Bryan W. Shaw, Ph.D., *Chairman*
Buddy Garcia, *Commissioner*
Carlos Rubinstein, *Commissioner*
Mark R. Vickery, P.G., *Executive Director*

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

July 7, 2010

Via First Class Mail

Mr. Kent Lowery, President
Kinney County Groundwater Conservation District
502 South Ellen Street, Suite B
Brackettville, Texas 78832-0369

Re: **Notice of Executive Director's Report and Recommendation for Kinney County Underground Water Conservation District; TCEQ Docket No. 2010-0875-DIS**

Dear Mr. Lowery:

The Executive Director has published the enclosed notice as required under the Texas Water Code. As the notice states, the Executive Director's Report and Recommendation in the above-mentioned matter is scheduled to be presented at the Commission's Agenda meeting on **August 11, 2010 at 9:30 a.m.** The Agenda will be held at TCEQ Park 35 Complex, 12118 North I-35, Building E, Room 201S, Austin, Texas. **For further information concerning procedures of the Commission, you may contact the Commission's Public Interest Counsel at (512) 239-6363.**

If you have any questions regarding this letter, please contact me at (512) 239-3400.

Sincerely,

Jim Sallans
Attorney
Litigation Division

cc: Office of the Chief Clerk, MC 105
Blas Coy, Public Interest Counsel, TCEQ, MC 103

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

NOTICE OF HEARING ON THE EXECUTIVE DIRECTOR'S REPORT AND RECOMMENDATION FOR ACTION IN THE MATTER OF KINNEY COUNTY GROUNDWATER CONSERVATION DISTRICT TCEQ Docket No. 2010-0875-DIS

The Texas Commission on Environmental Quality ("TCEQ" or the "Commission") has scheduled this matter to be considered by the Commission based on the determination that the Kinney County Groundwater Conservation District (the "District") has not fully implemented its management plan and a finding that the District is not operational by the State Auditor's Office. The Executive Director recommends that the Commission take all actions it considers appropriate, including dissolution of the District and/or the District's Board, pursuant to TEX. WATER CODE § 36.303 and 30 TEX. ADMIN. CODE § 293.22(c).

The Commission will hear the matter at:

9:30 a.m.—August 11, 2010
TCEQ Park 35 Complex
12118 North I-35
Building E, Room 201S
Austin, Texas

The Executive Director, Kinney County Groundwater Conservation District, and the Commission's Public Interest Counsel will be allowed to provide evidence on the matter to assist the Commission in determining the appropriate action as required by TEX. WATER CODE § 36.303 and 30 TEX. ADMIN. CODE § 293.22(c). Upon failure of Kinney County Groundwater Conservation District to appear, **the factual allegations in the Executive Director's Report and Recommendation will be considered and the appropriate action will be taken by the Commission, including the possibility of dissolution of the District and/or the District's Board. The specific allegations included in this notice are those set forth in the Executive Director's Report and Recommendation.** Kinney County Underground Water Conservation District, the Executive Director and the Commission's Public Interest Counsel are the designated parties to this proceeding.

Legal Authority: TEX. WATER CODE chs. 7 and 36, and TEX. ADMIN. CODE chs. 70 and 293.

Further information regarding this proceeding may be obtained by contacting James Sallans, Staff Attorney, Texas Commission on Environmental Quality, Litigation Division, Mail Code 175, P.O. Box 13087, Austin, Texas 78711-3087, telephone (512) 239-3400. Information concerning the hearing procedures and public participation in the proceeding may be obtained by contacting Blas Coy, Public Interest Counsel, Mail Code 103, at the same P.O. Box address given above or by telephone at (512) 239-6363.

The original of any document filed prior to the hearing must be filed with the Office of the Chief Clerk; MC 105, P.O. Box 13087, Austin, Texas 78711-3087. When contacting the Commission regarding this matter, reference the TCEQ Docket Number provided at the top of this notice.

Jim Sallans
TCEQ Litigation Division

Bryan W. Shaw, Ph.D., *Chairman*
Buddy Garcia, *Commissioner*
Carlos Rubinstein, *Commissioner*
Mark R. Vickery, P.G., *Executive Director*

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

June 18, 2010

Via Certified Mail, Return Receipt Requested, Article No. 7009 1680 0002 2322 7533
Via First Class Mail, Postage Pre-Paid

Mr. Kent Lowery, President
Kinney County Groundwater Conservation District
502 South Ellen Street, Suite B
Brackettville, Texas 78832-0369

Re: **Notice of Executive Director's Report and Recommendation for Kinney County Groundwater Conservation District; TCEQ Docket No. 2010-0875-DIS**

Dear Mr. Lowery:

The Executive Director filed the enclosed Executive Director's Report and Recommendation with the Office of the Chief Clerk of the Texas Commission on Environmental Quality ("TCEQ" or "Commission"). Based on the determination that the District has not implemented its management plan and a finding that the District is not operational by the State Auditor's Office, the Executive Director recommends that the Commission take all actions it considers appropriate pursuant to 30 TEX. ADMIN. CODE § 293.22(c).

The above-referenced case is scheduled to be presented at the Commission's Agenda meeting on **August 11, 2010 at 9:30 a.m.** The Agenda will be held at TCEQ Park 35 Complex, 12118 North I-35, Building E, Room 201S, Austin, Texas. **For further information concerning procedures of the Commission, you may contact the Commission's Public Interest Counsel at (512) 239-6363.**

If you have any questions regarding this letter, please contact me at (512) 239-3400.

Sincerely,

Jim Sallans
Attorney
Litigation Division

cc: Office of the Chief Clerk, MC 105
Blas Coy, Public Interest Counsel, TCEQ, MC 103

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY

2010 JUN 18 AM 11:29

CHIEF CLERKS OFFICE

TCEQ DOCKET NO. 2010-0875-DIS

EXECUTIVE DIRECTOR'S REPORT AND RECOMMENDATION FOR ACTION IN THE MATTER OF KINNEY COUNTY GROUNDWATER CONSERVATION DISTRICT

EXECUTIVE DIRECTOR'S REPORT

1. The Executive Director of the Texas Commission on Environmental Quality ("Commission" or "TCEQ"), by and through a representative of the Litigation Division, hereby issues this Report and Recommendation for Action pursuant to TEX. WATER CODE chs. 7 and 36, and 30 TEX. ADMIN. CODE chs. 70 and 293.

2. Kinney County Groundwater Conservation District (the "District") is subject to the enforcement authority of the Commission pursuant to TEX. WATER CODE § 7.002 because the violations alleged herein are within the Commission's general jurisdiction, pursuant to TEX. WATER CODE § 5.013, as they involve violations of the state's underground water conservation program.

3. The Executive Director has concluded that pursuant to 30 TEX. ADMIN. CODE 293.22(c) it is required to prepare and file a report with the Commission based on the determination that the District is not operational. In February 2010, the State Auditor's Office made the determination in Audit Report No. 10-023 ("Attachment A"), pursuant to TEX. WATER CODE §§ 36.302(a), (c) and (e). It found the District not operational for failure to implement the District's management plan objectives as required under 30 TEX. ADMIN. CODE § 293.22(a)(5). The State Auditor's Office (the "SAO") also documented significant financial and operational deficiencies, and determined that the District had not fully implemented recommendations made by the SAO in January 2006.

BACKGROUND

4. The District is a Groundwater Conservation District, created by HB 3243 of the 77th Texas Legislature, composed of territory entirely within Kinney County, Texas. It is located at 502 South Ellen Street, Bracketville, Texas. The District is responsible for the management of groundwater and is a district as defined in TEX. WATER CODE ch. 36.

5. The District's management plan was developed and submitted to the Texas Water Development Board ("TWDB") as required under TEX. WATER CODE §§ 36.1071 and 36.1072. The management plan was certified by the TWDB in February 2004.

6. In January 2006, the SAO published SAO Audit Report No. 06-021 (the "2006 Report"). The 2006 Report covered District operations from September 2001 through August 2005. The SAO concluded the District was operational in that it achieved 75 percent of its management plan objectives in 2004 and 78 percent of objectives of the management plan in 2005. The SAO, however, requested the District implement 32 recommendations to address operational and financial weaknesses.

7. The District submitted a revised management plan to the Water Development Board which was certified in June 2008. The management plan included 10 specific objectives.

8. In February 2010, the SAO published SAO Follow-Up Audit Report No. 10-023 (the "2010 Report"). The 2010 Report covered District operations from September 2005 through June 2009. In the 2010 Report the SAO concluded that the District was not operational because it had not achieved 80 percent of management plan objectives from October 2008 through the end of September 2009. The SAO reported that the District did not consistently comply with its own rules and objectives or requirements under the Texas Water Code. Specifically, the District failed to: issue permits in a timely manner; ensure that annual audits were conducted; monitor usage for all permitted wells; ensure that all board members disclosed potential conflicts of interests; and consistently record and retain minutes of the public meetings of the District's board.

9. In addition to finding that the District was not operational, the SAO reported significant financial and operational deficiencies, including many that had been previously reported in the 2006 Report. The SAO found that the deficiencies prevented the District from ensuring that it: had timely, complete, and accurate financial information; was able to meet its financial obligations; and could protect its obligations from violations, abuse, and fraud. Furthermore, the SAO concluded that the District failed to demonstrate proper oversight as required under TEX. WATER CODE § 36.057, and that the District failed to fully implement 31 of the 32 audit recommendations in the 2006 Report.

10. On April 22, 2010, the TCEQ received the State Auditor's Update from the District on the District's status, which indicates that a majority of the current management plan objectives, cited by the SAO as the basis for the "not operational" finding, have not been met and that audit reports requested by the TCEQ are incomplete.

EXECUTIVE DIRECTOR'S RECOMMENDATION

11. Pursuant to 30 TEX. ADMIN. CODE § 293.22(c) and TEX. WATER CODE § 36.303, the Executive Director recommends that the Commission take all actions the Commission considers appropriate, including:

i. Issuing an order requiring the District to take certain actions or to refrain from taking certain actions;
ii. Dissolving the District's board in accordance with TEX. WATER CODE §§ 36.305 and 36.307 and calling an election for the purpose of electing a new board;
iii. Requesting the attorney general to bring suit for the appointment of a receiver to collect the assets and carry on the business of the District, in accordance with TEX. WATER CODE § 36.3035;
iv. Dissolving the District in accordance with TEX. WATER CODE §§ 36.304, 36.305 and 36.308; or
v. Making recommendations to the Legislature for any such actions the Commission deems necessary to accomplish comprehensive management in the District.

12. **ACCORDINGLY**, the Executive Director respectfully reports and recommends that, pursuant to TEX. WATER CODE ch. 36 and 30 TEX. ADMIN. CODE ch. 293, the Commission take appropriate action as required by TEX. WATER CODE §§ 36.302(f) and 36.303 to provide for proper oversight, address operational status and financial and operational deficiencies, and protect the assets of Kinney County Groundwater Conservation District.

Respectfully submitted,

Texas Commission on Environmental Quality

Mark R. Vickery, P.G.
Executive Director

Stephanie Bergeron Perdue, Deputy Director
Office of Legal Services

Kathleen C. Decker, Division Director
Litigation Division

by _____
Jim Sallans
Texas Commission On Environmental Quality
State Bar of Texas No. 00785413
Litigation Division, MC 175
P.O. Box 13087
Austin, Texas 78711-3087
(512) 239-3400
(512) 239-3434 (FAX)

Attachment A

John Keel, CPA
State Auditor

A Follow-up Audit Report on

The Kinney County Groundwater Conservation District

February 2010

Report No. 10-023

State Auditor's Office
John Keel, CPA
State Auditor

A Follow-up Audit Report on

The Kinney County Groundwater Conservation District

SAO Report No. 10-023
February 2010

Overall Conclusion

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, issues permits for wells located in zones of the Edwards Trinity Aquifer, the Edwards Aquifer, and the Austin Chalk Aquifer.

Kinney County had a population of 3,233 as of 2008.

See Appendix 2 for additional background information.

Significant financial and operational deficiencies continue to exist at the Kinney County Groundwater Conservation District (District). Many of these deficiencies were identified in the State Auditor's Office's 2006 audit of the District. These deficiencies prevent the District from ensuring that it (1) has timely, complete, and accurate financial information; (2) is able to meet its financial obligations; or (3) can protect its assets against violations, abuse, and fraud. In addition, the District's board of directors has not consistently demonstrated proper financial oversight as required by Texas Water Code, Section 36.057 (a). The lack of adequate financial oversight, combined with the District's difficulty in hiring and retaining qualified staff, contributed to the identified weaknesses in the District's accounting procedures and controls. The State Auditor's Office can provide limited-to-no assurance that amounts in this report are accurate and complete because the District was not able to provide complete and reliable information. Because the District did not provide assurances that the information provided to auditors was complete and accurate, the findings, conclusions, and supplemental information in this report are subject to that limitation.

The District is not operational because it has not achieved 80 percent of its management plan objectives. Texas Water Code, Section 36.302, directs the State Auditor to determine whether a water district is operational based on whether a district is actively engaged in achieving the objectives of its management plan. The District's management plan, which was certified by the Water Development Board in June 2008, had 10 objectives that primarily address the following broad goals: performing public outreach through publishing informative articles in local newspapers; seeking funds and intergovernmental assistance to map water flows in the three aquifers within the District; and maintaining intergovernmental and regional planning efforts with regional stakeholders.

In addition, the District did not consistently meet its own rules and business objectives or comply with Texas Water Code requirements. Specifically, the District did not (1) issue new permits in a timely manner, (2) ensure that statutorily required annual audits were conducted, (3) monitor water usage for all permitted wells, (4) ensure that all board members disclosed potential conflicts of interest, or (5) consistently retain minutes of the board's public meetings.

This audit was conducted in accordance with Texas Government Code, Sections 321.0131 and 321.0132.

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

The District also has not fully implemented 31 (96.8 percent) of 32 audit recommendations in *An Audit Report on the Kinney County Groundwater Conservation District* (State Auditor's Office Report No. 06-021, January 2006). Fifteen (47.0 percent) of the 32 recommendations were not implemented, while implementation of 16 (50.0 percent) of 32 recommendations was incomplete/ongoing. Implementing these recommendations may have helped the District address its significant financial and operational weaknesses.

Auditors also identified other less significant issues that were communicated separately in writing to the District.

Summary of Management's Response

The District agrees with most of the findings and recommendations in this report. However, the District disagrees that it does not comply with the permit processing provisions of Texas Water Code, Chapter 36 (see Chapter 3-A).

The District's overall management's response is presented in Appendix 5. The District's management's responses to the specific recommendations in this report are presented immediately following each set of recommendations in the Detailed Results section of this report.

Summary of Information Technology Review

This audit did not include a review of the District's information technology or the controls over its information technology.

Summary of Objectives, Scope, and Methodology

The objectives of this audit were to determine whether the District:

- Has taken corrective action to address recommendations made in *An Audit Report on the Kinney County Groundwater Conservation District* (State Auditor's Office Report No. 06-021, January 2006).
- Has accounting procedures and controls that:
  - Ensure that it is able to meet its financial obligations.
  - Ensure that accurate, timely, and complete financial information is available for making management decisions.
  - Protect against violations, abuse, and fraud.
- Achieves its management goals and objectives as outlined in its management plan.

- Complies with selected statutes, rules, and regulations.

The scope of this audit covered all District activity from September 1, 2005, through June 30, 2009.

The audit methodology included collecting information and documentation, performing selected tests and other procedures, analyzing the results of the tests, and conducting interviews with District management and staff. The audit was completed in 3,000 hours, which would have resulted in a total cost of $270,000, at a standard rate of $90 per hour, if the work had been billed to the District.

Contents

Detailed Results

Chapter 1
The District's Accounting Procedures and Controls Are Significantly Deficient 1

Chapter 2
The District Is Not Operational Because It Has Failed to Meet Most of Its Management Plan Objectives 10

Chapter 3
The District Did Not Consistently Comply with Statutes, Rules, and Regulations That Govern District Operation 14

Chapter 4
The District Has Failed to Fully Implement 31 of 32 Prior Audit Recommendations 23

Appendices

Appendix 1
Objectives, Scope, and Methodology 28

Appendix 2
District Background Information 31

Appendix 3
District Financial Information for Fiscal Years 2008 to 2009 32

Appendix 4
Management Letter from External Auditors Regarding the District's Fiscal Year 2006 Financial Statements 37

Appendix 5
Overall Management Responses 39

Detailed Results

Chapter 1

The District's Accounting Procedures and Controls Are Significantly Deficient

Significant financial and operational deficiencies continue to exist at the Kinney County Groundwater Conservation District (District). Many of these deficiencies were identified in the State Auditor's Office's 2006 audit of the District.[1] These deficiencies prevent the District from ensuring that it (1) has timely, complete, and accurate financial information; (2) is able to meet its financial obligations; or (3) can protect its assets against violations, abuse, and fraud. In addition, the District's board of directors (board) has not consistently demonstrated proper financial oversight as required by Texas Water Code, Section 36.057 (a). The District also has been unable to hire and retain qualified staff. These issues have contributed to the weaknesses in the District's accounting procedures and controls and increase the potential for errors, theft, and fraud. The State Auditor's Office (auditors) did not identify any instances of fraud during testing of the District's revenue and disbursements; however, the deficiencies that auditors identified in the District's financial processes raise questions about whether the District would be able to detect or prevent fraudulent activity.

In addition, because of the District's lack of accounting procedures and controls and the board's lack of oversight, auditors have no assurance that the District's financial records are complete and accurate.

Chapter 1-A

The District Has Not Implemented Controls Necessary to Ensure the Timeliness, Accuracy, and Completeness of Financial Information

The District cannot provide assurance that its financial records are accurate and complete. Additionally, the District was unable to respond to requests for financial information in a timely manner. The District has not obtained financial audits for fiscal years 2007 and 2008, and it has not recorded adjusting entries from its fiscal year 2006 audit. The District also misclassified transactions and lacked adequate supporting documentation for financial transactions.

[1] See *An Audit Report on the Kinney County Groundwater Conservation District* (State Auditor's Office Report No. 06-021, January 2006).

The District has failed to obtain annual financial audits.

Texas Water Code, Section 36.153, requires the District to obtain an annual financial audit of its financial condition. However, the District's most recent financial audit was conducted for fiscal year 2006. That audit issued a qualified opinion because of a scope limitation (see text box for a definition of qualified and unqualified opinions); it also specified that liabilities exceeded the assets by a total of $54,977. The audit firm that conducted the 2006 audit stated: "It was impractical to confirm accounts receivable as of September 30, 2006, and we have not been able to otherwise satisfy ourselves as to account balances at that date." In addition, a management letter that the external auditors directed to the District noted several significant deficiencies in internal control (see Appendix 4 for a copy of the letter). The external audit firm identified adjusting entries of approximately $250,000 that had not been made to the District's accounting records for fiscal year 2006.

Terminology

Qualified Opinion: A qualified opinion is expressed when (1) there is a lack of sufficient appropriate audit evidence or restriction on the scope, or (2) the financial statements contain a departure from generally accepted accounting principles.

Unqualified Opinion: An unqualified opinion is expressed when the financial statements present fairly in all material respects the financial position, results of operations, and cash flow of the entity in conformity with generally accepted accounting principles.

Source: Codification on Statements on Auditing Standards, Section AU 508.20, American Institute of Certified Public Accountants.

The District did not obtain the adjustments in a timely manner for entry into its financial records. The State Auditor's Office (auditors) requested and obtained in October 2009 the adjusting entries from the external audit firm that conducted the fiscal year 2006 audit; however, auditors did not validate the accuracy of the adjusting entries. The District has contracted with a different external audit firm to conduct the financial opinion audits for fiscal years 2007 to 2009. Without ensuring that financial audits are conducted in a timely manner, the District cannot ensure that it has accurate, timely, and complete financial information for making management decisions. (See Chapter 3 for more information about the District's lack of financial audits.)

Auditors identified financial inaccuracies resulting from the misclassification of transactions in the District's financial records.

Auditors identified several instances in which the District misclassified assets, liabilities, or revenues in its financial records. Specifically, auditors judgmentally selected and tested 10 revenues transactions, 8 of which were improperly classified. One transaction was a $109,980 water use fee that accompanied a permit application in fiscal year 2006 that the District incorrectly recorded as revenue. These funds should not have been classified as revenue; they should have been classified as a liability because the money was to be kept in escrow until a final decision was made on the application. If the District did not approve the permit application, it would have had to refund the water use fee. The remaining 7 misclassified revenue transactions totaled $14,973.37 and were related to expenses that the District incurred in fiscal year 2009 for legal services and other costs associated with a permit application. The District initially expected to be reimbursed for these costs by the permit applicant and recorded these transactions as revenue. When auditors requested additional documentation, the board's president determined

that the District would not receive reimbursement for those costs as initially expected.

Other examples of misclassified transactions include:

- The District credited money received from one permittee to another permittee's account. Auditors identified this error during testing and notified District staff.
- The District inappropriately recorded $6,000 related to a loan that was obtained from the Water Development Board as an asset in fiscal year 2005. This should not have been classified as an asset; it should have been classified as a liability. Furthermore, even though the District repaid the loan in fiscal year 2006, it carried this $6,000 as an asset every year from fiscal year 2005 to 2009. As of October 2009, the District had not corrected this error.

Without accurate financial data, the District cannot ensure that it has timely and complete financial information for making management decisions.

The District did not have controls to identify errors in invoices prior to payment and did not retain documentation to adequately support its financial information.

The amounts on 10 of 30 expenditure transactions tested for fiscal years 2008 and 2009 were incorrect. These errors were all related to overbillings by the District's former legal counsel amounting to $2,742. The District billed permit applicants for some of these legal costs. The District did not ensure that these invoices were adequately reviewed before District funds were expended.

Thirty-three percent of expenditure transactions and 37 percent of revenue transactions tested for fiscal year 2008 did not have adequate supporting documentation. Auditors also identified other transactions for fiscal years 2008 and 2009 for which the information in the District's financial records was different from the supporting documentation. Auditors tested fiscal year 2009 transactions for revenues and expenditures. Auditors noted improvement in the documentation supporting the District's revenue transactions for fiscal year 2009; however, the District did not have supporting documentation for 2 (40 percent) of 5 fiscal year 2009 expenditure transactions tested. Without adequate supporting documentation, District management cannot determine whether it paid or received the correct amount of funds.

Current Assets

Resources that are expected to be realized in cash, sold, or consumed during the next year (or longer operating cycle) are classified as current assets. The basic types of current assets are cash, cash equivalents, secondary cash resources, receivables, inventories, and prepaid expenses.

Source: *2010 Generally Accepted Accounting Principles (GAAP) Guide*, Volume 1, Chapter 3.

In addition, the District recorded transactions totaling $167,863 in Other Current Assets in fiscal year 2005. A current asset is defined as an asset on the balance sheet that is expected to be sold or otherwise used in the near future (see text box). However, as of

June 30, 2009, the District's financial records still listed Other Current Assets of $167,863. When auditors asked for an explanation of what these assets were, the District stated that it could not find an explanation in any of its records for how these assets were created or why these funds were classified as current assets. Because District management cannot substantiate the existence of the original transactions that made up the $167,863, the District should determine whether its financial records should be corrected.

The District also lacked adequate supporting documentation for its recorded escrow amounts. Escrow accounts are established to retain deposits for application fees and other administrative costs. Auditors were unable to determine whether the escrow accounts contain only funds that relate to the permit applicants because of the lack of supporting documentation. Additionally, the escrow funds were comingled with operating funds.

Without supporting documentation, the District cannot ensure that the amounts paid, received, and recorded in its financial records are accurate.

Recommendations

The District should:

- Ensure that audits of financial statements are conducted in a timely manner.
- Record any adjusting entries in the District's financial records in a timely manner.
- Ensure that financial transactions are accurately and properly recorded in its financial records.
- Maintain supporting documentation for all financial transactions.

Management's Response

The District will:

- *Complete the current audits for Fiscal years 2007 and 2008.*
- *Complete an audit for the recently ended Fiscal year 2009.*
- *Correct any entries that require adjustment based on the outcome of the audit. The District Treasurer has already made a number of corrections based on the recommendations of the State Auditor.*
- *Contract with an accounting firm to provide bookkeeping services until professional staff can be hired to perform that task, after which the*

accounting firm will be retained to review and correct bookkeeping entries on a quarterly basis.

- *Maintain the recently renovated and repaired filing system to ensure all financial records are fully documented.*

Special Note regarding the $167,863 in Other Current Assets in fiscal year 2005: the District Treasurer was able to organize the financial records and determine that the origins of this asset. The $167,863 represents an account receivable from funds originally owed by the 16 plaintiffs in the Boulware litigation (see discussion above) as production fees. The Agreed Settlement approved by the Board in July 2007 required the District to forgive any claim to the disputed production fees, so this asset will be removed from the balance sheet.

Chapter 1-B

The Board Did Not Provide the Governance Necessary to Ensure That the District Recorded Accurate Financial Information, Protected Assets, or Had Sufficient Policies and Procedures

Texas Water Code, Section 36.057(a)

Texas Water Code, Section 36.057, states that the District's board shall be responsible for the management of all the affairs of the District.

The District's board has not demonstrated the financial oversight of the District that is required by Texas Water Code, Section 36.057(a). Financial oversight of the District is part of the board's general management responsibility as specified in Texas Water Code, Section 36.057(a) (see text box). The board's lack of proper financial oversight has contributed to the weaknesses in the District's accounting procedures and controls. If properly implemented, the board's financial oversight of the District would include ensuring that written policies and procedures for the District's financial processes and day-to-day operations are developed and implemented. The board's lack of oversight, failure to develop documentation, and failure to ensure consistency in District operations increase the potential for errors, fraud, and theft of District assets to occur.

The board did not provide the governance necessary to ensure that the District recorded accurate financial information and protected assets.

The board failed to correct the deficiencies in its financial oversight of the District noted in the prior audit. Specifically:

- As was reported in the previous audit report, one of the District's employees had a felony criminal record. In April 2007, the board promoted this person to the general manager position. According to a September 24, 2009, news article in the *Brackett News*, the board's president stated that the board in place at that time had promoted this person to general manager with the expectation that she would re-create the fiscal years 2005 to 2006 financial records. In the same article, the

board's president stated that it took the board 18 months to discover that the general manager did not know how to re-create the financial records.

- The District does not have procedures to ensure that District assets are safeguarded upon an employee's separation from the District. For example, based on information from auditors' interviews with District board members, the general manager retained possession of District equipment upon termination of her employment in January 2009. Subsequent to a discussion with auditors, the District requested in November 2009 that the former general manager return the equipment, and the former general manager complied with the request.

- The board often tabled operation- and financial-related decisions because it had incomplete information related to the District's budgets and expenditures, which reduced the board's ability to make timely and appropriate decisions. Auditors noted improvements in the format and amount of detail in the financial information provided to the board beginning in January 2009. However, the District's fiscal year 2008 and 2009 budgets did not contain all the elements required by Texas Water Code, Section 36.154. For example, the budget from the September 18, 2008, board meeting did not contain a Statement of Outstanding Obligations or the amount of cash on hand.

- The board approved a $4,950 purchase of software and equipment without obtaining competitive bids as required by District bylaws and with no evidence that proper purchasing procedures were followed. The check for the purchase was made payable to the former general manager, and the District did not have any packing slips or other documentation showing that the items pictured on the invoices were the same items actually delivered to the District. One of the items purchased was a $1,995 server that was not included in the list of equipment that the board approved for purchase.

The District lacks policies and procedures to ensure consistent day-to-day operations and accurate recording of financial information.

Although the District's bylaws and the Texas Water Code offer some guidance relating to financial matters, the District has not consistently followed that guidance. In addition, the District lacks written policies and procedures to (1) ensure that it accurately records and tracks financial information and (2) create consistency in day-to-day operations. The lack of documentation and consistency in District operations increases the risk that errors, fraud, and theft of District assets can occur. Specifically:

- The District lacks policies and procedures for the recording of accounts payable and accounts receivable. As a result, the District did not begin implementing the recording of accounts payable and accounts receivable until fiscal year 2008. During limited testing, auditors identified four

instances in fiscal year 2008 when the District did not accurately record accounts receivables and accounts payables.

- The District does not have a documented process for invoicing permittees for annual water usage, and it may not be able to determine whether it has received all revenues that it should have been collecting. Some permittees pay for water usage in one annual payment, while others pay on a quarterly basis. As noted above, auditors identified an instance in which the District credited a payment to the wrong account; however, the District did not provide evidence that it identified the error, billed the permittee whose payment was applied to another permittee, or noted that the second permittee had overpaid. Having a documented process for invoicing permittees and tracking payments could help the District reduce these types of errors.

- The District does not have policies and procedures for conducting bank reconciliations. The District did not conduct and document timely bank reconciliations for 10 (48 percent) of 21 months tested. Eight of the 10 months, from October 2007 to May 2008, were not reconciled until July 2008. In addition, the preparer of the reconciliation did not sign or date the reconciliation for 17 (81 percent) of the 21 months tested, and there was no evidence that another person had reviewed any of the reconciliations.

Developing and implementing a comprehensive policies and procedures manual could help the District ensure consistency in day-to-day operations and safeguard its assets. This is of particular importance because the District has utilized volunteers or temporary employees to conduct its day-to-day operations.

Recommendations

The board should maintain sufficient financial oversight of District operations by:

- Ensuring that all employees hired are qualified to perform the responsibilities of the position.

- Considering requiring that a background check be conducted on top candidates.

- Ensuring that District budgets contain the required information and are sufficiently detailed to provide the board with information to make timely and appropriate decisions.

- Ensuring that purchases comply with the District's bylaws and contain the necessary supporting documentation.

The District should develop and implement written policies and procedures for all financial processes and day-to-day operations, including:

- The recording of accounts payable and accounts receivable.
- The invoicing of permittees for annual water usage.
- The reconciliation of bank statements to the District's financial records.

Management's Response

The District will:

- *Contract with a firm to perform background checks on all candidates prior to hiring.*
- *Contract with an accounting firm to correct and amend the current budget and establish the proper formats for all future budgets.*
- *Review all purchases before authorizing payment to ensure the purchases was authorized, that the authorized item was the item purchased, and all supporting documentation is included with the invoice.*
- *Contract with an accounting firm to review current accounts receivable and accounts payable and review, on a quarterly basis, all future receivable and payable account entries.*
- *The District Treasurer will reconcile bank statements each month.*

Chapter 1-C

The District May Not Be Able to Meet Its Financial Obligations

Auditors did not conduct a financial opinion audit on the financial statements of the District. However, based on issues that auditors identified during testing, it appears that the District may not be able to meet its financial obligations. As noted above, the District's fiscal year 2006 audited financial statements specified that liabilities exceeded the assets by a total of $54,977. In addition, as noted in its minutes, the board authorized transfers from escrow accounts to the interest and general fund accounts to pay for routine expenses from 2006 to 2009. Escrow accounts are established to retain deposits for application fees and other administrative costs. Auditors also identified issues related to the accuracy and completeness of the District's financial records. These issues, for which the District could not provide information to the contrary, would reduce its assets and increase its liabilities for both fiscal year 2008 and fiscal year 2009. In addition, auditors also identified what appear to be overstatements of revenue for fiscal year 2009.

See Appendix 3 for more information about the District's stated financial information for fiscal years 2008 and 2009.

Chapter 2

The District Is Not Operational Because It Has Failed to Meet Most of Its Management Plan Objectives

The District is not operational because it has not achieved 80 percent of its management plan objectives. Texas Water Code, Section 36.302, directs the State Auditor to determine whether a water district is operational based on whether the district is actively engaged in achieving the objectives of its management plan (see text box).

Texas Water Code, Section 36.302 - Legislative Audit Review; Determination of Whether District is Operational

(a) A district is subject to review by the State Auditor under the direction of the Legislative Audit Committee pursuant to Chapter 321, Texas Government Code.

(b) The Texas Commission on Environmental Quality, the Texas Water Development Board, and the Parks and Wildlife Department shall provide technical assistance to the State Auditor's Office for a review performed under Subsection (a).

(c) In a review performed under Subsection (a), the State Auditor shall make a determination of whether a district is actively engaged in achieving the objectives of the district's management plan based on an analysis of the district's activities.

The District's management plan, which was certified by the Water Development Board in June 2008, had 10 objectives that primarily address the following broad goals: performing public outreach through publishing informative articles in local newspapers; seeking funds and intergovernmental assistance to map water flows in the three aquifers within the District; and maintaining intergovernmental and regional planning efforts with regional stakeholders. The finding that the District is not operational is based on review of the District's management plan objectives for its fiscal year from October 1, 2008, through September 30, 2009. As of September 2009, the District had accomplished only 2 of its 10 objectives. This is a significant decrease from the District's performance in 2005 (the last year measured by the auditors), when it achieved 78 percent of the objectives in its previous management plan.

The District met two objectives that focused on planning and coordination with stakeholders through a regional planning group. However, a 20 percent achievement rate fails to demonstrate that the District is operational.

In a previous audit of the District, the State Auditor's Office determined that the District had met 75 percent of its previous management plan's objectives in 2004 and had met 78 percent of the objectives in 2005.[2] The District's 2008 management plan had one more objective than its 2003 management plan had. However, the 2008 objectives were general and easier to attain, such as publishing articles in the local newspapers, applying for grants, and participating in regional planning. By contrast, the 2003 objectives focused more on the District's operations and specific business processes, such as requiring all new and exempt wells to operate within District rules and requiring an annual evaluation of the District's rules to determine whether any amendments were necessary.

[2] See *An Audit Report on the Kinney County Groundwater Conservation District* (State Auditor's Office Report No. 06-021, January 2006).

The District did not prepare an annual report for its board in 2008.

The District's 2008 management plan directs the District's general manager to prepare and submit an annual report to the board within 90 days of the end of the fiscal year. However, the District's general manager did not prepare an annual report for the fiscal year ending 2008. The District also did not prepare an annual report for fiscal year 2009, partly because the District has been without a general manager since January 2009.

The annual report should include an update on the District's performance related to its management plan objectives and all reports or other documentation showing what actions were taken to meet the objectives. Without an annual report, the board's ability to assess the District's performance may be limited. For example, although the District had met two objectives, there was no reporting of these accomplishments to the board. More significantly, there was no reporting that the District had failed to meet 8 of its 10 management plan objectives.

The District failed to achieve 80 percent of its objectives.

Table 1 lists each of the District's 2008 management plan objectives and whether the District had achieved the goal as of November 2009.

Table 1

District Performance Related to Its 2008 Management Plan Objectives
As of November 2009

Objective	Standard Achieved?	Auditor Comments
A 1. A report defining activities performed to obtain grant funding during each year will be incorporated into the Annual Report submitted to the Board of the District.	No	The board contacted state and federal entities to explore funding options, but it had not applied for funds.
B 1. Submit an article regarding the elimination of wasteful practices regarding groundwater to a local publication for distribution in Kinney County and enclosed in the District's Annual Report to the Board of Directors.	No	The District issued a newsletter in November 2008 that affirms the District's mission to protect water resources, but the newsletter did not address the elimination of wasteful groundwater management practices.
C 1. A report of the meeting with the Nueces River Authority will be noted in the Annual Report, which will be presented to the Board of Directors of the District, regarding conjunctive surface water management issues.	Yes	Although the District did not issue an annual report, auditors verified that the District and the Nueces River Authority are both members of the Region J Planning Group. The purpose of the Region J group is consistent with the objective of addressing conjunctive water management issues.
D 1. Quarterly, the General Manager will make a report to the Board of the District; regarding the Palmer Drought Severity Index.	No	The District started to retain this information for reporting purposes in September 2009 (during audit fieldwork).
E 1. The District will annually submit an article regarding water conservation for publication to at least one newspaper of general circulation in Kinney County and provide a copy of said article in the Annual Report to the Board of Directors.	No	The District issued a newsletter in November 2008 that affirmed the District's mission to protect water resources, but the newsletter did not address water conservation.

District Performance Related to Its 2008 Management Plan Objectives As of November 2009		
Objective	Standard Achieved?	Auditor Comments
E 2. Track the request and include annual status updates in the Annual Report to the Board of Directors; regarding a county survey with recommendations regarding appropriate locations for groundwater recharge structures.	No	The District had not taken action to achieve this objective.
E 3. A copy of [an] article regarding rainwater harvesting methods will be included in the Annual Report to the Board of Directors.	No	The District had not created any article that addresses rainwater harvesting methods.
E 4. A report detailing the results of monitoring precipitation enhancement programs will be included in the Annual Report to the Board.	No	The District had not taken actions to achieve this objective.
E 5. A copy of the Natural Resources Conservation Service (NRCS) report regarding brush management will be included in the Annual Report to the Board of Directors.	No	The District did not have a copy of this report nor was there an annual report to the board.
F 1. Each year, a summary of activities regarding intergovernmental coordination with agencies like the Texas Railroad Commission, Texas Commission on Environmental Quality (TCEQ), and Texas Parks and Wildlife regarding natural resource issues relating to groundwater in Kinney County will be included in the Annual Report submitted to the Board of Directors of the District.	Yes	The District participated in joint planning activities that required intergovernmental coordination through the Region J Planning group; the purpose of the Region J Planning is to address natural resource issues.

Recommendation

The District should ensure the accomplishment of and reporting on management objectives. This includes the employment of necessary resources to meet its daily operational needs.

Management's Response

The District has already found the means to accomplish some of the District goals despite the lack of professional staff available to perform the required tasks. For example, although the audit is essentially correct that the District has not filed an annual report detailing efforts to obtain grant funding, the Board of Directors has investigate a number of potential funding sources for grants, and did obtain grant funding from the San Antonio Water System to the United State Geologic Survey to study the Kinney County aquifer systems. Because this funding did not come directly to the District as a grant it does not technically meet the requirements of the Management Plan, but it does accomplish the same purposes.

*Through the **2010 Plan of Action**[3] the District will address each of the goals in the 2008 Management Plan, and will fully document all efforts—successful and unsuccessful—to complete those tasks.*

[3] See Appendix 5 for copy of the 2010 Plan of Action that the District submitted with its management responses.

Chapter 3

The District Did Not Consistently Comply with Statutes, Rules, and Regulations That Govern District Operation

The District did not consistently meet its own rules and business objectives or comply with Texas Water Code requirements. Specifically, the District:

- Did not issue new permits in a timely manner.
- Did not ensure that statutorily required annual audits of the District's financial condition were conducted.
- Did not adequately monitor water usage by permitted wells.
- Did not ensure that all board members disclosed potential conflicts of interest.
- Did not consistently retain minutes of the board's monthly public meetings.

Chapter 3-A

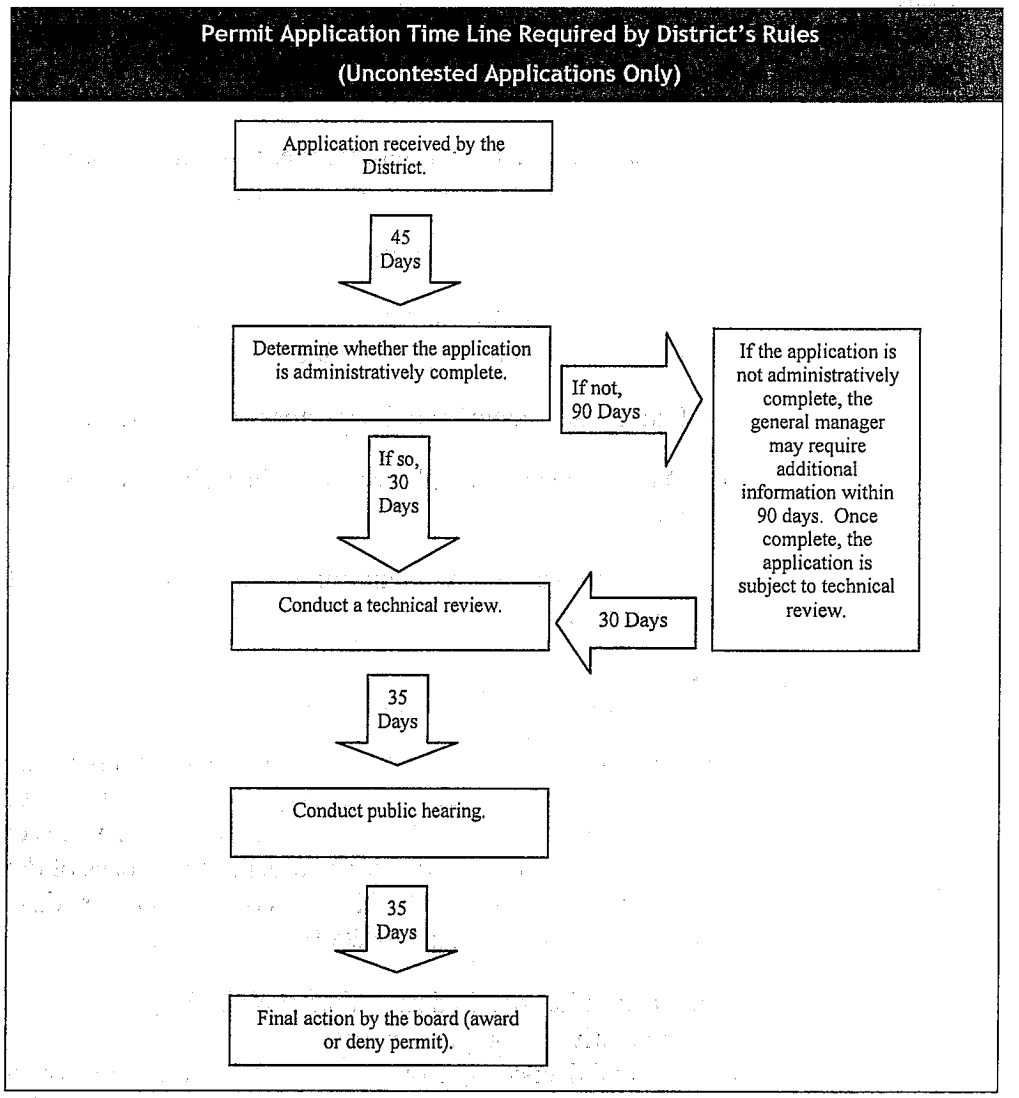
The District Did Not Issue New Permits in a Timely Manner

The District lacks consistent work processes and sufficient controls over its permit application process. The District also does not have a tracking system that shows the status of a permit application or identifies critical dates and milestones. Although the District was in the process of developing an organized filing system, the District's office appeared disorganized when auditors visited in September 2009.

The District has detailed rules that explain the requirements for an administratively complete application and establish deadlines for specific actions and decisions. However, the District did not consistently comply with its rules because it did not process applications for permits within the time frames set by the rules for establishing administrative completeness. In addition, the District did not consistently comply with Texas Water Code, Section 36.114(D), which requires the District to promptly consider and act on each administratively complete application for a permit or permit amendment.

According to District rules, it should take the District between 145 days and 235 days to complete the entire permit application process if the application is not contested (see Figure 1 on the next page).

Figure 1



Source: The State Auditor's Office created this chart based on procedures and deadlines in *2003 Rules of the Kinney County Groundwater Conservation District*, Section 9.01D.

From May 5, 2005, to October 2, 2007, the District received 20 applications for new permits. As of June 2009, action had been taken on only 6 of the 20 pending applications, and none of these applicants had been issued a permit. During the June 11, 2009, board meeting, the board imposed a six-month moratorium on issuance of new permits. The 14 pending applications had been in process at the District for an average of 1,285 days as of June 11, 2009, and the District had still not issued or denied permits for these applicants.

Permit Application Fees for Regular Permits

According to the District's fee schedule, the total deposit for application review, processing, and any hearing on an application for a regular permit should be the greater of $500 or $1.00 per acre foot of water sought by the applicant.

If the District's records show that the actual costs of reviewing, processing, and hearing the application is more than the deposit, the applicant should be billed for the excess costs.

In addition, the six permit applications denied at the June 11, 2009, hearing had been assessed fees that were inconsistent with the District's fee schedule. A previous general manager entered into an agreement with the permits' applicant that included a $20,000 application fee. The District's normal application fee is the larger amount of either $500 or $1.00 per acre foot (see text box). Because the six applications sought permits to pump water for 10,988 acre feet, using the District's fee schedule, the application fee would have been under $11,000.

The District adopted new rules for its permit application process that became effective October 29, 2009. Although these new rules simplify the language and streamline the permitting process, they do not include specific deadlines for milestones in the application process. Without prescribed time lines included in the rules, District staff may lack guidelines for processing the applications and the District's ability to ensure that its permittees' applications are processed in a timely manner may be impaired. However, it should be noted that the Texas Water Code contains the timelines for processing permit applications.

Auditors noted several conditions that may have contributed to the District's delays in processing new permit applications. Specifically:

- More than 63 percent of the District's financial expenditures in fiscal year 2008 were used to pay for ongoing litigation.
- The District had been without a general manager since January 2009.
- The members of the board, who are volunteers, had assumed control of day-to-day business operations, which would normally be delegated to a general manager or professional staff.

Permits for Renewal of Existing/Historic Permits[4]

Although the District had not processed applications for new permits in a timely manner, it did respond promptly to applications for renewals of existing/historic permits. Of the 38 applications to renew existing/historic permits that the District received from May 5, 2005, to July 9, 2009:

- The District determined that the applications were administratively complete[5] within an average of 2.2 days.
- The board approved the renewed permits within 85.2 days.

[4] Auditors did not test permit applications for exempt wells because these wells are exempt from many of the District's permitting requirements.

[5] It should be noted that the determination of administrative completeness for a renewal does not require as much documentation and is more streamlined than the requirements for new permit applications.

Recommendations

The District should:

- Comply with the provisions of the Texas Water Code for the processing of permit applications.
- Monitor its permit application process. This could require developing a system that documents the date and actions taken at each permit application milestone. Increased monitoring could help District management determine whether any applications have been delayed and to identify areas for improving the application process.

Management's Response

The District disagrees that it does not comply with the permit processing provisions of Chapter 36, Water Code. The discussion and diagram utilized by the State Auditor assume no contested case proceedings and that the "public hearing" required by Chapter 36 and the District rules is a single-day event; instead the hearing may be conducted over several days, weeks or even years. Even an uncontested application may be heard by the district on several different dates by continuing the public hearing to obtain additional information or reach compromises that will avoid a contested case.

The State Auditor is correct that some permit applications have not met the required deadlines such as the few applications that have not been reviewed for administrative completeness. The District appreciates the State Auditor's recognition that nearly two-thirds of the District's resources are spent on litigation (both defending suits in District court and conducting contested case hearings) instead of the important work administering the business of the District. Although the new District rules do not include the deadlines required by Chapter 36, Water Code, that does not change the law: the Chapter 36 requirements and deadlines still apply and the District will adhere to those deadlines accordingly. Clearly the District must find a way to do a better job processing permit applications.

The District will:

- *Implement a permit processing monitoring report, listing all active applications and where they are in the process.*

Chapter 3-B

The District Did Not Complete Statutorily Required Annual Audits of Its Financial Condition

As noted in Chapter 1, as of June 30, 2009, the District had not completed financial audits for fiscal years ending September[6] 2007 and 2008, even though Texas Water Code, Section 36.153, requires the District to have an annual audit conducted of its financial condition. In addition, as of June 2009, the District's prior external auditor still needed to reissue its 2006 financial audit report.

On September 10, 2009, the Commission on Environmental Quality granted the District an extension until June 30, 2010, to:

- Complete its fiscal year 2007 and 2008 audits.
- Reissue a dated fiscal year 2006 audit.
- Produce management and auditor communications concerning the qualified opinion from its fiscal year 2006 audit.

The District's former external auditor is reissuing the District's 2006 audit because the auditor did not date the final report. In addition, the fiscal year 2006 report issued a qualified opinion (see text box in Chapter 1 for definition) stating that "it was impractical to confirm accounts receivable as of September 2006, and we have not been able to otherwise satisfy ourselves as to account balances at that date." In a letter dated July 6, 2009, the Commission on Environmental Quality directed the District to take all necessary corrective actions so that its 2010 fiscal year audit will be unqualified. To do that, the District hired an external audit firm in October 2009 to conduct the financial audits for fiscal years ending 2007, 2008, and 2009.

Recommendations

The District should adhere to annual financial reporting requirements that include reissuing its 2006 audit report and complying with the extended deadlines for its fiscal year 2007 and 2008 audits. To meet these requirements, the District should consider:

- Developing a schedule for specific milestones in its annual audit process.
- Monitoring whether it is meeting target deadlines to identify problems that may require board action and to facilitate the timely completion of the annual financial audits.

[6] The District's fiscal year is from October 1 through September 30.

Management's Response

The District will:

- *Complete the ongoing audits for fiscal years 2007 and 2008.*
- *Complete the audit for fiscal year 2009 as agreed with the staff of the Texas Commission on Environmental Quality.*
- *Contract with an accounting firm to review and correct bookkeeping entries on a quarterly basis, which will make it possible to ensure timely completion of all future audits.*

Chapter 3-C

The District Did Not Adequately Monitor Water Usage by Permitted Wells

The District has a process to ensure that permittees submit required pumpage reports, which document the amount of water withdrawn during a specified time period (see text box). For each permittee that had not submitted a pumpage report by the January 31 due date, the District sent a certified letter that stated what the permittee needed to do to be in compliance, set a deadline for submitting the missing information, and warned of potential sanctions for failing to comply. A review of the board meeting minutes from September 2005 through August 2009 showed that the board discussed this action and approved these letters.

Rules of the Kinney County Groundwater Conservation District

Section 18.02, Annual Groundwater Pumpage Report: Before January 31 of each year, each permittee and each applicant for an existing and historic use permit must submit to the District a report on a form provided by the District stating the following:

A. Name of the permittee.
B. The well number(s).
C. The total amount of groundwater produced by the well or aggregate system during each separate month of the immediate preceding calendar year.

However, the District did not ensure that permittees with multiple wells submitted complete pumpage reports that accounted for the pumpage from all wells covered by their permits. Even though the District's files identified 107 individual wells as of March 26, 2009, the District had pumpage reports for only 66 (62 percent) individual wells. The pumpage reports either did not identify all the wells associated with a single permittee or the pumpage reports were missing for the remaining 41 wells.

According to a one board member, if the District does not receive a pumpage report, it assumes that the permittee had no water usage to report. However, the District does not verify this. Without adequate monitoring and ensuring that permittees account for water usage for each well, there is an increased risk that permittees may pump more water out of the aquifers than is authorized, which may have a long-term negative effect on the area's water sources.

Recommendation

The District should ensure that it verifies accurate permitted water usage for each well.

Management's Response

The District has had to set priorities for all the work to be done, and verifying pumping amounts is necessarily toward the bottom of that list. That does not mean it is not important, only that it is not AS important as getting permits issued, reviewing and amending rules, investigating aquifer conditions, and maintaining the files and finances of the District. It must also be noted that the majority of permittees are agricultural permits that are not currently pumping any groundwater. Reports were not filed for 41 wells that have already been reported to the District as having been capped. One would have to review every permit file to find that information; it is not included in the annual pumping report files and could be better documented with the pumping reports. However, until demand increases it is not cost effective to verify, in person, that wells are not being pumped.

The District will:

- *Investigate contracting with a neighboring groundwater conservation district for field services such as inspecting wells and reading well meters.*
- *Create an electronic database of all known and permitted wells that notes the status of each well (operating, capped or plugged) and the reported annual pumping. This will ensure all operating wells file pumping reports each year.*

Chapter 3-D

Although Board Members Regularly Recused Themselves When a Potential Conflict of Interest Existed, the District Did Not Ensure That All Board Members Properly Disclosed Potential Conflicts of Interest

The District did not ensure that all board members disclosed potential conflicts of interest in an affidavit as required by the Texas Local Government Code. Specifically:

- One of three board members who had not submitted a conflict of interest affidavit should have declared a spousal interest in property.
- One board member's affidavit did not identify a family property that should have been disclosed.
- Another board member's affidavit did not identify property that has water permits in which the board member had a substantial business interest.

Requiring all members of the board to file and regularly update a conflict of interest disclosure form could minimize the appearance of conflicts of interest and help add transparency to the District's processes.

Texas Local Government Code, Section 171.004, requires District board members, as local public officials, to file an affidavit stating the nature and extent of potential conflicts of interest and to abstain from participating in votes or decisions in which a conflict of interest may exist. The District's bylaws also require that each board member "disclose any conflict of interest with matters pending before the board and shall refrain from participation in the discussion or decision on such matters." However, bylaws do not require board members to update their affidavits as changes arise.

The District's board meeting minutes from September 2005 through August 2009 show that board members did recuse themselves from votes or board actions in which they might have an interest in the outcome. Also, auditors did not identify any inappropriate actions to benefit individual board members in any of the permit files, conflict of interest affidavits, and meeting minutes reviewed.

Recommendations

The District should ensure that all board member conflict of interest affidavits are on file and accurate. To do this, the District should consider:

- Adopting a policy requiring all board members and the District general manager to file a conflict of interest affidavit.

- Requiring all board members to regularly update the forms whenever applicable changes occur, such as changes in business interests, property ownership, or any other interest affected by groundwater permits.

Management's Response

The District already has a conflict of interest policy that matches the requirements of the Local Government Code, but will review that policy and ensure that all Board members are aware of the requirement to file conflict of interest affidavits. Board members will be expected to review each Board agenda and file a conflict of interest affidavit prior to the meeting whenever a conflict exists in addition to abstaining from the deliberations and vote on that matter.

Chapter 3-E

The District Did Not Retain Minutes for All Public Board Meetings

The District did not have written minutes for 11 (23 percent)) of 48 regular board meetings held from August 31, 2005, through June 30, 2009. Texas Water Code, Section 36.065, requires the board to "keep a complete account of all its meetings and proceedings and shall preserve minutes, contracts, records, notices, accounts, receipts, and other records in a safe place." Ten of the 11 missing minutes were from meetings held in 2005 and 2006. Since 2006, the District has shown improvement in recording meeting minutes, with only one meeting's minutes missing from 2007 through 2009.

Recommendation

The District should continue its efforts to maintain a complete archive of meeting minutes.

Management's Response

As the State Auditor noted, all but one of the missing records was from the period prior to the election of the current Board in 2006. The District will continue to ensure that all minutes are kept and adopted in a timely basis, and records kept both physically in the files of the District and electronically, including continuing to make the minutes available through the District's website.

Chapter 4

The District Has Failed to Fully Implement 31 of 32 Prior Audit Recommendations

Implementation Status Definitions

Fully Implemented - Successful development and use of a process, system, or policy to implement a prior recommendation.

Substantially Implemented - Successful development but inconsistent use of a process, system, or policy to implement a prior recommendation.

Incomplete/Ongoing - Ongoing development of a process, system, or policy to address a prior recommendation.

Not Implemented - Lack of a formal process, system, or policy to address a prior recommendation.

The District has fully implemented only 1 (3.0 percent) of 32 recommendations in *An Audit Report on the Kinney County Groundwater Conservation District* (State Auditor's Office Report No. 06-021, January 2006). Specifically:

- Fifteen of 32 (47.0 percent) recommendations have not been implemented.
- Implementation of 16 of 32 (50.0 percent) recommendations was incomplete/ongoing.
- One recommendation was fully implemented. (3.0 percent)

It should be noted that 17 of the 32 recommendations in the prior audit report were directly related to the implementation of a financial remediation plan, which the District has not yet implemented. Eight of those 17 recommendations are not implemented, and the remaining 9 have a status of incomplete/ongoing (see Table 2).

Table 2

Status of Implementation of Prior Audit Recommendations

Recommendation Number	Recommendation	Implementation Status as of June 30, 2009	Auditor Comments
1	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.	Incomplete/ Ongoing	The District does not follow a standard process for documenting all financial decision making. However, it made improvements in some areas. The board must approve all contracting and non-routine purchases. The District has included procedures for contracting and purchase approval in its rules and in resolutions adopted by the board regarding the authority granted to the District's general manager. Although the board met regularly to discuss the budget and approve expenditures, it often did not have sufficient information to make budget decisions or approve expenditures. As a result, many of the meetings were concluded without the board making a decision. Auditors noted improvements in the format and amount of detail provided in the District's financial information beginning in January 2009. In addition, the budget did not contain the elements required by Texas Water Code, Section 36.154. The board approved all contracting decisions tested; however, 3 (33.0 percent) of 9 contracts reviewed were not signed by a board member to execute the contracts. Auditors also noted weaknesses in the financial transactions reviewed (see Chapter 1 for details).
2	The District should act immediately to address its serious financial issues. Specifically, the District should: ▪ Develop and implement policies and procedures to govern financial activities.	Incomplete/ Ongoing	The District has not fully developed and implemented formal financial policies and procedures governing financial activity. However, the District has put in place (1) some policies through its bylaws and (2) rules for purchasing, general manager authority for contracting, and other activities.

Status of Implementation of Prior Audit Recommendations			
Recommendation Number	Recommendation	Implementation Status as of June 30, 2009	Auditor Comments
3	The District should act immediately to address its serious financial issues. Specifically, the District should: ▪ Properly segregate financial duties.	Incomplete/ Ongoing	Although there has been some segregation of duties between the general manager's authority and the approval of expenditures by the board, the District should take additional steps to ensure proper segregation of duties. The District's administrative assistant is responsible for receiving monies, writing receipts, entering transactions into the financial system, making deposits, and reconciling bank statements to the financial system. There was no indication that a secondary review of bank reconciliations was conducted for all 21 months tested.
4	The District should act immediately to address its serious financial issues. Specifically, the District should: ▪ Implement purchasing approval and receipt process for goods and services.	Incomplete/ Ongoing	The board implemented a purchasing approval processes that requires all purchases of more than $500 to be approved by the board prior to payment and competitive bids to be obtained for purchases of more than $1,000. Some board minutes indicated the approval of certain expenditures. Testing of 30 checks showed that the required two board signatures were present on the checks. However, the former general manager purchased a server and software for $4,950 in October 2007 without obtaining competitive bids as required in the District's bylaws. In addition, there was no other evidence that the amount on the invoice for the server and software was actually the amount paid or that the District had received the product described. The total cost exceeded the original payment to the general manager, and there was no indication that the board approved the cost increase.
5	The District should act immediately to address its serious financial issues. Specifically, the District should: ▪ Safeguard assets.	Incomplete/ Ongoing	The District has implemented some processes to safeguard resources against waste, loss, and misuse; however, the District did not consistently and properly safeguard assets. The former general manager reportedly retained possession of some District equipment when her employment ended. Also, District staff did not consistently follow procedures to ensure that checks written to the District are immediately deposited. In addition, auditors found an unsecured check at the District office that had been dated a month prior to the check being found. The District has installed an alarm system in its building, and there is a locked door between the District's office and the building's other tenant.
6	The District should act immediately to address its serious financial issues. Specifically, the District should: ▪ Comply with rules, contracts, and laws.	Incomplete/ Ongoing	The District did not consistently comply with its rules, contracts, and laws. Although the District processed applications for renewals of existing/historic permits in a timely manner, it did not process applications for new permits in a timely manner or in compliance with the time lines required in the Texas Water Code. In addition, one District board member failed to file a conflict of interest affidavit and affidavits from two other board Members were incomplete or inaccurate. However, board members did recuse themselves from votes or board actions in which the members might have an interest in the outcome. Also, auditors did not identify any inappropriate actions to benefit individual board members in any of the permit files, conflict of interest affidavits, and meeting minutes reviewed (see Chapter 3 for more information.)
7-15	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: ▪ Manager's and board members' fiduciary roles. ▪ Compliance with legal, regulatory, and other requirements.	Incomplete/ Ongoing	Overall, the District did not implement or start to develop a remediation plan. In the course of updating some of its processes, the District did implement some changes related to its financial management. Specifically: ▪ The District defined the general manager's authority in Rule 3.01, which limits the general manager's role to the District's day-to-day operations subject to the board's orders. However, auditors identified weaknesses in the board's reporting of conflict of interests. ▪ The District did not always comply with legal, regulatory, and other requirements.

Status of Implementation of Prior Audit Recommendations			
Recommendation Number	Recommendation	Implementation Status as of June 30, 2009	Auditor Comments
	▪ 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.		▪ While the board receives year-to-date budget comparisons during its monthly meetings, as of June 30, 2009, the District had not completed annual financial audits for fiscal years ending September 2007 and 2008. In addition, the District's prior external auditor still needed to reissue its 2006 financial audit. The lack of annual financial audits limits the District's fiscal management and decision-making abilities. ▪ The District has made some improvements in approving expenditures. However, the District does not have timely, accurate, and complete financial information for making management decisions (see Chapter 1 for more information). ▪ The District has not achieved 80 percent of its management plan's objectives. As a result, the District is not operational (see Chapter 2 for more information). ▪ The board approved all nine contracts tested and this approval was noted in the board's meeting minutes. However, as noted above, 3 (33.0 percent) contracts did not contain signatures of the board members to execute the contracts. None of the contracts was signed solely by the general manager, as was reported in the prior audit. ▪ The District has implemented some processes to safeguard resources against waste, loss, and misuse; however, the District did not consistently and properly safeguard its assets. ▪ As noted in Chapter 1, the District has not consistently generated reliable financial data. ▪ As noted in Chapter 1, the District has not been able to communicate useful financial information in a timely manner.
16-19	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.	Not Implemented	The District has not implemented a financial remediation plan. Without a financial plan designed to remediate the District's financial problems, the District risks repeating past mistakes and falling deeper into financial trouble. District management stated that the District will create a plan when the District's financial audits for fiscal years 2007, 2008, and 2009 are completed.
20-23	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.	Not Implemented	The District has not implemented a financial remediation plan.

Status of Implementation of Prior Audit Recommendations			
Recommendation Number	Recommendation	Implementation Status as of June 30, 2009	Auditor Comments
	▪ 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.		
24	The District should develop procedures to ensure that it complies with Texas Water Code and District Rules.	Not Implemented	The District has not complied with its rules for issuing new permits in a timely manner (see Chapter 3 for more information).
25	The District should develop record keeping and retention procedures to ensure that District records are complete, accurate, and available for public inspection as required by statue and district rules.	Not Implemented	The District has not ensured that board minutes are complete, accurate, and available for public inspection. The record keeping in the District's office appeared to be in disarray (see Chapter 3 for more information).
26	The District should create a process for handling objections to hearing reports as a part of its permit process.	Not Implemented	The District did not create a process for handling objections to hearing reports as part of its permit process. Board members stated that they feel this process is already covered in Texas Water Code, Chapter 36, and that a separate process for handling objections to hearing reports is not required.
27	The District should create a process for accepting or rejecting grants, gifts, donations, or gratuities made to or on behalf of the board.	Not Implemented	The District has not implemented a process to address the receipt of grants, gifts, donations, or gratuities.
28	The board should determine what authority is to be delegated to the general manager through resolution to the board.	Fully Implemented	The board identified the authority of its general manager in its rules.
29	The board should provide more oversight of the District.	Incomplete/ Ongoing	As of June 2009, the board was not providing adequate oversight over the District (see Chapters 1 and 3 for more information).
30	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.	Not Implemented	The District has not prepared annual reports for 2008 and 2009 as required by its management plan (see Chapter 2 for more information).
31	The District should comply with its groundwater management plan objectives to download the Palmer Drought Severity Index (PDSI) maps on a quarterly basis and prepare a biannual drought assessment report.	Not Implemented	The District started to retain the PDSI map information as of September 2009 for reporting purposes (see Chapter 2 for more information). The District did not retain any PDSI maps from September 1, 2005, to June 30, 2009.

Status of Implementation of Prior Audit Recommendations			
Recommendation Number	Recommendation	Implementation Status as of June 30, 2009	Auditor Comments
32	The District should comply with its groundwater management plan objectives to annually publish an article regarding water conservation in any of the newspapers that circulate in Kinney County.	Not Implemented	The District issued a newsletter that affirms the District's mission to protect water resources, but the newsletter did not address water conservation.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

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

- Has taken corrective action to address recommendations made in *An Audit Report on the Kinney County Groundwater Conservation District* (State Auditor's Office Report No. 06-021, January 2006).
- Has accounting procedures and controls that:
  - Ensure that it is able to meet its financial obligations.
  - Ensure that accurate, timely, and complete financial information is available for making management decisions.
  - Protect against violations, abuse, and fraud.
- Achieves its management goals and objectives as outlined in its management plan.
- Complies with selected statutes, rules, and regulations.

Scope

The scope of this audit covered all District activity from September 1, 2005, through June 30, 2009. The audit was completed in 3,000 hours, which would have resulted in a total cost of $270,000, at a standard rate of $90 per hour, if the work had been billed to the District.

Methodology

The audit methodology included collecting information and documentation, performing selected tests and other procedures, analyzing the results of the tests, and conducting interviews with District management and staff. This audit did not include a review of the District's information technology or the controls over the information technology.

Information collected and reviewed included the following:

- District financial records, contracts, and bank statements for fiscal years 2005 to 2009 (through June 30, 2009).

- The District's 2008 management plan.
- District board meeting minutes from September 1, 2005, to July 7, 2009.
- District current rules and proposed rules.
- Information from interviews with District staff.
- Information from interviews with staff at the Water Development Board and the Commission on Environmental Quality.
- Information from an interview with the external audit firm that audited prepared the District's fiscal year 2006 financial statements.
- Pumpage reports and permit files.
- Signature authority for the District's existing bank accounts.
- Listing of pending litigation involving the District.

Procedures and tests conducted included the following:

- Tested 30 checks from June 1, 2008, to June 30, 2009, to determine whether the checks had received proper board approval and were handled according to the District's procedures and guidance.
- Tested the District's compliance in 2008 with the objectives and performance standards in its 2008 management plan, which is the District's current management plan.
- Tested nine contracts to determine whether they were properly approved and executed.
- Tested board members' affidavits for conflicts of interest.
- Tested 38 existing/historic use permits and 20 new permit applications to determine whether the District issued permits appropriately.
- Tested 30 asset and 10 liability transactions for fiscal year 2008 and 5 asset and 5 liability transactions for fiscal year 2009 to determine whether the District had asset and liability accounting policies and procedures to ensure accurate, timely, and complete financial information.
- Tested 40 revenue transactions and 30 expenditure transactions for fiscal year 2008 and 5 revenue transactions and 5 expenditure transactions for fiscal year 2009 to determine whether the District had revenue and expenditure accounting policies and procedures to ensure accurate, timely, and complete financial information.

Criteria used included the following:

- Texas Water Code, Chapter 36 (Groundwater Conservation Districts).
- Texas Government Code, Chapters 551 (Open Meetings), 2155 (Purchasing: General Rules and Procedures), and 2254 (Professional and Consulting Services).
- District rules, resolutions, fee schedules, and bylaws.
- District code of ethics and policies related to travel, professional services, and management.

Project Information

Audit fieldwork was conducted from September 2009 through December 2009. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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

- Kathy Aven, CFE, CIA (Project Manager)
- Kelley Bellah, CFE (Assistant Project Manager)
- Ann E. Karnes, CPA (Assistant Project Manager)
- Anthony Patrick
- Jeremy Schoech
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Nicole M. Guerrero, MBA, CIA, CGAP, CICA (Audit Manager)

Appendix 2

District Background Information

The Kinney County Groundwater Conservation District (District) was created by House Bill 3243 (77th Legislature) effective September 1, 2001. The District, whose office is located in Brackettville, issues permits for wells located in zones of the Edwards Trinity Aquifer, the Edwards Aquifer, and the Austin Chalk Aquifer. *An Audit Report on the Kinney County Groundwater Conservation District* (State Auditor's Office Report No. 06-021, January 2006) covered District operations from September 1, 2001, to August 31, 2005. This follow-up audit covers District operations from September 1, 2005, to June 30, 2009.

Texas Water Code, Section 36.0015, specifies that having local groundwater conservation districts is the State's preferred method of groundwater management. This approach gives landowners local control with limited state oversight.

The District had issued 38 existing/historical permits and 2 regular permits as of August 2009. These 38 existing/historic permits were for 107 individual wells.

Two of the seven District board members active as of August 4, 2009, were on the board during the prior audit in 2005. The District has been without a general manager since January 2009.

Appendix 3

District Financial Information for Fiscal Years 2008 to 2009

Auditors did not conduct a financial opinion audit on the financial statements of the Kinney County Groundwater Conservation District (District). Below is a summary of the District's financial information according to the District's financial records from October 1, 2007, to June 30, 2009. The State Auditor's Office can provide limited-to-no assurance that amounts in this report are accurate and complete because the District was not able to provide complete and reliable information. Because of weaknesses identified in the District's accounting procedures and controls, as well as the misclassification of significant accounts in the District's financial records, auditors cannot provide assurance that the information that the District provided to auditors was complete and accurate. The findings, conclusions, and supplemental information in this report are subject to that limitation.

As discussed in Chapter 1 of this report, auditors identified several issues related to the District's financial information. These issues are summarized in Table 3.

Table 3

Errors Identified by Auditors Related to the District's Financial Information [a]	
Description of Error	**Identified Amount Related to the Error [b]**
The District inappropriately recorded a liability as an asset in each fiscal year from 2005 to 2009. As a result, the District may have overstated its assets for fiscal years 2005 to 2009 and understated its liabilities in fiscal years 2005 and 2006. The District paid the liability in 2006.	$6,000
The District's former legal counsel overbilled the District for legal costs related to a permit applicant. The District passed on this overbilled amount to the permit applicant. As a result, the District may have overstated its assets, in terms of cash received, for fiscal years 2008 and 2009.	$2,256
Current District management cannot substantiate the existence of the original transactions that make up the amount listed for Other Current Assets. As a result, the District should determine whether its financial records should be corrected.	$167,863
Liabilities	
The District incorrectly recorded a water use fee as a revenue transaction in fiscal year 2006. This fee should have been classified as a liability in each fiscal year from 2006 to 2009; as a result, the District may have understated its liabilities in fiscal years 2006 to 2009.	$109,980
The District's former legal counsel overbilled the District for legal costs. As a result, the District may have overstated its liabilities (accounts payable) in fiscal year 2008.	$170
Revenues	
The District misclassified expenses that the District incurred for legal services and other costs as revenue transactions. As a result, the District may have overstated its revenues in fiscal year 2009.	$14,973
Expenses	

Errors Identified by Auditors Related to the District's Financial Information [a]	
Description of Error	Identified Amount Related to the Error [b]
The District's former legal counsel overbilled the District for legal costs. As a result, the District may have overstated its expenses for fiscal years 2008 and 2009.	$2,742

[a] These are issues that auditors identified during testing of the District's financial records and may not include all errors or other issues related to the District's financial records. Auditors identified other less significant issues during testing that are not reported in this table.

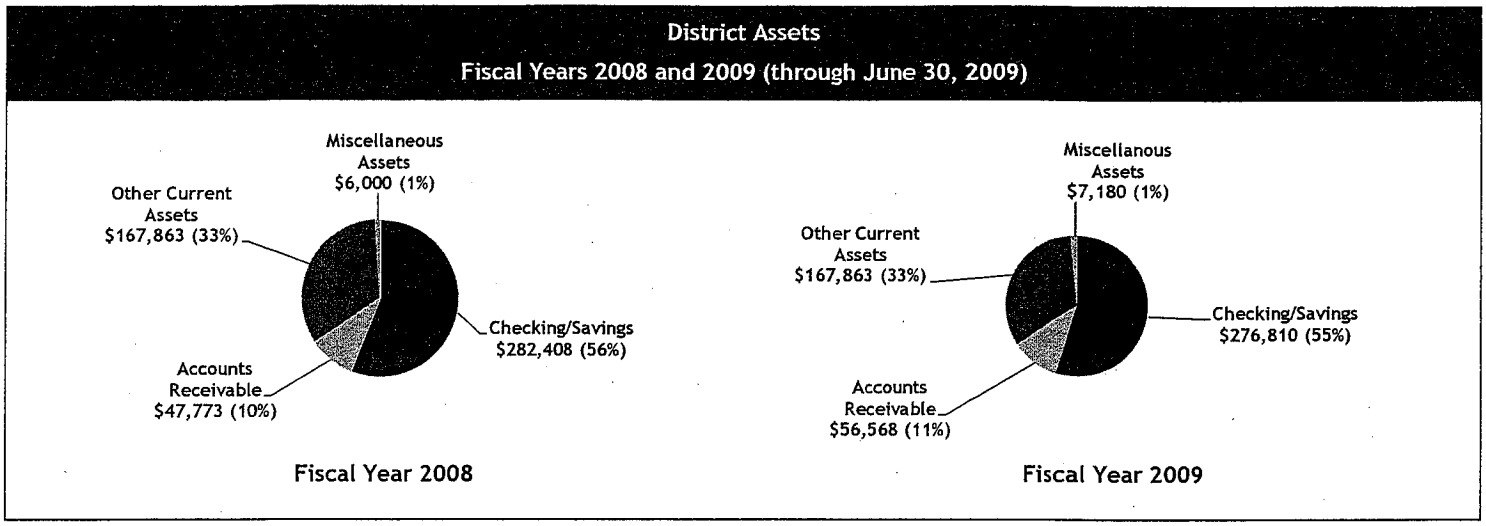
[b] The amounts in this table are the totals for the errors that auditors identified during testing and may not reflect the total amount of actual errors in the District's financial information. These amounts also do not reflect the adjusting entries to the District's fiscal year 2006 financial records identified by the District's external audit firm.

Below is a summary of the District's financial information by category and type of transaction, according to the District's financial records. Auditors found the financial information provided by the District was not sufficiently reliable to accurately determine the financial condition of the District. However, auditors used the information to provide descriptive and summary information.

Assets

Figure 2 on the next page shows the breakdown of the District's reported assets for fiscal years 2008 and 2009. More than 80 percent of the District's checking/savings accounts consisted of an escrow account for a single permit applicant. In addition, the District cannot substantiate the amount listed for Other Current Assets in fiscal years 2008 and 2009 (see Chapter 1-A). The District did not record any Accounts Receivable until February 2008.

Figure 2

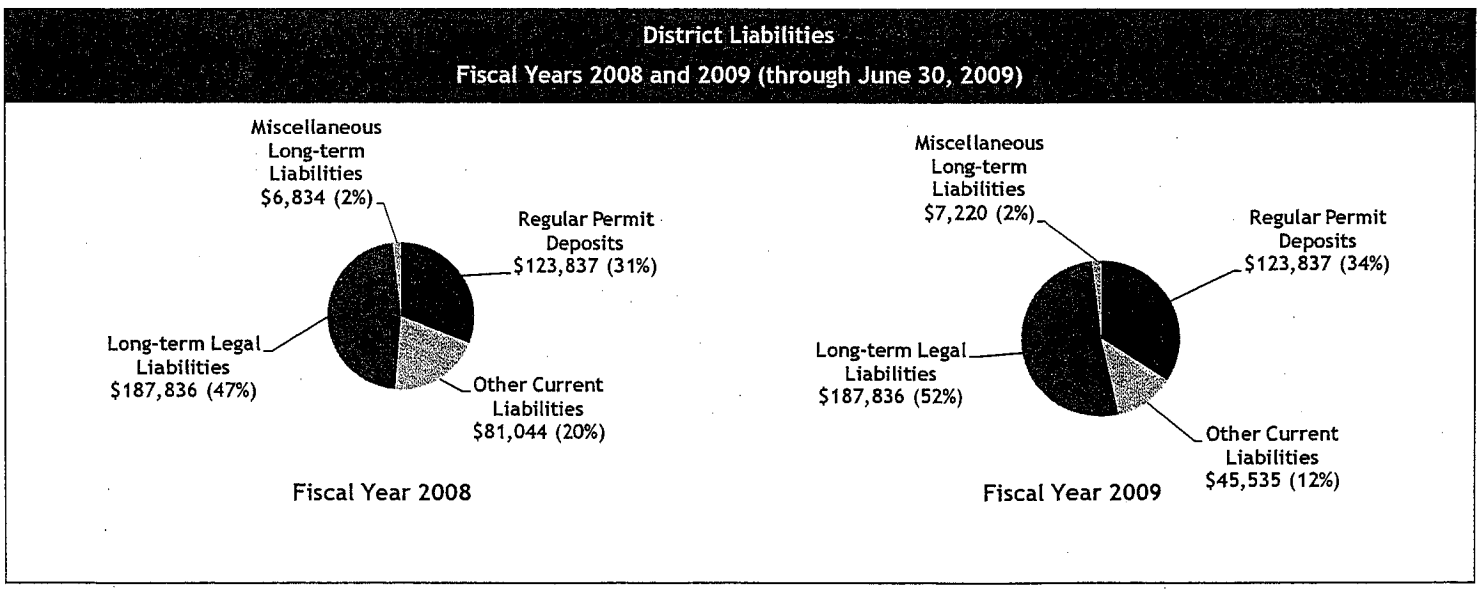


Source: District's financial records for fiscal years 2008 and 2009.

Liabilities

Figure 3 shows the breakdown of the District's reported liabilities for fiscal years 2008 and 2009. The Long-term Legal Liabilities listed in fiscal years 2008 and 2009 represents legal expenses that the District incurred in or before fiscal year 2005. The District made some payments to reduce its Liabilities balance in fiscal years 2006 and 2008. Regular Permit Deposits are deposits related to a permit application that must be returned to the applicant if the permit is not approved. More than 93 percent of the Regular Permit Deposits in fiscal years 2008 and 2009 were related to one applicant.

Figure 3

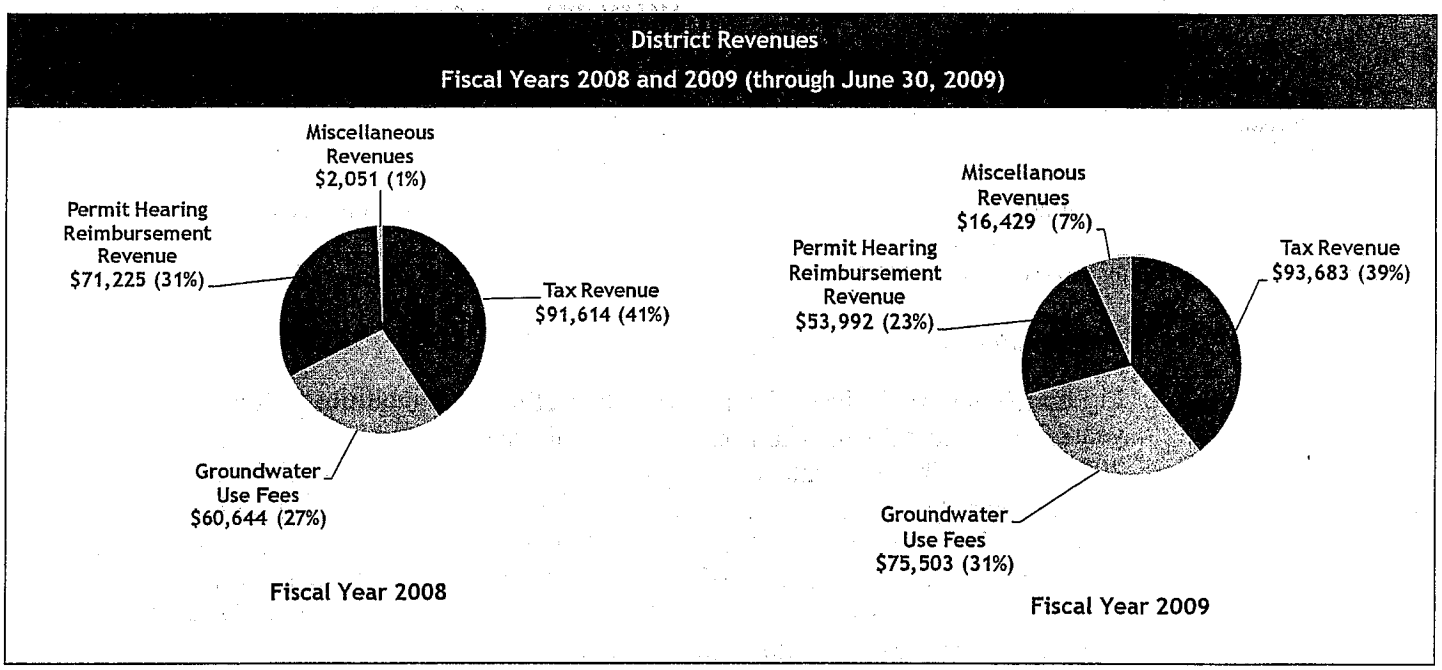


Source: District's financial records for fiscal years 2008 and 2009.

Revenues

Figure 4 shows the breakdown of the District's reported revenues for fiscal years 2008 and 2009. Permit Hearing Reimbursement Revenue for fiscal years 2008 and 2009 were primarily funds the District received from applicants for legal services. Tax Revenue was based on a tax rate of $.0592 per $100 for fiscal year 2008 and $.0612 per $100 valuation for fiscal year 2009.

Figure 4

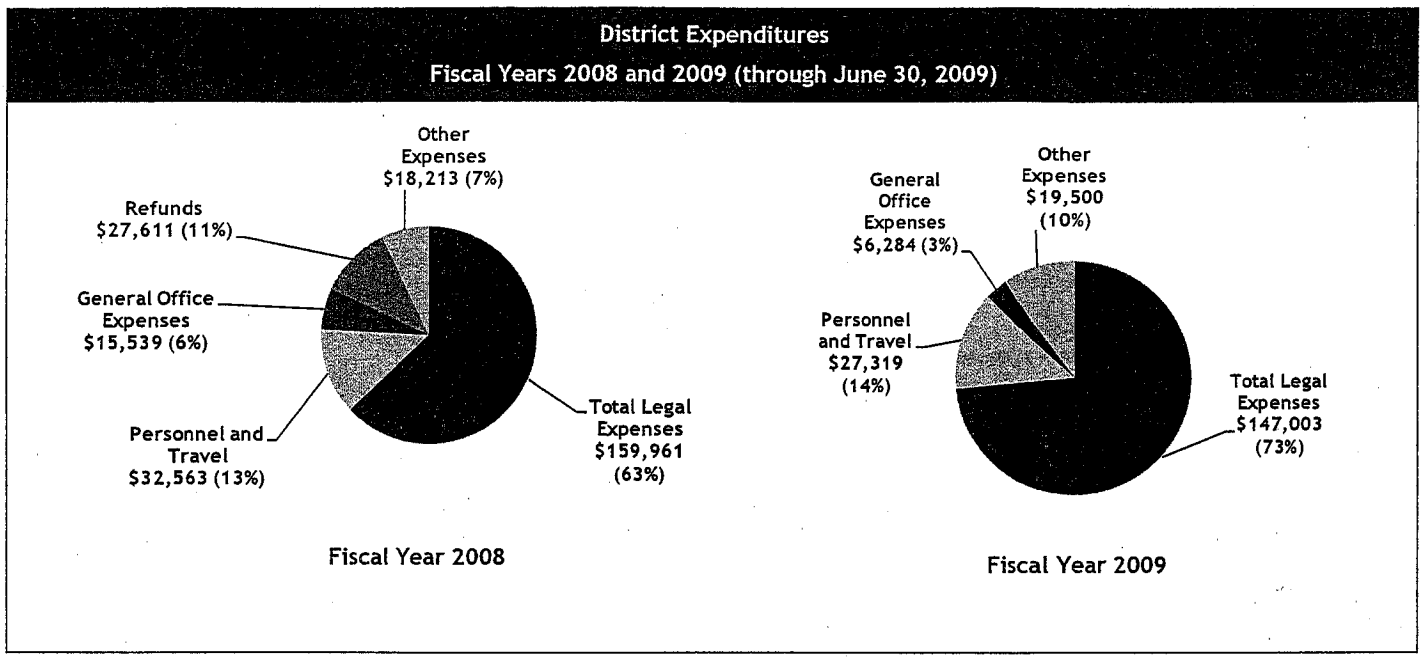


Source: District's financial records for fiscal years 2008 and 2009.

Expenditures

Figure 5 shows the breakdown of the District's reported expenditures for fiscal years 2008 and 2009. Total Legal Expenses for fiscal years 2008 and 2009 were paid largely to one legal counsel. Refunds for fiscal year 2008 were related to the settlement of a lawsuit. General Office Expenses contained a total of $1,200 in rent payments for each year, but they contained minimal, if any, utility payments.

Figure 5



Source: District's financial records for fiscal years 2008 and 2009.

Appendix 4

Management Letter from External Auditors Regarding the District's Fiscal Year 2006 Financial Statements

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To the Board of Directors of Kinney
County Groundwater Conservation District

In planning and performing our audit of the financial statements of the governmental activities of Kinney County Groundwater Conservation District (the District) as of and for the year ended September 30, 2006, in accordance with auditing standards generally accepted in the United States of America, we considered the District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Our Independent Auditor's Report was Qualified due to scope limitations, being we were not able to perform procedures necessary due to lack of adequate internal controls. Accordingly, we no not express an opinion on the effectiveness of the District's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing the assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency , or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiencies to be significant deficiencies in internal control.

Not all of the minutes of the Board of Directors were maintained or available, therefore there is no assurance regarding the discussion that may have taken place at a meeting of the Board and likewise, no assurance regarding official actions of the Board that may have had a financial impact.

The general ledger was not maintained. Continued neglect of the general ledger will not only continue to cause delays in the financial statements, but will allow for possible irregularities, including fraud, to exist and continue without timely detection.

Currently, employees who are responsible for cash functions also prepare the bank reconciliations. This provides an ineffective system of cash control, because it permits the possibility of fraudulent activities due to the lack of an adequate segregation of duties. Also, bank reconciliations were not always reconciled to the general ledger in a timely manner, with several months being reconciled at one time.

We noted that there are no standard procedures for receiving payments at the office. This is a severe weakness in internal control and should be remedied as soon as possible.

There was no support of the accounts receivable balance, the additions to or payments on the accounts leading to the inability to determine accurate accounts receivable balances. There was inadequate documentation procedures for transactions that may have occurred, a lack of reconciliation, inadequate filing procedures of bank deposit slips and other documentation, and inadequate review for cash receipts. This lack of control led to the inability to determine accurate accounts receivable balances.

The District maintains very informal controls over the billing procedures. We were not able to verify if all of the attorneys fees that could have been charged to users were ever billed or if all of the user fees were billed.

There is no reconciliation of accounts payable to the general ledger. Original invoices for some of the items selected for expense testing were unable to be provided. This deficiency was the result of the overall lack of fiscal management at the District during the period under audit.

This communication is intended solely for the information and use of management, Board of Directors, and others with the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Schuler & Schuler

Schuler & Schuler
Certified Public Accountants

May 22, 2009

Kinney County Groundwater Conservation District
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Fax (830) 563-9606

February 8, 2010

Ms. Kathy Avens
State Auditor's Office
Robert E. Johnson Bldg.
1501 N. Congress Ave.
Austin, TX 78701

Enclosed please find the management's response to the last State Auditor's report.

Dr. Kent Lowery
President
KCGCD Board of Directors

Encl.

Management Response to the State Auditor's Office Follow-up Audit Report on the Kinney County Groundwater Conservation District

The Kinney County Groundwater Conservation District ("District") has been in operation since 2001. The District's proximity to the City of San Antonio and sharing management of the Edwards Aquifer with the Edwards Aquifer Authority present a number of challenges, including contentious debates over available groundwater supply, permit issues, and district operations. The District has endured turnover in Directors and General Managers along with multiple lawsuits and contested case hearings on permits. All of these factors have combined to inhibit the District's ability to implement consistent policy and management of the District's affairs.

The Auditor's report is essentially correct. Over the last five years the District has failed to meet all of its Management Plan objectives, failed to establish strong accounting procedures and perform audits, and failed to achieve the audit recommendations from the 2005 audit. The District has, however, made a lot of progress towards addressing each of these problems. The District's auditor is currently working on audits for fiscal years 2007, 2008 and 2009. The District officers, on their own time with no compensation (See § 8846.056, Special District Local Laws Code), completely reorganized the District records and completed filing records all the way back to 2004. The District Treasurer also organized and corrected financial records for the last 5 years both to provide complete answers to the State Auditor and the District's auditor, and to better ascertain the District's current financial situation. In addition, the Board has formulated a **2010 Plan of Action** (attached) that will rectify each of the deficiencies cited and implement each of the recommendations from the State Auditor. While many of the problems have already been addressed since the audit in September 2009 there are still a number of objectives that must be met and financial issues to be addressed.

Although most of the District's failures are directly attributable to the lack of professional management, there is no doubt the buck stops with the elected Board of Directors. Only two of the current seven directors were serving on the Board when the original 2005 audit was completed by the State Auditor's Office. The new Board members inherited all the problems listed in that audit report along with the massive debt incurred by the previous board. The current Board has addressed a number of problems, including:

1) Settled a long-standing and expensive lawsuit with 16 permit applicants (unfortunately 3 new litigants are attempting to intervene in that lawsuit to undo the settlement);
2) Adopted the current management plan in 2008;
3) Participated in joint planning through Groundwater Management Area 10;
4) Adopted new rules to better address the aquifer conditions found in Kinney County;
5) Completed a long-standing and expensive contested case hearing (which is now being appealed to District Court);
6) Issued 39 permits for Existing and Historic Use;
7) Issued over 120 permits to drill new wells since October 2005;
8) Issued 2 Regular permits for new use; and
9) Switched from a manual to an automatic financial software invoicing system that allows the District to accurately track incoming payments (or lack thereof) and generates timely reminder letters and past due statements.

Financial Issues

When the District was first formed in 2001 the Board called for a confirmation and tax authorization election. Both passed, granting the District authority to assess property taxes at a rate not to exceed 10 cents per $100 of property valuation. The first tax rate set by the Board was 5 cents, or one-half the authorized rate. The current tax rate is 6.46 cents per $100 valuation. The property tax rollback provisions

limit the District to tax rates that will increase the revenues by no more than 8 percent per yer. Assuming property values in the District inflate at a rate of 4% per year (the average increase over the last 8 years), and assuming the District increases the tax rate at the maximum allowable without incurring a rollback election,[1] it will take the District until 2021 to reach the maximum 10 cent tax rate. At the current tax rate property taxes account for $106,000 of the District's revenue. The District also charges production fees as authorized by § 36.205, Water Code, and those fee rates are already set at the maximum. The production fees produce approximately $70,000 in annual revenue. The current budget allows only $6,000 toward debt retirement on debt in excess of $240,000. If the District can manage to reduce its legal costs by $10,000 under the FY 2010 budget and continues to increase revenues at the maximum rate, the full debt should be paid in 10 years[2]. If the original tax rate had been set at the maximum, or if the District could tax the maximum rate this year, the District would bring in an additional $60,000 in tax revenues and could pay off the debt in under four years.

The combination of the low tax rate set by a prior Board, along with the statutory limitations on increases in that tax rate, and the large debt inherited by the current Board present an almost insurmountable financial burden.

Litigation

At the moment the District is defending against 5 separate lawsuits. The original lawsuit filed by 16 permit applicants (*Boulware et al v. Kinney County Groundwater Conservation District*, Cause No. 3469, 63rd Judicial District) reached a settlement, but three new interveners[3] have prevented the District Court from approving that settlement agreement. The other lawsuits were all filed in 2009:

1) *Willy Jo Dooley, L.P. v. Kinney County Groundwater Conservation District*, Cause No. 3850, 63rd Judicial District. This suit seeks a writ of mandamus requiring the District to accept applications filed by Mr. Dooley without the correct application fees and filed during a moratorium on accepting new applications. The suit also seeks a declaration that the applications, once accepted, be processed under the old District rules instead of the new rules adopted in fall of 2009.

2) *John C. Hagee Royalty Trust v. Kinney County Groundwater Conservation District*, Cause No. 3872, 63rd Judicial District. This suit seeks declarations that would: require the District to reinstate the plaintiff's expired permits; hold § 36.1131(b)(3), Water Code, unconstitutional; rule the District's deadlines are unconstitutional; prohibit the District from imposing a moratorium on new applications while considering substantive rule changes; hold § 36.066(g) Water Code, unconstitutional; and reinstate the expired permits.

3) *Grass Valley Water, L.P. v. Kinney County Groundwater Conservation District*, Cause No. 3859, 63rd Judicial District. This suit is an appeal of the District's denial of the Plaintiff's permit applications. The suit also seeks declarations that the District's rules are ultra vires, that the District is not authorized to require applicant's to pay the District's legal costs in processing their applications, that the District may not require payment of production fees prior to issuing a permit, and that § 36.066(g), Water Code, is unconstitutional.

---

[1] The tax revenues for 2009 were a little over $110,000; a rollback election would likely cost the district more than the entire increase would net.

[2] This calculation assumes no increase in other costs to the District, paying no interest on the debt, and averaging $23,000 in debt payments each year.

[3] The interveners are: Prototype Machine Company, Grass Valley Water, L.P., and John C. Hagee Royalty Trust.

4) *Grass Valley Water, L.P. v. Kinney County Groundwater Conservation District*, Cause No. 3879, 63rd Judicial District. This suit challenges the new District rules adopted in the fall of 2009.

All of the lawsuits ask the District Court to award the plaintiff's their attorney's fees, and the appeal filed by Grass Valley Water, L.P. (No. 3 above) also asks the Court to order the District to return payments of $135,000 plus interest.

Although the District believes it will either prevail or find a mutually agreeable settlement in all of the above lawsuits, each suit represents a potential financial drain on the District's already depleted coffers. Even if the District prevails and the Court orders payment of the District's attorney's fees and other court costs, there are no guarantees the District will be able to collect those amounts from the plaintiffs. There is also the very strong likelihood that the plaintiffs will appeal any adverse decisions, further extending both the uncertainty and associated costs with defending the appeals.

As mentioned above, even when the District makes an attempt to find a "middle ground" and settle a dispute, others intervene, prolonging the litigation. (See *Boulware et al v. Kinney County Groundwater Conservation District*, Cause No. 3469, 63rd Judicial District.)

Management

The District has also suffered from a lack of professional management. The original General Manager left the position shortly after the election of the new board in 2006. It took several months to fill the position, and there were no applications received from anyone with groundwater conservation district experience. Although the District has contracted with General Managers of nearby districts, those relationships were very short-lived and ultimately just a stop-gap measure. The Board bears the responsibility for hiring the new General Manager in 2007, and the audit correctly states that was a bad decision. The Board is looking for a new General Manager by: placing ads in area newspapers, the San Antonio Express news, and various Texas websites; working with the consulting firm of Kay Kutchins & Associates, Inc. as a "headhunter" to find appropriate candidates; and contacting groundwater conservation district professionals throughout the state. So far there are, again, no applications from anyone with the necessary professional experience, or even something close. The District currently operates through volunteer help from the Directors and one part-time employee, along with a management consulting contract with the District's General Counsel who has District management experience. The Board is consider increasing the proposed salary for the General Manager position—though there are obviously budget constraints—and will consider any and all options available to obtain professional management for the District.

The lack of a professional manager has led to a number of problems, especially that the District did not have anyone who could prepare proper monthly and annual reports and implement the various goals of the District's Management Plan. The 2008 Management Plan sets a number of performance standards for the General Manager to report in an Annual Report to the Board; no reports were filed both when the District had a General Manager and of course when the position is vacant. Although the Board remains ultimately responsible, the lack of professional staff prevented the District from achieving those goals in the past. The **2010 Plan of Action** addresses how the Board will directly address this situation in the immediate future.

The Board has already taken the following action to make operations of the District more professional and in accordance with the requirements of Chapter 36, Water Code and other laws governing the District.

1) Contracted with an attorney to perform a compliance audit of the District to determine where the current plans, rules and policies are deficient and recommend changes.

2) Contracted with an auditor to conduct financial audits for Fiscal Years 2007, 2008 and 2009.

3) Provided all Board members with copies of **Code of Ethics and Accounting Policies and Procedures.**

4) Obtained funding from the San Antonio Water System for a United States Geologic Survey study of Kinney County aquifers.

5) Conducted a workshop with Dr. Robert Mace, Deputy Executive Administrator, Water Science & Conservation Division (TWDB), Dr. Bill Hutchison, Director for Groundwater Resources, Water Science & Conservation Division (TWDB), and Caroline Runge, representing GMA7 to discuss the process for setting a Desired Future Condition for GMA10.

6) Conducted a workshop with Michael Chadwick, Senior Geologist Groundwater Planning & Assessment of the Water Supply Division (TCEQ) and Debi Lockerman, Certified Public Accountant District Review of Water Supply Division (TCEQ) to discuss the district audits.

7) Adopted new rules to better address the aquifer conditions in Kinney County.

8) Created a system to log all Public Information Act requests as they are received to ensure a timely response.

9) Established meeting rules that require all District meetings to be conducted under Robert's Rules of Order following strict parliamentary procedure to ensure fairness to all Directors and to all visitors attending.

10) Adopted new Personnel Policies & Procedures that require a complete background check and drug test prior to employment. Interview requirements and procedures have been updated as well.

11) Purchased adequate secure storage for all District records to ensure privacy and to increase efficiency.

12) Inventoried all District equipment and numbered all inventoried items.

13) Created a complete Policies & Procedures Manual and as policies are written or revised then approved by the Board they are incorporated into this manual, which will be maintained at the District office.

The Board of Directors is dedicated to addressing all the problems raised in the State Auditor's report, and will make the process of bringing the District into compliance as transparent as possible.

Kinney County Groundwater Conservation District
2010Plan of Action

A) Financial
   1) Complete overdue Financial Audits.
   2) Contract with a bookkeeping firm to:
      a) Repair and reconstruct the financial records for prior years.
      b) Establish proper bookkeeping procedures for current and future years.
   3) Adopt management policies that provide for:
      a) Recording accounts payable and accounts receivable.
      b) Property invoicing and crediting permit accounts.
      c) Performing bank reconciliations.
      d) Establish hiring practices that include background checks.
      e) Provide director oversight of staff and contractor activities.

B) Management Plan
   1) Complete, through contractors, annual reports for 2008 and 2009.
   2) Prepare a Plan of Action to complete the objectives of the Management Plan no later than December 31, 2010.

C) Processing Permits
   1) Compile a report/database of all pending applications, including those waiting a determination of administrative completeness, those in hearings and those ready to be issued.
   2) Prepare a priority plan of action to address the permit application backlog.
   3) Process existing applications, to the extent possible and subject to contested case hearings.

D) Compliance Audit
   1) Review all district rules, policies and procedures to ensure:
      a) The adopted rules, policies and procedures conform to state and federal law; and
      b) All state and federal laws are covered by the existing rules, policies and procedures.
   2) Either amend inadequate rules, policies and procedures or draft and adopt additional rules, policies and procedures.

E) Audit Recommendations
   1) Review both the 2005 and 2009 audits with the Board of Directors
   2) Prioritize the list of recommendations
   3) Set milestones to accomplish the recommendations during FY 2010
   4) Set deadlines for the prioritized recommendations and milestones
   5) File monthly reports on milestones reached

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The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas "Tommy" Williams, Member, Texas Senate
The Honorable Jim Pitts, House Appropriations Committee
The Honorable Rene Oliveira, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Kinney County Groundwater Conservation District Board of Directors

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