An Audit of Palo Pinto County Municipal Water District No. 1

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The Palo Pinto County Municipal Water District No. 1 (District) is unable to complete the construction of the Turkey Peak Reservoir after taking on approximately $94.7 million in bond debt. Without the reservoir, the District's customers, including the City of Mineral Wells, may face water shortages.

The District followed its processes for collecting revenues and processing expenditures, complied with the Texas Water Development Board (TWDB) requirements, and mostly complied with statutory requirements.

- *Audit Objective* | p. 13

This audit was conducted in accordance with Texas Water Code, Section 49.199.

PRIORITY

INSUFFICIENT FINANCING FOR TURKEY PEAK RESERVOIR PROJECT

The estimate of Turkey Peak Reservoir construction costs on which the District relied was significantly lower than the bids it received, and the District has paused construction indefinitely after taking on approximately $94.7 million in debt.

Chapter 1 | p. 3

LOW

REVENUES AND EXPENDITURES

The District followed its processes for collecting revenues and processing expenditures. However, the District should establish a process for promptly removing signatory authority when signers leave the organization.

Chapter 2-A | p. 8

MEDIUM

COMPLIANCE WITH PROGRAM AND STATUTORY REQUIREMENTS

The District complied with the requirements of the TWDB's financial assistance program and with most Texas Water Code and Texas Government Code requirements. The District should implement processes and policies as needed to ensure full compliance.

Chapter 2-B | p. 10

For more information about this audit, contact Audit Manager Amadou Ngaide or State Auditor Lisa Collier at 512-936-9500.

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Summary of Management's Response

Auditors made recommendations to address the issues identified during this audit, provided at the end of each chapter in this report. The District agreed with the recommendations.

Ratings Definitions

Auditors used professional judgment and rated the audit findings identified in this report. The issue ratings identified for each chapter were determined based on the degree of risk or effect of the findings in relation to the audit objective.

PRIORITY: Issues identified present risks or effects that if not addressed could ***critically affect*** the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

HIGH: Issues identified present risks or effects that if not addressed could ***substantially affect*** the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.

MEDIUM: Issues identified present risks or effects that if not addressed could ***moderately affect*** the audited entity's ability to effectively administer the program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.

LOW: The audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks ***or*** effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

For more on the methodology for issue ratings, see Report Ratings in Appendix 1.

PRIORITY

Chapter 1
Insufficient Financing for Turkey Peak Reservoir Project

The Palo Pinto County Municipal Water District No. 1 (District) obtained financing approval from the Texas Water Development Board (TWDB) for the construction of the Turkey Peak Reservoir. However, the estimate of construction costs on which the District relied to obtain state financial assistance was significantly lower than the bids the District received after it obtained that financing. As a result, the District has paused construction of the reservoir indefinitely after taking on approximately $94.7 million in bond debt. Without the reservoir, the District's customers, including the City of Mineral Wells, may face water shortages (see text box).

Turkey Peak Reservoir

The Turkey Peak Reservoir has been a recommended strategy in regional and state water plans since at least 2008. The 2022 state water plan listed the project cost as $102.5 million.

According to the *Brazos Region G 2026 Water Plan*, the proposed reservoir would increase storage by 83 percent over the existing reservoir, Lake Palo Pinto. The reservoir would supply approximately 1.9 billion gallons annually; without the reservoir, the regional water plan projects annual shortages of 1.3 billion gallons in 2040 and 1.6 billion gallons in 2080.

The regional water plan also noted that during the 2015 drought, storage levels in Lake Palo Pinto were reduced to critical levels. A TWDB report dated February 2015 noted that the lake was at 8 percent of storage capacity.

Sources: *2026 Brazos G Regional Water Plan* and TWDB.

The cost to build the Turkey Peak Reservoir was significantly underestimated when obtaining financing and the District is unable to complete the project.

The construction cost was significantly underestimated when the District applied for $200 million in financing assistance[1] in February 2024. The TWDB approved the financing in July 2024,

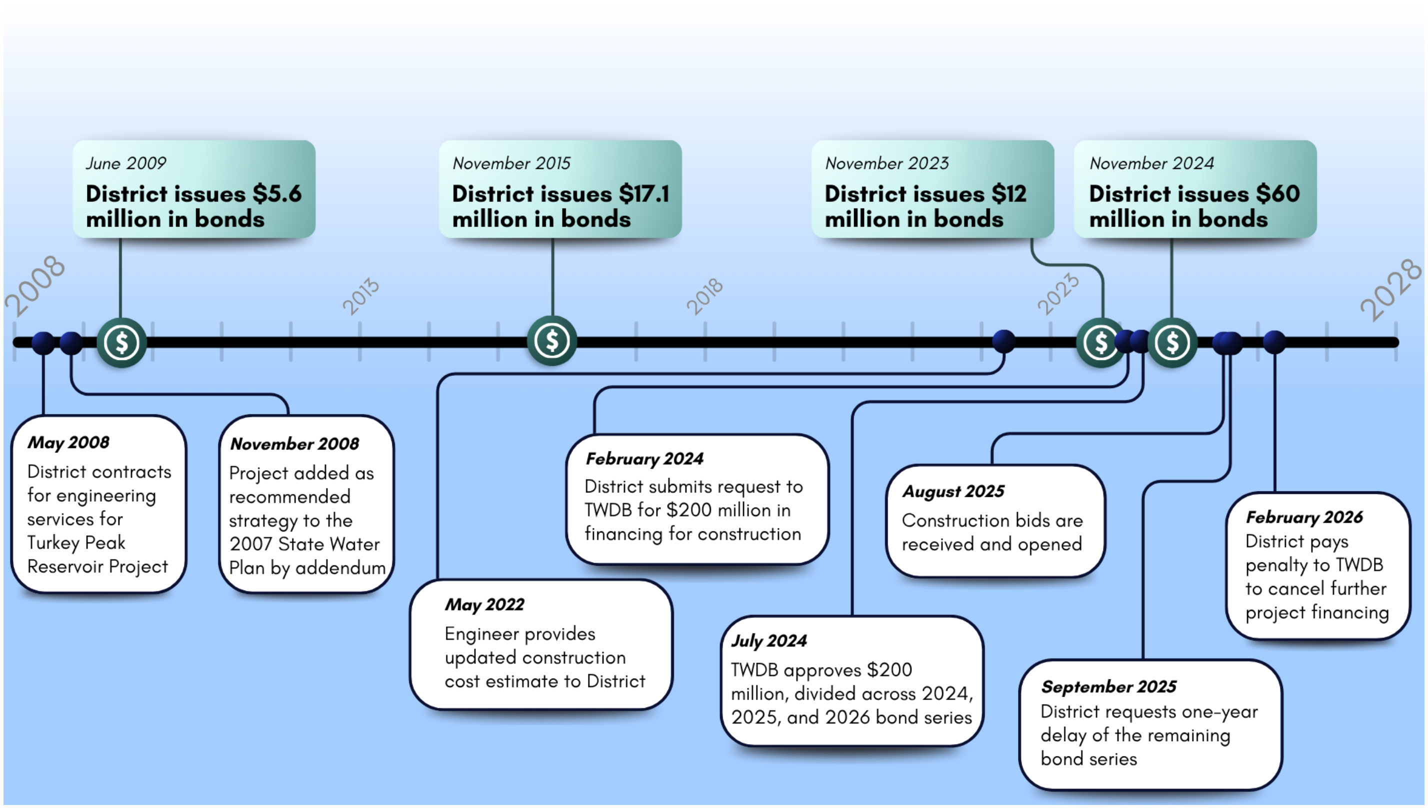
[1] The $200 million in financing was divided into three annual bond issuances of $60 million, $100 million, and $40 million.

divided into three annual bond issuances. The District issued the first bond series of $60 million in November 2024.

When construction bids were received and opened in August 2025, they ranged from approximately $350 million to $459.3 million. Unable to proceed due to the gap in financing, the District indefinitely postponed construction of the Turkey Peak Reservoir and cancelled further borrowing. In February 2026, the District paid a $70,753 penalty to the TWDB for cancelling the remaining $140 million of borrowing TWDB authorized in July 2024. Without the reservoir, the District may not be able to meet future water demands due to projected shortages. Figure 1 provides a project timeline.

Figure 1

Timeline of the Turkey Peak Reservoir Project



Sources: District and TWDB.

Calculating the Construction Cost Estimate. In preparing the construction cost estimate for its application for financing assistance, the District relied on an estimate prepared by its engineer in May 2022, which it adjusted to reflect 2 years of 5-percent inflation. However, the adjusted estimate did not capture the effects of highly uncertain market conditions or other factors that may have influenced the actual bid amounts.

The District was informed that the estimate might not match actual construction costs. The cover letter of the engineer's May 2022 estimate noted that it was "written during a period of extreme financial pricing uncertainty" and "annual escalation rates of 5% or higher are being considered in future cost projections, all with high uncertainty." Given that the project's start date was unknown at that time, the engineer recommended taking additional steps to verify the accuracy of the construction cost estimate over time and when a construction date was determined. Those additional steps included adjusting the estimate at six-month intervals and considering industry pricing indicators and published information about changes in construction costs.

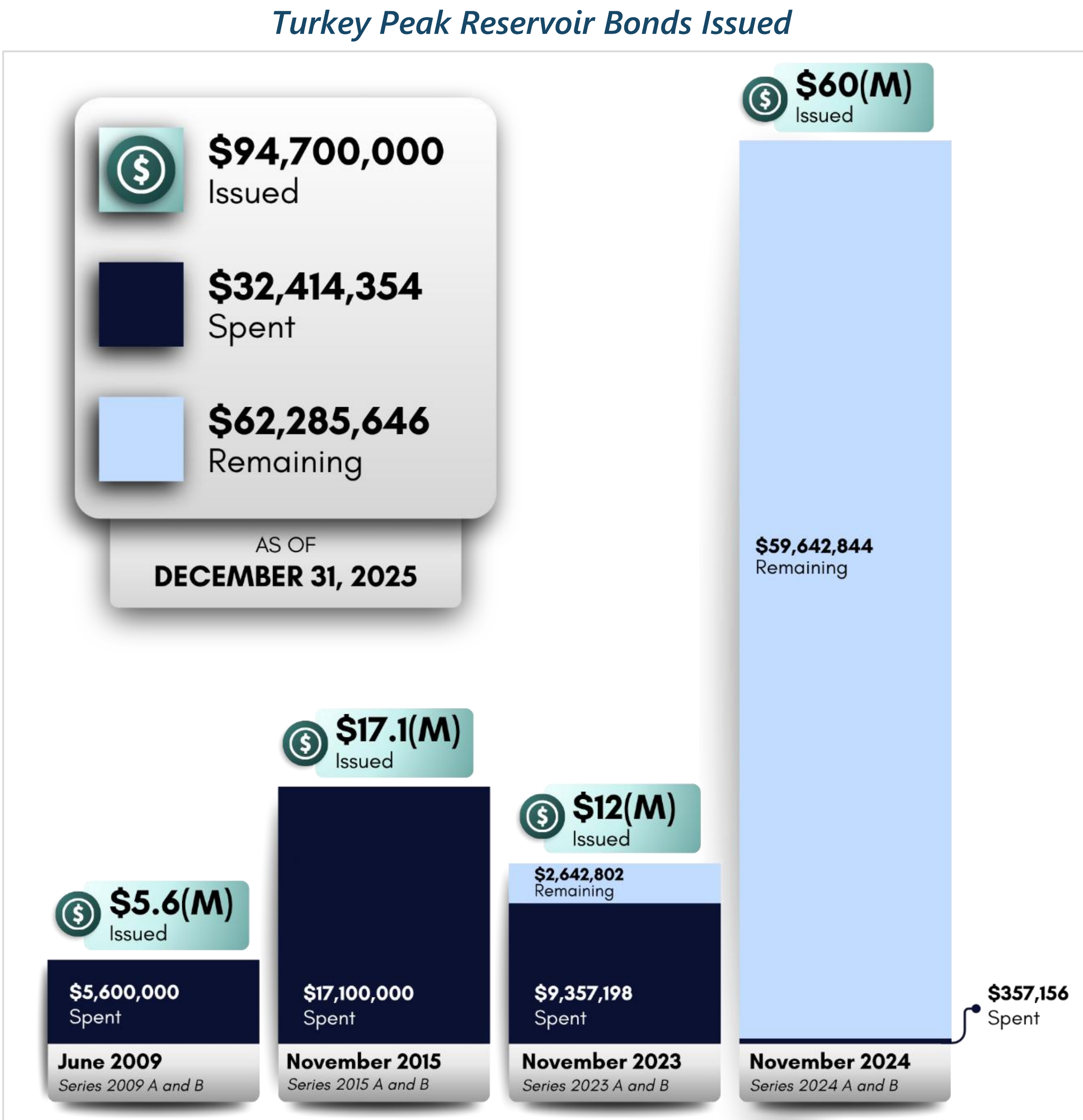
In addition, a provision in the contract between the District and its engineer stated that the District should employ an "independent cost estimator" for "greater assurance as to probable Construction Cost."

Total Funds Borrowed and Spent. Between June 2009 and November 2024, the District issued a total of $94.7 million in bonds through the TWDB for purposes of developing and constructing the Turkey Peak Reservoir. The TWDB also approved a grant of $2.4 million to the District for the project through the Economically Distressed Areas Program in January 2009.

Since 2009, the District has expended $32.4 million of bond proceeds on project design, land acquisition, and other related activities. As of December 31, 2025, a total of $62.3 million of bond funds remained unspent, mostly in escrow accounts subject to control by the TWDB. The District has not announced its plans for the unspent funds as of March 2026.

The District's bonds are guaranteed by the City of Mineral Wells, which is contractually required to repay the bonds through its water purchases from the District. The City of Mineral Wells increased the rates paid by water users to fund bond repayment. Figure 2 on the next page summarizes the amounts borrowed and spent on the project.

Figure 2



Sources: District and TWDB.

Recommendation

The District should continue to confer with relevant stakeholders to identify potential solutions to address projected water shortages.

Management's Response

> The District agrees that it needs to continue working with the Texas Water Development Board and all other relevant and reasonable parties to find solutions for funding the Turkey Peak Reservoir construction.

LOW

Chapter 2-A
Revenues and Expenditures

The District followed its processes for collecting revenues and processing expenditures and correctly calculated and collected customer fees. However, as of February 2026 its bank signature cards included a board member signatory who had left the District's Board of Directors at the end of December 2025.

The District collected revenues and processed expenditures accurately, but it should have a process to update its bank signature authority promptly.

Revenues. The District accurately calculated, collected, and recorded approximately $26.2 million in revenue from its 3 water supply customers from September 2023 through December 2025. Of this amount, 96.4 percent, or approximately $25.2 million, came from the City of Mineral Wells (City).

Expenditures. The 87 expenditures tested, including the 27 expenditures related to the Turkey Peak Reservoir project (see Chapter 1), were reasonable, accurate, properly approved, and correctly categorized in the District's financial records. According to those records, expenditures between September 2023 and December 2025 totaled approximately $25.9 million.

In addition, the 27 Turkey Peak Reservoir expenditures complied with the requirements of the TWDB financial assistance program.

However, bank signature cards obtained in February 2026, which authorize users to withdraw and transfer funds, included a signatory who had left the District's Board of Directors at the end of December 2025.

Access to Accounting System. The District relied on the City for its accounting system, including configuring and maintaining restrictions on access. No evidence of unauthorized posting, altering, or deleting of the District's accounting records was identified.

The District provided limited evidence supporting the City's assertion that access to the District's portion of the system was restricted to two District employees. However, it did not have a process for reviewing or monitoring user access to the system.

Recommendations

The District should establish processes to:

- Ensure that signatory authority is removed promptly when signers leave the organization.
- Actively monitor information technology user access to the accounting system.

Management's Response

1. Ensure that signatory authority is removed promptly when signers leave the organization.

The District acknowledges a time gap between board action and the approval of meeting minutes, as recognized by financial institutions, and will implement a resolution when its financial positions change due to board members leaving or to positions being given to other board members. By confirming this through a resolution, it can be conveyed immediately to and accepted by the District's financial institutions.

2. Actively monitor information technology user access to the accounting system.

The District agrees that this is an opportunity for improvement and will work with software and user partners to improve its security processes.

MEDIUM

Chapter 2-B
Compliance With Program and Statutory Requirements

The District complied with the requirements of the TWDB's financial assistance program and with most requirements of the Texas Water Code and Texas Government Code.

The District should fully comply with statutory requirements.

The District complied with the TWDB's financial assistance program requirements. This included making all required bond payments and exceeding the minimum required ratio of resources to debt, as well as submitting required filings and disclosures between September 2023 and December 2025.

In addition, the District complied with most Texas Water Code requirements, including obtaining financial audits and preparing and approving annual budgets for fiscal years 2023, 2024, and 2025. The District also appointed board officers and obtained bonding for board members and employees who handle funds. Board members signed sworn statements and took oaths of office prior to performing Board duties, as required.

However, the District did not comply with all statutory requirements. For example, the District's board did not have a resolution authorizing the District's current check approval process as required. Other instances of noncompliance are outlined in Figure 3 on the next page.

Figure 3

Noncompliance with Texas Water Code

Criteria/Requirements	Description of Noncompliance
Section 49.055: Oaths of office must be submitted to the Secretary of State within 10 days of execution.	The District did not send the oaths of office to the Secretary of State within that time frame. The District sent in the oaths in response to auditor inquiries.
Section 49.199: The District must have a travel expenditure policy.	The District did not have a travel expenditure policy.
Section 49.199: The District must have policies and procedures for selection, monitoring, or review and evaluation of professional services.	The District had a policy on selecting professional services but did not have a policy for monitoring or reviewing and evaluating such services.

In addition, the District could not provide adequate documentation showing how it complied with Texas Government Code, Chapter 2254, when selecting its engineer. This statute requires selection of professional services based on demonstrated competence at a fair and reasonable price rather than through competitive bidding. The statute requires the selection of the most highly qualified provider and an attempt to negotiate a fair and reasonable price when procuring engineering services.

Recommendations

The District should:

- Direct the Board to pass a resolution authorizing the District's check approval process to bring it into compliance with the Texas Water Code.
- Ensure that the board members' oaths of office are submitted to the Secretary of State as required.
- Develop and approve policies as required.
- Document its selection of, and negotiations with, providers of engineering services.

Management's Response

1. Direct the Board to pass a resolution authorizing the District's check approval process to bring it into compliance with the Texas Water Code.

The District agrees that a process has been utilized in the past, but not consistently. The District recognizes this as an opportunity for improvement and agrees to implement.

2. Ensure that the board members' oaths of office are submitted to the Secretary of State as required.

The District recognizes this as an opportunity for improvement. As of the date of this letter, the District is current with the filings of the Oaths of Office.

3. Develop and approve policies as required.

The District recognizes this as an opportunity for improvement. As of the date of this letter, the District is current with its filings identified during this audit and has enlisted its outside team members to identify policies and practices that require updating and vigilant monitoring.

4. Document its selection of, and negotiations with, providers of engineering services.

The District agrees this practice is required and vital with the requisition of any item or service. The District would like to add that, due to the extended nature of building reservoirs, this practice may be redundant, but it also acknowledges that, whether redundant or not, periodic reviews are never a bad thing.

Appendix 1

Objective, Scope, and Methodology

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

- Benjamin Nathaniel Keyfitz, CPA, CFE (Project Manager)
- Dirk Henson, CFE (Assistant Project Manager)
- Kristyn Dempter, CFE
- Marcus Kahler
- Bianca F. Pineda, CIA, CISA, CFE, CGAP (Quality Control Reviewer)
- Amadou Ngaide, MBA, CIDA, CFE, CICA (Audit Manager)

Objective

The objective of this audit was to determine whether the Palo Pinto County Municipal Water District No. 1 (District) had processes and related controls to ensure that it complied with applicable statutes and requirements.

Scope

The scope of this audit covered the District's compliance with applicable statutes and requirements such as Texas Water Code, Chapter 49, and Texas Government Code, Chapter 2254, from September 2023 through December 2025. The scope included Turkey Peak Reservoir project financial transactions during the same timeframe.

The scope also included a review of significant internal controls related to the District's financial processes.

Methodology

We conducted this performance audit from December 2025 to May 2026 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. In addition, during the audit, matters not required to be reported in accordance with *Government Auditing Standards* were communicated to the District's management for consideration.

Addressing the Audit Objectives

During the audit, we performed the following:

- Interviewed District staff and select members of the Board of Directors (Board).
- Identified the relevant criteria:
  - Texas Water Code, Chapter 49.
  - Texas Government Code, Chapter 2254, Subchapter A, Professional Services Procurement Act.
  - State Water Implementation Fund for Texas (SWIFT) bond requirements.
  - District policies, rules, and bylaws.
- Conducted tests of compliance with applicable statutory requirements and District policies and procedures. Tested elements included:
  - Annual budgets, annual financial audits, Board member and employee bonding, oaths of office, sworn statements, and procurement of professional services.
- Performed tests of the District's revenues, expenditures, fund transfers, and Turkey Peak Reservoir project activities to assess the accuracy, completeness, and integrity of the financial records. This included:
  - Performing data analysis of expenditure records using detailed general ledger data.

- Reviewing the District's bank signature cards for appropriateness.
- Reviewing a sample of checks to determine whether they included the required signatures.
- Recalculating water supply revenue transactions to determine whether the District collected the appropriate amounts.
- Testing a targeted sample of 60 expenditure transactions, representing 3 percent of 2,198 expenditures, to determine whether each transaction was authorized, reasonable, allowable, supported, and accurately recorded.
- Testing a targeted sample of 27 Turkey Peak Reservoir project expenditures, representing 20 percent of 134 expenditures, to determine whether each transaction was authorized, reasonable, allowable, supported, and accurately recorded.
- Reviewing Turkey Peak Reservoir project cash balances and related funding activity.

The samples tested were not representative of the populations; therefore, it would not be appropriate to project the test results to the populations. The sample design was chosen to address specific risk factors such as dollar amount, vendor, transaction description, and transaction type.

Data Reliability and Completeness

Auditors determined that the revenue and expenditure data from the District's general ledger was sufficiently reliable and complete for the purposes of the audit. For all data, auditors:

- Observed the District's data extraction for revenue and expenditures.
- Reviewed the report parameters used to extract the data.
- Analyzed the populations for reasonableness and completeness.

To assess expenditure data, auditors compared all of the District's expenses to the audited financial statements for reasonableness and completeness. In addition, auditors compared the District's Turkey Peak expenses to the bank account statements for reasonableness and completeness.

To assess revenue data, auditors recalculated revenues using water supply agreements and annual changes to rates and compared these calculations to bank deposits.

Report Ratings

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; noncompliance with state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair

The Honorable Dustin Burrows, Speaker of the House, Joint Chair

The Honorable Joan Huffman, Senate Finance Committee

The Honorable Robert Nichols, Member, Texas Senate

The Honorable Greg Bonnen, House Appropriations Committee

The Honorable Morgan Meyer, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

Palo Pinto County Municipal Water District No. 1

Members of the Board of Directors

Mr. Howard Huffman, General Manager