

Table 3 presents additional details on compensation to board members in fiscal years 2008 through 2011 and the first two months of fiscal year 2012.

Table 3

District Compensation to Members of Its Board Fiscal Years 2008 through October 2011					
Board Member	Fiscal Year 2008	Fiscal Year 2009	Fiscal Year 2010	Fiscal Year 2011	Fiscal Year 2012 (through October 2011)
Othal Brand, Jr.	\$ 3,633.92	\$ 3,179.68	\$ 2,952.56	\$ 5,450.88	\$ 454.24
Othal Brand, Sr.	2,725.44	2,725.44	681.36	0.00 ^a	0.00 ^a
Chris Burns	2,725.44	2,952.56	2,725.44	4,088.16	454.24
Joe Corso	0.00 ^b	0.00 ^b	1,362.72	5,223.76	454.24
Leo Montalvo	3,179.68	3,179.68	2,952.56	4,542.40	227.12
W. D. Moschel	2,952.56	2,725.44	2,952.56	4,769.52	454.24
Totals	\$15,217.04	\$14,762.80	\$13,627.20	\$24,074.72	\$2,044.08
^a Othal Brand, Sr. was deceased in fiscal year 2010.					
^b Joe Corso was not a board member in fiscal years 2008 and 2009.					

Source: District accounting records.

Texas Water Code, Section 49.060(c), requires board members who receive fees of office or reimbursements to file with the District a verified statement showing the number of days spent in service of the District and a general description of the duties performed for each day of service. None of the compensation or reimbursements the District made to board members in fiscal years 2008 through 2011 were supported by verified statements from the board members. However, the reimbursements were allowable, reasonable, and supported by other documentation.

The District should strengthen controls over capital assets and preventive maintenance.

District capital asset balances that auditors tested were recorded accurately and were complete for fiscal year 2011. However, the District should improve controls over its asset list, capital improvements and board approval of asset acquisitions, and preventative maintenance. Auditors were not able to determine asset balances for fiscal years 2008 through 2010 because of a lack of sufficient asset documentation detail for those years.

Capital asset list. The District's asset list did not comply with the Commission on Environmental Quality's *Water District Financial Management Guide*¹

¹ All water districts subject to Texas Water Code, Chapter 49, (which includes the District) are subject to the *Water District Financial Management Guide*.

because the list did not provide sufficient detail to clearly identify the assets. For 5 (26 percent) of 19 assets that auditors tested, there was insufficient detail to clearly identify the asset, although the assets did exist. For example, items were labeled on the asset list as “Tractors” and “Ford Truck.” One large asset, an excavator, was incorrectly described as “2 Tractors” on the asset listing.

For 2 (11 percent) of 19 assets that auditors tested, the District did not calculate accumulated depreciation expense properly. As a result, the District underreported total accumulated depreciation by \$44,728.71 (3 percent of the value of the assets tested). This would also increase operating expenditures in the years when the District underreported related depreciation.

Capital improvements. The District’s capitalization policy states that “Significant repairs and betterments which extend the lives of existing capital assets are also capitalized.” For fiscal year 2011, 6 (55 percent) of 11 repair expenditures that auditors tested were not capitalized in accordance with the District’s policy. Those expenditures totaled \$83,806 (less than 1 percent of the total value of the District’s capital assets). Additionally, for 4 (29 percent) of 14 assets that auditors tested and that the District put into service in fiscal years 2008 through 2011, the District did not have evidence that its board properly approved the acquisition of these assets.

Preventive maintenance. The District did not have a preventive maintenance schedule or a plan to help ensure that it maintained its equipment properly. As a result, the District did not monitor necessary maintenance. The District had maintenance binders for heavy equipment and vehicles, but there was no documentation or evidence of maintenance on pumps or logs of failures and shutdowns. Not having a preventive maintenance schedule or plan impairs the District’s ability to ensure that its heavy equipment will continue to meet the District’s needs.

The District’s maintenance documentation also is incomplete. Auditors could not determine the completeness of maintenance documentation for 9 (75 percent) of 12 assets tested because the District’s asset list did not contain specific identifying information such as serial numbers, make, year, or license plate numbers.

The District did not have certain controls over revenues it receives from customers other than the City of McAllen.

From fiscal year 2008 through fiscal year 2011, the City of McAllen provided an average of 91 percent of the District’s revenue, and the District recorded that portion of its revenue properly. In addition, the District receives revenue from the sale of raw water to farmers and irrigators and from flat-rate fee assessments. The District accurately recorded revenue balances that auditors tested; however, the District could not readily identify the amounts that it had

billed customers or amounts that customers paid with regard to the flat rate assessment.

Additionally, the District's lack of policies and procedures for collection, notification, and tracking of amounts collected or due could adversely affect the amount and timeliness of revenue collection (see Chapter 3-B for additional information on flat-rate fee assessments).

The District has improved compliance with financial reporting requirements.

For fiscal year 2011, the District complied with Texas Water Code, Section 49.191, which requires it to obtain a financial audit within 120 days of the end of the fiscal year; it also complied with Texas Water Code, Section 49.194, which requires it to submit the audit report to the Commission on Environmental Quality within 135 days of the end of the fiscal year.

However, the District did not comply with those requirements for fiscal years 2008 through 2010. Although the District obtained financial audits for those years, the audit reports were not completed within 120 days of fiscal year end, and the District did not submit the audit reports to the Commission on Environmental Quality within 135 days of the end of the fiscal year. This occurred because of delays in closing the District's year-end accounting records.

Recommendations

The District should:

- Develop a formal, comprehensive, long-term master plan that aligns with the District's mission and goals.
- Develop realistic budgets to help ensure that revenue covers expenditures and that it does not need to sell assets to continue operations.
- Develop and implement policies and procedures required by the Commission on Environmental Quality's *Water District Financial Management Guide*.
- Seek assistance from professionals in setting up financial policies and providing training, as appropriate, for its staff and board.
- Implement controls to help ensure compliance with Texas Water Code requirements.
- Establish and implement a process to record revenue from flat-rate fee assessments and irrigation payments received to comply with the intent of the *Water District Financial Management Guide*.

- Provide necessary training and resources to District employees to enable them to use automated tools such as spreadsheets to track flat-rate fee assessments and prepaid deposits.
- Continue to submit required audit reports to the Commission on Environmental Quality within the required time frame.

Chapter 1-B

The District Should Implement a Process to Mitigate the Risks Associated with Related-party Transactions

The individual who is both the District's general manager and the president of its board has multiple businesses that provided services to the District in fiscal

Selected Requirements of Texas Local Government Code, Chapters 171 and 176

Texas Local Government Code, Chapter 171, requires both an affidavit and abstention from voting if a public official has a substantial interest (10 percent or more of the voting stock or shares of the business entity, or owns either 10 percent or more or \$15,000 or more of the fair market value of the business entity) on a decision or any matter involving the business entity, and an affidavit stating the nature and the interest.

Texas Local Government Code, Chapter 176, applies to public officials, as well as individuals seeking to enter into a contract with a local government entity. A conflicts disclosure statement is required to be filed by a local government official if the individual seeking to conduct business with the local government entity has other business relationships with the official or is a family member. A person who does business with a local government entity is required to file a completed conflict of interest questionnaire if the person has a business relationship with the local government official or is a family member of the official.

years 2008 through 2011. However, the District did not have a consistent process to manage related-party agreements and to help ensure compliance with requirements in Texas Local Government Code, Chapters 171 and 176 (see text box for additional details).

Records at the Office of the Secretary of State show that the District's general manager and board president has ownership interests in or is a registered officer for multiple businesses with which the District conducts business. Those businesses performed multiple services for the District during fiscal years 2008 through 2011 such as providing labor, material, equipment, Internet services, and security systems. The District made payments totaling more than \$106,000 for those services. The District's board was aware of this, and the general manager and board president abstained from voting on board decisions regarding those businesses.

Minutes from board meetings indicated that, on three occasions, board members approved the District's obtaining

services from businesses in which the District's general manager and board president had ownership interests or for which that individual was a registered officer. However, the scope of work and rates and costs for those services were not documented in the board meeting minutes, and the District also did not establish contracts detailing the scope of work and payment limits. As a result, auditors could not determine whether the District received the best value for those services and could not determine the appropriateness of the related-party transactions.

Although the board acknowledged the relationships between its general manager and board president and the businesses with which the District has done business, it has not set guidelines or developed a written policy that addresses related-party transactions and potential conflicts of interest. For

that reason, the distinction between personal business interests and District work should be clarified. Without clearly defined policies and procedures and periodic monitoring for compliance, the District and its board risk the appearance of impropriety or actual impropriety.

Additionally, for at least one of the services obtained through the related-party transactions discussed above, the District may have been required to comply with procurement requirements in Texas Water Code, Section 49.273, which requires competitive bidding based on the value of the contract being awarded.

Recommendations

The District should:

- Ensure that all board members are fully aware of conflict of interest and disclosure requirements.
- Develop and implement policies for conducting business with related parties that comply with the Texas Water Code and the Texas Local Government Code.
- Prepare, document, and maintain in the District files all required disclosure affidavits and questionnaires.
- Clearly identify through written policy the duties of the general manager when that individual is also a board member.
- Use the *Water District Financial Management Guide* as a resource in developing policies and procedures regarding related-party transactions.

Chapter 1-C

The District Should Improve Compliance with Certain State Procurement Requirements

Although the District substantially complied with most competitive bidding requirements for major construction and renovation contracts, it did not comply with requirements regarding the contractor selection process for its procurement of professional services. The District also should improve the terms and provisions in its professional and consulting services contracts to better protect its interests.

The District substantially complied with most competitive bidding requirements for its major construction and renovation contracts; however, it should improve compliance with requirements for purchases of equipment and other services.

For the six major construction and renovation contracts that auditors tested, the District substantially complied with most competitive bidding requirements. Those six contracts totaled more than \$2.56 million. Because each of those contracts exceeded \$50,000, the District was required to comply with requirements for competitive bidding, public advertising, bid security, performance and payment bonds, and sealed bids. Additionally, the District had adequate documentation to demonstrate that it properly monitored those contracts to help ensure that the work conformed to plans and specifications and that District payments to contractors were properly approved and reflected the work performed.

Auditors identified certain issues related to equipment purchases exceeding \$50,000 and services that were less than \$50,000 in value. (Procurement requirements differ with the cost threshold of the work to be contracted.) Those issues were as follows:

- The District did not seek competitive bids for its purchase of three vehicles totaling \$60,184. The District should develop policies and procedures that identify when it should use a competitive process. Without policies and procedures and a competitive process, the District cannot ensure that it receives the best value.
- The District did not obtain a required payment bond from a contractor that performed \$49,560 in electrical work. Texas Government Code, Section 2253.021(a), requires payment bonds for contracts exceeding \$25,000.

The District should improve its management of professional services contracts.

The District did not comply with the requirements of Texas Water Code, Section 49.199(a)(4), related to professional services. That statute requires written policies and procedures for selection, monitoring, or review and evaluation of professional services. The District did not have policies and procedures, and it procured more than \$500,000 in professional services in fiscal year 2008 through fiscal year 2011. The District also could not provide documentation demonstrating compliance with Texas Government Code, Chapter 2254, which requires the District to undertake a selection process for professional services.

Table 4 shows payments the District made for professional fees in fiscal years 2008 through 2011.

Table 4

District Professional Fees Paid Fiscal Years 2008 - 2011				
Description	Fiscal Year			
	2008	2009	2010	2011
Professional Fees - Engineering	\$28,548	\$42,755	\$20,668	\$67,771
Professional Fees - Engineering/Survey	0	40,610	0	8,490
Professional Fees - Auditing and Accounting	16,399	20,475	29,783	36,898
Professional Fees - Survey/Appraisal	40,495	25,946	116,229	33,400
Totals	\$85,442	\$129,786	\$166,680	\$146,559
Total for fiscal years 2008 - 2011: \$528,467				

Source: District accounting records.

The District has not established certain policies and procedures for contracts.

The District has no policies and procedures for procuring, executing, and monitoring its contracts. In addition, the District does not maintain consistent documentation pertaining to contracting decisions. For example, the minutes from District board meetings did not consistently reflect all board approvals to bid for contracts and advertise for bid proposals; discussion and approval of bids; and decisions to award contracts, and the dollar amount of contracts. Texas Water Code, Section 49.057, specifies that the board is responsible for the management of all the affairs of the District, including all contracting.

The District's professional and consulting services agreements, letters, and contracts did not always contain certain provisions.

The majority of the District's professional and consulting services agreements, letters, and contracts that auditors tested did not contain provisions that would help to ensure that the contractor delivered the expected services. For example, only 3 of the 13 contracts that auditors tested contained provisions detailing the term of the contract (see Appendix 12 for a list from the *State of Texas Contract Management Guide*, which is a good resource for strengthening contracting practices).

Recommendations

The District should:

- Develop and implement written policies and procedures for procurement of services that address competitive bidding, and ensure that those policies and procedures comply with state law.
- Ensure that the District's board documents all contract approvals and complies with the requirements of Texas Water Code, Section 49.057.
- Develop and implement policies and procedures for selecting, monitoring, and reviewing and evaluating professional services in compliance with Texas Water Code, Section 49.199.
- Document compliance with Texas Government Code, Chapter 2254, when procuring all professional services.
- Consider using the *State of Texas Contract Management Guide* as a tool for identifying best practices in developing professional and consulting services contracts.

The District Should Establish a More Effective Governance Framework

The District did not comply with certain board governance and management requirements of Texas Water Code, Chapter 49. For example, the District's board has not developed required policies and procedures to address items such as a code of ethics for directors, officers, employees, and persons who are engaged in handling investments for the District; travel expenditures; and the selection, monitoring, or review and evaluation of professional services. In addition, neither the board nor District employees who handled cash were bonded as required by Texas Water Code, Sections 49.055 and 49.057.

Table 5 summarizes the District's compliance with selected Texas Water Code requirements.

Table 5

District Compliance with Selected Sections of Texas Water Code, Chapter 49			
Section in Texas Water Code	Statutory Requirement	Summary of District Compliance ^a	Auditor Comments
Requirements Regarding Sworn Statements and Bonds			
49.055(b)	Directors must make sworn statements after assuming office as prescribed by the State Constitution for public office before assuming duties.	Substantially Complied	Members of the District's board made sworn statements.
49.055(c)	Each director shall execute a bond before assuming office for \$10,000 payable to the district and conditioned on the faithful performance of that director's duties.	Did Not Comply	No members of the District's board executed a bond.
49.055(d)	Sworn statements shall be filed with the Secretary of State within 10 days after execution of the oath of office.	Did Not Comply	According to the Office of the Secretary of State, as of February 2012, no sworn statements had been filed. Individuals who were members of the District's board during this audit signed sworn statements from May 2008 to May 2010.
Requirements Regarding District Management			
49.057(b)	The board shall adopt an annual budget.	Substantially Complied	The District presented annual budgets to its board, and the board approved those budgets.
49.057(e)	The board shall require an officer, employee, or consultant, including a bookkeeper, financial advisor, or system operator, who routinely collects, pays, or handles any funds of the district to furnish good and sufficient bond, payable to the district, in an amount determined by the board to be sufficient to safeguard the district.	Did Not Comply	The District's board did not obtain bonds from any of the employees who collected, paid, or handled District funds.

District Compliance with Selected Sections of Texas Water Code, Chapter 49

Section in Texas Water Code	Statutory Requirement	Summary of District Compliance ^a	Auditor Comments
49.058	Conflicts of Interest. A director is subject to the provisions of Chapter 171, [Texas] Local Government Code, relating to the regulation of conflicts of interest of officers of local governments. [Section] 171.004 requires an affidavit and abstention from voting if a public official has a substantial interest in a business entity.	Partially Complied	The individual who is both the District's general manager and the president of its board has multiple businesses that provided services to the District in fiscal years 2008 through 2011. However, the District did not have a consistent process to manage related-party agreements (see Chapter 1-B for additional details).
49.060 (a)-(c)	Fees of Office - a director is entitled to receive fees of not more than \$150 a day for each day the director actually spends performing the duties of a director. A district may not set the annual limit greater than \$7,200. Each director must file a verified statement showing the number of days actually spent in service for the district and a general description of the duties performed for each day of service.	Partially Complied	The District exceeded the daily maximum amount but remained under the annual maximum amount for each board member (see Chapter 1-A for additional details). No board members filed verified statements explaining the services they provided and when they provided services.
49.199(a) (1)-(6)	Policies and audits of districts. The board shall adopt in writing: code of ethics for directors, officers, employees; policy on travel expenditure; policy on district investments; policy for selection, review and evaluation of professional services; policies for management information including budgets for use in planning and controlling costs.	Partially Complied	The District has not developed written policies and procedures for a code of ethics, travel expenditures, the procurement of professional services, or management information. The District has an investment policy; however, that policy does not include all of the required components.
49.271	Contracts for construction.	Substantially Complied	See Chapter 1-C for detailed information on the results of audit testing in this area.
49.065	The Board shall keep a complete count of all its meetings and proceedings and shall preserve its minutes, contracts, records, notices, accounts, receipts, and other records in a safe place.	Substantially Complied	Although the District's board consistently recorded its meeting minutes, some of the minutes do not include complete details of the Board's decisions and actions taken during Board meetings.
^a Definitions of the degrees of compliance: <ul style="list-style-type: none"> Substantially Complied: The District complied with all or most of the statutory requirement. Partially Complied: The District complied with at least one part of the statutory requirement. Did Not Comply: The District did not comply with any part of the statutory requirement. 			

Source: Auditor analysis of District and board documentation.

The District did not comply with Texas Water Code, Chapter 51, regarding the source of payments for maintenance and operating expenses.

Texas Water Code, Section 51.305, requires that "Not less than one-third nor more than two-thirds of the estimated maintenance and operating expenses shall be paid by assessment against all land in the district to which the district can furnish water through its irrigation system or through an extension of its irrigation system." However, as discussed in Chapter 1-A, the District relied on the City of McAllen for 91 percent of its operating revenue in fiscal years 2008 through 2011. The City of McAllen does not pay an assessment;

instead, it pays only for water that the District delivers to it. As a result, from fiscal year 2008 to fiscal year 2011, only 2 to 3 percent of the District's revenue was from flat-rate fee assessments.

Texas Water Code, Section 51.338, states that the District may adopt and enforce reasonable rules, regulations, and specific charges, fees, or rentals, in addition to taxes, for providing any District facility or service. The District has an irrigation water order and delivery policy; however, that policy relates only to supplying water for irrigation. The District has no policies or procedures regarding the collection, charge, or notification of flat-rate fee assessments to landowners within the District.

Recommendations

The District should:

- Comply with all requirements of the Texas Water Code.
- Coordinate with the Commission on Environmental Quality to determine whether modifications to Texas Water Code, Section 51.305, may be necessary.

Information on District Real Property Ownership, Rates and Fees, and Irrigable Acres Served

This chapter presents information on the District's real property ownership, the rates and fees the District charges, and irrigable acres the District serves.

Chapter 3-A

The District Asserts That It Has Protected Its Interests in Real Property Where Its Water Distribution Lines Are Located

According to the District, at the time the District was formed in 1921, county real estate records did not contain a complete description of the location of the canals and lateral water distribution lines throughout the District. Minutes from recent District board meetings reflect the board's concern about encroachment on District property and how to avoid having to relocate water lines in the future due to encroachment.

The District has initiated certain actions to protect its ownership interest in real property located within the District. Specifically:

- In November 2009, after conducting research, the District filed documents in the Hidalgo County real estate records to make known the District's ownership claim to real property adjacent to its water distribution lines. The District asserts that it has "fee simple" interest (see text box) and has notified certain property owners of its ownership interest and the property owners' encroachment.
- In February 2010, the District sent a letter to the city manager for the City of McAllen requesting that the City of McAllen continue to require subdividers of property to submit their subdivision plats to the District for review and approval to determine whether any of the District's facilities may be affected by a subdivision and whether that could affect District drainage.

Fee Simple Ownership

Fee simple ownership is absolute title to land, free of any other claims against the title.

Source:
http://www.law.cornell.edu/wex/fee_simple

The City of McAllen asserts that the District is claiming ownership of land that belongs to private citizens who are unaware of the cloud on their title. An affidavit from a local attorney expressed the belief that the District's filings cloud the title to more than 1,000 titles in the City of McAllen. According to the city attorney for the City of McAllen, that could be a source of revenue for the District because the property owners would have to pay the District to remove the cloud on their titles.

While the District has taken the actions described above to protect its real property interests, auditors did not verify the District's assertions about its title claims because that was not within the scope of the audit.

Chapter 3-B

The District's Rates and Fees are Generally Comparable to Other Districts in the Rio Grande Valley

The District's rates and fees are generally comparable to 15 other water districts in the Rio Grande Valley. As a result, auditors concluded that the District was not overcharging customers for irrigation in comparison to other districts' charges (see Appendix 5 for additional details).

Customers within the District who wish to irrigate their property must purchase water tickets from the District. Auditors tested 30 customer payments for purchases of irrigation water and determined that the District charged the customers appropriate rates.

The District also assesses an annual flat-rate fee of \$9.02 for each acre of land the customer owns within the District. Auditors tested 30 payments for the flat-rate fee assessments charged to District customers from October 2011 to December 2011 and determined that the District charged customers the appropriate rates. As discussed in Chapter 1-A, the District does not have policies or procedures regarding the collection, charge, or notification of flat-rate fee assessments to landowners within the District. The District collected \$23,963 (based on the audited financial statement prepared by the District's accounting firm) in fiscal year 2011.

Recommendation

The District should develop and implement policies and procedures regarding the collection, charge, or notification of flat-rate fee assessments to landowners within the District.

Chapter 3-C

The District's Conversion of Water Rights from Irrigation to Municipal Reflects the Changing Demographics of the District

The Texas Water Rights Commission, a predecessor agency of the Texas Commission on Environmental Quality, issued certificates of adjudication for water rights for approved claims that specified the ownership of water rights. The District was issued certificate of adjudication 23-848 in October 1971 with water rights categorized by municipal use and irrigation use. The water rights govern the amount of water that the District is allowed to pump (divert) from the Rio Grande River.

As the population of the City of McAllen has grown and the need for municipal water has increased, there has been a decrease in the rural land that needs to be irrigated. To adapt to that change, the District sought to amend its certificate of adjudication to change 10,000 acre-feet of irrigation rights to 5,000 acre-feet of municipal rights. Irrigation rights have a priority value, and when they are converted to municipal rights, the conversion factor is 2:1; therefore, the 10,000 acre-feet of irrigation rights were converted to 5,000 acre-feet of municipal rights. Those rights are still owned by the District, but their use has been changed to municipal. Those rights would be used to divert water to municipalities in the District, rather than for irrigation (see Appendix 6 for additional details and information on irrigable acres served by the District).

Definition of an Acre-foot

An **acre-foot** is the volume of water needed to cover 1 acre to a depth of 1 foot. It equals 325,851 gallons.

Source: *Rights to Surface Water in Texas*, Commission on Environmental Quality Publication G1-228.

In August 2011, the District conveyed 1,100 acre-feet of irrigation rights to the City of McAllen for approximately \$1.3 million. The 1,100 acre-feet of irrigation rights will convert into 550 acre-feet of municipal rights. That sale reduced the District's irrigation rights from 9,752.60 acre-feet to 8,652.60 acre-feet (see Appendix 6 for additional details).

Information on District Water Usage

This chapter presents information on the District's water use and water diversion.

The Commission on Environmental Quality did not identify waste of water by the district.

The Commission on Environmental Quality conducted an inquiry into alleged water waste by the District and did not find evidence of the waste of water by the District (see Appendix 8 for additional details.)

The District's general manager and board president acknowledged to auditors that he had devised a method to return water to the Rio Grande River after it had been pumped out; however, there is not a way to determine the amount of any water returned, if any, or whether it involved a waste of water.

Auditors did not perform work to determine whether the City of McAllen had any patterns of use that may have constituted a waste of water because that was not in the scope of the audit.

The District pumps (diverts) water from the Rio Grande River.

The Commission on Environmental Quality classifies the act of removing water from the Rio Grande River as "diversion."

The District's water diversion is segregated by use based on the type of water rights (municipal, mining, or irrigation). The municipal use recipient is the City of McAllen. Irrigation use recipients include farmers, homeowners, the Palm View Golf Course in McAllen, the McAllen Country Club, and the McAllen Cemetery Association (see Appendix 7 for additional details).

The District also diverts water for other owners of water rights such as the U.S. Department of Interior's Fish and Wildlife Service.

The City of McAllen's water needs are increasing.

See Appendix 9 for information on water allocated to the City of McAllen and related projections for the future.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

The objectives of the audit were to:

- Determine whether the Hidalgo County Water Improvement District No. 3 (District) has controls that are designed and operating to help ensure that financial transactions comply with applicable law, policies and procedures, and contract terms.
- Provide information on rates and fees the District charges.
- Provide information related to water use by the District.

Scope

The audit scope included a review of the District's financial processes, procurement of goods and services, governance processes, and rates and fees for fiscal years 2008 through 2011. The scope covered fiscal years 2007 through 2011 for water usage information.

Methodology

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

Auditors assessed the reliability of the District's data by (1) interviewing District staff and accountants knowledgeable about the data and systems and (2) conducting testing to determine whether the information from the District's system reconciles to the information maintained by the accounting firm that prepares the District's monthly financial information. Auditors determined that the data was sufficiently reliable for the purposes of this audit.

Information collected and reviewed included the following:

- House Committee on Border and Intergovernmental Affairs and Senate Intergovernmental Relations Committee sub-committee testimony during the 82nd legislative session.
- District's audited financial statements and management letters for fiscal years 2008 through 2011.

- District policies and procedures.
- District bank statements and bank reconciliations from September 2007 through August 2011.
- District contracts from September 2007 through December 2011.
- District board meeting minutes from September 2007 through October 2011.
- Rates and fees charged by the District and 15 comparable water districts in the Lower Rio Grande Valley.
- District revenue and expenditure detail from September 2007 to October 2011.
- The District's 2011 Flat Rate Assessment Levy Report.
- Certificates of adjudication for water rights owned by the District.
- Various reports for water diversion and water use obtained from the Commission on Environmental Quality Water Master for fiscal years 2008 through 2011.
- The Commission on Environmental Quality's investigation of allegation of water waste by the District.
- *2012 State Water Plan* by the Water Development Board.
- Excerpts from the McAllen Public Utility Water and Wastewater System Master Plan.
- 2009 Water Conservation and Drought Contingency Plan by the City of McAllen.

Procedures and tests conducted included the following:

- Testing internal controls over the District's financial information.
- Testing selected expenditures and revenues for fiscal years 2008 through 2011 to determine whether the District's financial information was entered accurately and completely into the financial statements prepared by the District's accountant.
- Comparing rates charged by the District to rates in comparable districts in the Rio Grande Valley to determine whether the District had comparable rates or if it was overcharging customers.

- Testing District capital assets for existence, proper approval, if they are safeguarded and recorded accurately in accounting records for fiscal year 2011.
- Observed the District's process for handling cash to determine the adequacy of controls over cash receipts and petty cash.
- Testing payments to District board members for fiscal year 2008 through 2011 for compliance.
- Testing construction contracts for fiscal years 2008 through 2011 for compliance with procurement requirements and whether construction contractors' requests for payment were adequately supported and approved by the District's engineer prior to submission to the District's board of directors for review, approval, and payment.
- Testing contracts for construction and consulting and professional services to determine compliance with procurement requirements.
- Testing billings for non-municipal customers to determine whether the District charged the correct rates.
- Testing the City of McAllen's payments to the District for water for fiscal years 2008 through 2011 and flat rate invoices for fiscal year 2011 to determine whether the District charged the correct rates to the City of McAllen.
- Reviewed the District's preventative maintenance records to determine whether the District had an appropriate preventative maintenance schedule and monitoring process to meet the obligations of the District.

Criteria used included the following:

- Texas Water Code, Chapters 49 and 51.
- Commission on Environmental Quality *Water District Financial Management Guide*.
- Texas Government Code, Chapters 551, 552, and 2254.
- Texas Local Government Code, Chapters 171, 176, and 201.
- Title 30, Texas Administrative Code, Chapter 303.

Project Information

Audit fieldwork was conducted from January 2012 through March 2012. 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.

- Lucien Hughes (Project Manager)
- Kathy Aven, CIA, CFE (Assistant Project Manager)
- Shahpar Ali, CPA, MS
- Karen Mullen, CGAP
- Laura Nienkerk, MACy
- Sherry Sewell, CGAP
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Michael Stiernberg, MBA, JD, State Bar (Legal)
- Nicole M. Guerrero, MBA, CIA, CGAP (Audit Manager)

Governor's Request for This Audit

Below is the letter from Governor Rick Perry requesting this audit.



OFFICE OF THE GOVERNOR

RICK PERRY
GOVERNOR

June 20, 2011

John Keel, CPA
State Auditor
State Auditor's Office
P.O. Box 12067
Austin, Texas 78711-2067

RE: Audit relating to the Hidalgo County Water Improvement District No. 3

Dear Mr. Keel:

I am writing to request your assistance in ensuring that the Hidalgo County Water Improvement District No. 3 ("district") is still fulfilling its statutory purpose in providing raw water to its customers at reasonable rates. As you are aware, I vetoed Senate Bill 978, which would have allowed the residents of the City of McAllen as well as the members of the District to vote for the dissolution of the District. This would have set a troubling precedent. But the concerns that led to this legislation should not be ignored. Therefore, I am writing to request that your office look into the following issues and report back to the legislature:

- Any financial weaknesses or misappropriation of funds within the district.
- The district's practice of filing liens claiming fee simple ownership against hundreds of private residential and commercial properties.
- The total amount of actual irrigable acres served by the district, compared to the 9,752 acre-feet allocated for irrigation use under its water rights.
- The total amount of water diverted over the past five years by the district, by use, type and recipient.
- Any patterns of use by the city or the district that may constitute a waste of water.

POST OFFICE BOX 12428 AUSTIN, TEXAS 78711 (512) 463-2000 (VOICE)/DIAL 7-1-1 FOR RELAY SERVICES
VISIT WWW.TEXASONLINE.COM THE OFFICIAL WEB SITE OF THE STATE OF TEXAS

John Keel, CPA
June 20, 2011
Page 2

- The amount of water that is allocated to the city but not used, the city's current need and its projected 20-year need.

Please feel free to contact Terry Zrubek at (512) 463-1778, to request any help you may need in accomplishing this review. I truly appreciate your attention to this matter.

Sincerely,

A handwritten signature in black ink that reads "Rick Perry". The signature is written in a cursive, slightly slanted style.

Rick Perry
Governor

RP:trp

cc: The Honorable Juan "Chuy" Hinojosa, State Senator, Texas Senate
The Honorable Veronica Gonzales, State Representative, Texas House of Representatives
The Honorable Richard F. Cortez, Mayor, City of McAllen, Texas
Mr. Othal Brand, Jr., General Manager, Hidalgo County Water Improvement District No. 3

District Background Information

Created in 1921, the Hidalgo County Water Improvement District No. 3 (District) is a political subdivision of the State of Texas and a public body with statutory duties to provide water for irrigation and other purposes. The District pumps and delivers raw water from the Rio Grande River to farmers and citizens of the City of McAllen. The District maintains a system of canals, lateral water distribution lines, pipelines, and other water transportation and irrigation facilities on land owned by the District.

By resolution, on March 9, 1926, the District's board of directors voted to convert the District from a water improvement district to a water control and improvement district. Water control and improvement districts have broader powers than water improvement districts. For example, in addition to irrigation, a water control and improvement district is authorized to provide for the improvement of rivers, creeks, and streams to prevent overflows, permit navigation or irrigation, or aid in those purposes. A water control and improvement district also can provide for the construction and maintenance of pools, lakes, reservoirs, dams, canals, and waterways for irrigation, drainage, or navigation, or to aid those purposes.

Table 6 shows events that occurred during the 82nd legislative session related to the District. Senate Bill 978 was introduced to dissolve the District.

Table 6

Events That Occurred During the 82nd Legislative Session Related to the District	
Date	Event
February 25, 2011	Senate Bill 978 (SB978) received by the Secretary of the Senate.
March 8, 2011	SB978 referred to the Senate Intergovernmental Relations Committee.
April 7, 2011	SB978 passed in the Senate.
April 14, 2011	SB978 referred to the House Border and Intergovernmental Affairs Committee.
May 25, 2011	SB978 passed in the House of Representatives.
May 27, 2011	House amendment(s) laid before the Senate.
May 27, 2011	Senate concurs in House amendment(s).
May 29, 2011	SB978 signed in the Senate and the House.
May 30, 2011	SB978 sent to the Governor.
June 17, 2011	SB978 vetoed by the Governor.

Source: Texas Legislature Online.

Table 7 shows information on District office and field staff and their salaries as of December 31, 2011.

Table 7

District Office and Field Staff and Their Salaries (as of December 31, 2011)	
Position	Hourly Salary
Office Staff	
General Manager ^a	\$ 0.00
Bookkeeper	\$18.03
Clerical Assistant	\$12.13
Field and Maintenance Staff	
Canal Rider	\$ 8.00
Canal Rider	\$19.35
Foreman	\$16.84
Laborer	\$12.13
Laborers (5 positions)	\$ 8.90
Welder Assistant	\$11.00
Welder and Fabricator	\$20.00
^a The General Manager, who is also a member of the District's board, does not receive a salary.	

Source: The District.

District Revenue

Tables 8 and 9 summarize Hidalgo County Water Improvement District No. 3 (District) revenue for fiscal years 2008 through 2011.

Table 8

District Revenue Fiscal Years 2011 and 2010						
Source of Revenue	Fiscal Year 2011			Fiscal Year 2010		
	Amount of Revenue	Percent of Total Water Sales	Percent of Total Operating Revenue	Amount of Revenue	Percent of Total Water Sales	Percent of Total Operating Revenue
Water Sales to the City of McAllen	\$747,975	89%	86%	\$1,184,612	92%	90%
Water Sales to Other Customers	<u>95,572</u>	11%	11%	<u>101,618</u>	8%	8%
Total Water Sales	\$843,547			\$1,286,230		
Flat-rate Levies	\$23,963		3%	\$24,036		2%
Totals	\$867,510	100%	100%	\$1,310,266	100%	100%

Source: Commission on Environmental Quality.

Table 9

District Revenue Fiscal Years 2009 and 2008						
Source of Revenue	Fiscal Year 2009			Fiscal Year 2008		
	Amount of Revenue	Percent of Total Water Sales	Percent of Total Operating Revenue	Amount of Revenue	Percent of Total Water Sales	Percent of Total Operating Revenue
Water Sales to the City of McAllen	\$1,044,945	94%	92%	\$1,261,947	95%	94%
Water Sales to Other Customers	<u>65,616</u>	6%	6%	<u>60,214</u>	5%	4%
Total Water Sales	\$1,110,561			\$1,322,161		
Flat-rate Levies	\$24,055		2%	\$24,320		2%
Totals	\$1,134,616	100%	100%	\$1,346,481	100%	100%

Source: Commission on Environmental Quality.

District Rates and Fees for 2011

Table 10 shows Hidalgo County Water Improvement District No. 3 (District) rates compared to the highest and lowest rates charged in the region.

Table 10

Lower Rio Grande Valley Rates and Fees Comparison 2011			
Service	Lowest Rate in Region	Highest Rate in Region	Rate Charged by the District
In-district Irrigation (cost per acre)	\$7.25	\$26.00	\$7.25
Out-of-district Irrigation (cost per acre)	\$12.50	\$78.00	\$12.50
Floodway Irrigation (cost per acre)	\$7.65	\$11.50	\$9.70
Yard Irrigation (cost per yard - less than 1 acre)	\$8.00	\$40.00	\$18.70
Municipal (cost per acre-foot supply and delivery)	\$35.00	\$84.72	\$66.80
Municipal (cost per acre-foot delivery only)	\$30.00	\$55.39	\$35.84
Flat-rate Tax (cost per acre)	\$9.02	\$66.06	\$9.02

Source: Water districts in the Lower Rio Grande Valley.

District Water Rights and Acres Served

Table 11 shows water rights owned by and irrigable acres served by the Hidalgo County Water Improvement District No. 3 (District) before and after the District's sale of 1,100 acre feet of water rights to the City of McAllen on August 12, 2011. Irrigable acres served apply only to irrigation water rights. All water rights the District owns fall under certificate of adjudication 23-848.

Table 11

District Water Rights and Acres Served				
Type of Water Rights	Prior to Sale of Water Rights on August 12, 2011		As of August 12, 2011	
	Acre-feet	Irrigable Acres Served	Acre-feet	Irrigable Acres Served
Irrigation	9,752.60	3,200	8,652.60	3,901.04
Municipal	13,980	Not applicable	13,980	Not applicable
Mining	100	Not applicable	100	Not applicable

Source: Commission on Environmental Quality.

Table 12 shows the timeline of District-owned water rights by type since 1971 and amendments approved to change the use of the water rights from irrigation to municipal and mining rights. District irrigation water rights have decreased from 19,852.60 in 1971 to 8,652.60 in 2012, while total municipal rights have increased from 8,980.00 in 1971 to 13,980.00 in 2012.

Table 12

Time Line of District Water Rights Activity on Certificate of Adjudication 23-848 ^a					
As of Date	Type of Water Use (in acre-feet)				
	Irrigation	Municipal		Mining	Totals
		Dedicated for the City of McAllen	Not Designated for a Specific Municipality		
October 18, 1971	19,852.60 (The number of irrigable acres served was 7,941.04.)	8,980.00	0.00	0.00	28,832.60
October 10, 1978	13,852.60 (The number of irrigable acres served was 5,541.04.)	8,980.00	3,000.00	0.00	25,832.60
September 8, 1995	9,752.60 (The number of irrigable acres served was 3,901.04.)	8,980.00	5,000.00	100.00	23,832.60
January 5, 2012	8,652.60 (The number of irrigable acres served was 3,901.04.)	8,980.00	5,000.00	100.00	22,732.60

^a This table does include 1,100 acre-feet sold to the City of McAllen on August 12, 2011.

Source: Commission on Environmental Quality.

District Raw Water Diversion

Table 13 summarizes Hidalgo County Water Improvement District No. 3 (District) raw water diversion from 2007 through 2011.

Table 13

District Raw Water Diverted (in acre-feet)										
Use	2011		2010		2009		2008		2007	
	Amount	Percent of Water Diverted	Amount	Percent of Water Diverted	Amount	Percent of Water Diverted	Amount	Percent of Water Diverted	Amount	Percent of Water Diverted
Municipal ^a	13,980.00	66%	17,124.90	59%	18,368.90	59%	17,192.72	69%	10,980.00	66%
Irrigation ^b	7,247.31	34%	11,817.21	41%	12,684.11	41%	7,688.28	31%	5,726.91	34%
Totals	21,227.31	100%	28,942.11	100%	31,053.01	100%	24,881.00	100%	16,706.91	100%
^a The municipal recipient is the City of McAllen. ^b Examples of irrigation recipients include farmers, homeowners, the Palm View Golf Course, the McAllen Country Club, and the McAllen Cemetery Association.										

Source: Commission on Environmental Quality.

Commission on Environmental Quality Investigation

Below is the Commission on Environmental Quality's (Commission) summary regarding its investigation of allegations that the Hidalgo County Water Improvement District No. 3 wasted water. The summary states that the Commission did not find evidence of wasted water.

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

January 30, 2012

Mr. Lucien Hughes
Managing Senior Auditor
State Auditor's Office
P.O. Box 12067
Austin, Texas 78711-2067

Re: Audit relating to Hidalgo County Water Improvement District No. 3

Dear Mr. Hughes:

The Rio Grande Watermaster's Office (RGWM) received a request to investigate whether any evidence exists that the Hidalgo County Water Improvement District No. 3 (District) wasted approximately 500 acre-feet of water during the time period of March 2011.

The investigation discovered that at no time was the District certified by the RGWM to divert a volume of 500 acre-feet of water; therefore the RGWM made no request for water to be released from Falcon Lake. As a result, had the District diverted and distributed this volume of water without a RGWM certification, there would have been a shortage of water downstream at the Anzalduas Dam during the alleged waste event. The RGWM also reviewed the District's delivery records and found no allocation of this water volume to the District's customers.

Since there was not a shortage of water indicated at the Anzalduas Dam gage during the alleged waste event, the RGWM investigated the District's diversion site to determine if the District had return diverted flows back to the Rio Grande River. From the onsite investigation the RGWM concluded that the District does not have any physical means by which to return water flows back to the river; therefore there is no evidence that a diversion and return could have taken place.

Based on the investigation information above, the RGWM did not find evidence to indicate a waste of water by the District during March 2011. If you have any additional questions about this matter, please feel free to contact me at (512) 239-4481.

Sincerely,



Ramiro Garcia, Jr., Director
Field Operations Central Texas Area
Office of Compliance and Enforcement

P.O. Box 13087

Austin, Texas 78711-3087

512-239-1000

Internet address: www.tceq.state.tx.us

City of McAllen's Current and Projected Water Need

Table 14 shows the amount of water allocated to and used by the City of McAllen in 2011 by source.

Table 14

City of McAllen Water Allocation and Use 2011		
Source of Water	Amount of Water Allocated for Municipal Use (in acre-feet)	Amount of Water Used (in acre-feet)
Hidalgo County Water Improvement District No. 3	13,980.00	13,980.00
United Irrigation District	11,250.00	11,250.00
Hidalgo County Irrigation District No. 2	6,140.00	8,458.65
City of McAllen	678.84	678.84
Totals	32,048.84	34,367.49
Total Amount of Water Used Above Allocations		2,318.65

Source: Commission on Environmental Quality.

Table 15 shows the projected growth in the City of McAllen's retail population and peak hour water demand from 2009 through 2025. This table also includes water supplied by the City of McAllen to a wholesale customer, the City of Edinburg.

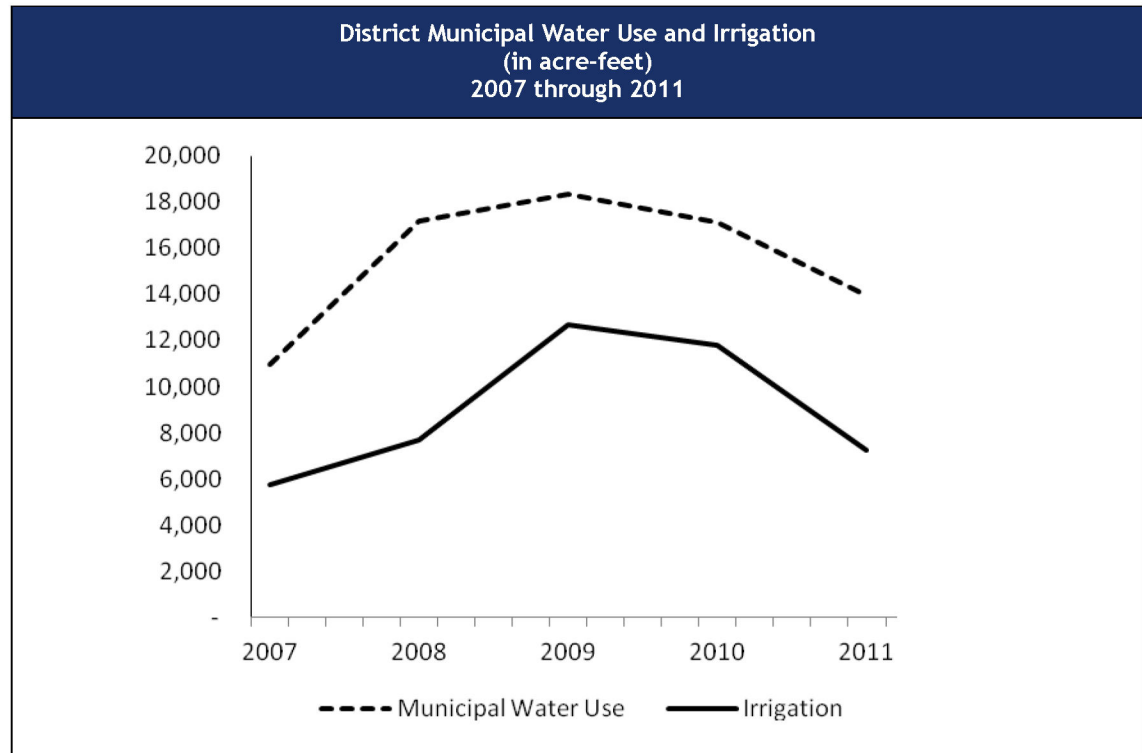
Table 15

City of McAllen Projected Retail Population and Peak Hour Water Demand 2009 through 2025			
Year	Retail Population	Peak Hour Water Demand (millions of gallons of water per day)	Total Average Daily Demand (millions of gallons of water per day)
2009	140,703	65.9	20.6
2010	144,394	67.5	21.1
2011	145,820	68.5	21.4
2012	147,247	69.4	21.7
2013	148,673	70.4	22.0
2018	155,805	78.6	25.3
2025	164,132	84.5	27.2

Source: City of McAllen *Public Utility Water and Wastewater System Master Plan*.

Figure 1 shows municipal water use and irrigation for the Hidalgo County Water Improvement District No. 3 (District) from 2007 through 2011.

Figure 1

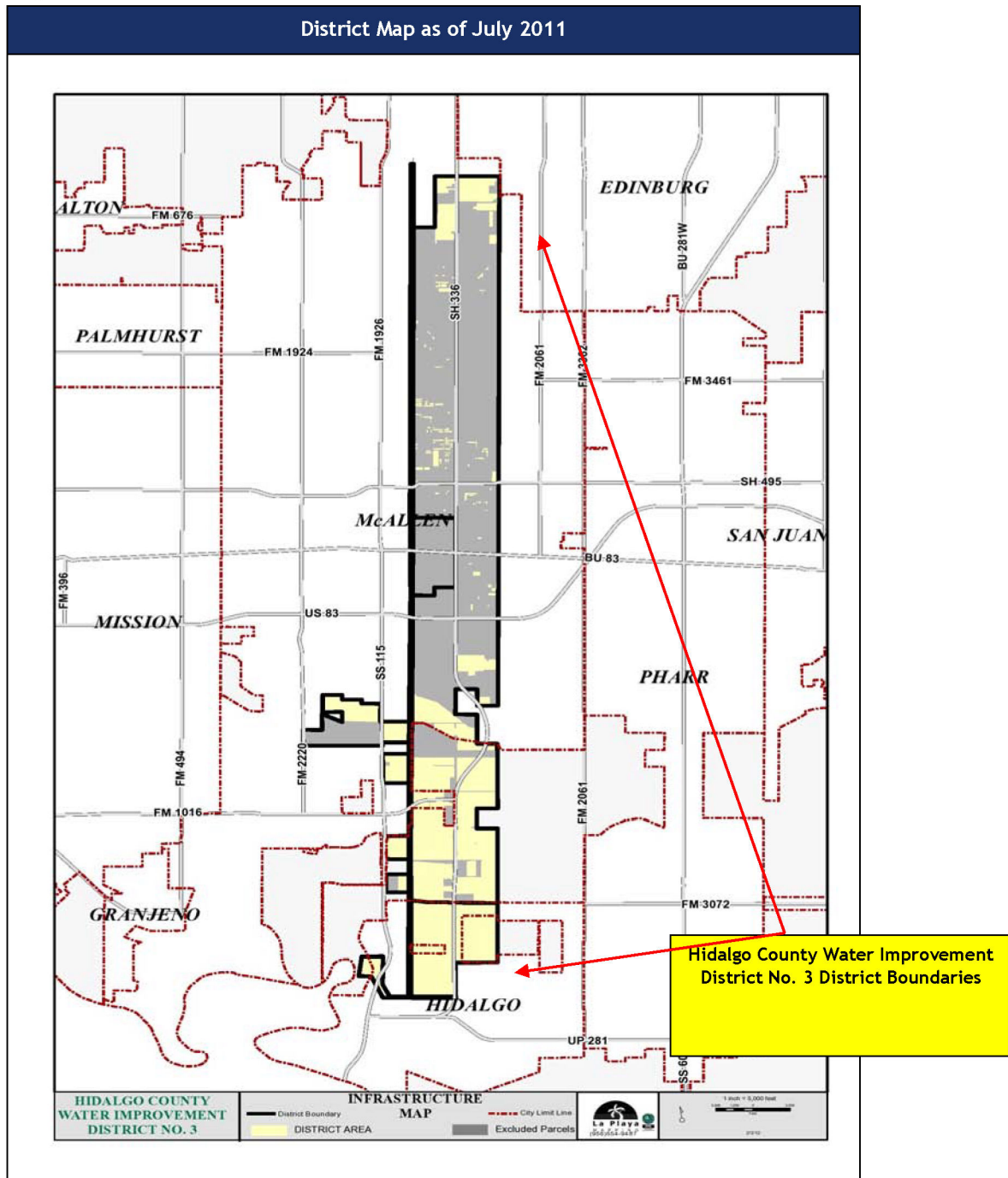


Source: Commission on Environmental Quality.

District and County Maps

Figure 2 shows a map of the Hidalgo County Water Improvement District No. 3 (District) as of July 2011.

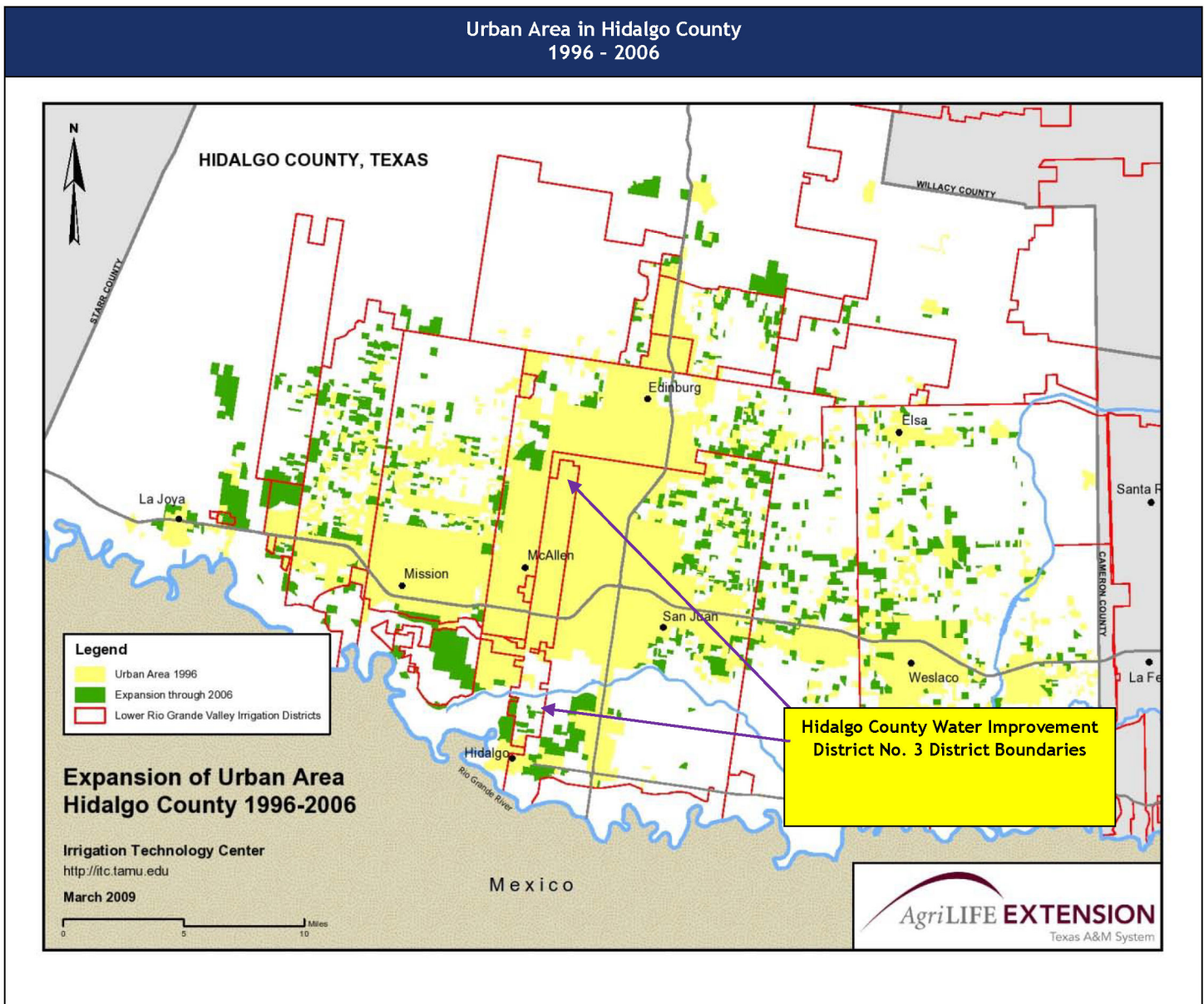
Figure 2



Source: The District.

Figure 3 shows the expansion of the urban area in Hidalgo County from 1996 through 2006.

Figure 3

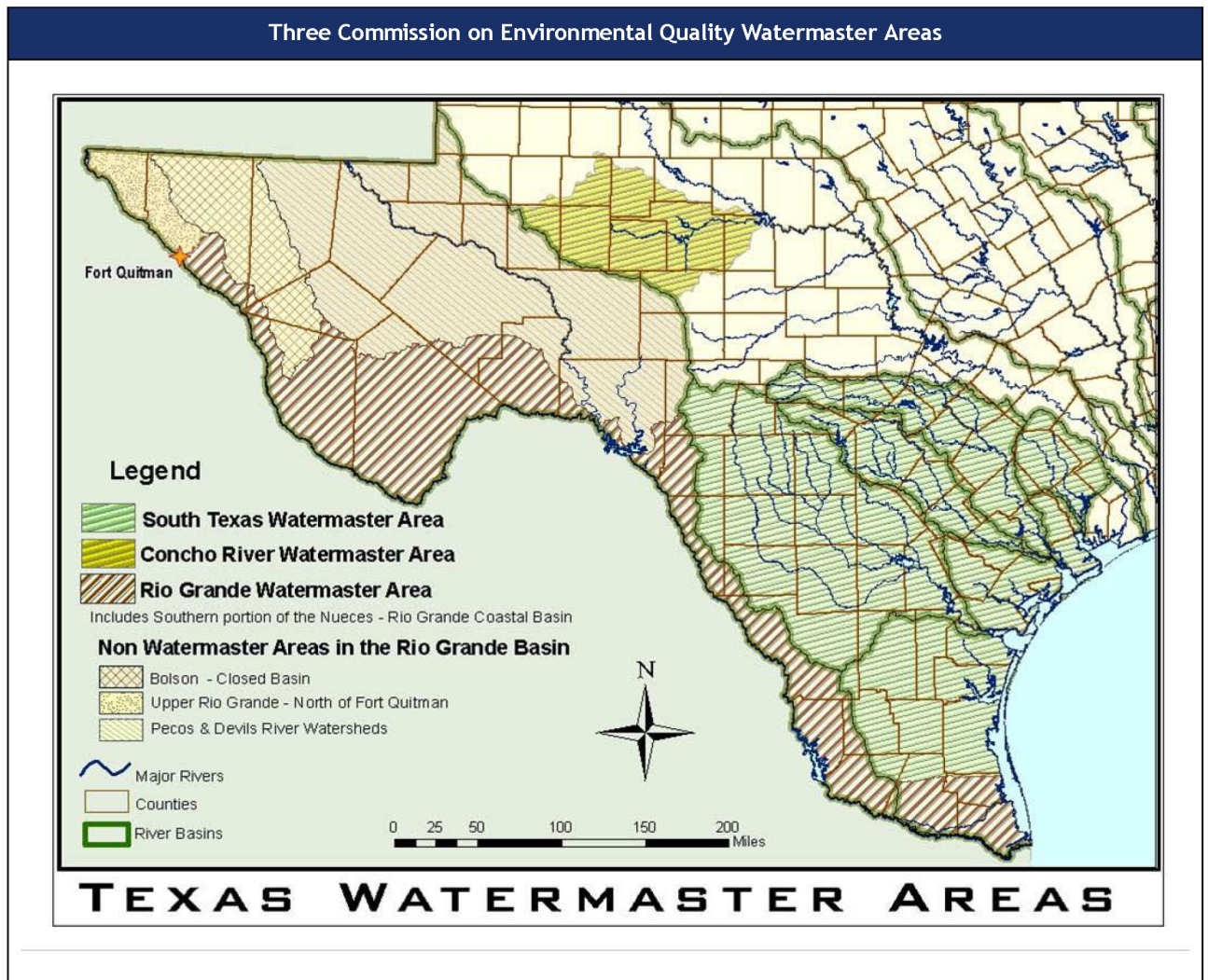


Source: The Irrigation Technology Center, Texas AgriLife Extension Service.

District Watermaster Area

Figure 4 shows three watermaster areas of the Commission on Environmental Quality. The Hidalgo County Water Improvement District No. 3 (District) is in the Rio Grande Watermaster Area.

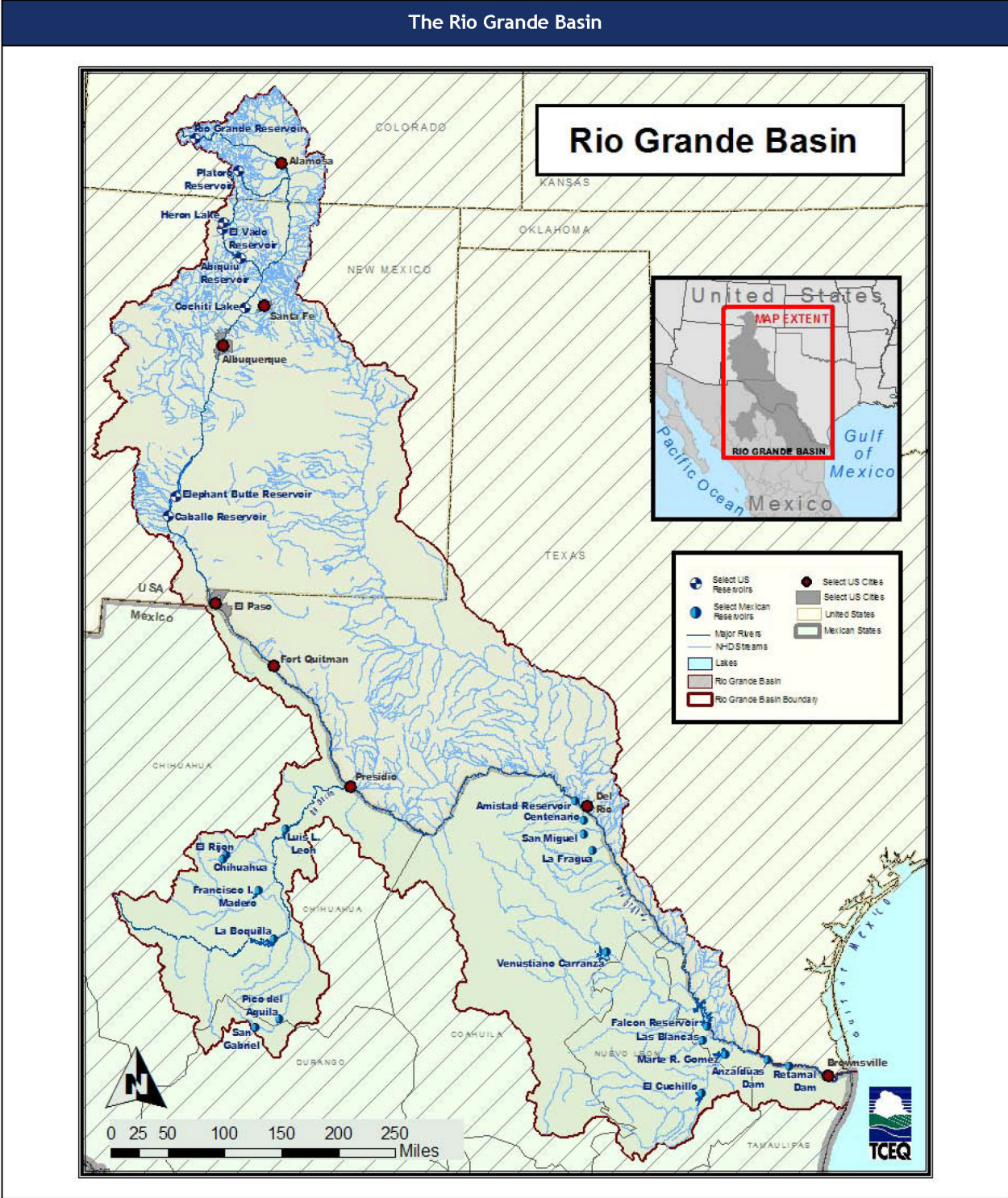
Figure 4



Source: Commission on Environmental Quality.

Figure 5 shows the Rio Grande Basin, the source of water for the District.

Figure 5



Source: Commission on Environmental Quality.

Comparison of District Contract Provisions for Professional and Consulting Services and Excerpts from State of Texas Contract Management Guide

The State Auditor's Office reviewed 13 professional and consulting services contracts that the Hidalgo County Water Improvement District No. 3 (District) executed with various attorneys and engineering firms and for other services such as public relations, accounting, and auditing. Auditors assessed the provisions of the contracts to determine their adequacy in protecting the District's interests by comparing them to selected best practices provisions listed in the *State of Texas Contract Management Guide* (Guide).

The Guide provides suggestions and best practices to improve statewide contracting practices. Although the District is not subject to the Guide, the Guide is a good resource for strengthening contracting practices. The Guide includes provisions and clauses considered essential in contracts.

Table 16 presents selected best practices provisions and clauses in the Guide, including suggested language or descriptions of the provision or clause. Auditors compared 13 of the District's professional and consulting services contracts to the best practices provisions and clauses, and Table 16 specifies whether the 13 contracts included the best practices provisions.

Table 16

Analysis of 13 District Professional And Consulting Services Contracts and Whether They Contained Provisions Recommended by the <i>State Of Texas Contract Management Guide</i>		
Provision	Number of District Contracts That Contained the Provision	Number of District Contracts That <u>Did Not</u> Contain the Provision
Introduction: Introduce all participants and identify agency and contractor key personnel.	7	6
Scope of Work: Discuss the scope of the contract (i.e., what the agency is buying). Although this may seem overly simplistic, a total and complete meeting of the minds on this point will avoid problems during the life of the contract.	13	0
Indemnification: Contractor shall defend, indemnify, and hold harmless the State of Texas, its officers, and employees, and (Agency Name), its officers, and employees and contractors, from and against all claims, actions, suits, demands, proceedings, costs, damages, and liabilities, etc.	3	10
Price: Total amount of contract or fee schedule.	8	5
Specifications: Defines the requirements of the request for proposal.	6	7

Analysis of 13 District Professional And Consulting Services Contracts and Whether They Contained Provisions Recommended by the State Of Texas Contract Management Guide		
Provision	Number of District Contracts That Contained the Provision	Number of District Contracts That Did Not Contain the Provision
Antitrust: Neither Respondent nor firm, corporation, partnership, or institution represented by Respondent or anyone acting for such firm, corporation, or institution has (1) violated the antitrust laws of the State of Texas under Texas Business and Commerce Code, Chapter 15, or the federal antitrust laws; or (2) communicated the contents of this Proposal either directly or indirectly to any competitor or any other person engaged in the same line of business during the procurement process for this RFP [Request for Proposal].	0	13
Payment: Prior to authorizing payment to Contractor, {Insert agency name here} shall evaluate Contractor's performance using the performance standards set forth in all documents constituting this Contract. Contractor shall provide invoices to {Insert agency name here} for Commodities/Services provided/performed. Invoices must be submitted not later than the 15th day of the month after the Services are completed. No payment whatsoever shall be made under this contract without the prior submission of detailed, correct invoices.	1	12
Affirmation Clauses: All statements and information prepared and submitted in the response to this RFP are current, complete and accurate (example clause...many more to be included in contract).	0	13
Dispute Resolution: The dispute resolution process provided for in Texas Government Code, Chapter 2260 shall be used by {Insert agency name here} and Contractor to resolve any dispute arising under the Contract.	1	12
Term of Contract: CONTRACT TERM. The services requested shall be provided for a period of ____ [state initial term, ex. Two (2) years], beginning ____ [insert start date], or the last signature date, whichever is later, and ending ____ [Length of contract term should not extend past end of biennium in which execution of contract occurs, i.e. no later than August 31, 20XX]. [If applicable, include the following] This contract may be renewed for up to [state renewal options, ex. three (3) one (1) year renewal options] upon mutual agreement of the parties to be evidenced in writing prior to the expiration date of the initial term. [Length of renewal term should run so it expires within biennium] At the sole option of {Insert agency name here} the Contract may be extended as needed, not to exceed a total of {Insert extension period} months.	3	10
Confidential Information: Notwithstanding any provisions of this Contract to the contrary, Contractor understands that {Insert agency name here} will comply with the Texas Public Information Act, Texas Government Code, Chapter 552 as interpreted by judicial opinions and opinions of the Attorney General of the State of Texas. {Insert agency name here} agrees to notify Contractor in writing within a reasonable time from receipt of a request for information related to Contractor's work under this contract. Contractor will cooperate with {Insert agency name here} in the production of documents responsive to the request. {Insert agency name here} will make a determination whether to submit a Public Information Act request to the Attorney General. Contractor will notify {Insert agency name here} General Counsel within twenty-four (24) hours of receipt of any third party requests for information that was provided by the State of Texas for use in performing the Contract. This Contract and all data and other information generated or otherwise.	2	11
Abandonment or Default: If the contractor defaults on the contract, [agency name] reserves the right to cancel the contract without notice and either re-solicit or re-award the contract to the next best responsive and responsible respondent.	0	13
Right to Audit: Pursuant to [Section] 2262.003 of the Texas Government Code, the state auditor may conduct an audit or investigation of the vendor or any other entity or person receiving funds from the State directly under this contract or indirectly through a subcontract under this contract.	0	13

Analysis of 13 District Professional And Consulting Services Contracts and Whether They Contained Provisions Recommended by the State Of Texas Contract Management Guide		
Provision	Number of District Contracts That Contained the Provision	Number of District Contracts That Did Not Contain the Provision
Force Majeure: Neither Contractor nor {Insert agency name here} shall be liable to the other for any delay in, or failure of performance, of any requirement included in any PO resulting from this RFP caused by force majeure.	0	13
Ownership/Intellectual Property: For the purposes of this Contract, the term "Work" is defined as all reports, statistical analyses, work papers, work products, materials, approaches, designs, specifications, systems, documentation, methodologies, concepts, research, materials, intellectual property or other property developed, produced, or generated in connection with this Contract. All work performed pursuant to this Contract is made the exclusive property of {Insert agency name here}.	1	12
Independent Contractor: Contractor or Contractor's employees, representatives, agents and any subcontractors shall serve as an independent contractor in providing the services under any PO resulting from this RFP. Contractor or Contractor's employees, representatives, agents and any subcontractors shall not be employees of {Insert agency name here}. Should Contractor subcontract any of the services required in this RFP, Contractor expressly understands and acknowledges that in entering into such subcontract(s), {Insert agency name here} is in no manner liable to any subcontractor(s) of Contractor. In no event shall this provision relieve bidder of the responsibility for ensuring that the services rendered under all subcontracts are rendered in compliance with this RFP.	0	13
Termination: This Contract shall become effective on the date signed by the appropriate official of {Insert agency name here} and shall expire on _____ unless otherwise sooner terminated as provided in this Contract. Notwithstanding the termination or expiration of this Contract, the provisions of this Contract regarding confidentiality, indemnification, transition, records, right to audit and independent audit, property rights, dispute resolution, invoice and fees verification, and default shall survive the termination or expiration dates of this Contract. {Insert agency name here} may, in its sole discretion, terminate this Contract upon thirty (30) days' written notice to Contractor. Such notice may be provided by facsimile or certified mail; return receipt requested and is effective upon Contractor's receipt.	2	11

Source: *State of Texas Contract Management Guide, Version 1.9, January 10, 2012*, Office of the Comptroller of Public Accounts.

Management's Responses

HIDALGO COUNTY WATER IMPROVEMENT DISTRICT NUMBER THREE

Board of Directors
President – Othal Brand, Jr.
Vice President – W. D. Moschel
Secretary – Chris Burns
Member – Leo Montalvo
Member – Joe Corso

1325 Pecan Blvd.
McAllen, Texas 78501
(956) 686-8303
Fax (956) 686-1022

May 21, 2012

Mr. John Keel, CPA
State Auditor
State Auditor's Office
P. O. Box 12067
Austin, Texas 78711-2067

Attn: Lucien Hughes

RE: Hidalgo County Water Improvement District No. 3 (the "District")

Dear Mr. Keel:

This will acknowledge receipt of what we understand to be the final draft version of *An Audit Report on The Hidalgo County Water Improvement District No. 3* (the "Audit Report"). This letter, together with the attachments hereto and our prior letter dated May 10, 2012 and the attachments to that earlier letter, constitute the District's response to and comments on the Audit Report. It is our understanding that the District's full responses will be incorporated into and published with the Audit Report including the version to be available for viewing on the website of the State Auditor's Office and any other distributed copies. In the event your office should make additional modifications to the Audit Report, the District reserves the right to amend or supplement its responses and comments with respect to those modifications.

It has been a pleasure to work with your office and audit staff who have been courteous, cooperative, and professional throughout this process. We recognize that undertaking and completing the task requested by Governor Perry in his letter, dated June 20, 2011, presented unusual challenges for your office and that some of the matters addressed in that request are outside the customary scope of a financial audit. In general, we believe that many of the findings and conclusions in the Audit Report are fair, and most of the suggestions and recommendations for changes in or improvements to procedures or operations are welcome and appreciated. A majority of the weaknesses or deficiencies identified in the Audit Report have already been addressed or corrected as noted in our responses. Those matters which relate to compliance with applicable requirements of the *Texas Water Code* or other statutes have also either already been addressed or will be corrected as quickly as is reasonably possible. To the extent that consideration of recommendations in the Audit Report may require the involvement of the

Mr. John Keel
State Auditor
May 21, 2012
Page 2

elected directors of the District, we can assure you that those matters will be presented to and addressed by the board in a deliberate but timely and responsible manner and implemented when determined to be feasible and appropriate.

Notwithstanding the many politically charged allegations made by proponents of dissolution of the District during the 82nd Texas Legislature, we appreciate and are pleased that your audit team found no evidence of any misappropriation of funds or any other actual misuse or waste of resources at the District and that the Audit Report confirms that result. We do appreciate that the focus of many of the findings, conclusions and recommendations in the Audit Report relate directly to the need to strengthen policies, procedures and controls to insure that no such events occur in the future and to provide transparency to the public regarding District transactions and operations. We share those goals and intend to consider and implement many of your audit team's suggestions for improved practices.

The Audit Report does include some findings and conclusions with which the District does not agree. We have described the basis for each of those disagreements in the attached responses. We respectfully request that your office either modify those findings and conclusions accordingly or incorporate the District's responses in their entirety into the Audit Report if you determine that a modification is not justified or appropriate. In a few instances, the disagreement with the Audit Report is based on the tone, emphasis, or arrangement of the report. In most instances, the disagreement is based on the District's judgment that a finding or conclusion is inaccurate because it is based on (i) erroneous information or data obtained by or provided to your office by third parties, (ii) an incorrect interpretation of accurate data or information provided by either third parties or the District, (iii) incomplete information, or (iv) the absence of information which may not have been requested by or furnished to your office during the audit process. In each of those cases, the District has attempted to supplement its attached responses with the accurate or additional information or data or the reason why available data may have been misinterpreted or misunderstood.

Finally, this letter also is intended to provide your office with representations from District management which are made in good faith and to the best of our knowledge and belief. By way of limitation, please understand that each of the directors whose signature appears below has been involved to a different degree and extent in the audit process. For most of the directors, that involvement has been limited to a single interview by one or more members of the audit team. Most of the directors have not been privy to or informed as to the specific data or information either requested by or furnished to the audit team by the District staff, accountants, attorneys, engineers, or other individual directors. Except to the extent disclosed in the Audit Report itself, none of the directors have been privy to or informed as to data or information requested by or furnished to the audit team by other third parties. Subject to the foregoing limitations, the good faith representations from District management are as follows:

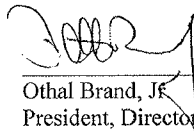
Mr. John Keel
State Auditor
May 21, 2012
Page 3

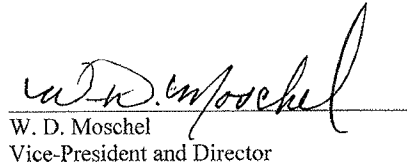
- (1) We understand that the objectives of your audit are to look into and report back to the legislature regarding those issues identified and set out in that certain letter request, dated June 20, 2011, from Governor Rick Perry to the State Auditor (Appendix 2 to the Audit Report). We further understand that you have determined that the scope of the audit would be limited to the District's fiscal years 2008 through 2011 as to financial matters and 2007 through 2011 as to water usage.
- (2) To the best of our knowledge and belief, the District has made available to you all information relevant to the foregoing objectives, within the applicable fiscal years, and requested by the audit team (together with such other information, whether or not requested, believed in good faith by the District to be relevant to the foregoing objectives) including:
 - (a) financial and program records, related data, and reports;
 - (b) notices, agendas, and minutes from District board meetings;
 - (c) policies and procedures;
 - (d) pumping reports and information;
 - (e) pertinent personnel records;
 - (f) information concerning related parties;
 - (g) bank statements for all District accounts; and
 - (h) significant contracts, grants, and agreements.
- (3) The District has primary responsibility for (i) program results, (ii) efficient use and protection of resources, (iii) identification of and compliance with applicable state and federal laws and regulations, (iv) collection, maintenance, reporting, dissemination, and use of accurate, complete, reliable and timely information, (v) the fair presentation of financial position and program results in District reports, and (vi) the internal controls associated with the foregoing responsibilities.
- (4) To the best of our knowledge and belief, the District has identified and disclosed to you all significant outstanding lawsuits filed against the District and/or settled or otherwise disposed of during the applicable fiscal years.
- (5) To the best of our knowledge and belief, the District has disclosed to you any known significant deficiencies in internal controls relevant to the foregoing audit objectives.
- (6) To the best of our knowledge and belief, there have been no known instances of fraud, illegal acts, or abuse involving management or employees of the District, and, to the best of our knowledge and belief, no such instances are currently under investigation.

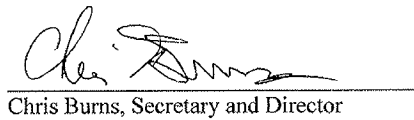
Mr. John Keel
State Auditor
May 21, 2012
Page 4

- (7) To the best of our knowledge and belief, the District has disclosed all plans, intentions, and actions that may significantly affect the audit results.
- (8) To the best of our knowledge and belief, the District has properly recorded all material transactions in the accounting records of the District.
- (9) To the best of our knowledge and belief, information provided by the District to the audit team is complete and correct.

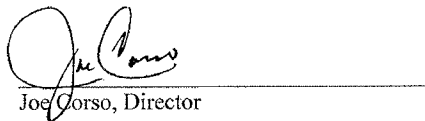
Thank you for the courtesies extended to the District by your office and audit team and for the opportunity to review and respond to the Audit Report. If you require any additional information or clarification from the District, please feel free to contact the management staff. We hope the Audit Report and the District's responses will result in a better appreciation for and understanding of all issues regarding the operations of the District and its relationship with its water customers and users including the City of McAllen.


Othal Brand, Jr.
President, Director and General Manager


W. D. Moschel
Vice-President and Director


Chris Burns, Secretary and Director


Leo Montalvo, Director


Joe Corso, Director

Hidalgo County Water Improvement District No. 3 Management's Responses to Audit Report

Proposed Summary of District Management's Response to Overall Conclusion and Key Points section of Audit Report:

The audit of Hidalgo County Water Improvement District No. 3 (the "District") resulted from a request by Governor Rick Perry to investigate concerns expressed during the 82nd Texas Legislature. One of the most serious concerns arose from allegations of significant misappropriation, loss or waste of District funds or assets. Although the State Auditor's Office found no evidence of any misappropriation of funds and did not find or report any such losses or instances of unreasonable or wasteful expenditures, the Audit Report focuses instead on what are described as "significant weaknesses in the management of finances and operations" and a claimed failure to establish a "framework for effective governance, oversight, and planning". However, a thorough analysis of those findings demonstrates that they are more appropriately seen as recommendations for enhanced transparency and improved documentation to prevent any future problems rather than evidence of actual and detected past instances or events. The District and its directors appreciate the spirit of the recommendations and intend to seriously consider and implement many of them as appropriate to improve internal controls and management of its operations and to adopt better practices. To the extent that the Audit Report does identify areas of noncompliance with requirements of the Texas Water Code or other statutes, the District has either already taken steps to correct those deficiencies or will aggressively pursue and implement policies to insure future compliance.

Lastly, the District does believe that the Audit Report inaccurately concludes the District has been liquidating assets to cover operating losses and to sustain itself. The responses to specific sections of the Audit Report demonstrate instead that conservative management of resources and assets has enabled the District to fulfill its mission and obligations to both irrigation customers and the City of McAllen while, at the same time, maintaining substantial cash reserves, preserving essential and non-surplus land and water rights, and implementing and continuing an aggressive capital improvements program. In addition, the District has been able to meet those objectives despite a continuous and concerted effort by the City of McAllen to take over or dissolve the District, acquire the District's assets by means of actual or threatened condemnation proceedings, and deplete or diminish the District's cash reserves and water delivery and supply revenues through lawsuits and legislative initiatives.

The management of the District welcomes the Audit Report and the directors and officers are heartened by the overall findings which clearly demonstrate no misappropriations or waste of the District's assets and resources have occurred and also indicate a generally sincere and effective effort to guide the operations of the District in a good faith manner consistent with the statutory mission and fiduciary obligations to further the public trust and the purposes for which they were elected to serve.

Chapter 1-A Financial Controls

During the 82nd Texas Legislature, supporters of a bill to dissolve the District and turn its assets over to the City of McAllen made unfounded and untrue allegations of misappropriation of funds and waste of resources. The most incendiary of those allegations was a claim that almost \$8 million in District assets were missing or had somehow disappeared between 2009 and 2010. When Governor Rick Perry requested an examination of the District, he specifically requested, among other things, that the State Auditor look into and report back to the legislature whether there had been any misappropriation of funds within the District.

The State Auditor did not find evidence of any misappropriation of funds at the District and certainly did not uncover any evidence of a misappropriation, disappearance or loss of \$8 million in District assets. The financial statements of the District (as reviewed and prepared annually by Long Chilton L.L.P., an independent accounting firm) show that the net assets of the District were \$8,083,612 as of the Fiscal Year ending August 31, 2009 and were \$7,863,305 as of the Fiscal Year ending August 31, 2010 – a decrease of \$220,307. Because of progress or completion of various construction projects during FY 2010, the capital assets of the District actually increased by \$2.3 million during that same period.

On pages 4-5, the Audit Report describes compensation payments to directors which exceeded statutory daily limits by \$77.12 month but which were also well below the mandatory annual limits. Although the Audit Report points out that directors had not completed and filed verified statements supporting compensation and reimbursements, as required by the Texas Water Code, the State Auditor does conclude that all reimbursements reviewed were “allowable, reasonable, and supported by other documentation.” All of the District’s currently serving directors have repaid the District in full for any compensation which exceeded any statutory limits. The District promptly implemented a policy requiring the completion and filing of verified statements as a precondition to payment of any compensation or reimbursement to directors. True and correct copies of the receipts for director repayments, as well as the form of verified statement currently in use by the District, are attached as Exhibits 1 and 2 to this response.

Other than the director compensation payments described above, the State Auditor does not identify or reference anywhere in the Audit Report any instance in which the District has made an unreasonable or excessive expenditure from its funds or incurred any expenses inconsistent with or inappropriate to its statutory authority or purposes. Although there are no such findings or any evidence of misappropriation of funds or waste or loss of assets, the Audit Report emphasizes and focuses instead on what the State Auditor has described as “significant weaknesses in the management of its finances and operations” and concludes that the District has not established a “framework to provide for effective governance, oversight, and planning” (see pages i and 1). Among those “weaknesses”, the Audit Report criticizes the District for “noncompliance with various provisions of the Texas Water Code”.

Despite that latter criticism, the only references in the Audit Report to any failure by the District to comply with the Texas Water Code are:

- the absence of written policies and procedures for selection, monitoring, or review and evaluation of professional services as required by Section 49.199(a)(4), Texas Water Code (to be addressed and corrected although District has complied with substantive statutory requirements for procurement of professional services as discussed in letter from R. K. Whittington attached as Exhibit 3 to this response)
- the failure to obtain bonds and to file sworn statements for elected directors as required by Section 49.055(c)-(d), Texas Water Code (bond requirement already corrected as evidenced by true and correct copy of Hartford director bond attached as Exhibit 4 to this response; filing of sworn statements to be addressed and corrected)
- the failure to obtain a bond for District employees who handle cash as required by Section 49.057(e), Texas Water Code (already corrected as evidenced by true and correct copy of Hartford employee theft policy attached as Exhibit 5 to this response)
- exceeding daily limit on and inadequate documentation of director compensation as required by Section 49.060, Texas Water Code (already repaid and corrected as described above and evidenced by true and correct copies of verified statement form and receipts attached as Exhibits 1 and 2 to this response)
- late completion of annual financial audits for FY 2008-2010 and late filing of those audit reports with TCEQ as required by Sections 49.191 and 49.194, Texas Water Code (already corrected as all audit reports were completed and filed for FY 2008-2010 and were timely completed and filed for FY 2011)
- competitive bidding requirement of Section 49.273, Texas Water Code (not applicable except for construction and repair and renovation of district facilities and for the purchase of equipment, materials, machinery, and all things that constitute or will constitute the plant, works, facilities, or improvements of the district as discussed in memorandum from Glenn Jarvis attached as Exhibit 6 to this response)
- conflict of interest provisions of Section 49.058, Texas Water Code (complied with all requirements as evidenced by conflict of interest affidavits attached as Exhibits 7 and 8 to this response and abstention from voting as acknowledged on page 9 of Audit Report)
- payment of maintenance and operating expenses from assessments on irrigable land as required by Section 51.305, Texas Water Code (as acknowledged in the State Auditor's recommendations on page 17 of the Audit Report, this statute may require modification because urban or partially urban water control and improvement districts across the State of Texas are no longer able to comply with the "not less than 1/3 nor more than 2/3 limitations")

Except as discussed above with respect to excess director compensation (all of which has been repaid in full to the District), it is noteworthy that none of the foregoing compliance issues resulted in any loss of funds or other assets or resources of the District -- a fact which is not mentioned in the Audit Report. As indicated and as discussed below, neither the District nor any director or employee of the District failed to comply with any statutory requirement in the Texas Water Code, or otherwise, relating to conflicts of interest or competitive bidding.

During the audit process, the District made all financial and operational records available to the State Auditor's staff. As stated on page 23 of the Audit Report, the audit team requested and reviewed, among many other documents and records, all minutes of District board meetings from September 2007 through October 2011 and all bank statements and reconciliations from September 2007 through August 2011. In addition, the audit team conducted extensive interviews with the District's directors and management, staff, and outside accountants. The District's policies, procedures and customary practices with respect to review, monitoring, approval, and oversight of accounts payable and receivable, revenues and expenditures, contract management, and capital improvement projects are readily apparent from the information available to and gathered by the State Auditor's staff. Contrary to the conclusion that the District has not established a framework to provide for effective governance or oversight, the District and its board of directors have a well established and consistent process that includes, among other things, the following:

- (1) The board of directors meets regularly and at least monthly in meetings noticed and conducted in accordance with Chapter 551, Texas Government Code -- the "Open Meetings Act".
- (2) Each director is provided with a meeting packet which includes all bank statements for District accounts and a listing of all revenues and bank deposits and all expenses and checks written since the last board meeting.
- (3) The meeting packet for each director includes monthly financial statements (reflecting District assets and liabilities and revenues and expenses) prepared by an outside independent accounting firm.
- (4) Every expense and disbursement of the District is reviewed and approved by the board of directors.
- (5) The District general manager and outside engineer present written monthly reports to the board of directors regarding the status of purchase and construction contracts and capital improvement projects.
- (6) The board of directors reviews and approves all purchase and construction contracts including all change orders and all invoices and progress payments.

The Audit Report includes an erroneous finding that the District has been offsetting operating losses from FY 2008 through FY 2011 by selling assets and a conclusion that the District may not be able to sustain its operations (see pages 1-2 and Appendix 4). That finding is apparently based on (i) a calculation that the District's operating revenues and expenses for those years totaled \$4,658,873 and \$5,520,667, respectively, for a four-year cumulative operating loss of \$861,794 and (ii) an assumption that no other funds were available for the operations of the District except the \$5,796,212 in proceeds realized from the sale of land and water rights. That finding is in error because it does not take a number of relevant facts into account. First, as of September 1, 2007, the District had cash or cash equivalents in reserve in the amount of \$2,714,486 -- more than three times the total operating loss sustained over the following four years. Second, the operating shortfalls include depreciation expense -- a non-cash item. Third, none of the asset sales proceeds were used by the District to cover operating expenses -- even in FY 2011 when the total shortfall was \$469,707 (attributable entirely to more than \$450,000 in expenses resulting from legal and legislative disputes with the City of McAllen and a \$436,637 decrease in revenues caused by the predatory water purchase strategy adopted by McAllen and

its Public Utilities Board). Due to a resulting temporary cash flow shortage, the District arranged for an interim operating loan during the Spring of 2011. Fourth, at the end of FY 2011 and after the conclusion of the 82nd Texas Legislative session and the resumption of water purchases by McAllen, the District was able to repay the interim loan in full and to restore its reserves to \$2,041,723 including the \$500,000 line of credit (the net reduction being equivalent to the difference in the cost of new capital assets and improvements in excess of proceeds from the sale of surplus land and water rights).

In addition to the foregoing, during this same period of FY 2008 through FY 2011, the District was able to undertake and complete the purchase and construction of new and essential capital improvements costing \$6,585,527 -- paid for entirely from (i) the District's available cash reserve, (ii) proceeds from the sale of 1,300 acre-feet of surplus water rights from the District's adjudicated allocation for irrigation, and (iii) from the sale of surplus land which was no longer essential to the maintenance of either the District's irrigation system or its other facilities for water conservation and delivery.

By implication, the Audit Report seems to assume that the sale of land by the District was entirely voluntary and was done solely to cover operating losses. In fact, all of the land sales were to the City of McAllen and the majority of those sales were negotiated and conducted following either McAllen's actual initiation or threat of condemnation or eminent domain proceedings. With respect to the sale of irrigation water rights, those sales were consummated only after the District completed a detailed and well-documented investigation and determined that the water rights were actually surplus and would not be needed by the District to fulfill its obligations to either the City of McAllen or its irrigation customers. That entire process was conducted in compliance with the applicable requirements of the Texas Water Code.

Despite an Audit Report which details more than \$6.2 million in seventeen (17) separate capital improvement projects completed between February 2008 and August 2011 (see Table 2 on page 3), the State Auditor concludes that the District does not have a formal, comprehensive, long term master plan for capital improvements or other objectives. Although that conclusion is erroneous, it also does not account for some of the realities and need for ad hoc flexibility necessary to operate a water control and improvement district along the Rio Grande River and in a hurricane and flood-prone area with a mission including water conservation and protection and both the irrigation of rural farmland and the supply and delivery of water to a rapidly growing municipality such as McAllen. In fact, many if not most of the listed projects listed (i) were either conceived and planned before the Audit Report period, (ii) resulted from the need to accomplish remediation from Hurricane Dolly in 2008 or Hurricane Alex in 2010 or preventive measures and structures in anticipation of future hurricanes and flooding, or (iii) became necessary in response to initiatives undertaken by other governmental entities and outside the control of the District (eg., construction of the border wall by the federal government, construction of a new reservoir and Bicentennial Boulevard expansion by the City of McAllen).

The District's governing body and staff were continuously and intimately involved in the planning, monitoring and management of the capital improvement projects listed on Table 2 and are similarly involved in the planning for current and future projects. Based on nothing more than a review of the District's board meeting agendas, director meeting packets, and minutes, the

State Auditor's staff is or should be aware that the outside engineers attend virtually every board meeting and deliver regular and detailed written and oral reports to the directors regarding capital improvement needs and planned and ongoing purchases and construction projects essential to meeting those needs. On February 11, 2009, the engineers presented a detailed written *Capital Improvements Program* and proposed budget for the consideration of the board of directors. A copy of the minutes of that board meeting and the 2009 program and budget were provided to the State Auditor's staff and are attached as Exhibits 9 and 10 to this response. Again on May 24, 2011, the District general manager and engineers presented a detailed and comprehensive oral report and written budget to the board of directors regarding the status and plans for \$3.1 million in capital improvement projects. A copy of the minutes of that board meeting and the attached budget report were also provided to the auditors and are attached as Exhibit 11 to this response. In addition to the above-described capital improvement programs, as part of its master planning efforts, the District has developed and approved a detailed *Water Conservation and Drought Management Plan*.

Although the Audit Report includes a finding that a small sampling (a total of no more than 94 transactions from a period of 48 months) revealed a lack of some supporting documentation for invoices or review and approval, there was no evidence or finding that any of those transactions resulted in an improper expenditure. In fact, as discussed above and as reflected in the agendas, meeting packets, and minutes for board minutes, the District's directors review and approve every check and disbursement by the District for both operating and capital expenses. That review and approval process is documented in those materials.

The Audit Report describes cite a small number of errors detected in identifying and recording capital assets, recording depreciation of capital assets, and recording the capitalization of certain repairs and betterments to capital assets. Although the State Auditor cites those errors as evidence of a control weakness, District management does not believe the examples cited are indicative of an opportunity for misappropriation or waste of District funds or assets. All capital addition expenditures by the District must be properly authorized and approved by the board of directors before disbursement. The District's board members receive copies of all bank statements and bank reconciliations. A few of the errors noted in the Audit Report in recording of capital additions are the result of charging the disbursement to the wrong ledger account. The authorization and support for the capital expenditure are not at issue. The State Auditor did not find any instances of missing capital equipment. Importantly, the District's capital assets are substantially comprised of infrastructure improvements which are not subject to any risk of misappropriation, theft, waste or loss. The District believes the internal controls in existence are properly designed to address any risks associated with the possibility of misappropriation or waste of District funds or other assets.

District management acknowledges the findings on page 6 of the Audit Report that a preventive maintenance plan and documentation of maintenance activities for District equipment and facilities have either been absent or inadequate. The District intends to promptly develop such a plan and written policies to insure that the plan is effectively implemented. Management has already taken affirmative steps to correct deficiencies in documentation including routine and regular entries in inspection and maintenance logs on all District equipment.

Finally on page 7 in Chapter I-A of the Audit Report, the State Auditor states that the District is unable to identify amounts of billings and payments of flat rate assessments and lacks policies and procedures for collection, notification, and tracking of flat rate billings, payments and balances. As a result, the State Auditor concludes that the foregoing could adversely affect the District's revenue collections.

First, the District's total annual flat rate assessments for the current FY 2012 are \$28,068.33 which is approximately two percent (2%) or less of the District's projected operating revenue for the year. More importantly, using its current software program, the District is able to track and document flat rate assessment billings, payments, adjustments, and balances. The District is required to comply with the procedures for assessing, notifying, and collecting flat rate assessments as set out in the Texas Water Code rather than in any other policies or procedures the District might elect to adopt.

The District utilizes computer software developed by Eclipse Consulting & Technical Services, Inc. (ECTS) to manage its flat rate assessment billings and collections. An account is established for each owner of assessable irrigable acreage in the District. The computer record for each account reflects the original amount of the flat rate assessment billed to the land owner and the date of the assessment, the amount of any interest or penalty added to delinquent assessments, the amount and date of any payments on the account, and the total amount, if any, of the balance due on the account. Account information is reportable in a variety of formats. Two separate report forms on individual flat rate assessment accounts (account names redacted) are attached as Exhibits 12 and 13 to this response. The attached exemplar for a "View Detail Transactions" report (Exhibit 12) shows a balance due including interest of \$16.81 for 2010 and \$18.55 for 2011. The attached exemplar for an "A/R Transaction Inquiry" report (Exhibit 13) shows an account for which all assessments have been timely paid by check with no balance owed. In addition to individual account information, the District can access an "Accounts Receivable Totals Summary" to determine total amounts by year of the flat rate assessments, interest, payments and unpaid balances due. An exemplar report as of May 12, 2012 is attached as Exhibit 14 to this response. The first full year of use for this software was 2007 so the totals for 1974 through 2006 are posted amounts reflecting balances as of 2007 for those prior years. To the best of the District staff's knowledge, the State Auditor's staff did not request or review the reports available from the ECTS software before making the findings reflected in the Audit Report.

The procedures for assessing and collecting flat rate assessments are set out in Sections 51.306 *et seq.*, Texas Water Code, and are followed by the District. Currently, the flat rate assessment imposed by the District is \$9.02 per acre. Bills for assessments are mailed to landowners on or about October 1 and are considered delinquent if not paid by the next January 31. Interest is added to each unpaid account as of February 1. Delinquent notices are sent in June to each landowner with an unpaid balance. No landowner with an unpaid assessment is allowed to purchase water for irrigation from the District until the assessment, together with any interest, is paid in full.

Chapter 1-B Related Party Transactions

The State Auditor has concluded that the District does not have a consistent process to manage related-party agreements and to insure compliance with Chapters 171 and 176, Texas Local Government Code. That conclusion appears to be based upon the circumstances surrounding transactions between the District and three companies in which the President and General Manager of the District has a substantial interest as defined in Section 171.002(a), Texas Local Government Code. Both the District and the official in question disagree with that conclusion and believe that there was full compliance with the applicable statutory requirements and that the transactions in question actually benefited the District and conserved its resources by providing for the purchase of comparable or better services and materials at a lower price or cost than would have otherwise been available.

Each of the District's directors have been made aware of and complied with the requirements of Chapters 171 and 176, Texas Local Government Code. The official record keeper of the District maintains a folder of conflict of interest affidavits and disclosure statements filed with the District. A complete copy of that folder and its contents have been provided to the State Auditor's staff prior to the completion of the Audit Report.

Othal Brand, Jr., the President and General Manager and a director of the District, has a substantial interest in Brandwood Wireless, O. E. Investments, and Rioplex Wireless, each of which companies has provided goods or services to the District for compensation. As required by Section 171.004, Texas Local Government Code, before any vote or decision on any matter involving those business entities, Mr. Brand filed an affidavit stating the nature and extent of his interest. Two separate affidavits were filed with the official record keeper of the District on or about October 9, 2007 and October 14, 2009 and have been maintained in the above-described folder for such records and kept in the offices of the District. True and correct copies of those affidavits were provided to the State Auditor's staff and are attached as Exhibits 7 and 8 to this response. As required by the statute and as acknowledged on page 9 of the Audit Report, Mr. Brand abstained from participation in matters relating to those three entities including voting on any board decisions regarding transactions with those businesses. On each occasion, Mr. Brand disclosed his substantial interest in the entity to the other directors and, based on a comparison and review of prior transactions, the board of directors determined that the District would be able to obtain the services and/or materials at a lower price or cost than it had otherwise been paying for similar or comparable services or materials.

As is the case with all other expenditures of the District, information regarding the amount of each disbursement to the entities in question is routinely provided to and reviewed and approved by the District's directors. District records relating to transactions with these entities were made available to and were reviewed by the State Auditor's staff during the audit process. Significantly, the Audit Report does not reference any evidence that any of the prices or costs of these related-party transactions were unreasonable or unfair to the District.

Section 49.273, Texas Water Code, requires contracts to be competitively bid only if the contract is for construction and repair and renovation of district facilities or for the purchase of equipment, materials, machinery, or things that constitute or will constitute the plant, works,

facilities, or improvements of the district and if the amount of the contract exceeds \$25,000 (see memorandum from Glenn Jarvis attached as Exhibit 6 to this response). None of the transactions with the entities in which Mr. Brand has a substantial interest, even if aggregated, exceeded that amount and were subject to competitive bidding requirements.

Chapter 1-C Procurement Requirements

The Audit Report references a purchase by the District of three vehicles which was not based on competitive bids (page 11). In connection with the description of that transaction, the State Auditor concludes that the District should develop policies and procedures that identify when the District should use a competitive process. Although a competitive bidding process may be a preferred practice under certain circumstances, the District is not required by Section 49.273, Texas Water Code, to obtain competitive bids for the purchase of vehicles which do not or will not constitute the plant, works, facilities or improvements of the District. The referenced transaction did not violate the Texas Water Code or any other procurement statute applicable to the District. See memorandum from Glenn Jarvis attached as Exhibit 6 to this response.

The Audit Report describes a transaction with a company for electrical work in which the District failed to require and obtain a payment bond. Such companies would ordinarily provide services and materials to the District as a subcontractor and through a general contractor. Although prime contractors are required to furnish a payment bond on contracts over \$50,000, subcontractors are not required to provide a payment bond regardless of the contract amount. Because the electrical contractor was dealing directly with the District in this case, it was considered a "prime contractor" within the meaning of Section 2253.001, Texas Government Code, and the District inadvertently overlooked the payment bond requirement. The District has since obtained a payment bond from the electrical contractor. A true and correct copy of the Texas Statutory Payment Bond from Old Republic has been furnished to the State Auditor's office and is attached as Exhibit 15 to this response.

With respect to the procurement of professional services for engineering and surveying and for accounting and auditing, the Audit Report states that the District (i) does not have written policies and procedures as required by Section 49.199(a)(4), Texas Water Code, and (ii) could not provide the audit team with documentation of compliance with Chapter 2254, Texas Government Code, although no such documentation was either identified nor is it required by the statute.

The District is in the process of gathering and reviewing written policies and procedures from other districts and will address and correct its noncompliance with Section 49.199, Texas Water Code.

The District disagrees with the conclusion in the Audit Report that the District is required "to undertake a selection process for professional services" under Chapter 2254 (see letter from R. K. Whittington attached as Exhibit 3 to this response). Section 2254.003, Subchapter A, Chapter 2254, Texas Government Code, expressly prohibits the selection of a provider of professional services through competitive bidding and imposes only two requirements on the governmental entity making a selection. Those requirements are that the selection be made (i) on

the basis of demonstrated competence and qualifications to perform the services and (ii) for a fair and reasonable price. Neither Section 2254.003 nor Section 2254.005 describes, sets out, specifies, requires or even references a “process” or any particular procedure or procedures for making the required determinations of competence, qualifications, or fairness or reasonableness of price. Neither section requires public notices, advertising, requests for proposal, requests for qualifications, or any other of many possible methods for identifying and selecting a competent and qualified professional. The only process described in or required by Section 2254.005 is not a selection process but rather a process for negotiating with alternate providers if contract negotiations with the selected provider are unsuccessful.

Although no selection process is actually required, both the outside engineering and surveying firm and the independent auditing firm currently performing services for the District were selected through a process involving a request for qualifications and interviews. In 2005, the District invited professional engineers to respond to a request for qualifications. Ferris & Flinn, LLC submitted its qualifications and was selected based on its demonstrated competence and experience. The District and the engineering firm subsequently negotiated a contract which was approved by the District’s board of directors. A true and correct copy of the board minutes authorizing the request for proposals, selecting Ferris & Flinn, LLC, and approving the engineering contract have been provided to the State Auditor’s staff and are attached as Exhibits 16, 17 and 18 to this response. The contract includes compensation rates and terms and a provision that allows the District to cancel the contract for any reason at any time. The District’s board reviews and approves every invoice, each of which includes a description of the work performed and detail of hours spent and expenses. Ferris & Flinn, LLC has separated its billing into twenty-seven (27) different projects over the last six-year period.

It is noteworthy that the Audit Report does not include any findings that any of the professional service providers selected by the District are either incompetent or unqualified or have charged or been paid amounts which are either unreasonable or unfair. Although the Audit Report includes recommendations that the District insure compliance with Sections 49.057 and 49.273, Texas Water Code, and Chapter 2254, Texas Government Code, there are no suggestions in the report that the District has either violated or failed to comply with those statutes.

Chapter 2 Governance Framework

With respect to those matters identified in Table 5 on pages 15-16 and for which the Audit Report states that the District either did not comply or partially complied, the District has either already corrected any deficiency or initiated steps to bring the District into compliance. The only exception is the conclusion that the President and General Manager of the District may have only partially complied with Chapters 171 and 176, Texas Local Government Code, with respect to conflicts of interest and related-party transactions or that the District did not have a consistent process in place to manage such agreements. The District disagrees with any such conclusion for the reasons described in the response to Chapter 1-B above.

As applied to water control and improvement districts located in urban or partially urban areas and which engage in the dual capacity as a supplier of irrigation water for farmland and the deliverer of raw water for municipal purposes, the limitations contained in Section 51.305, Texas

Water Code, are archaic and impossible to attain. There are very few, if any, such districts in the Rio Grande Valley or in other regions of Texas which do or can comply with the statutory requirement that not less than one-third (1/3) nor more than two-thirds (2/3) of maintenance and operations expenses be paid from flat rate assessments. The District agrees with the suggestion in the Audit Report that modifications to the statute may be necessary and appropriate and is currently working with the Texas Irrigation Council and the Valley Water Managers Association to achieve a legislative solution.

The Audit Report suggests that the District has (i) no rules, regulations or policies relating to the delivery and supply of water to the City of McAllen and (ii) no policies or procedures relating to the collection, charge, or notification of flat rate assessments to landowners within the District. The terms and conditions regarding the use of District facilities for delivery of raw water to the City of McAllen and the charges for that service are governed by a written contract between the District and McAllen. Therefore, no other rules, regulations, charges, fees, or policies are necessary. The policies and procedures relating to the billing and collection of flat rate assessments are clearly set out in Chapter 51 of the Texas Water Code. Those policies and procedures, as well as the regular and customary practices of the District in compliance with the statutory provisions, are described in detail in the response to Chapter 1-A above.

Chapter 3-A Protection of Real Property Interests

During the 82nd Texas Legislature, proponents of dissolution of the District claimed that the District has filed liens which clouded the title of hundreds of private residential and commercial property owners within the municipal boundaries of McAllen. In his letter request resulting in this audit (Appendix 2), Governor Rick Perry asked the State Auditor to look into and report back to the legislature regarding “the district’s practice of filing liens”.

The District acquired and owns the land on which its irrigation and water delivery system is located (including pumping facilities, reservoirs, canals and laterals) and has a legitimate interest in protecting that system and property interest for the benefit of its water users and customers. A few years ago, the City of McAllen stopped requiring developers and landowners to submit proposed subdivision plats to the District for review and approval -- a process which allowed the District to identify and inform landowners of the existence and location of its facilities and to negotiate agreements and easements, as appropriate, to accommodate and protect those system components. Once McAllen stopped requiring District review and approval, the District’s ownership interests were frequently overlooked or ignored and its facilities were often built over, damaged, or even destroyed or removed. Unable to persuade McAllen to include the District in the review and approval process, in 2009 the District caused a detailed and accurate legal description of the boundaries of its irrigation system to be recorded in the official real estate records of Hidalgo County, Texas. The recorded instrument was not and could not be a cloud on the title of any other property unless it represented an unfounded or inaccurate claim of a non-existent ownership interest. That was not the case.

Other than the 2009 recorded instrument, the District has not filed any liens of any type against any property interests at any time since it was established in the early 1920’s. See letter

from R. K. Whittington describing results of title search for lien filings by District dating back to 1921 and attached as Exhibit 19 to this response.

Chapter 3-B District Rates and Fees

Once again, the Audit Report states that the District has no policies or procedures relating to the collection, charge, or notification of flat rate assessments to landowners within the District. To the contrary, the policies and procedures relating to the billing and collection of flat rate assessments are clearly set out in Chapter 51 of the Texas Water Code. Those policies and procedures, as well as the regular and customary practices of the District in compliance with the statutory provisions, are described in detail in the response to Chapter 1-A above.

Chapter 3-C Conversion of Water Rights from Irrigation to Municipal Use

The water rights downstream of Falcon Dam, including those of the District, were originally adjudicated by a state district court in the Valley Water Suit rather than under the Water Rights Adjudication Act of 1967. The Valley Water Suit was filed in the 1950's and finally disposed of by a final judgment in 1969. See *State of Texas, et al. v. Hidalgo County Water Control and Improvement District No. 18, et al.*, 443 S.W.2d 728 (Tex.Civ.App.-Corpus Christi 1969, writ ref'd. n.r.e.). The adjudication was based on the unusual circumstances of the Rio Grande River and the resulting water rights are of different types than the rest of the State of Texas or even those areas of the Rio Grande River upstream from Falcon Dam.

An application to convert the 1,100 acre-feet of irrigation water rights sold by the District to the City of McAllen in August 2011 to municipal use water rights is currently pending before the Texas Commission on Environmental Quality (TCEQ).

Chapter 4 Information on District Water Usage (including data on District Raw Water Diversion in Appendix 7 and City of McAllen's Current and Projected Water Need in Appendix 9)

The data and information contained in Table 13 regarding the quantity of water diverted by the District to the City of McAllen for municipal use is not accurate for the years 2007, 2008 and 2011. Based on the pumping records of the District, the actual metered water volumes diverted and delivered to the City of McAllen for the period from 2007 through 2011 are as follows:

District Raw Water Diverted (in acre-feet)					
Use/User	2007	2008	2009	2010	2011
Municipal/McAllen	14,373.80	19,098.20	18,368.90	17,248.20*	18,436.80**

* McAllen purchased almost no water from the District from November 2010 through June 2011

** The District deliveries of water to McAllen included the entire 13,980 acre-feet of municipal water allocation held by the District, 1,608 acre-feet of water transferred from United Irrigation District, 678.84 acre-feet of McAllen water allocation, and 1,237.10 acre-feet of "no charge" water

The discrepancy between these diversion volumes and those reported by the Rio Grande Water Master through TCEQ is most likely the result of water allocations pumped and delivered by the District but charged to the account of the actual holder of the certificate of adjudication. TCEQ's records reflect the identity of the certificate holder rather than the actual entity pumping the water.

For the same reason, as well as other factors, the volumes of water shown to be diverted and delivered to and used or resold by the City of McAllen in 2011 (as reflected in Table 14) are erroneous and do not reflect wasteful practices engaged in by the City of McAllen and its Public Utilities Board to deprive the District of water delivery revenues under the existing contract. The actual allocations and deliveries of water for 2011 (based on actual diversion records obtained directly from each of the four districts) are as follows:

City of McAllen Water Allocation and Use 2011		
Source of Water	Water Allocated for Municipal Use (in acre-feet)	Water Actually Diverted to McAllen (in acre-feet)
Hidalgo County Water Improvement District No. 3	13,980.00	18,436.80*
United Irrigation District	11,250.00	9,570.74**
Hidalgo County Irrigation District No. 2	10,111.02***	13,059.64****
City of McAllen	678.84	
Totals	36,019.86	41,067.18*****

* Includes the entire 13,980 acre-feet of municipal water allocation held by the District, 1,608 acre-feet of water transferred from United Irrigation District, 678.84 acre-feet of McAllen water allocation, and 1,237.10 acre-feet of "no charge" water

** Includes 8,635.69 acre-feet of allocation held for McAllen by United Irrigation District and 935.05 acre-feet of "no charge" water (and excludes 2,540.86 acre-feet transferred to District and 73.45 acre-feet of unpumped allocation)

*** Includes 2,000 acre-feet of water leased by McAllen from Brownsville Irrigation District

**** Includes 8,229.86 acre-feet of allocation held for McAllen, 2,000 acre-feet of water leased by McAllen from Brownsville Irrigation District, and 2,829.98 acre-feet of "no charge" water

***** 5,047.32 acre-feet of water diverted to McAllen in excess of municipal use allocation is made up almost entirely by 5,002.13 acre-feet of "no charge" water pumped by three districts and resulting from excess water in Rio Grande River which was not charged to the districts' or McAllen's allocation accounts

During the 80th Texas Legislature in 2007, the City of McAllen made its first unsuccessful attempt to take over the District through a proposed bill. In October 2007, McAllen entered into a contract with Brownsville Irrigation District to lease 2,000 acre-feet of municipal water rights for a term of 20 years. Rather than annual or periodic lease payments, the City of McAllen paid Brownsville Irrigation District \$2.2 million in advance for the leased rights and for the entire 20-year lease term. Although Hidalgo County Irrigation District No. 2 had the highest delivery charges and loss percentage of the three districts supplying municipal water in the area, the City of McAllen elected to arrange for District No. 2 to pump the leased water under the "take or pay" contract. During several of the subsequent years including the latter part of 2010 and first part of 2011, the City of McAllen left substantial portions of its water allocation held by District No. 3 unused and chose instead to take delivery of its leased water from District No. 2. Because of the

high lease rate coupled with District No. 2's delivery charges and 20% loss calculation, each acre foot of the leased water cost the McAllen and its water customers approximately \$131 (a total of approximately \$263,000 per year) -- more than 3.5 times the cost to take delivery of and use water rights it already owned from District No. 3. The cost incurred by the City of McAllen to divert revenues from District No. 3 in this manner does not include the interest cost attributable to paying the lease for twenty years in advance to Brownsville Irrigation District and depriving McAllen of the use of those funds. At an average interest rate of three percent (3%) per year over twenty years, the cost of the water rights leased from Brownsville Irrigation District almost doubles.

Although Table 15 in the Audit Report is apparently intended to project the future water needs of the residents and businesses in McAllen, the measure used is inappropriate for that purpose. The table uses Peak Hourly Demand figures obtained from the *City of McAllen Public Utility Water and Wastewater System Master Plan* for the years 2009 through 2025. Those demands are the maximum expected hourly demand during the highest demand period. A peak hour demand is normally used to size pumping and storage facilities and distribution lines in a potable water system and does not indicate a municipality's water supply needs in terms of acre feet per year or any other measure of either volume or quantity. The City of McAllen Master Plan likely contains information on projected water supply needs on an annual basis. Those figures or projected Rio Grande Water Right needs would be more useful information to predict McAllen's future water use and the demand which might be imposed on the District for water supply and delivery.

HIDALGO COUNTY WATER IMPROVEMENT DISTRICT NUMBER THREE

Board of Directors
President-Othall Brand, Jr.
Vice President-W.D. Moschel
Secretary-Chris Burns
Member-Leo Montalvo

1325 Pecan Blvd
McAllen, Texas 78501
(956) 686-8303
Fax (956) 686-1022

May 10, 2012

Mr. Lucien Hughes
Managing Senior Auditor
State Auditor's Office
P. O. Box 12067
Austin, Texas 78711

Via Electronic Transmission

Dear Mr. Hughes:

This is to follow up on our telephone conference call Wednesday morning with Cathy Aven, Nicole Guerrero, and Sharpar Ali of your staff relating to the District's comments and current responses to some of the issues contained in the SAO Draft Report which you forwarded to me in your email of April 19, 2012. During the telephone conference we discussed the tone of the Report and some specific information that we believe you should consider with respect to certain parts of the SAO Draft Report.

We have previously forwarded to you information relating to documentation that the 3 payments to directors of \$681.36 was for attending Board meetings (pages 4-5 of the Report).

With respect to the issues discussed during our telephone conference and in the interest of promptness in forwarding the information to you, I am attaching with this letter, information that has been compiled by the District, its attorneys, accounting, and engineer since receiving the SAO Draft Report, with respect to issues described in each submittal:

1. Copy of a letter dated May 9, 2012, to Mr. John Keel, State Auditor, from R. K. Whittington, one of the District's attorneys which discusses identified portions of the Report pertaining generally to the District's method of selection and management of providers of professional services and consulting contracts.
2. Copy of memorandum from Glenn Jarvis, an attorney for the District, dated May 8, 2012, to the effect that the purchase of equipment such as vehicles or

other materials and machinery does not require bidding and advertisement in accordance with § 49.273, Texas Water Code, because vehicles do not constitute or will constitute the plant, works, facilities, or improvements of the District as provided in § 49.273(a). This refers to the statement that the District did not seek competitive bids for its purchase of three (3) vehicles.

3. Comments of Mr. Frank Ferris, an engineer for the District, dated May 11, 2012, containing his comments regarding the District's Capital Improvement Plan discussed on Page 3 of the Report; explanation of the reason that the District did not solicit quotes for the water well cleaning and testing because they were scoped at different types under separate contracts; the clay liner because it was a sole source procurement (see Report, page 11); circumstances dealing with the payment bond noted on page 11 of the Report which has been corrected; other issues pertaining to the procurement of professional services; and the District's title to land.
4. A memorandum from the District resulting from discussion with the District Auditors, which comments upon the references in Chapter 1 of the Report pertaining to the District's financial controls which could create opportunities for misappropriation of funds; comments on the District's operating expenditures for the years 2008-2011; use of asset sales for capital improvements and not for operational purposes; and the District's control over flat rate assessments.

The District does have a method to track flat rates as described in the attached letter from The Eclipse Consulting and Technical Services, Inc. Flat Rate, assessed in October, is delinquent in February and delinquent statements are promptly issued. Accounts delinquent on flat rate are not allowed to purchase water and delinquent taxes are collected when a property owner desires water or clear title.

Attached is a letter from Ewing, Lara explaining the discrepancy in the flat rate identified in the draft audit. There was an increase in the flat rate on July 25, 2011.

5. Copy of the District's signature card authorization and resolution to its Depository Bank, which authorizes signatures on District checks. This is in reference to the Report's findings on page 4 stating that there is no documentation to indicate that the Board had designated responsibility for signing checks to the Board member. In practice, at least two (2) Board members sign checks at a District meeting.

As discussed during the telephone conference, the District understands the unusual nature of this audit, the fact that it was initiated by a letter from Governor Perry and the State Auditor has the authority to audit water districts like the District. The District would note, however, that the tone of the Report could focus initially on the issues

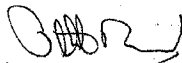
Mr. Lucien Hughes
May 10, 2012
Page 3 of 3

raised in the Governor's letter in one portion of the Report, and that in other portions of the Report to the normal audit compliance review conducted by the State Auditor in such circumstances.

Please note that related party comments will be submitted under separate cover.

We appreciate the opportunity of conferring with the State Auditor staff on these issues and your attention to them. As discussed during the telephone conference, we do reserve the right to make further responses as the Draft Report is revised and ultimately becomes the final Report.

Respectfully,



Othal E. Brand, Jr., President
Board of Directors

Encl.

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
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 Harvey Hilderbran, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Hidalgo County Water Improvement District No. 3

Members of the Board of Directors

Mr. Othal Brand Jr., President and General Manager
Mr. W. D. Moschel, Vice President
Mr. Chris Burns, Secretary
Mr. Joe V. Corso
Mr. Leo Montalvo



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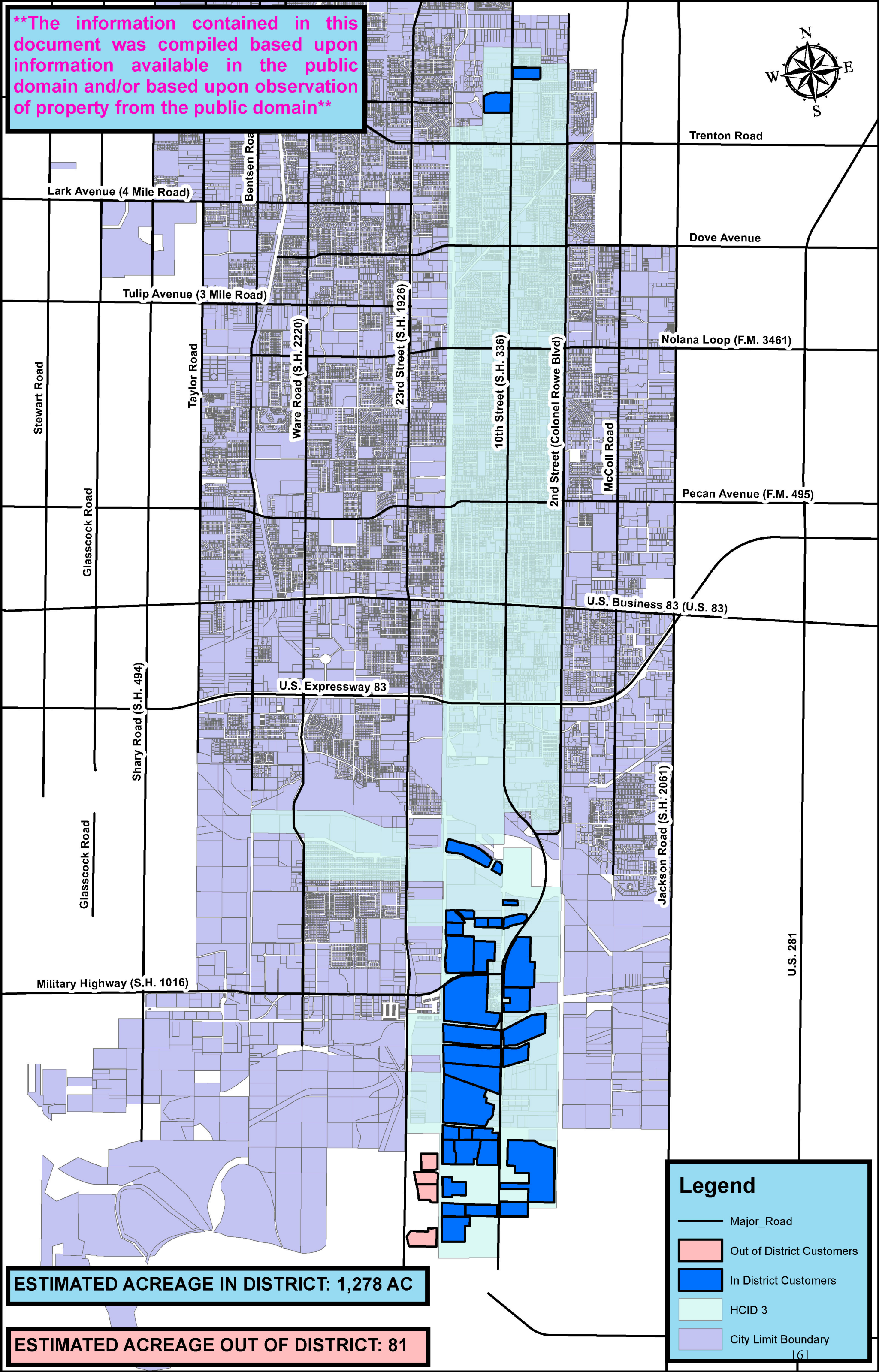
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To report waste, fraud, or abuse in state government call the SAO Hotline: 1-800-TX-AUDIT.

Exhibit F

HCWID 3 and MPU Boundaries Map

****The information contained in this document was compiled based upon information available in the public domain and/or based upon observation of property from the public domain****



ESTIMATED ACREAGE IN DISTRICT: 1,278 AC

ESTIMATED ACREAGE OUT OF DISTRICT: 81

Legend

Major_Road

Out of District Customers

In District Customers

HCID 3

City Limit Boundary

161

Exhibit G

HCWID 3 Certificate of Adjudication No. 23-848, 848A, and 848B and
McAllen Certificate of Adjudication 23-353

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



AMENDMENT TO A
CERTIFICATE OF ADJUDICATION

CERTIFICATE No. 23-848D TYPE: §§ 11.122, 11.085 PRIORITY: Class A, Municipal

Owner: Hidalgo County Water
Improvement District No. 3

Address: 1325 Pecan Blvd
McAllen, Texas 78501

Filed: December 18, 2014

Granted: August 21, 2015

Purpose: Municipal, Mining &
Agricultural

County: Hidalgo, Val Verde,
Kinney, Maverick,
Dimmit, Webb, Zapata,
Starr, Cameron, and
Willacy

Watercourse: Rio Grande

Watershed: Rio Grande Basin

WHEREAS, a portion of Certificate of Adjudication No. 23-848 authorizes Hidalgo County Water Improvement District No. 3 (Owner/Applicant) to divert and use from the Rio Grande, Rio Grande Basin, not to exceed 8,980 acre-feet of Municipal Priority water per year for municipal purposes in the City of McAllen; 5,000 acre-feet of Municipal Priority water per year for municipal purposes in the Owner's service area; 8,552.60 acre-feet of Class A water per year for agricultural purposes to irrigate 3,901.04 acres in the Owner's service area; and 100 acre-feet of Class A water per year for mining purposes in Hidalgo County, Texas; and

WHEREAS, Owner seeks to amend its portion of Certificate of Adjudication No. 23-848 to add mining use to the 8,552.60 acre-feet of Class A water for agricultural purposes and to add agricultural use to the 100.00 acre-feet of Class A water for mining purposes; and

WHEREAS, Owner seeks to change the place of use for mining purposes to Val Verde, Kinney, Maverick, Dimmit, Webb, Zapata, Starr, Hidalgo, Cameron, and Willacy Counties; and

WHEREAS, Owner seeks to authorize an exempt interbasin transfer to those portions of Kinney, Maverick, Dimmit, and Webb Counties within the Nueces River Basin, and to those portions of Hidalgo, Cameron, Starr, and Willacy Counties within the Nueces-Rio Grande Coastal Basin; and

WHEREAS, Owner further seeks to add a diversion segment for mining purposes

being anywhere along the east bank of the Rio Grande between Val Verde, Kinney, Maverick, Webb, Zapata, Starr, Hidalgo, and Cameron Counties in the Rio Grande; and

WHEREAS, the upstream boundary of the diversion segment is located at Latitude 29.431503° N, Longitude 101.044572° W, in Val Verde County; and

WHEREAS, the downstream boundary of the diversion segment is located at Latitude 25.955256°N, Longitude 97.146311° W, in Cameron County, Texas.

WHEREAS, the Texas Commission on Environmental Quality finds that jurisdiction over the application is established; and

WHEREAS, this amendment, if granted, is subject to requirements and orders of the Rio Grande Watermaster; and

WHEREAS, the Executive Director recommends special conditions be included in the amendment; and

WHEREAS, no requests for a contested case hearing were received for this application; and

WHEREAS, the Commission has complied with the requirements of the Texas Water Code and Rules of the Texas Commission on Environmental Quality in issuing this amendment; and

WHEREAS, the Texas Commission on Environmental Quality is of the opinion and so finds the proposed changes will not impair the rights of any person entitled to the use of a portion of the American share of the waters of the Rio Grande;

NOW, THEREFORE, this amendment to Certificate of Adjudication No. 23-848, designated Certificate of Adjudication No. 23-848D, is issued to Hidalgo County Water Improvement District No. 3, subject to the following terms and conditions:

1. USE

- A. In lieu of the previous authorizations, the Owner is authorized to divert and use, from the Rio Grande, Rio Grande Basin, not to exceed;
 - 1. 8,980 acre-feet of Municipal Priority water per year for municipal purposes in the City of McAllen, Hidalgo County, Texas.
 - 2. 5,000 acre-feet of Municipal Priority water per year for municipal purposes in the Owner's service area, Hidalgo County, Texas.
 - 3. 100 acre-feet of Class A water for mining and agricultural purposes in the Owner's service area, Hidalgo County, Texas.
 - 4. 8,552.60 acre-feet of Class A water per year for agricultural purposes to

irrigate 3,901.04 acres in the Owner's service area and mining purposes in Val Verde, Kinney, Maverick, Dimmit, Webb, Zapata, Starr, Hidalgo, Cameron, and Willacy Counties, Texas.

- B. Owner is also authorized an exempt interbasin transfer to those portions of portions of Kinney, Maverick, Dimmit, and Webb Counties within the Nueces River Basin, and to those portions of Hidalgo, Cameron, Starr, and Willacy Counties within the Nueces-Rio Grande Coastal Basin for mining purposes.

2. DIVERSION

In addition to the previous authorizations, Owner is authorized to divert water for mining purposes anywhere within a diversion segment along the east bank of the Rio Grande in Val Verde, Kinney, Maverick, Webb, Zapata, Starr, Hidalgo, and Cameron Counties between the following two points:

1. Upstream boundary of the diversion segment is located at Latitude 29.431503° N, Longitude 101.044572° W, in Val Verde County, Texas.
2. Downstream boundary of the diversion segment is located at Latitude 25.955256°N, Longitude 97.146311° W, in Cameron County, Texas.

3. CONSERVATION

Owner shall implement water conservation plans that provide for the utilization of those practices, techniques, and technologies that reduce or maintain the consumption of water, prevent or reduce the loss or waste of water, maintain or improve the efficiency in the use of water, increase the recycling and reuse of water, or prevent the pollution of water, so that a water supply is made available for future or alternative uses. Such plans shall include a requirement that in every water supply contract entered into, on or after the effective date of this amendment, including any contract extension or renewal, that each successive wholesale customer develop and implement conservation measures. If the customer intends to resell the water, then the contract for resale of the water shall have water conservation requirements so that each successive customer in the resale of the water will be required to implement water conservation measures.

4. SPECIAL CONDITIONS

- A. Within 90 days prior to the diversion of water for mining use, Owner or contract customer must submit to the TCEQ a water conservation plan to comply with Title 30 TAC Chapter 288.3.
- B. Owner shall install a measuring device which accounts for, within 5% accuracy, the quantity of water diverted from the Rio Grande. Owner shall allow representatives of the Texas Commission on Environmental Quality Rio Grande Watermaster reasonable access to the property to inspect the measuring device.
- C. Owner shall contact the Rio Grande Watermaster prior to diversion of water

authorized by this amendment.

- D. The use of water authorized in USE Paragraph 1 is intended for use by the Owner. All contracts for the sale of all or part of this water by the Owner shall be filed with the Executive Director and found sufficient in accordance with (TAC) §§ 303.51-53 prior to the diversion of water. If the buyer is not currently a water right holder of record in the Middle or Lower Rio Grande, the buyer shall also apply for and be granted a water rights permit authorization which may include a Temporary Water Use Permit, Contractual Permit, or an amendment to this Certificate of Adjudication.

This amendment is issued subject to all terms, conditions and provisions contained in Certificate of Adjudication No. 23-848, as amended, except as specifically amended herein.

This amendment is issued subject to all superior water rights in the Rio Grande Basin.

Owner agrees to be bound by the terms, conditions, and provisions contained herein and such agreement is a condition precedent to the granting of this amendment.

All other matters requested in the application which are not specifically granted by this amendment are denied.

This amendment is issued subject to the Rules of the Texas Commission on Environmental Quality and to the right of continuing supervision of State water resources exercised by the Commission.


For the Commission

Date Issued: **August 21, 2015**

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



THE STATE OF TEXAS
COUNTY OF TRAVIS

I hereby certify that this is a true and correct copy of a Texas Commission on Environmental Quality document which is filed in the permanent records of the Commission. Given under my hand and the seal of the Commission.

AMENDMENT TO
CERTIFICATE OF ADJUDICATION

Bridget C. Bohac JAN 03 2013

Bridget C. Bohac, Chief Clerk
Texas Commission on Environmental Quality

CERTIFICATE NO. 23-848C

TYPE: 11.122

PRIORITY: Municipal

Owner: City of McAllen

Address: P.O. Box 220
1300 Houston Avenue
McAllen, Texas 78505

Filed: January 11, 2012

Granted: December 18, 2012

Purpose: Municipal

County: Hidalgo

Watercourse: Rio Grande

Watershed: Rio Grande Basin

WHEREAS, City of McAllen (Applicant or City) acquired a portion of Certificate of Adjudication No. 23-848 which authorizes the diversion and use of not to exceed 1,100 acre-feet of Class A water per year from the Rio Grande, Rio Grande Basin for agricultural purposes to irrigate land in Hidalgo County, Texas; and

WHEREAS, the City only acquired the 1,100 acre-feet of water and not the land to which it was appurtenant; and

WHEREAS, Applicant seeks to amend its 1,100-acre-foot portion of Certificate of Adjudication No. 23-848 to change the purpose of use from agricultural to municipal; and change the place of use to the City's water service area in Hidalgo County; and

WHEREAS, the City is not seeking to change the diversion point and indicates Hidalgo Water Improvement District No. 3 will divert and deliver the water for the City's use; and

WHEREAS, pursuant to 30 Texas Administrative Code (TAC) §303.43, the conversion factor of 0.5 is used when converting from Class A to Municipal priority water, resulting in 550 acre-feet of Municipal Priority water for municipal purposes; and

WHEREAS, the Texas Commission on Environmental Quality finds that jurisdiction over the application is established; and

WHEREAS, this amendment, if granted, is subject to requirements and orders of the Rio Grande Watermaster; and

WHEREAS, the Executive Director recommends special conditions be included in the amendment; and

WHEREAS, no requests for a contested case hearing were received for this application; and

WHEREAS, the Commission has complied with the requirements of the Texas Water Code and Rules of the Texas Commission on Environmental Quality in issuing this amendment; and

WHEREAS, the Texas Commission on Environmental Quality is of the opinion and so finds the proposed changes will not impair the rights of any person entitled to the use of a portion of the American share of the waters of the Rio Grande;

NOW, THEREFORE, this amendment to Certificate of Adjudication No. 23-848, designated Certificate of Adjudication No. 23-848C, is issued to City of McAllen, subject to the following terms and conditions:

1. USE

In lieu of the authorization to divert and use not to exceed 1,100 acre-feet of Class A water per year from the Rio Grande, Rio Grande Basin for agricultural purposes, Hidalgo Water Improvement District No. 3 is now authorized to divert for Owner's use not to exceed 550 acre-feet of Municipal Priority water per year from the Rio Grande, Rio Grande Basin for municipal purposes in, Owner's water service area, as it presently exists or as it may exist in the future in Hidalgo County, Texas

2. CONSERVATION

Owner shall implement water conservation plans that provide for the utilization of those practices, techniques, and technologies that reduce or maintain the consumption of water, prevent or reduce the loss or waste of water, maintain or improve the efficiency in the use of water, increase the recycling and reuse of water, or prevent the pollution of water, so that a water supply is made available for future or alternative uses. Such plans shall include a requirement that in every water supply contract entered into, on or after the effective date of this amendment, including any contract extension or renewal, that each successive wholesale customer develop and implement conservation measures. If the customer intends to resell the water, then the contract for resale of the water shall have water conservation requirements so that each successive customer in the resale of the water will be required to implement water conservation measures.

3. SPECIAL CONDITIONS

A. Hidalgo County Water Improvement District No. 3 shall maintain a measuring device which accounts for, within 5% accuracy, the quantity of water diverted from the Rio Grande for Owner's use, and shall allow representatives of the TCEQ Rio Grande Watermaster reasonable access to the property to inspect the measuring device.

- B. Owner or Hidalgo County Water Improvement District No. 3 shall contact the Rio Grande Watermaster prior to diversion of water authorized by this amendment.
- C. The use of water authorized in USE Paragraph 1 is intended for use by the Owner and diversion by Hidalgo County Water Improvement District No. 3. All contracts for the sale of all or part of this water by the Owner shall be filed with the Executive Director and found sufficient in accordance with Title 30 Texas Administrative Code 303.51-53 prior to the diversion of water. If the buyer is not currently a water right holder of record in the Middle or Lower Rio Grande, the buyer shall also apply for and be granted a water rights permit authorization which may include a Temporary Water Use Permit, Contractual Permit, or an amendment to this Certificate of Adjudication.

This amendment is issued subject to all terms, conditions and provisions contained in Certificate of Adjudication No. 23-848, as amended, except as specifically amended herein.

This amendment is issued subject to all superior water right holders below Amistad Reservoir in the Rio Grande Basin.

Owner and Hidalgo County Water Improvement District No. 3 agree to be bound by the terms, conditions, and provisions contained herein and such agreement is a condition precedent to the granting of this amendment.

All other matters requested in the application which are not specifically granted by this amendment are denied.

This amendment is issued subject to the Rules of the Texas Commission on Environmental Quality and to the right of continuing supervision of State water resources exercised by the Commission.



For the Commission

Date Issued: **December 18, 2012**

TEXAS NATURAL RESOURCE CONSERVATION COMMISSION



AMENDMENT TO
CERTIFICATE OF ADJUDICATION

RECEIVED

- 2 1995

TNRCC

RIO GRANDE WATERMASTER
MCALLEN, TEXAS

CERTIFICATE NO. 23-848B

PRIORITY : Municipal and Class "A"

Name : Hidalgo County Water
Improvement District
No. 3

Address : 1325 Pecan
McAllen, Texas 78501

Filed : June 30, 1995

Granted : SEP 08 1995

Purposes : Municipal, Irrigation
and Mining

County : Hidalgo

Watercourse : Rio Grande

Watershed : Rio Grande Basin

WHEREAS, Certificate of Adjudication No. 23-848 was issued to Hidalgo County Water Improvement District No. 3 on October 18, 1971 and authorized diversion and use of not to exceed 8,980 acre-feet of water per annum from the Rio Grande with municipal priority for use by the City of McAllen, and not to exceed 19,852.60 acre-feet of water per annum with Class "A" priority from the Rio Grande to irrigate 7,941.04 acres in TWC Tract No. H-261 (Court No. 532), Hidalgo County, Texas.

WHEREAS, Certificate No. 23-848 was amended on October 10, 1978 wherein 2400 acres (6000 acre-feet) of the Class A irrigation water rights were changed to municipal use, resulting in an additional 3000 acre-feet of municipal water after conversion from irrigation use and reducing the Class A irrigation water to 13,852.60 acre-feet per annum.

WHEREAS, the applicant seeks to amend Certificate No. 23-848, as amended, to authorize a change in the purpose of use of 100 acre-feet out of the aforesaid 13,852.60 acre-feet of Class "A" irrigation water rights to mining use in applicant's service area in Hidalgo County, Texas and to change the purpose of use of 4000 acre-feet of Class "A" irrigation water rights to municipal use resulting in an additional 2000 acre-feet of municipal water after conversion; and

WHEREAS, the Texas Natural Resource Conservation Commission finds that jurisdiction over the application is established;

WHEREAS, no person protested the granting of this application;

WHEREAS, the Commission has complied with the requirements of the Texas Water Code and Rules of the Texas Natural Resource Conservation Commission in issuing this amendment; and

WHEREAS, the Commission is of the opinion and so finds:

- (a) The proposed changes will not impair the rights of any person entitled to the use of a portion of the American share of the waters of the Rio Grande;
- (b) The proposed changes will not violate the terms of the permanent injunction and restraining order made final in the Lower Rio Grande Valley Water Suit.

NOW, THEREFORE, this amendment to Certificate No. 23-848, as amended, is issued to Hidalgo County Water Improvement District No. 3, subject to the following terms and conditions:

1. USE

In lieu of previous authorizations:

- a. With municipal priority, to divert and use not to exceed 8,980 acre-feet of water per annum from the Rio Grande for use by the City of McAllen.
- b. With municipal priority, to divert and use not to exceed 5000 acre-feet of water per annum from the Rio Grande for use in the service area of the certificate owner.
- c. With Class "A" priority, to divert and use not to exceed 9,752.60 acre-feet of water per annum to irrigate 3,901.04 acres of land in Hidalgo County, Texas.
- d. Certificate owner may divert and use 100 acre-feet from the Rio Grande for mining purposes for use in the service area of the certificate owner.

2. WATER CONSERVATION

The certificate owner shall implement a water conservation plan that provides for the utilization of those practices, techniques, and technologies that reduce or maintain the consumption of water, prevent or reduce the loss or waste of water, maintain or improve the efficiency in the use of water, increase the recycling and reuse of water, or prevent the pollution of water, so that a water supply is made available for future or alternative uses. Such plan shall include a requirement that

in every wholesale water contract entered into, on or after the effective date of this amendment, including any contract extension or renewal, that each successive wholesale customer develop and implement conservation measures. If the customer intends to resell the water, then the contract for resale of the water must have water conservation requirements so that each successive wholesale customer in the resale of the water be required to implement water conservation measures.

This amendment is issued subject to all terms, conditions and provisions contained in Certificate No. 23-848, as amended, except as specifically amended herein.

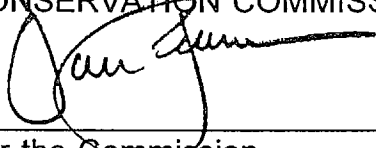
This amendment is issued subject to all superior and senior water rights in the Rio Grande Basin.

Certificate owner agrees to be bound by the terms, conditions and provisions contained herein and such agreement is a condition precedent to the granting of this amendment.

All other matters requested in the application which are not specifically granted by this amendment are denied.

This amendment is issued subject to the Rules of the Texas Natural Resource Conservation Commission and to the right of continuing supervision of State water resources exercised by the Commission.

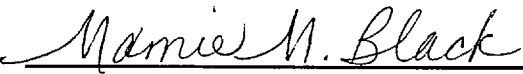
TEXAS NATURAL RESOURCE
CONSERVATION COMMISSION



For the Commission

DATE ISSUED: **SEP 08 1995**

ATTEST:



for Gloria A. Vasquez, Chief Clerk

AMENDMENT TO
CERTIFICATE OF ADJUDICATION

CERTIFICATE NO. 23-848A

CLASS "A"

Name : Hidalgo County Water
Improvement District
No. 3

Address : 1325 Pecan Blvd.
McAllen, Texas

Filed : July 24, 1978

Granted : September 25, 1978

Purpose : Municipal

County : Hidalgo

Watercourse : Rio Grande

Watershed: Rio Grande Basin

WHEREAS, the 13th Court of Civil Appeals entered its Final Judgment in Cause No. 261, styled State v. Hidalgo County Water Control and Improvement District No. Eighteen, 443 S.W. 2d 728 (Tex. Civ. App. - Corpus Christi 1969, writ ref'd n.r.e.), known as the Lower Rio Grande Valley Water Suit, adjudicating the rights to use a portion of the public waters of the State of Texas, and pursuant to the terms of the Judgment, the Texas Water Rights Commission duly issued Certificate of Adjudication No. 23-848 to Hidalgo County Water Improvement District No. 3, which authorized the holder to divert and use a maximum of not to exceed 8980 acre-feet of water per annum from the Rio Grande, with municipal priority, for municipal use by the City of McAllen; and to divert and use a maximum of not to exceed 19,852.6 acre-feet of water per annum measured at the point of diversion from the Rio Grande to irrigate 7941.04 acres of land in TWC Tract No. H-261 (Court No. 532), Hidalgo County, Texas, and caused the Certificate to be recorded in Volume 1, pages 627-628, of the Certificate of Adjudication Records of Hidalgo County, Texas; and

WHEREAS, Hidalgo County Water Improvement District No. 3 has withdrawn the irrigation service rights from 2400 acres of the 7941.04 acres within its boundaries (TWC H-261) which have become impractical to irrigate due to urbanization and transferred and awarded same to municipal use, which is a higher order of preference; and

WHEREAS, the Texas Water Commission finds that jurisdiction of the application is established; and

WHEREAS, at a public hearing on September 1, 1978, the Texas Water Commission considered an application by Hidalgo County Water Improvement District No. 3 wherein applicant sought to amend Certificate of Adjudication No. 23-848 in order to change the purpose of use of 2400 acres of Class "A" water rights from irrigation to municipal; the Texas Water Commission is of the opinion and so finds:

- (a) The proposed changes will not impair the rights of any person entitled to the use of a portion of the American share of the waters of the Rio Grande;
- (b) The proposed changes will not violate the terms of the permanent injunction and restraining order made final in the Lower Rio Grande Valley Water Suit; and

WHEREAS, at the public hearing Hidalgo County Water Improvement District No. 3 was named as a party; and

WHEREAS, by law the Executive Director and Public Interest Advocate of the Texas Department of Water Resources were named as parties; and

WHEREAS, no person appeared to protest the granting of this application; and

WHEREAS, the issuance of this permit granting this application is not adverse to any party; and

WHEREAS, the Commission has assessed the effects of issuance of this permit on the bays and estuaries of Texas; and

WHEREAS, when converted to municipal purposes Commission Rules require that each acre of Class "A" irrigation water right shall be allocated 1.25 acre-feet of water per annum and the priority of municipal use shall be applicable thereto.

NOW, THEREFORE, this amendment to Certificate of Adjudication No. 23-848 is issued to Hidalgo County Water Improvement District No. 3 subject to the following provisions:

1. USE

Certificate holder is authorized to divert and use not to exceed 3000 acre-feet of water per annum measured at the diversion point, from the American share of the Rio Grande for municipal purposes in its service area.

In lieu of certificate holder's irrigation authorization in Certificate of Adjudication No. 23-848, with Class "A" priority, certificate holder is authorized to divert and use a maximum of not to exceed 13,852.6 acre-feet of water per annum measured at the diversion point from the Rio Grande to irrigate 5541.04 acres in TWC Tract No. H-261 (Court No. 532), Hidalgo County, Texas.

2. SPECIAL CONDITION

This amendment is issued subject to all terms, conditions and provisions contained herein and such agreement is a condition precedent to the granting of this amendment.

All other matters requested in the application which are not specifically granted by this amendment are denied.

This amendment is issued subject to the Rules and Regulations of the Texas Water Commission and to its right of continual supervision.

TEXAS WATER COMMISSION

/s/ Dorsey B. Hardeman

Dorsey B. Hardeman, Acting Chairman

Date Issued:

October 10, 1978

/s/ Joe R. Carroll

Joe R. Carroll, Commissioner

(SEAL)

Attest:

/s/ Mary Ann Hefner

Mary Ann Hefner, Chief Clerk

CERTIFICATE OF ADJUDICATION

ADJUDICATION NO: 23-848 PRIORITY: Class A and Municipal
OWNER: Hidalgo County Water Improve- ADDRESS: 1801 1/2 Highway
ment District No. 3 McAllen, Texas 78501
PURPOSE: Irrigation, municipal COUNTY: Hidalgo
WATERCOURSE: Rio Grande WATERSHED: Rio Grande

The 13th Court of Civil Appeals of Texas entered its final judgment in Cause No. 261, styled The State of Texas, et al. v. Hidalgo County WC&ID No. 18, et al., 443 S.W.2d 728, (Error ref. n.r.e.), adjudicating the rights to use a portion of public waters of the State of Texas. This "Certificate of Adjudication" is issued subject to the following conditions and to the Rules and Regulations of the Texas Water Rights Commission.

1. USE:

- ✓ (a) With municipal priority, holder is authorized to divert a maximum of not to exceed 8,980 acre-feet of water per annum measured at the point of diversion from the Rio Grande for municipal use by the City of McAllen.
- ✓ (b) With Class A priority, holder is authorized to divert and use a maximum of not to exceed 19,852.60 acre-feet of water per annum measured at the point of diversion from the Rio Grande to irrigate 7,941.04 acres in TWC Tract No. H-261, (Court No. 532), Hidalgo County, Texas. The use of water is limited to the irrigation of the described lands.

2. SPECIAL CONDITIONS:

- (a) Waters diverted hereunder shall be allocated in accordance with the Rules, Regulations and Modes of Procedure and Orders of the Texas Water Rights Commission.
- (b) All requests for water shall be made to the Watermaster and all uses of water shall be reported in accordance with the Rules, Regulations and Modes of Procedure and Orders of the Texas Water Rights Commission.

This certificate is issued subject to the rules and regulations of the Texas Water Rights Commission and to its right of continual supervision.

TEXAS WATER RIGHTS COMMISSION

O. F. Dent, Chairman

DATE ISSUED:

October 18, 1971

TEST:

rey Strandtman, Secretary

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



AMENDMENT TO CERTIFICATE OF ADJUDICATION

8/28/13
AE

CERTIFICATE NO. 23-353C	TYPE: 11.122	PRIORITY: Municipal
Owner: City of McAllen	Address: P.O. Box 5489 McAllen, Texas 78502	
Filed: June 5, 2013	Granted: August 19, 2013	
Purpose: Municipal	Counties: Hidalgo	
Watercourse: Rio Grande	Watershed: Rio Grande Basin	

WHEREAS, the City of McAllen (Owner) owns a portion of Certificate of Adjudication No. 23-353 which authorizes the diversion and use of not to exceed 678.84 acre-feet of Municipal Priority water per year for municipal purposes from three points on the Rio Grande, Rio Grande Basin in Hidalgo County; and

WHEREAS, the City of McAllen seeks to amend Certificate of Adjudication No. 23-353 to add a diversion point for its 678.84 acre-foot portion of authorized water per year; and

WHEREAS, the additional diversion point will be on the Rio Grande at Latitude 26.116348°N, Longitude 98.272574°W, bearing S 8°46' 08" W, 13,156 feet from the northeast corner of Lot 4, Block 5, Rio Bravo Plantation Company Subdivision in Hidalgo County Texas; and

WHEREAS, the Texas Commission on Environmental Quality finds that jurisdiction over the application is established; and

WHEREAS, this amendment, if granted, is subject to requirements and orders of the Rio Grande Watermaster; and

WHEREAS, the Executive Director recommends special conditions be included in the amendment; and

WHEREAS, no requests for a contested case hearing were received for this application; and

WHEREAS, the Commission has complied with the requirements of the Texas Water Code and Rules of the Texas Commission on Environmental Quality in issuing this amendment; and

WHEREAS, the Texas Commission on Environmental Quality is of the opinion and so finds the proposed changes will not impair the rights of any person entitled to the use of a portion of the American share of the waters of the Rio Grande;

NOW, THEREFORE, this amendment to Certificate of Adjudication No. 23-353, designated Certificate of Adjudication No. 23-353C, is issued to the City of McAllen, subject to the following terms and conditions:

1. DIVERSION

In addition to the previous diversion points, Owner is also authorized to divert its authorized water from a point located on the Rio Grande at Latitude 26.116348° N, Longitude 98.272574° W, bearing S 8° 46' 08" W, 13,156 feet from the northeast corner of Lot 4, Block 5, Rio Bravo Plantation Company Subdivision in Hidalgo County, Texas.

2. CONSERVATION

Owner shall implement water conservation plans that provide for the utilization of those practices, techniques, and technologies that reduce or maintain the consumption of water, prevent or reduce the loss or waste of water, maintain or improve the efficiency in the use of water, increase the recycling and reuse of water, or prevent the pollution of water, so that a water supply is made available for future or alternative uses. Such plans shall include a requirement that in every water supply contract entered into, on or after the effective date of this amendment, including any contract extension or renewal, that each successive wholesale customer develop and implement conservation measures. If the customer intends to resell the water, then the contract for resale of the water shall have water conservation requirements so that each successive customer in the resale of the water will be required to implement water conservation measures.

3. SPECIAL CONDITIONS

- A. Owner shall install a measuring device which accounts for, within 5% accuracy, the quantity of water diverted from the Rio Grande. Owner shall allow representatives of the TCEQ Rio Grande Watermaster reasonable access to the property to inspect the measuring device.
- B. Owner shall contact the Rio Grande Watermaster prior to diversion of water authorized by this amendment.

This amendment is issued subject to all terms, conditions, and provisions contained in Certificate of Adjudication No. 23-353, as amended, except as specifically amended herein.

This amendment is issued subject to all superior water rights in the Rio Grande Basin.

Owner agrees to be bound by the terms, conditions, and provisions contained herein and such agreement is a condition precedent to the granting of this amendment.

All other matters requested in the application which are not specifically granted by this amendment are denied.

This amendment is issued subject to the Rules of the Texas Commission on Environmental Quality and to the right of continuing supervision of State water resources exercised by the Commission.



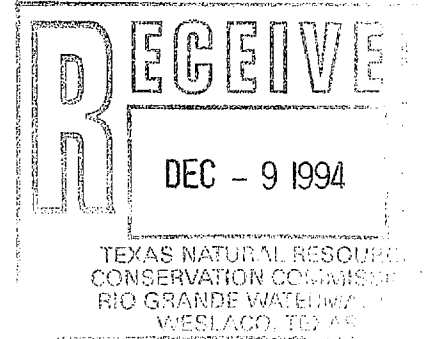
For the Commission

Date Issued: **August 19, 2013**

TEXAS NATURAL RESOURCE CONSERVATION COMMISSION



AMENDMENT TO
CERTIFICATE OF ADJUDICATION



CERTIFICATE NO. 23-353B

PRIORITY : MUNICIPAL

Owner : The City of McAllen

Address : P. O. Box 220
McAllen, Texas 78505

Filed : October 27, 1994

Granted : November 18, 1994

Purpose : Municipal

County : Hidalgo

Watercourse : Rio Grande

Watershed : Rio Grande Basin

WHEREAS, an application was received from the City of McAllen to combine the 832.50 acre-feet of Class "B" irrigation rights it owns pursuant to Certificate of Adjudication No. 23-746, as amended, with the rights authorized by Certificate No. 23-353, as amended, and to amend Certificate No. 23-353, as amended and combined, by changing the place of use, purpose of use (from irrigation to municipal use) and the diversion point of the 832.50 acre-feet of water rights; and

WHEREAS, a water conservation plan dated July, 1994 was submitted with the application; and

WHEREAS, as indicated in 31 TAC §303.43, the conversion of the 832.50 acre-feet of Class "B" irrigation rights to municipal rights will result in an authorization to use 333 acre-feet of water per annum for municipal use; and

WHEREAS, Certificate No. 23-353, as amended, currently authorizes the City of McAllen to divert and use not to exceed 345.84 acre-feet of water per annum for municipal purposes; and

WHEREAS, by Commission order approved on November 18, 1994, the water rights authorized by Certificate No. 23-746, as amended, were combined with the water rights authorized by Certificate No. 23-353, as amended, under Certificate No. 23-353, as amended, to be designated by this amendment; and

WHEREAS, the Texas Natural Resource Conservation Commission finds that jurisdiction over the application is established; and

WHEREAS, no person protested the granting of this application; and

WHEREAS, the Commission has complied with the requirements of the Texas Water Code and Rules of the Texas Natural Resource Conservation Commission in issuing this amendment.

NOW, THEREFORE, this amendment to Certificate No. 23-353, as amended and combined, is issued to the City of McAllen, subject to the following terms and conditions:

1. USE

In lieu of the authorization to divert and use 345.84 acre-feet of water per annum for municipal purposes, under Certificate No. 23-353, as amended, owner is authorized to divert and use not to exceed 678.84 acre-feet of water per annum from the Rio Grande for municipal use within the City's service area in Hidalgo County, Texas.

2. DIVERSION

Owner is authorized to divert the additional 333 acre-feet of water per annum authorized by this amendment from the diversion points currently authorized in Certificate No. 23-353, as amended.

3. SPECIAL CONDITIONS

- a. Owner shall implement the referenced water conservation which provides for the utilizing of those practices, techniques, and technologies that reduce or maintain the consumption of water, prevent or reduce the loss or waste of water, maintain or improve the efficiency in the use of water, increase the recycling and reuse of water, or prevent the pollution of water, so that a water supply is made available for future use or alternative uses. In addition, every wholesale water supply contract entered into, on or after the effective date of this amendment, including any contract extension or renewal, that each successive wholesale customer develop and implement water conservation measures. If the customer intends to resell the water, then the contract for the resale of the water must have water conservation requirements so that each successive wholesale customer in the resale of the water will be required to implement water conservation measures.
- b. Owner shall submit an annual water conservation progress report to the Commission until such time as the conservation goals included in the conservation plan have been met.

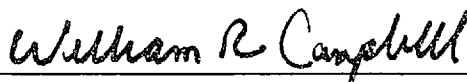
This amendment is issued subject to all terms, conditions and provisions contained in Certificate No. 23-353, as amended, except as specifically amended herein.

This amendment is issued subject to all superior and senior water rights in the Rio Grande Basin. Certificate owner agrees to be bound by the terms, conditions and provisions contained herein and such agreement is a condition precedent to the granting of this amendment.

All other matters requested in the application which are not specifically granted by this amendment are denied.

This amendment is issued subject to the Rules of the Texas Natural Resource Conservation Commission and to the right of continuing supervision of State water resources exercised by the Commission.

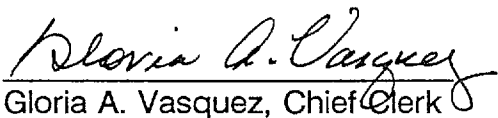
TEXAS NATURAL RESOURCE
CONSERVATION COMMISSION



For the Commission

Date Issued: November 18, 1994

ATTEST:



Gloria A. Vasquez, Chief Clerk

TEXAS WATER COMMISSION



AMENDMENT TO CERTIFICATE OF ADJUDICATION

CERTIFICATE NO. 23-353A

PRIORITY : Municipal

Name : City of McAllen

Address : P. O. Box 5489
McAllen, Texas
78502

Filed : September 8, 1992

Granted : December 16, 1992

Purpose : Municipal

County : Hidalgo

Watercourse : Rio Grande

Watershed : Rio Grande Basin

WHEREAS, Certificate of Adjudication No. 23-353 was issued to L. M. Berry on September 13, 1971, and authorized the owner to divert and use not to exceed 435 acre-feet of Class "B" water per annum from the Rio Grande to irrigate a maximum of 174 acres of land in TWC Tract No. H-50 (Court No. 96), Hidalgo County, Texas and Commission records currently show The City of McAllen as the owner of a 244.3 acre-foot portion of the water right to irrigate 97.72 acres of land;

WHEREAS, Certificate of Adjudication No. 23-400 was issued to Dixie Mortgage Loan Company on September 17, 1971, and authorized the owner to divert and use not to exceed 1207.675 acre-feet of Class "B" water per annum from the Rio Grande to irrigate a maximum of 483.07 acres of land in TWC Tract No. H-126 (Court No. 256), Hidalgo County, Texas and Commission records currently show The City of McAllen as the owner of a 287.20 acre-foot portion of the water right to irrigate 114.88 acres of land;

WHEREAS, Certificate of Adjudication No. 23-512 was issued to E. I. Fosmire on September 23, 1971, and authorized the owner to divert and use not to exceed 405 acre-feet of Class "B" water per annum from the Rio Grande to irrigate a maximum of 162 acres of land in TWC Tract No. H-183 (Court No. 333), Hidalgo County, Texas and Commission records currently show The City of McAllen as the owner of a 110 acre-foot portion of the water right to irrigate 44 acres of land;

WHEREAS, Certificate of Adjudication No. 23-557 was issued to Rufino Sotelo, et ux on September 27, 1971, and authorized the owner to divert and use not to exceed 97.5 acre-feet of Class "B" water per annum from the Rio Grande to irrigate a maximum of 39 acres of land in TWC Tract No. H-513 (Court No. 1003), Hidalgo County, Texas and Commission records currently show The City of McAllen as the sole owner of the water right;

WHEREAS, Certificate of Adjudication No. 23-597 was issued to David H. Keir on September 28, 1971, and authorized the owner to divert and use not to exceed 119.35 acre-feet of Class "B" water per annum from the Rio Grande to irrigate a maximum of 47.74 acres of land in TWC Tract No. H-301a (Court No. 598a), Hidalgo County, Texas and Commission records currently show The City of McAllen as the sole owner the water right;

WHEREAS, Certificate of Adjudication No. 23-818 was issued to The City of McAllen on October 14, 1971, and authorized the owner to divert and use not to exceed 5 acre-feet of Class "A" water per annum from the Rio Grande to irrigate a maximum of 2 acres of land in TWC Tract No. H-339 (Court No. 677), Hidalgo County, Texas and Commission records currently show The City of McAllen as the sole owner the water right;

WHEREAS, The City of McAllen has requested that their portions of the certificates listed above be combined under Certificate No. 23-353, and to amend Certificate No. 23-353, as combined, as follows:

1. Change the purpose of use of the aforesaid water rights to municipal use. The conversion of the water rights will be made in accordance with Commission rule 303.43 and will equate to 345.84 acre-feet of water per annum for municipal priority.
2. Change the places of use of the aforesaid water rights to the city's service area in Hidalgo County, Texas.
3. Specify the three diversion points to be utilized by the city;

WHEREAS, by Commission order approved on December 16, 1992, all of the water rights owned by The City of McAllen under the aforementioned certificates were combined under 23-353, to be designated by this amendment;

WHEREAS, the Texas Water Commission finds that jurisdiction over the application is established;

WHEREAS, no person protested the granting of this application;

WHEREAS, the Commission has complied with the requirements of the Texas Water Code and Rules of the Texas Water Commission in issuing this amendment; and

WHEREAS, the Texas Water Commission is of the opinion and so finds:

- (a) The proposed changes will not impair the rights of any person entitled to the use of a portion of the American share of the waters of the Rio Grande;
- (b) The proposed changes will not violate the terms of the permanent injunction and restraining order made final in the Lower Rio Grande Valley Water Suit;

WHEREAS, when converted to municipal purposes Texas Water Commission Rules require that each acre-foot of Class "A" irrigation water right shall be allocated 0.5 acre-feet of water per annum with municipal priority and each acre-foot of Class "B" irrigation water right shall be allocated 0.4 acre-feet of water per annum with municipal priority.

NOW, THEREFORE, this amendment to Certificate No. 23-353, as combined, is issued to The City of McAllen, subject to the following terms and conditions:

1. USE

Certificate owner is authorized to divert not to exceed 345.84 acre-feet of water per annum from the Rio Grande with municipal priority for use within the City's service area in Hidalgo County, Texas.

2. DIVERSION

- A. On the left, or north, bank of the Rio Grande at Latitude 26.078° N, Longitude 98.252° W, also bearing S 64° E, 1900 feet from the southeast corner of the Juan Antonio Villareal Survey No. 64, Abstract No. 44, approximately 17 miles southwest of Edinburg, Hidalgo County, Texas, which is operated by Hidalgo County Irrigation District No. 2.
- B. On the left, or north, bank of the Rio Grande at Latitude 26.117° N, Longitude 98.265° W, also bearing S 47° 15' E, 2000 feet from the southwest corner of the Antonio Gutierrez Survey No. 63, Abstract No. 34, approximately 15 miles southwest of Edinburg, Hidalgo County, Texas, which is operated by Hidalgo County Irrigation District No. 3.

- C. On the left, or north, bank of the Rio Grande at Latitude 26.182° N, Longitude 98.405° W, also bearing S 81° E, 900 feet from the southwest corner of the Nicolas Zamora Survey No. 48, Abstract No. 76, approximately 5½ miles southwest of Mission, Hidalgo County, Texas, which is operated by United Irrigation District.

3. SPECIAL CONDITION

The City of McAllen shall provide a response to the Commission staff review dated October 9, 1992, of the Water Conservation Plan contained in the application for this amendment within 120 days of the issuance of this amendment.

This amendment is issued subject to all terms, conditions and provisions contained in Certificate No. 23-353, as combined, except as specifically amended herein.

This amendment is issued subject to all superior and senior water rights in the Rio Grande Basin.

Certificate owner agrees to be bound by the terms, conditions and provisions contained herein and such agreement is a condition precedent to the granting of this amendment.

All other matters requested in the application which are not specifically granted by this amendment are denied.

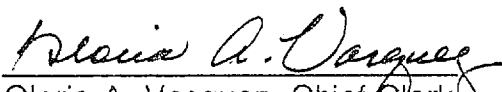
This amendment is issued subject to the Rules of the Texas Water Commission and to the right of continuing supervision of State water resources exercised by the Commission.

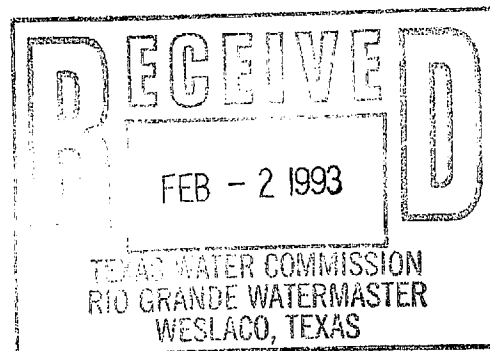
TEXAS WATER COMMISSION


John Hall, Chairman

DATE ISSUED: JAN 11 1993

ATTEST:


Gloria A. Vasquez, Chief Clerk



CERTIFICATE OF ADJUDICATION

ADJUDICATION NO: 23- 353

CLASS: B

OWNER: L. M. Berry

ADDRESS: Route 1, Box 481
Mission, Texas 78572

PURPOSE: Irrigation

COUNTY: Hidalgo

WATERCOURSE: Rio Grande

WATERSHED: Rio Grande

The 13th Court of Civil Appeals of Texas entered its final judgment in Cause No. 261, styled The State of Texas, et al. v. Hidalgo County WC&ID No. 18, et al., 443 S.W.2d 728, (Error ref. n.r.e.), adjudicating the rights to use a portion of public waters of the State of Texas. This "Certificate of Adjudication" is issued subject to the following conditions and to the Rules and Regulations of the Texas Water Rights Commission.

1. USE:

Holder is authorized to divert and use a maximum of not to exceed 435.00 acre-feet of water per annum measured at the point of diversion from the Rio Grande to irrigate 174.00 acres in TWC Tract No. H-50 , (Court No. 96), Hidalgo County, Texas. The use of water is limited to the irrigation of the described lands.

2. SPECIAL CONDITIONS:

(a) Waters diverted hereunder shall be allocated in accordance with the Rules, Regulations and Modes of Procedure and Orders of the Texas Water Rights Commission.

(b) All requests for water shall be made to the Watermaster and all uses of water shall be reported in accordance with the Rules, Regulations and Modes of Procedure and Orders of the Texas Water Rights Commission.

This certificate is issued subject to the rules and regulations of the Texas Water Rights Commission and to its right of continual supervision.

TEXAS WATER RIGHTS COMMISSION

DATE ISSUED:

O. F. Dent, Chairman

September 13, 1971

ATTEST:

Audrey Strandtman, Secretary

Exhibit H

Letter from HCWID 3 to MPU re: Rate Increase Justification

**HIDALGO COUNTY WATER IMPROVEMENT
DISTRICT NUMBER THREE**

1325 Pecan Blvd
McAllen, Texas 78501
(956) 686-8303
Fax (956) 686-1022

Othal Brand Jr.-President
Chris Burns –Vice President
Mark Freeland-Secretary

W. D. Moschel -Member
Lance Neuhaus -Member

July 30, 2021

Mr. Mark Vega
Utility Manager
McAllen Public Utilities
P.O. Box 220
McAllen, Texas 78505-0220

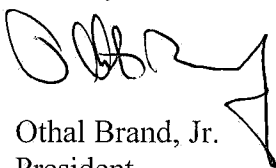
Dear Mr. Vega:

You have by now received Hidalgo County Control and Improvement District No. 3's notice of increase for water effective September 1 of this year. As you know the District will have new Legislative responsibilities to fulfill requiring additional cash outlay.

Additional two major projects are needed. One project is flood control structure modification to the District's Major Canal Delivery System to the City of McAllen. Lastly the Electrical upgrade to the District's Primary Pump Station on the river.

These are items needing the District present attention. Having addressed these Projects is not to say there could be a change in the rate in the future. The District is available to further discuss these project if you have any questions.

Thank you,

A handwritten signature in black ink, appearing to read 'Othal Brand, Jr.', with a stylized flourish at the end.

Othal Brand, Jr.
President

Exhibit I

Affidavit of Chris Ekrut and Comparative Rate Analysis

PUC DOCKET NO. _____

PETITION OF McALLEN PUBLIC	§	BEFORE THE
UTILITY APPEALING WHOLESALE	§	
WATER RATES CHARGED BY	§	PUBLIC UTILITY COMMISSION
HIDALGO COUNTY WATER	§	
IMPROVEMENT DISTRICT NO. 3 IN	§	OF TEXAS
HIDALGO COUNTY, TEXAS	§	

AFFIDAVIT OF CHRIS EKRUT

On this day, appeared before me, the undersigned notary public, Chris Ekrut, Chief Financial Officer of NewGen Strategies and Solutions, and after I administered an oath to him, upon his oath, he said:

“My name is Chris Ekrut. I am a Director and the Chief Financial Officer of NewGen Strategies and Solutions. I am more than twenty-one (21) years of age and capable of making this affidavit. I have personal knowledge of the facts stated herein, which are true and correct.

1. For the last 16 years, I have provided consulting services to municipalities, special districts, and investor-owned utilities, with an emphasis in the areas of water and wastewater rates and services. My professional experience includes, but is not limited to, advising retail public water and wastewater utilities with the following services:

- wholesale and retail cost of service and rate design studies;
- water and wastewater system valuations;
- preparation of financial and business plans;
- preparation of impact fee studies; and
- assistance in negotiating wholesale water and wastewater contracts.

My testimony on water and wastewater utility service matters has been admitted as qualified expert testimony in 16 contested case hearings before the Public Utility Commission of Texas (the “Commission”) and the State Office of Administrative Hearings. I have been engaged by the Office of Public Utility Counsel to provide my technical expertise on water and wastewater rulemakings. I am a member of the American Water Works Association (“AWWA”) and participate as a Committee Member of the Rates and Charges Subcommittee of the Texas Chapter of AWWA. I am also called upon regularly by EUCI to serve as an instructor for their training course entitled “Fundamentals of Cost of Service and Rate Design for Water Utilities.” I also serve as a

Faculty Member for the National Association of Regulatory Utility Commissioners' bi-annual Rate School. I received my undergraduate degree from West Texas A&M University in 2003 and a Masters of Public Administration from the University of North Texas in 2005.

2. I have prepared this affidavit as a Comparative Rate Analysis in support of the request for interim rates in the Original Petition filed by McAllen Public Utility ("MPU") with the Commission on October 27, 2021 (the "Petition") appealing wholesale water service rates charged to MPU by Hidalgo County Water Improvement District No. 3 ("HCWID 3"). My Comparative Rate Analysis is only for the purpose of supporting interim rates and is not intended to support any final adjusted rate that the Commission may set after conducting an evidentiary hearing in this proceeding.
3. HCWID 3's raw water delivery rate to the City of McAllen ("City") was increased from \$97.67 per acre-foot (or approximately \$0.2997 per 1,000 gallons) in August 2021 to \$113.96 per acre-foot (or approximately \$0.3497 per 1,000 gallons) in September 2021. This is an increase of \$16.29 per acre-foot (or approximately \$0.0500 per 1,000 gallons) and represents a year over year increase of 16.67%. The rate increase notice letter from HCWID 3 is Exhibit B to the Petition.
4. Under the City's raw water delivery contract with HCWID 3, which is Exhibit A to the petition, the City must pay for 13,980 acre-feet of water a year regardless of whether MPU actually utilizes the full contract allotment. In addition, any water taken by the City is multiplied by a factor of 1.1 to account for transportation losses. The HCWID 3 contract does not establish any kind of methodology HCWID 3 must adhere to when adjusting rates for raw water delivery service to MPU. At the rate charged prior to September 2021, this amount of water would cost the City approximately \$1,503,353 ((13,980 acre-feet * 1.1) * \$97.67 per acre-foot). At the rate charged after September 2021, this amount of water would cost the City approximately \$1,752,477 ((13,980 acre-feet * 1.1) * \$113.96 per acre-foot). This is an annual increase of \$250,507.62 (or approximately 16.6%) for the same raw water, delivered through the same facilities, as before the increase.
5. As noted in Exhibit G to the Petition, HCWCID 3 provided a letter to MPU attempting to justify the increase in the rate. This justification is limited to a statement regarding

additional legislative requirements specific to cash outlay as well as discussion of two capital projects. However, no quantification or cost impact of these new legislative requirements is provided, nor is any information regarding the cost or anticipated funding plan specific to the anticipated, yet to be constructed, capital improvements included. In short, the provided justification is insufficient, in my opinion, to support the requested increase. Further, if the anticipated capital improvements are to be cash-funded as I understand has been HCWCID 3's historical practice, then the increase from HCWCID 3 should be stated as a one-year increase sufficient to fund the capital improvements, with a return to prior year rate levels in the following year assuming no further capital investment is needed.

6. MPU requested that I perform a Comparative Rate Analysis to determine a range of reasonable rates to serve as a basis for interim rates established by the Commission during the pendency of this proceeding.
7. Based on available data from similarly situated utilities providing comparable service, HCWCID 3's adjusted delivery rate effective September 2021 is 56 percent to 122 percent higher than comparable providers. Table 1 illustrates how HCWCID 3's rates compare to rates charged by similar raw water suppliers.

TABLE 1
Comparison of Raw Water Delivery Pricing

<u>Water Provider</u>	<u>Cost per Acre-Foot</u>	<u>Cost per 1,000 gallons</u>
Hidalgo County Water Improvement District No. 3 (Sept 2021)	\$ 113.960	0.349730
Hidalgo County Water Improvement District No. 3 (August 2021)	97.670	0.299738
Harlingen Irrigation District No. 1 (2021) (Municipal Delivery Cost)	73.157	0.224511
Hidalgo County Irrigation District No. 1 (Calculated 2021)	65.890	0.202200
United Irrigation District (2021)	59.957	0.184001
Hidalgo County Irrigation District No. 2 (2021)	51.256	0.157300

8. From 2010 to the latest rate change in September 2021, the HCWCID 3 raw water delivery rate increased at a compounded annual rate of approximately 4.98%. See Schedule 1 illustrating the historical increases. During this same period, the Consumer Price Index (CPI) – All Urban Consumers (not seasonally adjustment), U.S., All Items Less Food and Energy Series CUUR0000SAOLIE as published by the Bureau of Labor Statistics increased at a compounded annual rate of approximately 2.13%. I used this CPI for my

analysis in this affidavit because it is the same price index used by Hidalgo County Irrigation District No. 1 (“HCID 1”) as agreed in that district’s contract with the City to adjust raw water pricing (See Petition Exhibit C, Page 5, Paragraph 5(j)).

9. As a comparison point only, I have developed for this Comparative Rate Analysis a comparable rate for raw water service that would be charged by HCID 1 to the City in September 2021 under the provisions of the contract between HCID 1 and the City. I find the HCID 1 contract to be instructive because the service provided for in that contract is comparable to that provided to MPU by HCWID 3, it is a relatively recently executed contract, and it provides what I consider to be a reasonable methodology for calculating raw water delivery rates in the region. I understand from discussions with MPU staff that MPU currently lacks a useable delivery point for water under the HCID 1 contract. Consequently, HCID 1 has not, to my knowledge, recently adjusted its rates under that contract. As further illustrated in the calculations attached to my affidavit as Schedule 1, the HCID 1 contract contains the following provisions related to pricing for raw water delivery that are relevant to my Comparative Rate Analysis:

- (c) The initial McAllen Water Base Charge shall be Forty Seven and No/100th Dollars (\$47.00) per acre-foot.
- (d) The McAllen Water Base Charge shall be adjusted annually proportional to the increases in the Consumer Price Index as provided herein.
- (e) In addition to the McAllen Water Base Charge, the City shall pay to the District an estimated energy pass-through charge.
- (f) Beginning with the effective date of this Contract, the Energy Charge for each year during the term of this Contract shall be estimated based upon the actual energy cost of the District per thousand gallons of total water diverted for the prior calendar year. For example, the District’s actual Energy Charge for the calendar year 2011 was \$0.0137 per thousand gallons of total water diverted
- (j) On an annual basis, the McAllen Water Base Charge shall be adjusted annually proportional to any increase in the *Consumer Price Index – All Urban Consumers (not seasonally adjusted)*, U.S. *All Items Less Food and Energy Series CUUR0000SAOLIE*, as published by the Bureau of Labor Statistics, hereafter referred to as “CPI”. In January of each year, the McAllen Water Base Charge for

the current year shall equal the McAllen Water Base Charge of the previous years multiplied by the product $[1 + (CPI2 - CPI1) / CPI1]$ where CPI1 is the index for the month of November prior to the beginning of the twelve (12) month period, and CPI2 is the index for the next to last month (November) of such twelve (12) month period.

- (k) In addition to the McAllen Water Delivery Charge, the City shall pay the District the product of twenty-five percent (25%) of the McAllen Water Supply delivered by the District to the Delivery Point times the then current District rate for delivery of agricultural irrigation water to compensate the District for its conveyance losses. As of the effective date of this Contract, the District's rate for delivery of agricultural irrigation water is fifteen and No/100th Dollars (\$15.00) per acre-foot.

Based on these provisions, the applicable pricing for water delivery under the HCID 1 contract, the term of which was effective beginning October 10, 2013, would have been approximately \$55.38 per acre-foot (See Schedule 1 for supporting calculations). Further adjusting this rate by the CPI as discussed in Paragraph 5(j) in the contract between the City and HCID No. 1 results in a comparable rate of approximately \$65.89 per acre foot as of September 2021. This rate is \$48.07 per acre foot (or \$0.14753 per 1,000 gallons) less than the revised water delivery rate adopted by HCID No. 3 effective September 2021.

10. As noted above, HCWID 3's raw water rate effective in September 2021 has not been supported by justifiable cost data, and the percent of increase exceeds comparable increases experienced under the CPI. Further, HCWID 3's current rate is markedly higher than rates charged by similarly situated utilities providing comparable service in the region today.
11. Considering the facts cited above, it is my professional opinion that the rate of \$113.96 per acre-foot adopted and made effective by HCWID 3 is unreasonable and unsupported by any verifiable data. The seller has not, and in my opinion cannot, demonstrate the changed conditions that are the basis for this change in rates. Further, if changed conditions could be demonstrated, I do not anticipate such changed conditions would be found reasonable on review by the Commission, and it would certainly be difficult for a

district like HCWID 3, that effectively only provides raw water delivery without any treatment or other services to MPU, to justify a rate increase of nearly 17 percent in one year.

12. It is also my opinion, given the unreasonable rates adopted by HCWID 3, that the Commission should grant interim rates in this proceeding. In setting an interim rate, I recommend the Commission adopt the historical HCID 1 raw water rate, adjusted for the CPI, as discussed and calculated above which is \$65.89 per acre-foot. However, in no event should the interim rate be set higher than the rate prior to the September 2021 increase, or \$97.67 per acre-foot.”

FURTHER AFFIANT SAYETH NOT.



Chris Ekrut, Chief Financial Officer
NewGen Strategies and Solutions

STATE OF TEXAS

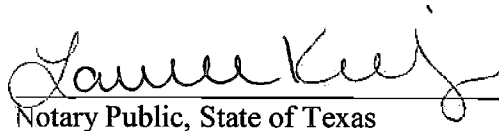
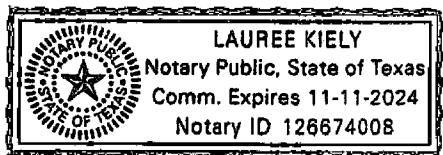
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COUNTY OF DALLAS

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Sworn to and subscribed before me the undersigned authority on this the 26th day
of October, 2021.


Notary Public, State of Texas

Petition of the City of McAllen

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021 (Aug)</u>	<u>2021 (Sept)</u>
Hidalgo County Water Improvement District No. 3													
Per Acre Foot	\$ 66.80	\$ 66.80	\$ 88.79	\$ 88.79	\$ 97.67	\$ 97.67	\$ 97.67	\$ 97.67	\$ 97.67	\$ 97.67	\$ 97.67	\$ 97.67	\$ 113.96
Per 1,000 gallons	\$ 0.20500	\$ 0.20500	\$ 0.27249	\$ 0.27249	\$ 0.29974	\$ 0.29974	\$ 0.29974	\$ 0.29974	\$ 0.29974	\$ 0.29974	\$ 0.29974	\$ 0.29974	\$ 0.34973
Period over Period Rate of Change (%)		0.00%	32.92%	0.00%	10.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	16.68%
Compounded Annual Rate of Change (%)	4.98%												
CPI (CUUR0000SA0L1E) Index Value as of November													
Index Value	222.077	226.859	231.263	235.243	239.248	244.075	249.227	253.492	259.105	265.108	269.473	279.507	279.884
Period over Period Rate of Change		2.15%	1.94%	1.72%	1.70%	2.02%	2.11%	1.71%	2.21%	2.32%	1.65%	3.72%	0.13%
Compounded Annual Rate of Change	2.13%												
	<u>Per Ac/ft</u>	<u>Per 1,000 gal</u>											
Hidalgo County Irrigation District No. 1													
Water Delivery Charge (2013)	\$ 47.00	\$ 0.14424		\$ 47.00	\$ 47.80	\$ 48.76	\$ 49.79	\$ 50.65	\$ 51.77	\$ 52.97	\$ 53.84	\$ 55.84	\$ 55.92
Energy Pass-Through Charge (2011)	4.46	0.01370	4.46	4.55	4.63	4.71	4.80	4.90	4.99	5.10	5.22	5.30	5.51
Conveyance Loss (2013)	3.75	0.01151			3.75	3.81	3.89	3.97	4.04	4.13	4.23	4.30	4.46
	\$ 55.21	\$ 0.16945			\$ 55.38	\$ 56.32	\$ 57.46	\$ 58.67	\$ 59.68	\$ 61.00	\$ 62.41	\$ 63.44	\$ 65.89
Per Acre Foot				\$ 55.38	\$ 56.32	\$ 57.46	\$ 58.67	\$ 59.68	\$ 61.00	\$ 62.41	\$ 63.44	\$ 65.80	\$ 65.89
Per 1,000 gallons				\$ 0.16995	\$ 0.17285	\$ 0.17633	\$ 0.18006	\$ 0.18314	\$ 0.18719	\$ 0.19153	\$ 0.19468	\$ 0.20193	\$ 0.20220