEPTEMBER 30, 2003			
	Governmental <u>Fund Type</u>	Account <u>Group</u>	Total
	General <u>Fund</u>	General Long-Term <u>Debt</u>	(Memorandum <u>Only</u> )
<b>ASSETS</b>			
Cash	\$ 11,618	\$	\$ 11,618
Taxes receivable	2,864		2,864
Amounts to be provided for retirement of long-term debt	_____	16,000	16,000
<b>TOTAL ASSETS</b>	<b><u>\$ 14,482</u></b>	<b><u>\$ 16,000</u></b>	<b><u>\$ 30,482</u></b>
<b>LIABILITIES</b>			
Accounts payable	\$ 141,422	\$	\$ 141,422
Deferred revenue	2,864		2,864
Note payable	_____	16,000	16,000
<b>TOTAL LIABILITIES</b>	<b><u>144,286</u></b>	<b><u>16,000</u></b>	<b><u>160,286</u></b>
<b>FUND EQUITY</b>			
Fund balance	(129,804)	-0-	(129,804)
<b>TOTAL FUND EQUITY</b>	<b><u>(129,804)</u></b>	<b><u>-0-</u></b>	<b><u>(129,804)</u></b>
<b>TOTAL LIABILITIES AND FUND EQUITY</b>	<b><u>\$ 14,482</u></b>	<b><u>\$ 16,000</u></b>	<b><u>\$ 30,482</u></b>

The accompanying notes are an integral part of these financial statements.

KINNEY COUNTY GROUNDWATER CONSERVATION DISTRICT      3  
 COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND  
 CHANGES IN FUND BALANCE - GOVERNMENTAL FUND TYPES  
 FOR THE YEAR ENDED SEPTEMBER 30, 2003

REVENUES

Ad valorem taxes	\$ 56,825
Contributions and grants	17,500
Miscellaneous	<u>8,798</u>
 Total revenues	 <u>83,123</u>

EXPENDITURES

Advertising	60
Archives and records	280
Education	983
Heming expenses	931
Insurance	4,108
Interest expense	431
Legal and professional	205,138
Memberships and fees	250
Office expense	3,774
Personnel	4,022
Tax collection fees	3,000
Travel	<u>438</u>

Total expenditures      223,415

Excess (deficiency) of revenues over (under) expenditures      (140,292)

Other sources      16,000

Other uses      (7,000)

Fund balance at beginning of year      1,488

Fund balance at end of year      \$ (129,804)

The accompanying notes are an integral part of these financial statements.

Below are the District's (1) combined balance sheet and (2) combined statement of revenues, expenditures, and changes in fund balance for 2004. These statements were audited by the District's external auditor, and the State Auditor's Office did not express an opinion on them. The 2004 audited financial statements that the District's external audit firm prepared showed a \$58,195 deficit. The expenditures reported on the Statement of Revenues, Expenditures, and Changes in Fund Balance contained a material omission because they did not include \$78,542 in legal and consulting expenses.

KINNEY COUNTY GROUNDWATER CONSERVATION DISTRICT		EXHIBIT C-1
BALANCE SHEET		
GOVERNMENTAL FUNDS		
SEPTEMBER 30, 2004		
		General Fund
<hr/>		
<b>ASSETS</b>		
Cash and Cash Equivalents	\$	79,576
Taxes Receivable		4,647
Receivables (net of allowance for uncollectibles)		78,542
Total Assets	\$	<u>162,765</u>
<b>LIABILITIES AND FUND BALANCES</b>		
<b>Liabilities:</b>		
Accounts Payable	\$	190,613
Escrow Payable		16,400
Deferred Revenues		4,647
Other Current Liabilities		9,300
Total Liabilities	\$	<u>220,960</u>
<b>Fund Balances:</b>		
<b>Unreserved and Undesignated:</b>		
Reported in the General Fund	\$	(58,195)
Total Fund Balances	\$	<u>(58,195)</u>
Total Liabilities and Fund Balances	\$	<u>162,765</u>

The accompanying notes are an integral part of this statement.

KINNEY COUNTY GROUNDWATER CONSERVATION DISTRICT  
 RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE  
 STATEMENT OF NET ASSETS  
 SEPTEMBER 30, 2004

<b>Total Fund Balances - Governmental Funds</b>	\$	(58,195)
Long-term liabilities, including notes payable, are not due and payable in the current period, and, therefore are not reported as liabilities in the funds. The net effect of including long-term debt at the beginning of the year in the governmental activities is to (decrease) net assets.		(16,000)
Current year long-term debt principal payments are expenditures in the fund financial statements, but they should be shown as reductions in long-term debt in the government-wide financial statements. The net effect of including the 2004 debt principal payments is to increase net assets.		5,000
<b>Net Assets of Governmental Activities</b>	<u>\$</u>	<u>(69,195)</u>

The accompanying notes are an integral part of this statement.

KINNEY COUNTY GROUNDWATER CONSERVATION DISTRICT  
 STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE  
 GOVERNMENTAL FUNDS  
 FOR THE YEAR ENDED SEPTEMBER 30, 2004

EXHIBIT C-3

	General Fund
<hr/>	
REVENUES:	
Taxes:	
Property Taxes	\$ 67,894
Fees	100,146
Total Revenues	<u>168,040</u>
EXPENDITURES:	
Current:	
General Government	96,432
Total Expenditures	<u>96,432</u>
Net Change in Fund Balances	71,608
Fund Balance - October 1 (Beginning)	<u>(129,803)</u>
Fund Balance - September 30 (Ending)	<u>\$ (58,195)</u>

The accompanying notes are an integral part of this statement.



**H. FUND BALANCE DEFICIT**

The General Fund had a deficit fund balance of \$58,195.

**L LITIGATION**

We have been advised by the District's attorney that the District is not currently named as a defendant in any lawsuits as of September 30, 2004.

**J. DETAIL OF GENERAL FUND EXPENDITURES**

During the year General Fund expenditures detail are as follows compared to approved budget.

	<u>Budget</u>	<u>Actual</u>
Advertising	\$ 100	\$ 54
Archives	250	-0-
Education	2,000	558
Hearing Expenses	5,000	-0-
Insurance	2,500	2,310
TWDB Interest Expense	479	130
Legal and Professional	79,583	66,498
Membership and Fees	500	575
Office	7,030	6,194
Open Records Request	750	60
Personnel	16,000	9,543
Tax Collection Fees	3,100	4,930
Travel (Mileage)	2,500	552
Per Diem	<u>700</u>	<u>28</u>
Total	120,492	91,432
TWDB Principal	<u>5,000</u>	<u>5,000</u>
Total Expenditures	<u>\$ 125,492</u>	<u>\$ 96,432</u>

## The District's Compliance with Statute and Its Rules

Table 2 provides detailed information on the Kinney County Groundwater Conservation District's (District) compliance with selected sections of the Texas Water Code and District rules.

Table 2

The District's Compliance with Statute and Its Rules				
Summary of Texas Water Code Section	Did the District Comply with Statute?	Related District Rule	Did the District Comply with Its Rule?	Comments
36.051 - Specifies requirements for groundwater districts' boards of directors.	Yes	2.02 - Specifies requirements for the District's Board structure and officers.	Yes	The District's enabling legislation (House Bill 3243, 77th Legislature, Regular Session) established requirements for the District's Board. House Bill 3243 required that (1) vacancies must be filled through appointments made by the Commissioner's Court and (2) the Board have seven members. Auditors determined that the District complied with these requirements.
36.053 - Specifies requirements for a quorum for groundwater district board meetings.	Yes	2.03 - Prohibits ex parte communications by Board members except under certain circumstances.	Yes	
36.054 - Specifies requirements for the officers of a groundwater district's board.	No	2.02 - Specifies requirements for the officers of the District's Board.	Yes	The District did not always submit officer forms to the Texas Commission on Environmental Quality within 30 days as required by the statute. It did not make two required submissions, and it made one submission after 30 days.
36.055 - Specifies requirements for sworn statements, bonds, and oaths of office required of groundwater district board members.	No	2.02 - Specifies requirements for the structure of the District's Board and Board officers.	Yes	The District did not always file board members' oaths of office with the Secretary of State within 10 days after execution as required by the statute. It did not file one oath and filed three oaths late.
36.056 - Specifies certain requirements for groundwater district general managers.	No	3.01 - Describes the authority of the District's general manager.	No	The District did not have evidence that its Board has, by Board order or resolution, provided full authority to the District's general manager as required by statute and District rule. However, the general manager has exercised full authority in the management and operation of the District.
		3.03 Allows a director to serve as the general manager.	Yes	

The District's Compliance with Statute and Its Rules				
Summary of Texas Water Code Section	Did the District Comply with Statute?	Related District Rule	Did the District Comply with Its Rule?	Comments
36.057 - Specifies requirements for management of groundwater districts.	No	None		The Board has not carried out its fiduciary responsibility in managing all the affairs of the District as required by statute. In addition, the District's general manager executes documents on behalf of the District, but the Board has not, by resolution, authorized this activity.
36.058 - Specifies conflicts of interest requirements for groundwater district board members.	Yes	2.03 - Prohibits ex parte communications by board members except under certain circumstances.	Yes	Although auditors did not find evidence of conflict of interest, auditors did find the appearance of conflict of interest. For example: <ul style="list-style-type: none"> <li>▪ The Board voted to approve a contract with Kinney County for election assistance. The county attorney drafted this contract. Two board members related to the county attorney did not abstain from the vote.</li> <li>▪ The general manager hired a consultant to perform services for the District without prior approval from the Board. This same consultant had performed services for the general manager's family.</li> </ul>
36.060 - Specifies requirements for fees and reimbursements that groundwater district board members can receive.	Yes	None		
36.061 - Specifies policies that groundwater district boards must implement.	Yes	None		
36.062 - Specifies requirements for offices and meeting places where groundwater districts conduct business.	Yes	4.01 - Specifies the District's mailing address.	Yes	
36.063 - Requires groundwater district boards to follow the requirements of the Open Meetings Act in Texas Government Code, Chapter 551.	No	2.04 - Specifies the frequency of the District's Board meetings and requires compliance with the Open Meetings Act.	No	Three (3 percent) of 96 meeting notice postings tested were not posted within 72 hours as required by statute. There was no evidence of posting of meeting notices for two meetings that were held. In addition, one meeting was called as an emergency meeting, but it did not meet the criteria for an emergency meeting.
		17.02 (B) - Specifies requirements for notices and scheduling of permit hearings.	No	The District did not post permit hearing notices in compliance with the District rule for 11 (34 percent) of 32 hearings tested.

The District's Compliance with Statute and Its Rules				
Summary of Texas Water Code Section	Did the District Comply with Statute?	Related District Rule	Did the District Comply with Its Rule?	Comments
		17.02 (C) - Specifies requirements for notices of rule-making hearings.	Yes	
		17.02 (D) - Specifies requirements for the timing and posting of hearings.	No	Two hearings were not posted with the county clerk as required by District rule. Although the Board allows a continuance without notice, Texas Government Code, Section 551.041, requires a notice for each meeting.
36.064 - Specifies requirements for meetings of groundwater districts' boards.	No	2.04 - Specifies the frequency of District Board meetings and requires compliance with the Open Meetings Act.	No	The Board has held special meetings, but since August 2004, it has not consistently held quarterly meetings required by statute or monthly meetings required by its rule. According to the District, these meetings were not held because permit hearings were being held. Auditors did not find certified agendas for 2 (11 percent) of the 18 executive sessions held.
36.065 - Specifies requirements for retaining complete accounts of all groundwater district board meetings and proceedings.	No	4.06 - Specifies requirements for minutes and records of the District.	No	Minutes for three Board hearings were unavailable, which constitutes noncompliance with statute and District rule. Auditors also noted errors in the records for both hard copy and recorded minutes for other hearings.
36.067 - Specifies requirements for contracts that groundwater districts enter into.	Yes	None		
36.1071 - Specifies requirements for groundwater districts' groundwater management plans.	Yes	18.01 - Specifies requirements for the District's management plan.	Yes	
36.111 - Specifies requirements for groundwater district records and reports regarding the drilling, equipping, and completing of water wells and of the production and use of groundwater.	Yes	18.03 - Specifies requirements for drilling records, reports, and logs.	Yes	
36.112 - Specifies requirements for groundwater district records and reports regarding drillers' logs.	Yes	18.03 - Specifies requirements for drilling records, reports, and logs.	Yes	

The District's Compliance with Statute and Its Rules

Summary of Texas Water Code Section	Did the District Comply with Statute?	Related District Rule	Did the District Comply with Its Rule?	Comments
36.113 - Specifies requirements for well permitting by groundwater districts.	No	9.01 (B) - Specifies general permitting policies and procedures.	No	Six (22 percent) of the 27 permit files tested did not contain all of the documentation required by statute and rule. This information is critical for determining whether an application is administratively complete.
36.114 - Specifies requirements for groundwater districts' well permit applications and hearings.	No	9.01 D (1) - Specifies well-permitting action requirements.	No	None of the 27 files tested contained information regarding the dates that the District (1) initially reviewed the applications for completeness or (2) determined whether the applications were administratively complete. Therefore, auditors were unable to determine compliance with statute and rule.  In addition, three applicants were scheduled for and subsequently billed for hearing costs, but their applications were not administratively complete.
		9.01 D (2) - Specifies well-permitting technical review requirements.	No	None of the 27 permit files tested contained information regarding the dates that the District's technical review was completed. Auditors estimated that the applications in the 27 files expired on May 28, 2004. However, the only dates in these files that related to the District's technical review were on letters to all applicants dated June 28, 2004 (31 days after the applications expired).
		9.01 D (3) (c) - Requires the District to act on applications within 35 days after the date of conclusion of the hearing.	No	Auditors were unable to determine whether the District acted on the applications in the 27 permit files within 35 days after the date of the hearing as required by Texas Water Code, Section 36.114. In addition, statute does not clearly define what is meant by "action taken." However, letters the District sent notifying applicants of the Board's final decision were sent from 41 days to 11 months later.
		17.08 - Requires the presiding officer to submit a hearing report to the District's Board within 14 days after the date a hearing is concluded.	No	Fifteen (94 percent) of the 16 hearing reports tested were not submitted as the rule requires. The only one of the 16 hearing reports tested that was submitted on time was that of an individual related to the general manager. In addition, the District has not established a deadline for filing objections or procedures for handling objections.

The District's Compliance with Statute and Its Rules

Summary of Texas Water Code Section	Did the District Comply with Statute?	Related District Rule	Did the District Comply with Its Rule?	Comments
		17.10 - Specifies that a request for rehearing and appeal must be made within 20 calendar days of the date of the Board's decision.	No	According to the District, it did not receive by the deadline nor grant any requests for rehearing. However, auditors found a request for rehearing in 1 of the 27 permit files tested that was filed by the deadline.
36.117 - Specifies requirements for exemptions, exceptions, and limitations on well permits.	Yes	9.04 - Specifies requirements for exclusions and exemptions on well permits.	Yes	
36.121 - Places limitations on the rulemaking power of groundwater districts for wells in certain counties.	Yes	9.04 A (8) - Specifies requirements for exclusions and exemptions on well permits.	Yes	
36.122 - Specifies requirements for the transfer of groundwater out of a groundwater district.	Yes	13.01 - Specifies requirements for transportation of groundwater out of the District.	Yes	Evidence in the 27 permit files tested indicates that transporters applied for permits, but transport was marked "no" on the applications.
36.151 - Specifies requirements for how groundwater districts make expenditures.	No	None		District Bylaw 9.3 (A) states that drafts can be signed by officers or employees that are authorized by Board resolution. Although the District's general manager signs checks, the Board has not granted this authority in a resolution as required. In addition, 8 (9.4 percent) of the 85 disbursements the auditors tested did not have two signatures as required by statute.
36.152 - Specifies requirements for groundwater districts' fiscal years.	Yes	None		
36.153 - Requires groundwater districts to obtain annual audits of their financial condition.	Yes	None		
36.154 - Specifies requirements for groundwater districts' annual budgets.	Yes	None		
36.155 - Specifies requirements for groundwater districts to name one or more banks to serve as the depository for district funds.	Yes	None		

The District's Compliance with Statute and Its Rules				
Summary of Texas Water Code Section	Did the District Comply with Statute?	Related District Rule	Did the District Comply with Its Rule?	Comments
36.1561 (a) - Specifies requirements for boards of groundwater districts when contracting with a person to act as an investment officer for a groundwater district.	Yes	None		The District is not currently making investments, but it has an investment officer.
36.157 - Specifies requirements for the payment of all costs and expenses incurred in the creation and organization of a groundwater district.	Yes	None		
36.158 - Specifies requirements applicable to a district's acceptance of grants, gratuities, advances, or loans in any form to or from any source approved by the board.	No	None		District Bylaw 1.7 (D) states that no director or employee should make personal investments that could reasonably be expected to create substantial conflict between his private interest and the public interest. The Board has not formally accepted or rejected two donations. One \$17,500 donation was paid directly to the District's attorneys for District legal expenses.
36.161 - Specifies requirements for groundwater districts in order to obtain funds from the Water Development Board.	Yes	None		
36.201 - Specifies requirements for a groundwater district to annually levy taxes to pay the bonds issued by the district.	Yes	None		The District's enabling legislation (House Bill 3243, 77th Legislature, Regular Session) established requirements for the District's levying of taxes. House Bill 3243 specified that the District may levy taxes at a rate not to exceed 10 cents per \$100 of assessed valuation. Auditors determined that the District complied with this requirement.
36.202 - Specifies additional requirements for a groundwater district to annually levy taxes.	Yes	None		
36.203 - Specifies requirements for groundwater districts in setting tax rates.	Yes	None		
36.204 - Specifies requirements for tax appraisal, assessment, and collection.	Yes	None		
36.205 (c) - Specifies requirements and authority for groundwater districts to set fees.	Yes	None		

The District's Compliance with Statute and Its Rules				
Summary of Texas Water Code Section	Did the District Comply with Statute?	Related District Rule	Did the District Comply with Its Rule?	Comments
36.207 - Specifies requirements for groundwater districts' use of permit fees authorized by special law.	Yes	None		



## *Amount of Water the District Permitted from August 12, 2004, through April 23, 2005*

Tables 3 through 5 summarize the amount of water (in acre feet) that the Kinney County Groundwater Conservation District permitted for the Edwards Trinity, Edwards, and Austin Chalk aquifers. The accuracy of this data and totals has not been audited.

Table 3

Kinney County Groundwater Conservation District Permit Hearings from August 12, 2004, through April 23, 2005								
EDWARDS TRINITY AQUIFER								
Permit Number	Applicant MEU <sup>a</sup> Claimed	Consultant MEU Proposed	Board MEU Granted	Applicant MHU <sup>b</sup> Claimed	Consultant MHU Proposed	Board MHU Granted	Consultant Aggregate Proposed Permitted Amount	Board Aggregate Permitted Amount
EH01-ET	0.66	0.66	0.66	0.00	0.00	0.00	0.66	0.66
EH01B-ET	3.21	3.21	3.21	0.00	0.00	0.00	3.21	3.21
EH02B-ET	980.00	613.89	613.89	0.00	0.00	0.00	613.89	613.89
EH03-ET	25,861.00	1,508.16	0.00	25,861.00	15,097.75	6,651.00	15,097.75	6,651.00
EH05-ET	117.00	53.27	53.27	0.00	0.00	0.00	53.27	53.27
EH06-ET	3,484.00	1,424.30	1,360.00	5,728.00	3,484.00	1,218.00	3,484.00	1,360.00
EH08-ET	2,559.00	1,356.03	593.00	2,501.00	1,726.54	593.00	1,726.54	593.00
EH12-ET	2,261.00	1,233.00	1,075.00	5,615.00	2,123.00	1,220.00	2,123.00	1,220.00
EH15-E	0.00	0.00	0.00	2,650.00	1,513.00	600.00	1,513.00	600.00
EH13-ET	0.00	0.00	0.00	972.00	972.00	400.00	972.00	400.00
EH16-ET	1,518.97	1,494.00	1,139.14	3,201.40	2,804.00	2,250.34	2,804.00	2,250.34
EH19-ET	107.00	106.45	0.00	622.00	244.00	110.00	244.00	110.00
EH20-ET	3,055.80	2,474.75	717.00	9,618.00	6,565.00	2,070.00	6,565.00	2,070.00
EH21-ET	1,087.68	1,088.00	518.00	2,689.00	1,300.00	518.00	1,300.00	518.00
EH23-ET	62.00	61.84	43.00	157.00	148.43	88.00	148.43	88.00
EH24-ET	5.00	5.00	5.00	219.00	219.00	72.80	219.00	72.80
EH25-ET	1,167.80	708.45	456.00	1,255.25	610.06	443.00	708.45	456.00
EH27-ET	20.50	20.50	20.50	0.00	0.00	0.00	20.50	20.50
EH30-ET	10.00	10.00	10.00	240.00	240.00	240.00	240.00	240.00
EH31-ET	3,048.97	2,075.70	1,308.00	4,404.00	3,112.00	1,227.00	3,112.00	1,308.00
EH33-ET	7,160.00	241.94	360.00	7,160.00	516.49	1,095.00	516.49	1,095.00
EH34-ET	498.00	251.95	12.00	1,347.00	1,347.00	756.00	1,347.00	756.00
EH39-ET	121.12	0.00	0.00	0.00	0.00	0.00	0.00	0.00
EH40-ET	1,609.00	1,080.59	332.00	1,295.95	598.01	510.00	1,080.59	510.00

**Kinney County Groundwater Conservation District  
Permit Hearings from August 12, 2004, through April 23, 2005  
EDWARDS TRINITY AQUIFER**

Permit Number	Applicant MEU <sup>a</sup> Claimed	Consultant MEU Proposed	Board MEU Granted	Applicant MHU <sup>b</sup> Claimed	Consultant MHU Proposed	Board MHU Granted	Consultant Aggregate Proposed Permitted Amount	Board Aggregate Permitted Amount
EH41-ET	40.00	40.00	40.00	300.00	241.95	175.00	241.95	175.00
<b>Totals</b>	<b>54,777.71</b>	<b>15,851.70</b>	<b>8,659.67</b>	<b>75,835.60</b>	<b>42,862.22</b>	<b>20,237.14</b>	<b>44,134.73</b>	<b>21,164.67</b>

<sup>a</sup> MEU = Maximum Existing Use (last to be reduced in Management Zone proportional reductions). Existing use period is January 1, 1992, through January 7, 2003.

<sup>b</sup> MHU = Maximum Historic Use (second to be reduced in Management Zone proportional reductions). Historic use period is January 1, 1960, through December 31, 1991.

Source: Information from the Kinney County Groundwater Conservation District. The accuracy of this data and totals has not been audited.

Table 4

**Kinney County Groundwater Conservation District  
Permit Hearings from August 12, 2004, through April 23, 2005  
EDWARDS AQUIFER**

Permit Number	Applicant MEU <sup>a</sup> Claimed	Consultant MEU Proposed	Board MEU Granted	Applicant MHU <sup>b</sup> Claimed	Consultant MHU Proposed	Board MHU Granted	Consultant Aggregate Proposed Permitted Amount	Board Aggregate Permitted Amount
EH32-E	64.00	53.37	53.37	0.00	0.00	53.37	53.37	53.37
EH35-E	0.00	0.00		0.00	0.00		0.00	
EH36-E	32.26	32.06	32.26	32.26	32.26	32.26	32.26	32.26
EH36B-E	730.32	0.00	0.00	0.00	563.01	530.00	563.01	530.00
EH37-E	40.32	31.45	31.45	40.00	31.45	31.45	31.45	31.45
EH37B-E	332.92	0.00	0.00	0.00	332.92	332.92	332.92	332.92
EH29-E	0.00	0.00	0.00	800.00	522.11	522.10	522.11	522.10
EH26-E	145.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
EH22-E	719.34	502.31	400.00	192.00	0.00	400.00	502.31	400.00
EH18-E	194.00	66.81	50.00	0.00	0.00	0.00	66.81	50.00
EH14-E	871.00	603.58	603.58	0.00	0.00	0.00	603.58	603.58
EH09-E	1,597.00	1,104.00	799.90	1,525.00	0.00	0.00	1,104.00	799.90
EH07B-E	260.00	103.23	103.23	0.00	0.00	0.00	103.23	103.23
EH07-E	260.00	17.49	17.49	0.00	0.00	0.00	17.49	17.49
EH04-E	6.15	6.15	6.15	0.00	0.00	0.00	6.15	6.15
EH02-E	450.00	50.00	50.00	450.00	300.00	300.00	300.00	300.00
<b>Totals</b>	<b>5,702.31</b>	<b>2,570.44</b>	<b>2,147.43</b>	<b>3,039.26</b>	<b>1,781.75</b>	<b>2,202.10</b>	<b>4,238.69</b>	<b>3,782.45</b>

<sup>a</sup> MEU = Maximum Existing Use (last to be reduced in Management Zone proportional reductions). Existing use period is January 1, 1992, through January 7, 2003.

<sup>b</sup> MHU = Maximum Historic Use (second to be reduced in Management Zone proportional reductions). Historic use period is January 1, 1960, through December 31, 1991.

Source: Information from the Kinney County Groundwater Conservation District. The accuracy of this data and totals has not been audited.

Table 5

Kinney County Groundwater Conservation District Permit Hearings from August 12, 2004, through April 23, 2005 AUSTIN CHALK AQUIFER								
Permit Number	Applicant MEU <sup>a</sup> Claimed	Consultant MEU Proposed	Board MEU Granted	Applicant MHU <sup>b</sup> Claimed	Consultant MHU Proposed	Board MHU Granted	Consultant Aggregate Proposed Permitted Amount	Board Aggregate Permitted Amount
EH38-AU	4,194.00	10.16	0.00	0.00	1,568.99	784.00	1,568.99	784.00
EH38B-AU	56.00	0.00	Withdrawn	25,220.00	10.00	Withdrawn	10.00	0.00
EH16B-AU	1,518.97	114.80	114.80	3,201.40	298.30	298.30	298.30	298.30
EH40B-AU	1,609.00	362.81	332.00	495.96	495.96	495.93	495.96	495.93
EH28-AU	549.93	549.93	549.93	1,040.00	646.10	646.10	646.10	646.10
EH17-AU	0.00	0.00	0.00	484.00	484.00	258.00	484.00	258.00
EH15B-AU	0.00	0.00	0.00	2,650.00	1,513.00	200.00	1,513.00	200.00
EH11-AU	500.00	828.60	425.72	3,200.00	1,190.00	1,190.00	1,190.00	1,190.00
<b>Totals</b>	<b>8,427.90</b>	<b>1,866.30</b>	<b>1,422.45</b>	<b>36,291.36</b>	<b>6,206.34</b>	<b>3,872.33</b>	<b>6,206.35</b>	<b>3,872.33</b>

<sup>a</sup> MEU = Maximum Existing Use (last to be reduced in Management Zone proportional reductions). Existing use period is January 1, 1992, through January 7, 2003.

<sup>b</sup> MHU = Maximum Historic Use (second to be reduced in Management Zone proportional reductions). Historic use period is January 1, 1960, through December 31, 1991.

Source: Information from the Kinney County Groundwater Conservation District. The accuracy of this data and totals has not been audited.

## Management's Responses

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### KINNEY COUNTY GROUNDWATER CONSERVATION DISTRICT

President, Cecil Smith, Director Precinct 2  
Vice-President, Don Hood, Director Precinct 4  
Secretary/Treasurer, Fotsie Hamdon, Director District at Large  
Chuck Hall, Director Brackettville At Large  
Duke Meek, Director Fort Clark Springs At Large  
Christopher Ring, Director Precinct 3  
Beth Ann Smith, Director Precinct 1  
Darlene Shahan, General Manager

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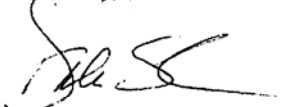
January 25, 2006

Kim McDonald  
State Auditor's Office  
1501 N. Congress  
P.O. Box 12067  
Austin, Texas 78711-2067

Dear Ms. McDonald,

Enclosed is the Management's Response to the Draft Audit Report. Please contact me if you have any questions.

Sincerely,



Darlene Shahan  
General Manager

CC: KCGCD Board Members  
Richard Lowerre

MANAGEMENT'S RESPONSE TO THE DRAFT  
AUDIT REPORT OF THE STATE AUDITOR'S  
OFFICE, DATED JANUARY 2006

BY  
THE KINNEY COUNTY GROUNDWATER  
CONSERVATION DISTRICT

**January 25, 2006**

# MANAGEMENT'S RESPONSE TO DRAFT AUDIT

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**Note: Quotes from the Draft Audit Report below are provided in italics.**

### **Summary of Management's Response**

The Kinney County Groundwater Conservation District appreciates the hard work of staff of the State Auditor's Office. As the District had hoped, the Final Audit Report should provide valuable guidance for the District. Given that the District is the first groundwater district to go through such a thorough audit, the final Audit Report should provide valuable guidance to many other groundwater districts.

With few exceptions, the District agrees with the recommendations in the Draft Audit Report and will implement those it has not already implemented. The Board of the District understands its responsibility and has made it clear that it will take all necessary steps to carry out those responsibilities.

As explained in its letter to the State Auditor's Office of January 18, 2006, the District has concerns with the tone and wording in some parts of the Draft Audit Report. For example, while the District can determine how it had done as compared with other groundwater districts on complying with statutes and rules, it is concerned by the non-objective criteria or terms used to describe its performance with regard to financial management.

In the following responses, the District also notes some of the errors it identified in the Draft Report. Likewise in response to Appendix 1, the District notes its concern with the cut-off for consideration of financial operations for the state audit, ending one month before the end of the District's fiscal year. The Draft Audit Report, therefore, does not take into consideration the District's financial conditions as reflected in its annual financial audit for October 2004 - September 2005. The Draft report does, however, base conclusions on the older FY 2003 and 2004 financial audits. Consideration of the most up-to-date financial evaluation could have resolved some issues.

Likewise, the District is concerned that key individuals were not interviewed to obtain information relevant to conclusions in the report, but not available in District records. For example, the current President and past President of the Board, and the technical and legal consultant that were in charge of the review of permits were not interviewed.

The District understands that there are limits on what a government body like the Auditor's Office can do, as there are limits on what the District can do with its limited resources. Overall, the District is pleased with the level of work the State Auditor's Office could invest in the audit. The District simply believes that the Draft Audit Report fails to present the complete picture in some areas because of the scope and implementation of the methodology.

Again, the Draft Audit Report sets a high standard for performance by groundwater districts, and the District appreciates the efforts of the State Auditor's Office to help this District set a more stable course for meeting those standards.

## RESPONSE TO ISSUES AND RECOMMENDATIONS

### Chapter 1:

**Summary.** The District does not disagree with any recommendation in the Draft Audit Report as a valid description of how any local government could manage its financial operations. The District does believe that there are other valid alternatives that could also be used, including some it was using, but is pleased to adopt the recommendations of the State Auditor's Office. The District will act to immediately implement all recommendations, or verify with legal counsel or district auditors that responses to the recommendations are already properly in place.

There are some areas of recommendation where more guidance would assist the District. For example, Recommendation 5 states "Safeguard assets." The District believes that currently it does this. If "safeguarding assets" means taking steps such as having a safe for its check book or further security around its office, that was not made clear.

Detailed responses to the recommendations and the apparent bases for them is provided below in bold, after the recommendation. Where the District believes it is currently implementing proper steps to meet the recommendations and the staff of the State Auditor's Office may not agree or be sure, the District would welcome any comment from or further with that Office.

### **Recommendations** (Recommendations from the Draft Report in italics)

*The District should act immediately to address its serious financial issues. Specifically, the District should:*

The District does intend to act immediately to address any specific recommendations which are identified, whether or not they should be characterized as serious.

1) *Set and follow a standard for documenting all financial decision making.*

The District agrees and believes its practices currently assure compliance.

2) *Develop and implement policies and procedures to govern financial activities.*

The District agrees and believes its practices currently assure compliance.

The District notes that on page 1, the Draft Audit Report appears to suggest that "manual" processes are not adequate, but it fails to note that computer accounting serves as back up or a double or back-up system for its financial activities. All receipts and disbursements are documented and reconciled on the District's computer as well as manually within the checkbook.

Checkbook and computer balances are reconciled monthly and financial reports are printed.

Likewise on page 1, the Report appears to disagree with the accounting methods used by the District's external audit firm. The Report does not appear to criticize the District for using that firm,



and it is a firm that currently represents 25-30 governmental entities. Thus, the District is concerned that this dispute would be a basis for suggesting that the District lacks proper financial safeguards. The District would appreciate any clarification that can be made on what it should do in this situations, if and when the District's auditors disagree with the State auditors.

*3) Properly segregate financial duties.*

The General Manager and Board of Directors are working on resolutions addressing the financial duties of the Board, General Manager and others. While the District believes the Board and General Manager have been operating under a proper segregation of duties, and documenting that clearly in minutes and other appropriate ways, better documentation of the delegation of authority is needed and will be completed. See also the comments on contracting in the Responses to the Overall Conclusions below.

*4) Implement a purchasing approval and receipt process for goods and services.*

See response to Recommendation No 3. The resolution will include a financial figure above which board approval will be required, and below which the General Manager may commit district funds. No one other than that General Manager or Board will be authorized to commit funds of the district. That has been the practice of the District.

The District disagrees with the suggestion near the bottom of page 3 of the Report that Board members who sign checks are failing in their responsibilities to review invoices. The District is not aware of any evidence or statements that suggests that the District is not doing what is necessary and appropriate. The District is not aware of any board members who sign checks who were interviewed to ascertain whether they had reviewed invoices for which they were signing checks. The Board members may not always review invoices, with good reason. They may, for example, already be aware of the activity and the costs. In many cases, invoices are reviewed or discussed with the General Manager at the time the checks are signed.

*5) Safeguard assets.*

The District believes it has such practices. The District has gone to considerable lengths to improve the security of the office and files. It shares an office building with a State agency that has similar security. All doors to the District's office are locked, including those between the District office and the state office. Only the President of the Board and General Manager have access to the keys for the office. A fire inspection has been performed by local fire officials. The checkbook is placed in a file cabinet during non-office hours and when there is any risk that it could be stolen.<sup>1</sup> The building has security lights on all corners and a light illuminates the door of the office. The City of

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<sup>1</sup> The District agrees that there was an instance one day when the District checkbook was on a table while others, including auditors, were in the office. That was a one time event, a result in part of having the auditors staff in the office seeking information from the General Manager while the General Manager was attempting to prepare checks. The General Manager did not view the state employees as a threat to stealing the checkbooks, but agrees that the better practice is to avoid any such risks. Such rare events, however, do not reflect a failure of adequate procedures. They reflect failures, at times, to follow all procedures.

Brackettville has a night patrol which checks this building along with the library and civic center located on the same lot.

The District has also made changes based on helpful comments by the staff or the State Auditor's Office. For example, the General Manager has created the practice of stamping immediately "for deposit only" the checks received at the district office. No checks remain unendorsed. If any questions arise concerning checks received, they are now returned to the sender for clarification. (The District had formerly held checks submitted with Texas Public Information Act Requests pending clarification of document requests and costs. That practice has stopped at the advice of the state audit team.)

6) *Comply with rules, contracts, and laws.*

The District agrees and believes its practices currently assure compliance.

*To fully address and resolve its financial issues, the District also should implement a long-term financial remediation plan to ensure that its financial management system supports:*

7) *Management's and Board members' fiduciary roles.*

See response to Recommendation 3 above.

8) *Compliance with legal, regulatory, and other requirements.*

The District agrees and believes it is currently in compliance. The District has tried to comply with the law in the fashion it has learned from other groundwater districts with more experience, although it recognizes that such practices can still be challenged if the law is not clear.

9) *Fiscal management and associated decision making.*

See response to Recommendation 3 above.

10) *Ongoing fiscal monitoring.*

The District agrees and believes it is currently in compliance.

On page 4, for example, the draft audit suggests that the Board has not been meeting in regular meetings as it should. It is true that many monthly meetings were labeled as "special meetings" rather than "regular" meetings, but those special meetings included the same type of agenda items as regular meetings. The board has averaged over 2 meetings a month, but it is also true that during the months the Board was meeting weekly or more for permit hearings, the Board did not always meet every month for a separate business meeting. With the end to the 40+ permits hearings of 2004 and 2005, the Board believes it has been able to return to more regular meetings for all its business. Based on the Draft Audit, the District will begin labeling monthly meetings as "regular meetings" to avoid any confusion that the activities are regular meetings and are different from special meetings.

11) *The District's groundwater management plan.*

The District agrees but is not sure how the plan relates to the financial operations or establishes a basis for a recommendation different from the other recommendations. Any guidance would be appreciated.

12) *Contract management.*

See response to recommendation 3 above. The District would also like to note that on page 3, the Report indicates that attorneys are not normally used in the permit-hearing process. The District believes there must be an error in the Report. The District believes, based on communications with a number of other districts, representatives of the Texas Alliance of Groundwater Districts, and attorneys who practice before such districts and other permitting agencies, that virtually all Districts routinely use attorneys in the permit hearing processes, and often before that process begins during review of applications. There are districts that hire attorneys to be hearing examiners. The District did not in the hope it could save money. There are districts that, like this District, use attorneys to present their evidence and advise Board members. In a situation where the applicants have threatened to sue, and in some cases sued, the District believes it was more than appropriate to assure the Board had access to legal counsel for all important aspects of the permit process.

13) *The safeguarding of resources against waste, loss, and misuse.*

The District believes it has such practices.

14) *Generation of reliable financial data.*

The District agrees and believes it is currently in compliance, although it does rely upon the assistance of its CPAs. It appears that the practices of the CPAs have been questioned by the Draft Audit Report.

15) *Communication of useful financial information in a timely manner.*

The District agrees and believes it is currently in compliance. The District would note that on page 2 of the Report, the issue of proper journal entries is raised. Those journal entries were made five days after the information was forwarded to the District by its auditors. The District understands the need to update financial information in a timely fashion and will continue to correctly record all year-end adjustments to its accounting records.

*The success of the financial remediation plan will depend, in part, in the manner in which it is executed. For that reason, it is critical that the District:*

16) *Clearly define the financial remediation plan's objectives.*

The District believes it will have the necessary plan in place in early 2006, however, any guidance or examples of such plans would be helpful.

17) *Specify time lines, benchmarks, and projected outcomes for each portion of the plan.*

Again, the District will implement this recommendation to its best ability. Examples of how this has been handled by other districts or other local governments would be helpful to the District, and possibly other districts.

18) *Assign responsibility for corrective actions to specific staff and hold them accountable for carrying out their responsibilities.*

The District believes it has such practices and to the extent this assignment needs to be better documented, see the District's response to recommendation 3 above.

19) *Implement a mechanism for regular review of plan implementation status.*

See the response to Recommendation 17.

*At a minimum, the District's financial remediation plan should include the following:*

20) *Development of a sound budgeting process that incorporates reasonable forecasting techniques, reliable financial data, and adequate staff input.*

The District believes that its close working relationship with its auditors provides a sound basis for its budgeting process. The costs associated with and the uncertainties in risks associated with threats of litigation, however, will likely continue to make forecasting more difficult for this District than many others.

21) *Development of a cash management plan that allows the District to better anticipate its financial condition.*

The District believes it currently has the necessary practices in place, subject to the uncertainties discussed in response to Recommendation 20 and with the potential for major water export and large fees associated with such export.

22) *Regular tracking of the costs associated with conducting business.*

The District believes it currently has the necessary practices in place. The financial resources of the District may, however, limit the degree of such "regular" tracking.

23) *Proper negotiation of contracts.*

The District believes it currently has the necessary practices in place, except for the formal adoption of a resolution by the Board, which is currently being drafted.

## **Chapter 2:**

**Summary:** The District agrees that the recommendations in this chapter are consistent with Texas

law and District rules and should be implemented. The practices needed to implement the recommendations have already been implemented or are in preparation.

**Recommendations:**

*The District should:*

- 1) Develop procedures to ensure that it complies with Texas Water Code and Board rules.*
- 2) Develop record keeping and retention procedures to ensure that District records are complete, accurate, and available for public inspection as required by Chapter 36 of the Texas Water Code and Board rules.*
- 3) Create a process for handling objections to hearing reports as a part of its permit process.*
- 4) Create a process for accepting or rejecting grants, gifts, donations, or gratuities made to or on behalf of the Board. This process will allow the District to reject any grants, gifts, etc. that present a conflict of interest or may provide the appearance of conflict of interest.*

*The Board should:*

- 5) Determine what authority is to be delegated to the general manager and provide this authority by resolution of the Board.*
- 6) Provide more oversight of the District.*

On this last recommendation, the District would appreciate any further guidance. The audit does not appear to indicate that changes may be needed, such as more oversight, except in the areas covered by other recommendations. Since the audit could not address every single aspect of the Board responsibility, the District assumes this recommendation is suggesting that there could be additional areas. The Board takes seriously its responsibility to oversee the actions of the District, and thus, welcomes any further detail from in the Final Audit Report.

**Chapter 3**

**Summary:** The District agrees that the recommendations in this chapter are consistent with the management plan of the District and should be implemented. The District will act to implement the recommendations as soon as possible.

**Recommendations:**

*The District should:*

- 1) Consistently prepare required annual reports and submit them to its Board as required by its groundwater management plan. The Board should then adopt the annual reports. The submission and approval of annual reports should be documented in the Board's meeting minutes.*

*2) Comply with its groundwater management plan objectives to:*

*a) Download PDSI maps on a quarterly basis and prepare a biannual drought assessment report.*

*b) Annually publish an article regarding water conservation in any of the newspapers that circulate in Kinney County*

## COMMENTS ON APPENDIX 1: OBJECTIVES, SCOPE, AND METHODOLOGY

**Scope of Audit -Time Period for Audit:** The District has already objected to certain aspects of the scope of the State Audit. The District urges that it be expanded. If not, the scope should be limited for all purposes, not just the financial conditions of the District.

The District believes the limit on the dates covered by the audit resulted in some inaccuracies and can result in misunderstandings by the public. If there is legal or other basis for cutting off the audit on August 31, 2005, the District is not aware of it, and the District urges that the reason be included in Appendix 1.

The Audit was limited to the period from September 1, 2001 to August 31, 2005. The first date is the date the law authorizing the District was effective. (The District was actually confirmed on January 12, 2002, at the time of the election to create the District.)

The dates used to limit the state audit, which includes the financial evaluation, do not coincide with the fiscal year of the District, which is October 1 to September 30. Thus, the District's financial audit for Fiscal Year 2005 (October 1, 2004 to September 30, 2005) was not considered by the State Audit, even though 11 of the 12 months covered by the annual audit coincided with the State Audit.

Thus, the District urges the Audit to include the figures from the 2005 audit as part of Appendix 2 to provide a better picture of the financial health of the District.

The Draft Audit Report does discuss other actions that occurred after the August 31, 2005 date, including the litigation. For example, the Audit includes on page iv the following:

Subsequent Events: Following the completion of audit work, in January 2006 a state district judge ruled against the District in a lawsuit filed by 13 landowners. The judge ruled that . . . this matter could further put the District's ability to continue as a going concern at risk.

Nothing similar is presented regarding the FY '05 annual audit, which was provided to the State auditors before the ruling of the district judge. The FY '05 annual audit did not raise any questions about whether the District was at risk of not being a "going concern." The issue was raised only in the 2003 audit, and not in the 2004 or 2005 audit. Yet the issue is presented as if it is a current concern of the District's financial auditors.

### **Scope of Audit- Interviews:**

Prior Legal and Technical Consultants: The District also asked the state auditors to discuss a number of their questions with the attorneys and consultant that no longer work for the District but were in charge of making the decisions questioned by the audit. The attorneys, Lloyd Gosselink, Blevins, Rochelle and Townsend are in Austin. The Consultant, Steve Walthour, is in San Antonio. Mr. Walthour took over a number of the roles of the general manager (determining administrative completeness and technical reviews) prior to the Hearings, and then when the current general manager recused herself in the permit proceedings. The attorneys served as co-presiding officers at

permit hearings and assisted with the permit application review process.

For example, the Audit suggests that the District did not need the attorney's assistance with the permit hearing process. Yet, neither these attorneys nor the consultant were asked by the audit why attorneys played the role they played in the process. Clearly, the ongoing threats of litigation make the work of this District different from that of many other ground water districts. There were also a number of legal issues that were raised in the hearings, that may have needed attention during the review process. Again, an interview with the attorneys or consultant could have resolved such issues.

The District repeatedly asked the audit team to refer questions regarding the Permit Hearing Process to legal counsel or the consultant who were responsible for all details of the hearing process. The General Manager had recused herself and did not participate in a number of the activities that were the subject of questions by the staff of the State Auditor. Apparently, neither legal or consulting were questioned regarding the Hearing Process, and the only questions directed to them regarded their bills.

District Board Members: The key officers were not interviewed. Thus, the recent past president, who presided for much of the period covered by the audit was not interviewed. The current president who was the presiding officer at all of the permit hearings was not interviewed. A quick survey of Directors indicate that the majority were not interviewed. It is not clear that any of the members of the Board were interviewed.



### COMMENTS ON APPENDIX 3 COMPLIANCE WITH STATUTES AND BOARD RULES

The District is concerned that some of the evaluations in this appendix and related text in several sections of the report are not accurate or only reflect unusual events that were out of the norm.

The areas of concern on Table 2 in this appendix are discussed below by referencing the page number and section of the law referenced in the Table.

#### Page 28

36.057. Division of Authority. If the comments are limited to financial issues, the District agrees that the Board should adopt a resolution related to the General Manager's authority, and one is in development. If the comments in the Report are intended to be critical of the practice of the District of allowing the General Manager to hire consultants and attorneys subject to approval of the Board, the District disagrees. The practice does meet the requirements of Texas law, although again the District agrees the practice should be documented in a resolution from the Board, in by laws or in rules.

36.058. Contracts. The first contract referenced is with the County Government, not the County Attorney. It is the District's position that all decisions for the County had to be made by the County Judge or Commissioners Court, and the role of the County Attorney as the one who drafted some or all of the language for the County should not be an issue. In a small county, avoiding all appearances of conflict may not be possible. The District should and will continue to make sure any appearance of conflict that can be avoided is avoided and if it cannot be avoided, it is disclosed or discussed in public so that fact can be considered by any decision makers.

The second contract referenced involves LBG Guyton, which has served as the consultant to the TWDB water planning group that includes Kinney County. The firm, therefore, has expertise valuable to the District, and it is highly respected. LBG Guyton researched the issues of conflict and confirmed to the General Manager that none existed. The Contract with LBG Guyton was ratified by the Board of Directors on November 2, 2005 and is referenced in the minutes of that meeting.

36.063. Postings. The District is aware of only one Meeting of the Board since January, 2002, that did not meet the 72 hour posting notice. One was promptly terminated when it discovered that there was a posting error. The meeting was then rescheduled and re-posted.

The District believes that all notices for all meetings have been posted with a few possible exceptions. The emergency meeting referred to was held by the Temporary Board of Directors, prior to the confirmation of the District in January, 2002. We cannot verify posting. There also appears to have been a hearing on District rules that was continued to a later date. The date to which the hearing was continued was apparently announced at that initial hearing, but the new date was apparently not posted based on legal advice at the time. The District will, nevertheless, post in such situations in the future to assure better public notice.

The District believes that all notices for all hearings on applications for permits were posted in compliance with State Law and District Rules.

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36.065. Minutes: All but two sets of minutes are accounted for and are available at the District office. All prepared minutes were available at the time of the site visits by the staff of the State Auditor's Office. At that time on one or more of the visits, there may have been one or two sets of minutes for recent Board meetings that had not yet been prepared, but they were all prepared in a timely fashion for District purposes.

The District has held 132 meetings since September, 2001. (An average of 2.5 meetings per month.) Additionally, the District processed 46 applications for permits involving 20 hearings and totaling more than 120 hours of board meetings, as the board heard all hearings, rather than paying a hearing examiner to hold them.

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36.113. Administrative Completeness: The District agrees that the applications do not now contain all of the information required for administrative completeness. The Board of Directors had been assured by sworn testimony of the District's technical consultant and statements by its legal consultants that all applications for permits were "administratively complete" and "technically complete" at the appropriate times. This part of the Permit Process was handled strictly by the District's legal and technical consultants who no longer work for the District and apparently were not interviewed for the audit.

In the future, the District will require the General Manager to submit documentation to the Board of the administrative completeness and technical completeness determinations when they are made. It should also be noted that, when the Board determined during the hearings that applications had been processed without complete information, they chose not to penalize the applicants who were legally responsible for providing the information required for a complete application, including proof of a meter on any well that was operating. (Applicants were required to fill out the form and attest that all information was complete, true and correct). Thus, rather than deny the applications or restart the permitting process as the rules authorized, the Board allowed applicants to provide missing information during the hearing or, in the case of meters, before permits were issued.

36.114. Technical Completeness: The comments above on Section 36.113 apply equally to the technical completeness process.

As for the comment related to District rule 17.08, it should be noted that the person acting as the general manager responsible for the application review and hearings process, including issuance of Hearing Reports, was Steve Walthour, not the current General Manager, who had recused herself. To the District's knowledge, Mr. Walthour had no relatives with applications pending or relatives on the Board of the Kinney County Groundwater Conservation District.

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36.114. Rehearings: The comment referencing District rule 17.10, is not correct. The District did comply with its rules. Requests for re-hearing were timely filed and are documented (and have been available) in the district records. The District's files contain all of the motions that were filed. The District has not stated that it did not receive such motions in a timely fashion. (There is a legal issue as to whether such motions need to be filed after the Board vote, the Board written order or the issuance of permits. Some applicants have filed motions with regard to the first two actions.)

It is true that the Board did not grant any motions for rehearing. The Board denied the motions by allowing the appropriate time to pass, as they are authorized to do.

36.151. Checks: At the time of District start up, the Interim General Manager was also a member of the Board of Directors and capable of signing checks. The account was set up by the secretary of the Temporary Board and included the names of all Board Members, which included the subsequent Interim General Manager. When the first General Manager was hired, the Board apparently did not pass a resolution authorizing anyone to sign checks for the District. This matter will be addressed in a resolution now in process.

**Page 32**

36.158. Donations Grants, etc: The District will take appropriate action on all donations, grants, etc, it receives in the future. The District disagrees, however, that it should be found to be out of compliance because of the "donation" for \$17,500 it never actually received, except as described below. The Board was not aware of the "donation" until well after it was made. The district's attorneys, who no longer work for the District, reduced their fees by \$17,500 in an invoice. There were never any deposits to the District's account in the amount of \$17,500. Thus, the "donation" was not approved at the time because it was handled by the attorneys as a credit to the District. When the matter was brought to the attention of the Board for the first during the Boards' approval of the FY 2004 audit, the matter was discussed by the Board, in public. Legal counsel, who had apparently received the money, did not indicate that any approval was required.

## COMMENTS ON OVERALL CONCLUSIONS

The overall conclusions are addressed in part in the Letter to the State Auditor's Office by counsel for the District on January 18, 2006. The District appreciated that opportunity to submit some early comments and hopes the letter was of assistance. The issues raised in that letter will not be repeated here. The following are additional comments on the discussion in the overall conclusion, with references to comments provided above.

As is discussed above, there are some disagreements on whether the District complied with certain law, rules and good financial practices.

Page i: Hiring Consultants: For example, at the bottom of the first page, there is a comment about the General Manager's practice of executing contracts on behalf of the District. For all of 2005, the practice has been to negotiate agreements with legal counsel and consultants and to make those contracts subject to approval by the Board. Even before 2005, the Board acted on most, if not all contracts, including that of Jace Houston, Lloyd Gosselink (Brian Sledge) and Steve Walthour. The minutes so demonstrate those actions and the current practice that was used for Lowerre & Frederick and LBG Guyton, is a practice that the District believes is efficient and complies with State law. The District does agree, however, that any such process should, as the Audit indicates, be documented in a formal action by the Board, and the District is taking steps to do so.

Page ii: Journal Entries and Expenses: The District believes it has, under the guidance of its external accounting firm, made the required journal entries. On 7/27/05 the journal entries were made, and the revised journal entries faxed to the District office on 7/22/05 under journal entries #'s 79, 80, 82, 83, 84 and 85. Under journal entry #82, \$78,541.94 legal expenses were accounted for in the District books. This amount had been previously accounted in the legal expenses, liability section. The \$78,542 referred to in the audit report is reflected as an account receivable rather than an expense, based on guidance from the District's legal consultants. Both the District and the District's accounting firm were advised by legal counsel as is reflected in fcc schedules in effect since August 21, 2003, that the fees could be collected from applicants. All amounts due to legal and consulting are reflected as amounts due by the District in liabilities. The amount is accounted as a receivable and as a liability - it is not an expense until paid. The \$78,542 referred to in your report is reflected as an account receivable rather than an expense, based on guidance from our legal counsel that this would be properly collected from applicants. These legal expenses are reported in the District's liabilities as an obligation to pay. The District's year end accounting adjustments are properly reflected in the annual audit's as presented to the Board for decision making purposes.

Page ii, §36.057(a): The District believes that, with few exceptions, the Board has complied with this section of the law. Some errors may have been made by General Managers, but the Board has demonstrated proper oversight under the law. The Board's minutes exhibit the oversight. Section 36.057 states:

MANAGEMENT OF DISTRICT. (a) The board shall be responsible for the management of all the affairs of the district. The district shall employ or contract with all persons, firms,

partnerships, corporations, or other entities, public or private, deemed necessary by the board for the conduct of the affairs of the district, including, but not limited to, engineers, attorneys, financial advisors, operators, bookkeepers, tax assessors and collectors, auditors, and administrative staff.

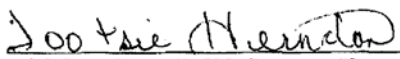
Page iii. Staff: The District is not aware of any prohibition of employment of a person serving probation. The knowledge of this person's efforts in obtaining education, and this person's prior employment, etc. was the basis for hiring this person to answer the District's telephone, make copies of documents, file and do other such tasks on a "part-time" basis. This person had worked for the Brackett News immediately before starting work for the District. This person had gained knowledge about the District. A quick check of employment records in Kinney County will yield information of other persons with "a felony criminal record" serving in community positions such the office of the Justice of the Peace office, law enforcement, retail grocery, secretarial staff for major businesses, etc. There would not appear to be any reason to raise this issue, unless the audit determined that the person was given an inappropriate responsibilities or had inappropriate access to funds or property of the District. If so, the District would like to be advised of that opinion of the State Auditor's Office and allowed to correct any such problem.


Page iii. Fees: The assertions as to fees collected in excess have been previously addressed with the audit team. Most of the fees involve "New Regular Permit Applications". The District believes it has resolved these issue with the State Auditors Office and will not discuss it further except to state that these fees were not for applications for "Existing and Historic" applications and were correctly posted to "Regular Permit" escrow accounting in the District records. A verification of all fees for Existing and Historic Applications collected by the District has been forwarded to the State Auditor with payment charts and corrections to "Deposits" received for Applications for Existing and Historic Permits and Regular Permits converted to Existing and Historic. All verifications were made from a deposit detail of the Districts electronic bookkeeping from 9/1/2001 through the Permitting Process.

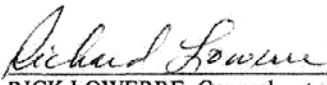
Page iv. Subsequent Events: As discussed above, it is not clear that this paragraph is appropriate or necessary in this report. If it is to be addressed, it would appear appropriate to advise the public that the Judge ruled that interpretation of Texas law that has been used by the District is the same as that used or supported by essentially all other groundwater districts. Thus, this District was not doing anything unusual.

  
CECIL SMITH, Board President

Attest:

  
TOOTSIE HERNDON, Secretary/Treasurer

  
DARLENE SHAHAN, General Manager

  
RICK LOWERRE, Counsel *w/permission*

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The Honorable Jim Keffer, House Ways and Means Committee

### **Office of the Governor**

The Honorable Rick Perry, Governor

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### **The Kinney County Groundwater Conservation District**

Ms. Darlene Shahan, General Manager



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