Appendix K: Compliance Issues

In performing a "Generally Accepted Auditing Standards" (GAAS) audit of a district, the auditor must comply with the Statements of Auditing Standards (SAS) 68 requirements. To comply with SAS 68 your auditor should take into consideration the following:

- The district's management is responsible for ensuring that the district complies with the laws and regulations that have a direct and material effect on the determination of amounts in the financial statements and, the auditor should design the audit to provide reasonable assurance that the financial statements are free of material misstatements resulting from violations of laws and regulations that have this effect.
- The financial effects of an act of noncompliance may be difficult to quantify. The potential fines for violations of the TWC for each day of noncompliance for each noncompliant act can quickly become significant to any audit client. Therefore, it is prudent not to dismiss any violation as **immaterial**.
- Another consideration is the civil or criminal litigation that could occur as a result of a particular violation. The financial burden to a district of the costs of litigation is also difficult to quantify.
- Although your Board is responsible for legal compliance, most boards hold the auditor accountable for undisclosed violations, therefore your auditor should ask the Board to identify all applicable laws and regulations to ensure full disclosure in the financial statements of any acts of noncompliance.

The following list contains the most common compliance issues, segregated by type:

1. Violation of a Commission Order

Release of escrowed construction funds: Escrowed construction funds may be released for expenditure only upon written Agency authorization.

Developer Reimbursement Audit performed: A developer reimbursement audit should be performed on the bond proceeds expenditures and submitted to the Agency within the time frame prescribed by the Commission in its bond approval order (**Appendix M**).

Letter of credit requirements: Required letter of credit should be obtained and renewed as required by the Agency's bond authorization.

2. Regulatory Assessment

Regulatory assessment paid: Your district should be current on its water and wastewater regulatory payments. This assessment is calculated on all retail water and/or wastewater sales. For more information, review Agency publication RG-199, *Regulatory Assessments Collected by Retail Public Utilities* (**Appendix O**).

3. Environmental Issues

State and/or Federal laws, rules and regulations regarding wastewater, water supply, solid waste, air quality discharges and hazardous substances: Your district must be in compliance with all State and Federal rules and regulations. It must also be current in its filings to the regulatory authorities.

4. Financial Issues

Compliance with the district's authorization to levy taxes: Your district's tax levies must comply with the powers granted to the district by the Texas Water Code and/or its enabling legislation. The tax levies must be authorized by the district's voters, unless this power has been granted by the district's enabling legislation.

Use of tax proceeds: Debt service tax receipts must be used for the payment of principal and interest on the district's bonded indebtedness and its tax collection costs. Maintenance taxes are used to fund your district's ongoing operations.

Use of bond proceeds: Bond proceeds from Agency approved bond issues may only be used for Agency authorized construction and other costs.

Transfers of funds: Transfers are allowed to the extent authorized by your district's bond resolutions, the TWC, Agency Rules, and the Property Tax Code. Authority for the transfer is to be disclosed in your district's Notes to Financial Statements.

Deposits and investments: Your district's deposits and investments must be collateralized according to the Public Funds Collateral Act (Government Code Chapter 2257) and invested according to the Public Funds Investment Act (Government Code Chapter 2256, Subchapter A).

Violation of bond resolutions: As directed by your district's bond resolutions, the district's balances are to be maintained and segregated; its assets are to be insured (**Security of Cash and Investments** on page 2-31), and any excess funds should be used accordingly.

Arbitrage rebate requirements: Federal restrictions on your district's bond proceeds may restrict the district's yield on its investments in the Capital Projects Fund and the Debt Service Fund.

Unauthorized assessment of impact fees: An impact fee is used to fund or recover the district's capital costs of constructing water, wastewater and drainage facilities and is assessed against new development. All impact fees go through a hearing process prior to adoption. Districts have the option of gaining Agency approval instead of the hearing process. Tap fees that do not exceed three times the actual installation and administration costs associated with setting up a new account are not impact fees.

Use of surplus funds: Except for those items in Rule 293.83, a district considering using its surplus bond funds, interest earned on invested bond proceeds, grants, contributions by others for costs sharing of facilities constructed with bond funds and litigation settlements related to projects financed by bond proceeds must receive approval from the Agency's executive director before committing these funds.

5. Management Problems

Conduct of district business: Your district's meetings are to be conducted according to the Open Meetings Act. Your districts must also comply with the Public Information Act. See **Open Meetings** on page 1-21.

Disqualification of directors: According to TWC Section 49.052, a director may be disqualified from board service if he: (1) is related to or employed by a developer, a director, your district's manager, its attorney, or another person providing professional services to the district or a developer; (2) is a developer of property in your district; (3) serves as an attorney, consultant, engineer, manager, architect, or in a professional capacity for the district or a developer; (4) is a party to certain contracts with the district or a developer; or, (5) fails to maintain the qualifications required by law to serve as your district's director.

Bonds for members of boards: Before performing his duties of office, a director must execute a \$10,000 bond payable to the district and conditioned on the faithful performance of that director's duties (TWC Section 49.055).

Compensation of board members: A director may receive a fee of office up to \$150 for each day he spent performing his official duties. Your Board is required 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 (TWC Section 49.060). Review the **Director Fees** section on page 1-18.

Adopted budget: Each year your district must adopt its budget for the upcoming fiscal year according to Rule 293.97(b). Review the **Annual Budget** section on page 1-6.

Conflicts of interest: A director is prohibited from directly or indirectly participating in a vote or decision, or acting as a surety on any matter involving a business entity in which the director has a substantial interest. Additionally, if it is reasonably foreseeable that an action involving the business entity would result in an economic benefit or any other benefit to the entity, the director should abstain from voting. Refer to Local Government Code Chapter 171 (Appendix O) and Appendix J, Article I, Section 1.04 (page J-2).

Disqualification of tax assessor and collector: Under TWC Section 49.059 no person may serve as tax assessor and collector for a district with retail water or wastewater sales if that person:

- is related within the third degree of blood or marriage, or is currently or within the last two years was, an employee of a developer, a director, a manager, an engineer, or an attorney for the district
- has financial ties to a developer, a director, an engineer, or an attorney for the district
- is a developer, a director, an engineer, or an attorney for the district