

GENERAL FINANCIAL GUIDANCE

Every year, each water district and authority must complete a report on its financial status. The type of financial report that your district is required to prepare depends upon your district's financial activity.

This *Water District Financial Management Guide (Guide)* provides standards for a typical district to follow when preparing and reporting on its annual activities. While the information and examples contained in the *Guide* are focused on a **small general-law single-purpose district that provides retail water and wastewater services and uses only governmental fund accounting**, this *Guide* is applicable to all districts, including large, multipurpose entities that use proprietary fund accounting. If your district's operations are complex or if your district uses proprietary fund accounting, you may need to adapt the *Guide* to fit your district's needs.

The *Guide* replaces both the *Water District Accounting Manual (WDAM, publication RG-80, 1995 Edition)* and the *Annual Audit Report Requirements of Texas Water Districts and Authorities (AARR, publication RG-81, 1995 Edition)*.

Purpose of This Guide

The *Guide* is designed to:

- Provide minimum standards for maintaining your district's fiscal records to comply with *Texas Water Code (TWC)* Section 49.196.
- Provide a reference source for your district when establishing its accounting system to meet your district's management needs.
- Provide the *Texas Commission on Environmental Quality's (Agency)* reporting requirements.
- Provide a reference source for your independent auditor who must evaluate and report on your district's internal control system.
- Instruct your district and its auditor on how to comply with the annual audit requirements of TWC Chapters 49 or 36 and the Agency's *Texas Administrative Code* Section (Rule) 293.94.

Districts Subject to This Guide

This *Guide* applies to all districts and authorities created under the Texas Constitution in either Article 3, Section 52 or Article 16, Section 59 [defined as a "conservation and reclamation district"] that must comply with TWC Chapter 49. We have not granted any exceptions to this *Guide's* applicability.

The Texas Legislature (Legislature) has defined the terms “water district” and “district” we use in this publication in TWC Section 49.001. While that definition does not include a navigation district or port authority, TWC Section 60.002 does require a navigation district to follow this *Guide*. The definition in TWC Section 49.001 excludes a Groundwater Conservation District (GCD) or Municipal Management District (MMD); however, those districts may choose to use the *Guide* to enhance their financial reporting responsibilities. To find laws specific to GCDs and MMDs, look under “Exempt from TWC Chapter 49” in the table on page O-6 in **Appendix O**.

Review Rule 293.94(e) and (f) and the *Guide’s Audit Report Requirements* section on page 3-1 for information on the statutory exceptions granted by the Legislature to preparing an audit.

When we refer to your *Board of Directors* (Board), we are referring to the district’s elected or appointed directors, commissioners, or supervisors who have been charged with the responsibility for guiding the district in fulfilling the needs for which it was created.

When we refer to your district’s *management*, we are referring to your district’s Board of Directors, even though they may have delegated some duties to the general manager or other district staff.

When we refer to your district’s *audit report*, we are referring to the complete audit report package, which may contain the following items in this order of presentation:

- the notarized filing affidavit
- your auditor’s opinion letter
- your Board’s discussion and analysis
- the district’s basic financial statements
- the notes to the financial statements
- the required supplementary information
- our supplementary information, if required
- the auditor’s management letter, if required

Legal Status of This Guide

Accounting Principles

TWC Section 49.192 requires your district’s financial statements to be prepared according to *generally accepted accounting principles* (GAAP) as adopted by the *American Institute of Certified Public Accountants* (AICPA).

The phrase *generally accepted accounting principles* is a technical accounting term that encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. It

includes not only broad guidelines of general application, but also detailed practices and procedures. Those conventions, rules, and procedures provide a standard to measure financial presentations.

Your auditor's opinion is based upon his judgment of whether:

- the accounting principles selected and applied have general acceptance
- the accounting principles are appropriate in the circumstances
- the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation
- the information presented in the financial statements is classified and summarized in a reasonable manner (neither too detailed or too condensed)
- the financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits (limits that are reasonable and practicable to attain in financial statements).

The determination that a particular accounting principle is generally accepted can be difficult as no single reference source exists. The sources of established accounting principles that are generally accepted in the United States are:

- **Level 1:** Accounting principles published by a body designated by the AICPA's Council to establish such principles (under Rule 203 of the AICPA's Code of Professional Conduct).
- **Level 2:** Publications of bodies (composed of expert accountants) that deliberate accounting issues in public forums for the purpose of establishing accounting principles or describing existing accounting practices that are generally accepted, provided those pronouncements have been exposed for public comment and have been cleared by a body referred to in Level 1 above.
- **Level 3:** Publications of bodies, organized by a body referred to in Level 1 above and composed of expert accountants, that deliberate accounting issues in public forums for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted, or publications referred to in Level 2 above that have been cleared by a body referred to in Level 1 above but that have not been exposed for public comment.
- **Level 4:** Practices or publications that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry or the knowledgeable application to specific circumstances of pronouncements that are generally accepted.

If the accounting treatment of a transaction or an event is not specified in a publication covered by the AICPA's Rule 203, your auditor should consider whether the accounting treatment is specified by another source of established accounting principles.

GAAP Hierarchy Summary

	Nongovernmental Entities	State & Local Governments (Districts)
Established Accounting Principles		
Level 1	FASB Statements and Interpretations, APB Opinions, and AICPA Accounting Research Bulletins	GASB Statements and Interpretations, plus AICPA and FASB publications if made applicable to state and local governments by a GASB Statement or Interpretation
Level 2	FASB Technical Bulletins, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position	GASB Technical Bulletins and the following publications if specifically made applicable to state and local governments by the AICPA: AICPA Industry Audit and Accounting Guides and AICPA Statements of Positions
Level 3	Consensus positions of the FASB Emerging Issues Task Force and AICPA Practice Bulletins	Consensus positions of the GASB Emerging Issues Task Force and AICPA Practice Bulletins if specifically made applicable to state and local governments by the AICPA
Level 4	AICPA accounting interpretations, "Q's and A's" published by the FASB staff, as well as industry practices widely recognized and prevalent	"Q's and A's" published by the GASB staff as well as industry practices widely recognized and prevalent
Other Accounting Literature		
	Other accounting literature, including FASB Concepts Statements, AICPA Issues Papers; International Accounting Standards Committee Statements; GASB Statements, Interpretations, and Technical Bulletins; publications of other professional associations or regulatory agencies; AICPA <i>Technical Practice Aids</i> ; and accounting textbooks, handbooks, and articles	Other accounting literature, including GASB Concepts Statements; publications in Levels 1 through 4 of the hierarchy for nongovernmental entities when not specifically made applicable to state and local governments; FASB Concepts Statements; AICPA Issues Papers; International Accounting Standards Committee Statements; pronouncements of other professional associations or regulatory agencies [in this case, the TCEQ]; AICPA <i>Technical Practice Aids</i> ; and accounting textbooks, handbooks, and articles

The AICPA recognizes the *Governmental Accounting Standards Board* (GASB) as the standard-setting authority for GAAP for state and local governments. GASB has designated the *National Council on Governmental Accounting* (NCGA) Statements and Interpretations issued before the formation of GASB to be the authoritative support for determining GAAP for

state and local governments **unless they have been superseded by GASB statements**.

NCGA Statement 1, Governmental Accounting and Financial Reporting Principles, issued in 1979, became the financial reporting model for state and local governments. When GASB was created in 1984 it agreed to reexamine the financial reporting model. Modifications were made to the model by various GASB statements and a comprehensive revision was introduced in 1999 with the issuance of *GASB Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments* (GASB 34). For more information, refer to the GASB and AICPA publications listed in **Appendix O**.

Water Code

TWC Section 49.192 authorizes this Agency to adopt accounting and auditing manuals. This *Guide* complies with this directive and is intended to be an aid to your Board, its employees, and consultants.

Your district’s Board is responsible for maintaining the district’s accounting system. TWC Section 49.196 requires your district’s fiscal records be prepared on a timely basis and maintained according to GAAP. The *Guide* includes the **minimum** details of an accounting system necessary to comply with that statute.

As this Agency and its publications do not set governmental accounting principles or auditing standards, if there are any inconsistencies with the AICPA’s standards or principles and this *Guide*, then the AICPA’s standards and principles control.

Ultimately, it is your Board’s responsibility, with the help of its contractors, consultants, and auditor, to be aware of and implement changes set forth in the statutes, the Agency’s Rules, GAAP, or *generally accepted auditing standards* (GAAS).

Legal Environment of Districts

General versus Special Law Districts

Districts derive their core powers and duties from either the various chapters of the Water Code (depending upon each district’s type) or special laws enacted by the Legislature. Districts must also follow other laws, including the Election Code, Government Code, Health and Safety Code, Local Government Code, Penal Code, Property Code, and Tax Code (Texas Statutes, **Appendix O**).

General law districts must follow the TWC Chapter under which they were created as well as TWC Chapters 49 and 50 which are applicable to most districts.

Special law districts have been either created by or altered by an act of the Legislature. Each special law district must refer to its enabling legislation as amended to determine its unique powers and duties. In cases of conflict, a district's special law provisions typically overrule the general law provisions (TWC Section 49.002).

When TWC Chapters 49, 50, and a district's general law chapters are silent, a district should refer to the other state laws as well as the district's bond resolutions and other legal restrictions to determine that district's legal circumstances. **This Guide does not provide guidance for legal compliance.** Your Board should contact its attorney who can interpret the laws and other restrictions according to your district's unique situation.

Rule 293.91(b) states that each general law district should comply with the reporting requirements provided in the TWC chapter under which it was created. A special law district may be subject to unique reporting requirements of the special act under which it was created or amended.

Continuing Right of Supervision

TWC Section 12.081 and Rule 293.3 clarify that the powers and duties of all districts and authorities created under the Texas Constitution in either Article 3, Section 52 or Article 16, Section 59 are subject to the continuing right of supervision by the Agency, including but not limited to:

- requiring audits or other financial information, inspections, evaluations, and engineering reports
- issuing rules necessary to supervise the districts and authorities

Financial Requirements

TWC Section 49.051 establishes that a district is governed by its Board.

TWC Section 49.057 makes your Board, not its consultants or employees, responsible for the management of your district's affairs.

Annual Budget

Regardless of whether your district uses governmental fund accounting or proprietary fund accounting, Rule 293.97(b) requires your Board to adopt an operating budget before the fiscal year begins. Additionally, GASB requires your Board to annually adopt a comprehensive operating budget (Codification of Governmental Accounting and Financial Reporting Standards, Section 1700, paragraph 101, "The Budget and Budgetary Accounting").

Amending the Budget. Your Board may make budget amendments from time to time at its discretion. The adopted budget and any subsequent amendments must be passed and approved by a resolution of your Board and must be made part of the Board's meeting minutes.

Is It Appropriated? For general law districts the adopted budget is not a spending limitation (a legally restricted appropriation); however, your Board may adopt rules to limit the spending authority of the district's directors and its general manager. These adopted limitations should be recorded in your district's manual (**District Manual**, page 1-18).

We Do Not Need a Copy of the Interim Budget. While our rules require your Board to adopt a budget for the upcoming year before the start of your district's fiscal year, we do not want or require you to send us a copy of your district's adopted budget. Your district's operating budget, as adopted and as amended, is required to be included in your district's audit report which is submitted for our review.

External Review. If your district provides wholesale potable water and wastewater services, TWC Section 49.200 requires your Board to adopt a program that provides your wholesale customers an opportunity to review and comment on your district's budget as it applies to their services before your Board can adopt the budget.

Purpose of the Budget. Your district's operating fund budget should serve as a planning tool. Depending on the district's development, plans should be implemented to determine your district's growth rate, the age of its facilities, all possible revenue sources, and a method to build a reserve for unplanned expenses.

Who Is Involved in the Budget Process? The following list explains some of the many roles your Board may request of its consultants.

- ***Bookkeeper.*** Coordinates the budget's preparation as he has the prior years' financial information and is responsible for providing the comparisons to your Board.
- ***Attorney.*** Usually works with the district's developer to establish and organize your district. Your attorney has input on alternate funding methods and pending elections or litigation and should be knowledgeable about the many laws affecting districts.
- ***Engineer.*** Has knowledge about your district from its inception and may make recommendations about major repairs and capital improvements.
- ***Operator.*** By working in the district on a daily basis, he has knowledge of pending repairs and system maintenance needs.
- ***Tax Collector.*** Has knowledge of property values in the district if a maintenance tax is needed.
- ***Financial Advisor.*** Should know if the district's operating reserve can support a good bond rating.
- ***Insurance Agent.*** Can provide information on policy coverage.

Selecting a Fiscal Year

TWC Section 49.158 and Rule 293.97 require your Board to adopt by resolution your district's fiscal year within 30 calendar days of becoming financially active. Your Board should consider the following issues when selecting its fiscal year:

- ***The Business of the District.*** Consider the needs of your district's principal business activity and your district's interaction with other entities [the local Agency watermaster, other districts, a primary government (a city), or a component unit].
- ***The Effect on Tax Collection Reporting.*** If the district assesses taxes on October 1, then a September 30 fiscal year end would allow a full 12 months of collections to be reported in your district's audit report.
- ***Your Auditor's Workload.*** Your auditor will have certain months of the year with a very heavy workload (tax season). Your district may want to set its fiscal year end at a date which will allow your auditor to timely perform your district's audit.
- ***Your Bookkeeper's Workload.*** If your district uses a contracted bookkeeping service, your Board should also consider the number of year-end closings that the bookkeeper must complete that month for their clients to ensure that your bookkeeper can be responsive to your auditor's needs.

TWC Section 49.158 allows a district to change its fiscal year end once during a 24-month period. Your Board then has 30 calendar days to notify us of an adopted or changed fiscal year end. If your Board has changed the district's fiscal year, you can prepare and submit a combined audit report to cover a fiscal period not to exceed 18 months.

Customer Deposits

TWC Section 49.212 allows your district to charge a deposit for any services or facilities that it provides. That section also allows your Board to decide whether it will allow the customers' deposit to earn interest at a rate determined by your Board. Most districts have chosen not to pay interest on their customers' deposits.

Your district cannot condition its services to a new customer on the payment of an outstanding charge incurred by a prior customer *unless* a legal relationship between the two customers causes the new customer to be liable for the debts of the other, or unless the new customer had agreed in writing to be responsible for the charges incurred by the previous customer. The prior customer's deposit must be used to recover any amounts owed. If that deposit does not cover the outstanding balance, your district's only recourse is to pursue the nonpaying customer.

We recommend that your Board annually evaluate the district's required deposit to ensure that the current deposit is sufficient to cover a typical

unpaid account or damage to the district's facilities depending upon your district's recent historical experience.

Insurance

There are no general law insurance coverage requirements for a district unless mentioned in your district's protective bond covenants. When considering your district's current coverage, we encourage your Board to annually evaluate your district's:

- potential risks
- financial ability to cover any losses, damage, and/or lawsuits

Bond Coverage

TWC Section 49.055 states that, before beginning to perform the duties of office, each director must execute a \$10,000 bond conditioned on the faithful performance of that director's duties.

TWC Section 49.057 compels your Board to require its directors, employees, and consultants who routinely collect, pay, or handle district funds to furnish a bond, payable to the district in an amount that your Board determines to be sufficient, to safeguard the district's assets. Your Board can also require a bond of its other consultants who do not routinely collect, pay, or handle district monies. That bond must be conditioned on the faithful performance of that person's duties and on the accounting for all of the district's funds and property. Your Board is allowed to pay the premium on the required surety bonds out of any available district funds, including bond proceeds.

Revenue Notes

TWC Section 49.153 and Rule 293.80 require Agency approval on most revenue notes executed by your district for a term longer than three years.

Developer Reimbursement

Rule 293.70 addresses the minimum procedures to be performed by your auditor when preparing his *agreed upon procedures* reimbursement report to the Board. Refer to this *Guide's* **Appendix M** and the **Developer Reimbursements** section of the Accounting Chapter on page 2-26 for more information.

Additionally, Rule 293.95(b) requires all districts to maintain sufficient records to determine the amounts paid by a developer or by any other parties on the district's behalf, including all contingent and actual liabilities. Those third-party payments are required to be disclosed by your district in its audit report, financial report, or financial dormancy affidavit.

Signing Checks

TWC Section 49.151 requires checks, drafts, orders, or other instruments to be signed by either:

- a majority of your district's directors
- the general manager, treasurer, bookkeeper, or other district employee *if authorized by Board resolution*

Unclaimed Property

An unclaimed deposit is not free money for your district. Unclaimed customer deposits and overpayments and employee wages and workers' compensation benefits remain the property of your district's customer or its employee under the Texas Unclaimed Property Law. These deposits, overpayments, and benefits are considered abandoned after a three-year period if there has been no contact from your district's former customer or employee. The Comptroller of Public Accounts is responsible for tracking and maintaining these deposits (Property Code Chapters 72 through 75). See this *Guide's Appendix O* (Texas Statutes) for more information.

Duty to Audit

TWC Sections 49.191 or 36.153 and Rule 293.94 require your Board to have the district's fiscal accounts and records audited each year. The audit must be performed by either a *certified public accountant* (CPA) or a public accountant in good standing with the Texas State Board of Public Accountancy (**Appendix O**). However, a district is exempt from the audit requirement if it meets the criteria for filing a financial dormancy affidavit or an annual financial report (Refer to **Audit Report Requirements** on page 3-1).

Your district's audit report must be completed within 120 calendar days after the close of your district's fiscal year (TWC Section 49.191). This allows your Board 15 calendar days to hold the required board meeting, approve the report, *AND* file the audit report with this Agency (TWC Section 49.194).

Additionally, Rule 293.91 requires your Board to submit a certified copy of any audit report on the district's affairs (other than its annual financial audit under TWC Section 49.191) within 15 days of its completion.

Your Auditor's Opinion

Your auditor will prepare a report on his audited financial statements. The Independent Auditor's Report will contain your auditor's opinion on the district's financial statements taken as a whole. The four audit opinions are:

- unqualified
- qualified
- adverse
- disclaimed

An *unqualified opinion* is commonly called a clean opinion. Your auditor is stating that the district's financial statements fairly present *in all material respects* the district's financial position according to GAAP. Your auditor may also need to add explanatory language to his Independent Auditor's Report on the district's financial statements that do not affect his unqualified opinion.

A *qualified opinion* is used when your auditor must state that, *except for* _____, the district's financial statements fairly present in all material respects the district's financial position according to GAAP. Your auditor might issue a qualified opinion following a natural disaster (flooding of the district's offices and the resulting destruction of the board meeting minutes) because there is a lack of sufficient competent evidential matter that has led the auditor to conclude that he cannot express an unqualified opinion and he has also concluded not to disclaim an opinion. When an auditor expresses a qualified opinion he will disclose his substantive reasons in an explanatory paragraph to the Independent Auditor's Report.

Your auditor will issue an *adverse opinion* when the district's financial statements **do not** fairly present the district's financial position according to GAAP.

If your auditor does not express an opinion on the district's financial statements, by default he is issuing a *disclaimer of opinion*.

The Single Audit Act, OMB Circular A-133, and Federal Grants

The Single Audit Act requires a district with a federal grant in excess of \$500,000 for fiscal periods ending after 12/31/2003 to prepare a "yellow book" audit following *generally accepted government auditing standards* (GAGAS, **Appendix P**). Your Board should be aware that, for a yellow book audit, your auditor is prohibited from serving as your district's bookkeeper under the national independence restrictions. While this Agency does not require the submission of a yellow book audit, our review process for districts receiving federal funds will include a verification that a yellow book audit was performed when necessary.

Where to File Your Audit Report

TWC Section 49.194 requires most districts to file a copy of their audit report with the Agency **within 135 calendar days** after the district's fiscal year end. That section also requires each district to submit an executed (notarized) filing affidavit (**Appendix N1**, on page N-2) with its audit report.

Please note that the Legislature has statutorily fixed this filing criteria. The statutes do not give this Agency the authority to extend your district's filing date or to allow your district to substitute other financial documents for those specified in the law.

Under TWC Section 49.194(b) if your Board refuses to approve the audit report, your Board must send us a copy of that report and the Board's statement explaining the reasons for the Board's failure to approve the report. This Agency's response will take into consideration the Board's stated circumstances.

In August 1994, we revised the Filing Affidavit (form TCEQ-0723) to incorporate information contained in the Board Certificate. A Board Certificate cannot be submitted in exchange for the required notarized Filing Affidavit. And, in September 1995, we revised the Filing Affidavit to reflect the legislative change that removed the requirement calling for a copy of the district's audit report to be filed with the local city or county clerk's office. We request that you file only one (1) copy of your district's audit report and filing affidavit with this Agency as we will recycle the extra copies.

The TWC currently exempts most GCDs and MMDs from the requirement to file their audited financial statements with us; however, we request that these districts send us a courtesy copy that we can make available to the public.

Additionally, districts with outstanding bonded indebtedness are required to file a copy of their audit report with the State Information Depository, which the Governor's May 25, 1995 Executive Order GWB 95-4 has designated as the *Municipal Advisory Council of Texas* (MAC). Refer to **Appendix O** for MAC's mailing address.

If your Board is considering issuing bonded debt within the next two fiscal years, your district must file a copy of its audit or annual financial report with the MAC. See this *Guide's* Chapter on Auditing Guidance and TWC Chapter 49's Subchapter G (*Audit of Districts*) for more information on your district's financial reporting, auditing, and filing requirements.

Your district must retain at least one (1) copy of the financial report for its records according to the Local Government Records Act (Local Government Code Chapters 201 through 205). Your copy of the district's financial report is the district's original record. Each district is responsible for maintaining an original, permanent record of its financial report in the district's official files.

In the 78th Regular Legislative Session House Bill 1541 revised TWC Section 49.194 to give your Board the option of electronically submitting your district's audit report with this Agency. If you choose to submit the audit report electronically, prepare a copy in **Adobe Portable Document Format** (PDF) and send it by e-mail to utildist@tceq.state.tx.us. For more information on PDF files, refer to:

www.tceq.state.tx.us/AC/help/site/help_pdf.html

Keep these points in mind:

- Put “District Audit” in the subject line of your e-mail.
- Put your name and telephone number in your message so we can call you if necessary.
- Make sure that your e-mail comes from an address that can receive replies, because we will reply to confirm that we received your audit report.
- If you do not receive a confirming reply worded something like:
Thank you for submitting the [*name of your district*] District’s [*month year*] audit report and related filing affidavit, which we received on [*date*].
then please contact us. There might have been a problem with your electronic submission. For example, there is a limit on the size of e-mails we can receive. If your files are larger than this limit (which changes as technology improves), you will not receive our confirmation e-mail. Call us at 512/239-4691 or e-mail us to ask about alternative methods of submitting your report.

Our Address

One (1) copy of your district’s audit report (including the completed filing affidavit) must be sent in PDF format by e-mail to utildist@tceq.state.tx.us or in hard copy to this address:

Texas Commission on Environmental Quality
Districts Review Team, MC 152
Utilities and Districts Section
Water Supply Division
PO Box 13087
Austin, Texas 78711-3087

Filing Deadlines

According to TWC Section 49.194(a), a district must submit an audit report to the executive director for filing within 135 calendar days after its fiscal year end. Or, according to TWC Section 49.198(c), a qualified district can submit a financial report within 45 calendar days after its fiscal year end. Or, according to TWC Section 49.197(d), a qualified district can submit a financial dormancy affidavit by January 31st following the year of financial inactivity (Refer to **Audit Report Requirements** on page 3-1). We have not been granted authority by the Legislature to extend this deadline.

Consult our Web site for a list of the financial reporting due dates (TCEQ publication RG-378) which reflects the date the Agency must receive your district’s report. We do not allow you to extend your statutory filing deadline by accounting for the report’s postmarked date (the date that the report was placed into the U.S. Postal System). Please allow enough time for the report to arrive at the TCEQ’s mailing address by the statutory due date. The due dates on our web site have been adjusted to account for days when the actual statutory due date falls on a weekend and/or a holiday.

Administrative Issues

Required Policies

TWC Section 49.199 requires districts to adopt certain administrative policies and a code of ethics. An example of these policies is included in **Appendix J**.

Recommended Practices

We encourage your Board to routinely evaluate the services provided by each of your consultants to ensure that your district's needs are being met. The Board should consider how often it issues *Requests for Proposals* (RFP) on its consultants. We recommend that your Board issue RFPs on all of its consultants (including your auditor) every fifth year so your Board and its customers can be satisfied that your district is getting the best return for its monies from the most qualified professional service providers.

TWC Section 49.057 requires districts to follow the Professional Services Procurement Act (Government Code, Chapter 2254, Subchapter A) when seeking services for a licensed or registered professional, including:

- attorney (required under TWC Section 49.057)
- financial advisor (required under TWC Section 49.057)
- CPA
- architect
- landscape architect
- land surveyor
- professional engineer
- state certified or state licensed real estate appraiser

Your Board cannot select or award a contract to these professional service providers on the basis of competitive bids. It must make the selection and award:

- on the basis of demonstrated competence and qualifications to perform the services
- for a fair and reasonable price

We suggest that your Board rank the proposals according to technical factors. You can also compare the estimated cost against the estimated hours. An unreasonably low estimate of hours or cost may be a reason for rejection.

Refer to **Appendix G** for a sample RFP on your district's independent auditor. Also, see the **Consultant Selection** section below for information on how to select your district's auditor. The sample RFP is designed to ensure that all proposals received will be in compliance with the Professional Services Procurement Act.

Refusing Cash

While your district can refuse the offer of cash as payment for a utility bill it cannot turn off the customer's services if the customer cannot or does not offer an alternative method of payment. Your Board should be willing to consider requests for an exception to its 'no cash' policy, especially from an elderly person who has a restricted bank account, which allows only a limited number of personal checks to be issued during his bank's billing statement period before he incurs an excess check charge. Your district's policies should not cause an unreasonable economic hardship upon its citizens.

Under TWC Section 49.057 your Board has the authority to manage all of the district's affairs, including the authority to make reasonable policy exceptions to accommodate certain customers' limitations. Your Board might offer the alternative of paying two months of bills by one check, with no late payment penalty for an elderly person with a restricted checking account.

Excess Bond Money

While your district is obligated to levy only enough taxes to retire its debt, your district could have bond monies remaining after a bond series has matured due to the receipt of delinquent tax payments. According to Attorney General Opinion JM-142 (**Appendix O**), *if your district is not affected by any other legal requirements* for the disposition of the surplus money, there are two ways your Board can dispose of these funds:

- refund the excess to the taxpayers
- if a refund is impractical, transfer the monies to your district's general operating fund

Refer to **Use of Surplus Funds** on page K-3 for information on the use of surplus funds during (not after) a bond's life cycle.

We recommend the Board seek the advice of its attorney or bond counsel to determine whether any other legal requirements exist that would affect how your district can dispose of its excess bond money.

Consultant Selection

While the following paragraphs focus on your Board's relationship with its CPA, many of the factors discussed below can be applied to your other professional service providers after your district has issued its RFPs.

When you receive proposals from various auditing firms, your Board should rank them according to each firm's individual qualifications. Your Board must make its selection on the basis of demonstrated competence and qualifications to perform the services. Remember to also compare each firm's estimated cost based upon estimated hours and the experience level of the staff involved. We recommend that your Board request the candidates present their written proposals at a regular board meeting and be available to answer

any questions the directors might have. This in-person meeting is helpful in evaluating how well a CPA (and other consultants) can communicate with your Board on complex issues.

Your Board cannot negotiate the proposals received by an attorney, an auditor, or most other service providers. Those proposals stand as submitted. If your Board engages *architectural, engineering, or land surveying services* it is **required** to negotiate the costs and other terms with the chosen qualified firm (Government Code, Chapter 2254). When your Board cannot come to an agreement with its *engineer, architect, or land surveyor*, your Board must formally end its negotiations with that candidate and select the next most highly qualified service provider and try to negotiate a contract with that candidate. Continue the selection and negotiation process until a contract is entered into.

Engagement Letter

Make sure your auditor's Engagement Letter clearly confirms the terms agreed upon and provides sufficient information about the scope of the audit that will be performed on your district as this will prevent misunderstandings. Unless your Board has hired its independent auditor to perform a specific type of audit, your auditor **will not** be performing a fraud audit (actively searching the district's records for evidence of fraud); rather he will prepare a standard financial audit where he will determine his 'level of comfort' and may look at a specific number of transactions, all transactions during a specific period of time, or transactions over a set dollar (threshold) amount during the course of his review of the district's financial condition.

The Engagement Letter is your auditor's formal communication with his client (your Board) in which he explains the terms of his audit. Your Board should carefully review the auditor's Engagement Letter as this letter documents your auditor's understanding about what your Board has asked him to do.

The Engagement Letter or other written documentation from the auditor should include information on the basis for his fee. The Engagement Letter is **not** a binding contract for the audit's total cost. Ethics rules prevent your CPA from guaranteeing the total cost of the audit by agreement with his client.

Audit Committee

To ensure good communication exists between your Board and its auditor, your Board should designate an audit committee made up of one or two directors to be the auditor's primary contact. If the auditor determines that the actual cost of the audit may exceed the estimate, he should communicate this situation to your district's audit committee who will bring any matters before the entire Board for its consideration and possible action at its next board meeting. Your Board may want to request a detailed listing of the audit's costs for its review.

How Your Auditor Audits

Your auditor will perform an intensive review of the district's accounting records, systems, and controls to test its compliance with state law, its bond resolutions, and GAAP. The audit involves reviewing your district's files, contracts, and board meeting minutes to verify the chosen transactions. He **may** look at a set number of transactions, all transactions during a set period of time, or transactions over a specific dollar amount and will exercise independent judgment to:

- Test customer billings for compliance with your district's rates;
- Review construction disbursements to determine whether and how the developer and other parties shared costs;
- Test the collection of interest earned on investments;
- Determine whether the district is receiving all appropriate revenues;
- Examine and analyze sources of income and disbursements;
- Analyze the district's bonded indebtedness;
- Review the district's accounts receivable and payable;
- Analyze the systems and controls used by the district's consultants;
- Evaluate the district's accounting system;
- Review the board meeting minutes;
- Review the district's contracts and agreements;
- Examine bond sale proceeds placed in escrow and determine if the escrowed funds were segregated and on deposit throughout the fiscal period or if they were disbursed; and
- Confirm compliance with state laws.

As your district's audit involves many tests of selected transactions and physical or written verification of some transactions, your auditor may question all of your district's consultants to determine that the accounting records are accurate and properly documented and all appropriate disclosures have been made.

While your auditor is aware that embezzlement can and does occur, it can be difficult to detect. Your Board cannot rely on the district's audit for fraud detection. Any questionable transaction noted by the auditor will be brought to the attention of your district's audit committee and/or the Board.

When conducting your district's audit, your auditor will address different interests from varying perspectives. Your auditor will review the district's records and accounting systems and suggest improvements to the Board, if any are noted during this process. He will examine compliance with the district's bond resolutions and the preparation of required reports. To meet these multiple objectives and best serve his public function, your auditor must maintain a professional independence from your district.

Your auditor will form a professional opinion on your district's financial statements. His opinion will not state that the district's financial statements are absolutely accurate. Your auditor will report on the district's financial statements "taken as a whole" and not on individual items within the financial statements. The information presented in the district's annual report is your Board's representation. Your auditor will present the annual report to your Board for its review before your auditor issues his final report. Your auditor will report all questionable transactions that he is aware of to your Board.

Your district's annual report may be included as part of the "official statement" used in the district's bond rating application and bond sale disclosure materials.

District Manual

We recommend your Board adopt a manual to address your district's unique procedural, administrative, and accounting practices. We recommend that your District Manual include information on limitations to each director's and the general manager's spending authority. Your Manual should also address your district's policies and limitations on the use of commercial transportation. If your Board has elected to provide its directors with the district's credit card, we recommend your Manual include clear limitations and documentation standards to limit each director's liability and to control opportunities for unauthorized expenditures. This *Guide* is not intended to replace, but to supplement, any manuals adopted by your Board.

Management Issues

Director Fees

TWC Section 49.060 was revised by House Bill 3214 during the 78th Regular Legislative Session to allow most boards to pay their directors a *fee of office* for each day a director spent *performing his duties*, which are defined in the Bill as participating in board or committee meetings and other activities involving substantive deliberation of district business or participation in related educational programs.

That section caps the *fees of office* at \$150 per day and requires your Board to set its own cap (up to \$7,200) by resolution on the total annual *fees of office* your district's directors can receive during the district's fiscal year. In Rule 293.97(a) we have defined a district's annual financial statutory limitation as the fiscal year adopted and used for reporting the district's financial activities. Refer to **TSI-8** on page N-29 for reporting clarification about the director fees.

Also, at your Board's discretion, a director may be reimbursed for his actual expenses reasonably and necessarily incurred while engaging in activities on your district's behalf. We recommend that your district set a policy to ensure that sufficient documentation is submitted to provide an audit trail of the director's actual expenses. The use of a district's credit card should be

limited to prevent a director or district employee from abusing this tool and circumventing the Board's formal approval process for district expenditures.

House Bill 3214 also:

- clarified what director activities **are not** eligible as a *fee of office*
- removed the option that had allowed a director to receive *per diems* instead of *fees of office*

If a majority of the directors during an open public board meeting turn down your *fee of office* or expense reimbursement request, the majority decision of the Board rules. There is no guarantee of payment, nor is there a guaranteed *fee of office* amount. While the Legislature has authorized a *fee of office* of **up to** \$150 per day and **up to** \$7,200 per fiscal year for each day's substantive performance (defined in TWC Section 49.060), your Board can restrict these amounts by setting a lower per day or per fiscal year cap. These restrictions should be recorded in your District Manual (**District Manual**, page 1-18).

Before a director can be paid a *fee of office* that director must submit his verified statement along with a general description of the duties he has performed for **each day of service**. We encourage your Board to define the elements necessary for reimbursement, including a descriptive statement of the services performed by the director.

If you and another board member attended your district's audit committee meeting with your auditor, and a third district director met with your engineer on that same day, and each of you filed a statement stating the actual date of service (11/10/2003) and a general description "attended a meeting," a review of the district's records would show that three out of the district's five directors (a majority of the Board) "attended a meeting" on the same day in November 2003. This has caused questions about whether a violation of the Open Meetings Act has occurred. Please ensure that your verified statement's description provides sufficient detail to ensure that no questions will occur about whether a quorum of your Board met without proper notice.

Director Qualifications

Each district must refer to its specific TWC chapter to determine its directors' qualification requirements. For an Agency appointment, Rule 293.32 applies.

Director Removal

The only way to remove a director is either to prove that the director is disqualified from service under TWC Section 49.052(a) or, if that director has missed at least half of the district's regular meetings scheduled during the prior 12 months, under TWC Section 49.052(g) the remaining board members by unanimous vote may remove a board member; however, the

removed director can petition this Agency for reinstatement under Rule 293.35. There are no recall election provisions to allow your district's voters to recall a director.

Director Relationships

We commonly receive calls about whether a director is disqualified because of some relationship with one of his relatives. TWC Section 49.052 disqualifies a director that is related within the third degree of affinity (marriage) or consanguinity (blood) to: a developer of property in the district; any other member of the Board; or, the manager, engineer, attorney, or other person providing professional services to the district. With few exceptions, relatives cannot serve on the same district's Board. The *degrees of relationship* are defined in Government Code Chapter 573.

That said, TWC Section 49.052 does not apply to special water authorities (defined in TWC Section 49.001), a district defined in TWC Section 49.181(h)(4), or a district whose principal function is to provide irrigation water to agricultural lands or to provide nonpotable water *for any purpose*. When in doubt we encourage your Board to seek the advice of your district's attorney.

Continuing to Serve

A director continues to perform the duties of his office under Article 16, Section 17 of the Texas Constitution until his successor has qualified for office (Attorney General Opinion JC-6; **Appendix O**).

Powers

The Prime Directive

While TWC Section 49.211 grants a district the functions, powers, and rights that will permit it to accomplish the purposes for which it was created, a district "may exercise only such powers as have been expressly delegated to it by the Legislature or which exist by clear and unquestioned implication." *Tri-City Fresh Water Supply Dist. No. 2 v. Mann*, 142 S.W.2d 945, 946 (Tex. 1940). Implied powers are those that are 'indispensable to the ... accomplishment of the purposes' for which the political subdivision was created; powers 'merely convenient' or 'useful' cannot be implied and may not be assumed by the political subdivision. *Id.* at 947 (Attorney General Opinion JC-202; **Appendix O**).

Texas courts narrowly construe enabling statutes holding that districts have only the power to do those things that are specifically stated or implied by the statutes. If your Board cannot find clear authority for a specific action or power, we encourage your Board to seek the advice of its attorney. If your Board does not have an attorney, we strongly encourage your Board to retain one that is knowledgeable in water district law. It's true: An ounce of prevention is worth a pound of cure.

Disconnections

TWC Section 49.212(c) allows your district to discontinue any or all facilities or services to prevent an abuse or to enforce payment of an unpaid charge, fee, or rental due the district, including taxes that have been delinquent for six months or more.

If your district provides only retail sewer services and it needs to enforce a delinquent account, upon request by your Board and subject to the existence of an agreement, another district can disconnect its water service to that customer. Rule 291.88(e) states where sewer service is provided by one **retail public utility (Appendix P)** and water service is provided by another retail public utility, the retail public utility that provides the water service shall disconnect water service to a customer who has not paid undisputed sewer charges:

- if requested by the sewer service provider, **AND**
- if an agreement exists between the two retail public utilities regarding such disconnection

Open Meetings

The Law

TWC Section 49.064 requires your district to hold “such regular and special meetings as may be necessary for the proper conduct of the district’s business.” Government Code Chapter 551 contains the Open Meetings Act. TWC Section 49.063 states “neither failure to provide notice of a regular meeting nor an insubstantial defect in notice of any meeting shall affect the validity of any action taken at the meeting.”

Handbook

The Office of the Attorney General has produced an *Open Meetings Handbook* that is a very useful reference source if you need more information on this Act (**Appendix O**).

Quorum

TWC Section 49.053 states that a majority of the Board makes up a meeting’s quorum, and the agreement of the *majority* of your Board is sufficient for transacting the district’s business. So if your Board is made up of five directors, three directors must be present to establish a quorum before your Board can meet **and** the unanimous agreement of all three directors present at that meeting is needed to transact your district’s business.

TWC Section 49.064 clarifies that a meeting of *less than a quorum* of your Board (a committee meeting) is not subject to the Open Meetings Act’s requirements.

Violations

The Open Meetings Act provides civil remedies and criminal penalties for violations of its provisions. Refer to that Act for more information.

District courts have original jurisdiction over criminal violations of the Open Meeting Act as misdemeanors involving official misconduct. Complaints about possible violations should be presented to your local district attorney or criminal district attorney. Neither the Attorney General's Office nor this Agency is authorized to enforce the Open Meetings Act.

Open Records

The Law

TWC Section 49.065 and Rule 293.95 requires your Board to keep a complete account of all meetings and proceedings and to preserve its minutes, contracts, records, notices, accounts, receipts, and other records in a safe place. Your district must comply with the Public Information Act (formerly called the Open Records Law; Government Code Chapter 552) and with the record retention provisions in Local Government Code Subtitle C (Chapters 201 through 205).

Rule 293.95 and TWC Section 49.196 allow your district's auditor to remove the District's fiscal records to record the district's fiscal affairs and prepare the audit report.

Although the public is allowed to inspect and make copies of the district's records under the Public Information Act, they may not remove records from your district's office. The Public Information Act restricts you from questioning the requestor except to establish proper identification or, when a large amount of information has been requested you can discuss how the scope of the request might be narrowed; otherwise, you are not allowed to inquire about the purposes for which the information will be used.

Handbook

The Attorney General's Office (**Appendix O**) has produced a *Public Information Handbook* if you need more information on the Public Information Act.

Assistance

Contact the Texas Building and Procurement Commission at (512) 475-2497 for questions on the allowed charges for providing public information.

The Attorney General's Office maintains an Open Government Hotline (toll-free at (877) 673-6839) that can provide assistance to your district's Board in informally resolving complaints and misunderstandings.

Violations

The Public Information Act provides civil remedies and criminal penalties for violations of its provisions. Refer to that Act for more information.

This Agency is not authorized to enforce the Public Information Act. Complaints about possible violations should be presented to your local district attorney or county attorney.

Maintenance of Administrative Records

The Law

Districts are subject to the Public Information Act which reads, in part, “it is the policy of this state that each person is entitled, unless otherwise expressly provided by law, at all times to complete information about the affairs of government and the official acts of public officials and employees,” and *public information* means “information that is collected, assembled, or maintained under a law or ordinance or in connection with the transaction of official business by a governmental body.” Proper maintenance of your district’s administrative records is important to ensure your district’s compliance with the Public Information Act and the Local Government Records Act (Local Government Code Chapters 201 through 205).

Records Management Program

The Local Government Records Act requires an active and continuing program for the creation, maintenance, and management of your district’s records. Your district records should include:

- all accounting records
- all engineering records
- all records which involve bonds, taxes, contracts and insurance documents
- inventory and cost records
- legal records and documents
- payroll and related personnel records
- all purchasing and receiving records

Your district should maintain a retention schedule so it can destroy non-useful records on a systematic basis.

Assistance

The *Texas State Library and Archives Commission’s* (TSLAC) State and Local Records Management Division’s staff (**Appendix O**) can assist your district in its efforts to comply with the records management laws. The TSLAC has issued records retention schedules applicable to districts. Their schedules state the retention period required by federal or state law, or court ruling. Refer to **Appendix F** for our recommended retention schedule.

Other Requirements

Filing Information

Rule 293.92 and TWC Section 49.455 require specific financial and technical information be filed with this Agency and your district's county clerk, including the:

- district's complete and accurate legal description and a map or plat of the district's boundaries
- most recent rate of district taxes
- date the district was confirmed, if required
- total amount of bonds outstanding that have been approved by the district's voters
- total initial principal amount of all district bonds payable in whole or in part by taxes which have been previously issued and remain outstanding
- district's complete Notice to Purchasers form required under TWC Section 49.452

We encourage you to seek the advice of your district's attorney if your Board is not sure whether TWC Section 49.452 or Rule 293.92 applies to your district.

Dissolution

Rule 293.92(1)(K)(vi) requires your Board to file a statement of dissolution and provide this Agency with a copy of the document evidencing the effective date upon the district's dissolution, annexation, or consolidation. If your district has prepared an audit report through the dissolution date, we would appreciate receiving a copy of that final closeout report.

CCN

TWC Section 49.215(d) exempts a district from the requirement to hold a *Certificate of Convenience and Necessity* (CCN) as a precondition for providing retail water or sewer service to any customer or service area. This subsection **does not** authorize a district to provide services within an area certified by another retail public utility or within the boundaries of another district without that district's consent, unless the district has a valid CCN to provide services to that area.

If your district has a CCN, your Board will need to review Rule 291.85 (Response to Requests for Service by a Retail Public Utility Within Its Certificated Area) and note the time limits for establishing service upon receipt of the service request.

TCEQ's Role

Reference Source

We are available as a reference source if you need assistance; however, we defer to your consultants as they are the experts in their chosen professional

fields and are aware of your district's unique situation and the laws that govern its operations.

Inspection

Under TWC Section 49.196 we may inspect a district's fiscal and financial records, and any other records we consider necessary. That section and Rule 293.4 also require that a district's fiscal records be available for public inspection during regular business hours. While the Legislature has not defined "regular business hours" within TWC Chapter 49, regular business hours are commonly understood to be Monday through Friday from 8:00 a.m. until 5:00 p.m. unless otherwise established by a resolution of your Board during an open board meeting.

Compliance

TWC Section 49.195 provides that we may perform a review on the audit report of each district. Refer to this *Guide's* Chapter on Auditing Guidance for more information. During our review we are required to notify the Board and its auditor if we note any violations or if we have any recommendations. TWC Section 49.195 prevents us from accepting your audit report for filing until your Board and the auditor remedy our objections and correct noted violations. If we determine that a penal law has been violated, we are required to notify the appropriate county or district attorney and the Attorney General.

TWC Section 49.194 requires us to file with the Attorney General the names of districts that do not comply with TWC Chapter 49, Subchapter G (*Audit of Districts*) provisions. Additionally, TWC Section 49.003 and Rule 293.94(j)(2) authorize us to seek civil penalties of up to \$100 per day against a district for its willful failure to comply with the filing provisions of the TWC after receiving our written notification. If your Board is late in filing its required financial status report, we may send you a reminder letter regarding your district's statutory duties, but it is ultimately the responsibility of your Board to ensure that the district is in compliance with the statutes. Refer to the Agency's **Report Review** section in the *Guide's* Chapter on Auditing Guidance on page 3-4 for more information.

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