

**INVESTIGATIVE AUDIT OF THE RECORDS OF THE
CASTALIAN SPRINGS-BETHPAGE UTILITY DISTRICT
FOR THE PERIOD SEPTEMBER 1, 2001, THROUGH AUGUST 31, 2002**

FINDINGS AND RECOMMENDATIONS

1. **FINDING:** Contractor apparently over billed district for water line project

The district's board of commissioners authorized the district's maintenance contractor, Hodges Backhoe and Trenching, Inc., owned by Gailon Hodges, to install water line pipe for the Buck Perry Road project. District records indicate that the district made a separate purchase of pipe for each project. According to invoices paid by the utility district, 16,600 feet of pipe was purchased for this project. Per invoices submitted by the contractor from February 14, 2001, to September 16, 2001, Hodges Backhoe and Trenching, Inc., laid a total of 21,424 feet of pipe for this project. The minutes of the October 18, 2001, meeting of the district's board of commissioners state that the board had questions regarding the invoices submitted for the project which the contractor answered for them. The minutes do not record the questions board members raised, nor do the minutes record any action taken by the board concerning the invoices. On January 15, 2002, the contractor submitted an invoice for additional expenses related to the Buck Perry Road project, from which he subtracted the cost of 3,132 feet of pipe, stating "less overpaid." As a result, the district ultimately paid the contractor \$ 83,197.87 for laying a total of 18,292 feet of pipe for the project. Nevertheless, the contractor was still paid for laying 1,692 feet of pipe in excess of the amount purchased by the district for the job and 2,122 feet in excess of the length per odometer measurement of the project "as built." According to a representative of the district's engineering firm, no "as-built" drawings were prepared for this project.

As noted in Finding 3, district officials did not obtain a bid for this or any other water line project or secure a written contract for the work. District records did not document the number of feet of line required to be laid, the expected cost of the proposed project, or a record of the completed project. As a result, invoices submitted by the contractor could not be reconciled to project specifications or records. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 5-2, states, "Compare invoices from independent contractors with service contract provisions such as: a. description of work performed, b. estimated completion date, c. estimated total labor cost."

RECOMMENDATION:

To help ensure that the district receives what it pays for, a signed contract detailing the specifications of the job should be obtained for all water line projects. If the total cost of the project exceeds the bid limit amount, bids must be obtained. Invoices submitted by the contractor should be compared to the contract specifications to determine if charges are allowable before payment is made.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. For each capital project, we will receive Board approval on all projects and approve a capital budget for the project and track all costs related to that project. All significant variances will be investigated and reported to the Board. All such projects in excess of the bid limit amounts will be bid according to the guidelines.

Manager:

Response is the same as that of the members of the board of commissioners.

2. **FINDING: No written contract for operation and maintenance services**

During the audit period, the district paid Hodges Backhoe and Trenching, Inc., \$17,500 a month. The minutes of the August 19, 1999, district board meeting at which the fee was increased to this amount do not state the nature of the agreement. Although the district and Hodges signed an agreement on October 17, 2002, during our audit, there was no written contract during the audit period describing the specific services expected for the monthly fee and no documentation on the contractor’s invoices of the services provided for the fee. The new contract states that Hodges has been “involved in maintaining the facilities, equipment, and lines of the Utility district for over 25 years. . . .” However, there is no documentation in the district’s files that the district has had any written contract with the contractor during that period. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 5-2, states, “Compare invoices from independent contractors with service contract provisions such as: . . . description of work performed . . .”

In addition to the monthly fee, which totaled \$210,000 during the period, the district paid the contractor, Hodges Backhoe and Trenching, Inc., or his son, Rodney Hodges, additional fees for overtime work, repair of leaks caused by third parties, road cuts and repairs, mowing around tanks and pumps, and moving rock at the job site.

For the year September 1, 2001, to August 31, 2002, the utility district paid a total of \$225,696.65 to Gailon Hodges through two companies owned and operated by him. This amount does not include any payments to Hodges for capital projects. The utility district provided all pipe and other materials, and supplies needed by the contractor for maintenance and line installation, as well as equipment and service for mobile phones, cell phones, and pagers. As explained in Finding 5, district officials gave complete control of such materials, as well as supplies and equipment to the contractor.

As stated above, the district paid Hodges overtime charges of \$8,960.50 during the period. However, overtime does not appear applicable to the district’s relationship with a

maintenance contractor who received a monthly fee. Hodges was not an employee of the district, and the district did not control his work hours.

Although district officials apparently paid the contractor \$17,500 each month to perform maintenance of the district's lines and facilities, the district received an unsatisfactory score on the last annual sanitary survey conducted by employees of the Department of Environment and Conservation, Division of Water Supply. One of the problems noted by the department was inadequate maintenance. The district was placed in the "Unsatisfactory" category of public water systems in Tennessee by the department.

It also appears that during the period, there was a continuing backlog of uncompleted routine service orders, cutoffs, and tap fee installations. Per the September 2002 monthly report prepared for the board, 86 work orders had not been completed. As of October 21, 2002, 22 taps had not been set, and cutoffs for late payments were not performed during at least 5 of the 12 months in our audit period. According to district office personnel, they were directed to notify Hodges Backhoe and Trenching, Inc., to perform these services.

District officials failed to obtain a contract for maintenance services and always assigned water line projects to Hodges Backhoe and Trenching, Inc., without obtaining bids. As a result, district officials appear to have effectively turned over management of district resources to Mr. Hodges. As a result of their failure to obtain a written contract, officials did not establish and maintain controls to ensure that the district's assets were safeguarded and that the district's liability was minimized.

As noted above, in October 2002, the district executed a contract with Hodges for maintenance through December 31, 2002. We reviewed the contract to determine if compliance with its terms could be assessed. In general, the contract does not appear to clarify the contractor's responsibilities sufficiently to constitute a meeting of the minds between the parties and could therefore be unenforceable. The contract failed to resolve many questionable issues connected to Hodges' relationship with the district.

RECOMMENDATION:

Members of the board of commissioners should fulfill their responsibility to safeguard public funds by determining the most efficient way to use those funds to meet the needs of the district's customers. Any contract for maintenance and operation services should help ensure accountability by describing the **specific** duties the contractor is expected to perform. The board should enforce the contract by requiring adequate supporting documentation of services rendered to be on file for all payments to the contractor. The board of commissioners or its designee should ensure that services listed as performed have actually been performed and that those services fulfill the terms of the contract.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We believe we have addressed this issue. Recently we bid out our maintenance contract (a new contractor was awarded the contract). The contract details the requirements and specifications of the contractor’s duties.

Manager:

Response is the same as that of the members of the board of commissioners.

3. **FINDING:** Failure to bid applicable purchases

Competitive bids were not obtained for applicable purchases, particularly water line construction projects costing in excess of \$10,000. Hodges Backhoe and Trenching, Inc., received the following payments for capital projects which were not bid as required:

Project Description	District Check Number	District Check Date	Amount Applicable to Project
Buck Perry Road	4848	02/14/01	\$ 9,999.50
	4905	03/09/01	9,999.50
	4994	04/11/01	9,999.50
	5056	05/11/01	9,999.50
	5138	06/19/01	9,996.00
	5178	07/13/01	9,996.00
	5254	08/15/01	9,996.00
	5317	09/17/01	9,996.00
	5591	01/15/02	<u>3,215.87</u>
Total Project		<u>\$83,197.87</u>	
Shiloh Road	5390	10/19/01	\$ 9,999.50
	5452	11/15/01	9,999.50
	5516	12/14/01	9,999.50
	5591	01/15/02	<u>6,597.26</u>
Total Project		<u>\$36,595.76</u>	
Harsh Lane	5854	05/15/02	\$ 9,999.50
	5919	06/15/02	9,999.50
	5987	07/12/02	9,999.50
	6057	08/09/02	25,000.00
	6158	09/18/02	<u>41,921.50</u>
Total Project		<u>\$96,920.00</u>	

As shown, in numerous instances, the contractor appeared to split the project cost into several billings to avoid the bid limit of \$10,000. However, the requirement to bid is based on the total cost of the project, not the amount of individual invoices. Section 7-82-801, *Tennessee Code Annotated* and the *Uniform Accounting Manual for Tennessee Utility Districts*, Section 5-1, describes required bidding procedures and limits.

RECOMMENDATION:

To obtain the best price and to comply with state statutes, members of the board of commissioners should ensure that required bidding procedures are followed for all applicable purchases. Adequate documentation should be maintained to provide evidence that correct bidding procedures were followed.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur and will comply.

Manager:

Response is the same as that of the members of the board of commissioners.

4. **FINDING: Capital projects contractor not licensed as required by state law**

As detailed in Finding 3, Hodges Backhoe and Trenching, Inc., performed the water pipeline installation for three district projects, each of which cost in excess of \$25,000. However, according to the State of Tennessee Licensing Contractors Board, neither Hodges nor his company holds a contractor's license. Section 62-6-103, *Tennessee Code Annotated*, states, "It is unlawful for any person, firm or corporation to engage in or offer to engage in contracting in the state, unless such person, firm or corporation has been duly licensed under the provisions of this chapter, as hereinafter provided." Section 62-6-102, *Tennessee Code Annotated*, defines a contractor as one who performs any project costing \$25,000 or more.

RECOMMENDATION:

To comply with state statutes, district officials should hire only licensed contractors to perform projects costing \$25,000 or more.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. The new contractor is licensed. Only duly licensed contractors shall be awarded contracts for new construction or maintenance in the future.

Manager:

Response is the same as that of the members of the board of commissioners.

5. **FINDING: Water line projects not approved**

It appears that for at least two projects, on Buck Perry Road and Shiloh Road, district officials allowed the district’s independent contractor to install substantially more water line than the amount approved by the Tennessee Department of Environment and Conservation (TDEC). In addition, it appears that district officials did not receive any approval at all from TDEC for a water line extension installed on Reese Road. Section 68-221-706, *Tennessee Code Annotated*, states, “The department shall exercise general supervision over the construction of public water systems throughout the state. . . . No new construction shall be done nor shall any change be made in any public water system until the plans from such new construction or change have been submitted and approved by the department.”

RECOMMENDATION:

To comply with state law, district officials should ensure that **all** construction of new water line projects, including all material increases in the amount of pipe to be installed, be approved in their entirety by the Tennessee Department of Environment and Conservation.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. For each capital project, we will approve all projects and approve a capital budget for the project and track all costs related to that project. All significant variances will be investigated and reported to the Board. All such projects in excess of the bid limit amounts will be bid according to the guidelines. All construction of new waterline projects including material changes in the project shall be submitted for approval with the Tennessee Department of Environment and Conservation pursuant to its regulations.

Manager:

Response is the same as that of the members of the board of commissioners.

6. **FINDING: Inventory not secured**

Inventory was not stored on property owned or controlled by the utility district. Instead, materials and supplies were stored on a site obtained by the district's maintenance contractor and owned by a third party. During fieldwork, auditors observed that the district's inventory of pipe, meter boxes, and other supplies was scattered haphazardly and could be accessed by anyone. Some of the pipe and other items were buried in the dirt or covered by vines and other vegetation. District records contained no documentation that an annual physical inventory was performed. According to district personnel, materials and supplies ordered were delivered directly to the storage site. District officials did not require that the contractor account for any of the materials and supplies used for maintenance or capital projects. As a result, district employees could not determine that all materials and supplies were used for district purposes. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 7-4, states:

Store the materials received in the designated storage area.

- a. The storage area should protect against unauthorized withdrawals and other losses.
- b. Such storage areas should be arranged or labeled for easy identification and article location.
- c. Scrap materials that have a known salvage value should be safely stored until sold.

Sections 7-5 and 7-6 of the manual cited above describe the requirements for accounting for materials by job and conducting an annual physical inventory.

RECOMMENDATION:

To help adequately secure and account for inventory, members of the board of commissioners should ensure that access to inventory is controlled, and all usage of inventory is recorded. An annual inventory must be performed, documented, and reconciled to inventory usage records. Discrepancies should be investigated and explained. In addition, the board should evaluate the liability risk involved in storing inventory on property not owned by the district.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We are in the process of improving controls over the inventory process. The first step in this process will be to find a secure site to store materials. Once this has been achieved, we will start the process of inventorying the materials. This process may take us a little longer to complete than some of the other recommendations, but we will implement this recommendation.

Manager:

Response is the same as that of the members of the board of commissioners.

7. **FINDING: Failure to maintain complete, updated fixed asset records**

Members of the board of commissioners did not ensure that complete, updated fixed asset records were maintained. In addition, many assets were not marked, and several assets, including radios, cellular phones, a Stihl weed-cutting machine, and a road-boring machine, were in the possession of the maintenance contractor. Generally accepted accounting principles and the *Uniform Accounting Manual for Tennessee Utility Districts*, Section 8-2, require that records for each fixed asset be maintained. The records should include a brief description, model number, serial number, purchase price, useful life, location of asset, location of title, and date and authorized method of disposal. In addition, all fixed assets should be identified (tagged or marked) as belonging to the utility district.

RECOMMENDATION:

To maintain adequate control over and properly account for individual fixed assets, members of the board of commissioners should require updated records of all such property. In addition, an inventory record should be maintained of high-risk, moveable assets such as small office machines and furnishings. At least once a year, the commissioners should ensure that a physical inventory of all district fixed assets be performed, documented and reconciled to fixed asset records. All discrepancies should be explained.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We will complete an inventory of our fixed assets, completing the necessary records and will maintain the accounting of such assets. Each year we will perform an annual inventory of these assets.

Manager:

Response is the same as that of the members of the board of commissioners.

8. **FINDING: City of Gallatin contract terms inadequate or not enforced**

Since March 1967, the district has had a written contract to purchase water from the City of Gallatin and to have the city bill and collect from district customers for water service provided by the district. However, the district did not enforce at least one of the contract's terms. Although required by the contract, district officials failed to require the city to deposit the district's collections in an account of the district in a depository designated by the district. Instead, city personnel deposited the district's collections in a city bank account and remitted collections to the district once a month by check.

In addition, it appears that the contract has the following weaknesses:

- A. The contract does not require the city to maintain and forward to the district a record of the collections it receives for the district.
- B. The contract does not address the fee the district pays for the city's collection service.
- C. The contract states that the city "will bill the District at the end of each month for water furnished [and] . . . shall furnish . . . daily reports . . . and . . . shall attach to its statement . . . a statement of services furnished by it during the billing month." However, no report specifications or billing detail requirements are included.
- D. The contract fails to adequately specify the timing and nature of the measurements the city will use to compute the amount the district is charged for water.

As a result of the district's failure to obtain an adequate contract, the district received invoices with no detail for water purchased. These invoices did not represent adequate documentation for the district's related disbursements. Similarly, the district did not receive any documentation from the city for collections made by the city, so that the district could not determine if the amounts received were correct. In addition, the district did not receive supporting documentation from the city for the amount charged by the city for the billing and collection services.

There is no documentation that the board has taken specific steps to enforce the terms of the existing contract or to renegotiate inadequate terms.

RECOMMENDATION:

To help ensure that the district receives amounts due and pays only for the water it purchases, members of the board of commissioners should contact city officials and obtain legal counsel, if necessary, to enforce the terms of its written contract and to clarify or amend ambiguous and inadequate provisions.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. The contract with the City of Gallatin is due to expire March 2007. The district does not have the ability to force amendments to the contract unilaterally; however, the utility district will require the city to give a detailed statement for water purchased and daily reports if read by the city regarding the master meters.

9. **FINDING: Ineligible commissioner**

One of the recently elected commissioners is apparently ineligible to serve. According to billing documentation, this commissioner has not been a customer of the district since July 1998. Section 7-82-307(mm)(2), *Tennessee Code Annotated*, states:

No person shall serve on a board unless the person is a customer of the utility district. As used in this subsection (mm), "customer" means a person who is periodically billed for utility service rendered by the district and who pays money for such service.

RECOMMENDATION:

To ensure compliance with state statutes, only qualified persons should be permitted to serve on the board.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. This commissioner has been made aware of his ineligibility. We will have an election to replace him.

10. **FINDING: Prenumbered receipts not issued for any collections**

District personnel did not issue prenumbered receipts for tap fees and miscellaneous collections. As a result, in at least four instances, tap fee payments could not be traced to deposit. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 3-1, states, “Prenumbered receipt documents for each revenue source should be issued with required accounting for all unused or spoiled receipts.”

RECOMMENDATION:

To help ensure accountability, district personnel should issue prenumbered receipts for all collections.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We will purchase the prenumbered documents and will issue such for all receipts.

Manager:

Response is the same as that of the members of the board of commissioners.

11. **FINDING: Daily cash reports not prepared, and cash receipts journal not maintained**

District personnel did not summarize collections on a daily cash report or maintain a cash receipts journal. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 3-1, states:

The cashier should summarize all cash receipts by source on a daily cash summary report, clearly indicating the amount to be deposited, the amount retained for change, and the amount of cash over or short. Each report should be dated and the date should be recorded on the corresponding deposit slips. The cashier should sign the daily cash summary report.

The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 2-5, states, “ A complete accounting system should include . . . 2.a. A cash receipts journal to record the daily summary of receipts by source. . . .”

RECOMMENDATION:

To help ensure that all collections can be traced to deposit, a daily cash report should be prepared to summarize all collections by district personnel, and a cash receipts journal should be maintained.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. We will prepare daily cash reports for all collections. A cash receipt journal will also be maintained.

Manager:

Response is the same as that of the members of the board of commissioners.

12. **FINDING:** Collections not deposited promptly

Several collections were not deposited promptly. The district's records indicated that some collections were not deposited until a month after being received by district personnel. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 3-1, requires prompt and intact deposit of collections.

RECOMMENDATION:

To minimize the risk of loss or misuse of district funds, members of the board of commissioners should ensure all collections are deposited promptly.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. We will ensure that all deposits are made within three days of receipt.

Manager:

Response is the same as that of the members of the board of commissioners.

13. **FINDING:** **No collateral for bank deposits in excess of the amount insured by the FDIC**

According to bank officials, district personnel had not requested or received from the bank an interest in collateral for the amount of bank deposits in excess of the amount insured by the Federal Deposit Insurance Corporation (FDIC). The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 10-4, states, “Obtain collateral security for investments exceeding insured limits, as set forth in Section 9-1-107, *Tennessee Code Annotated.*”

RECOMMENDATION:

To better protect the district’s bank deposits, the district’s board of commissioners should direct district personnel to obtain from the bank an interest in collateral for all amounts in excess of the amount insured by the FDIC. The district’s interest in the collateral pledged by the bank must be evidenced by a valid perfected security agreement. To be valid, the agreement must meet the requirements set forth in federal and state laws. An informal attorney general’s opinion No. I-9222, issued in August 1992, states, in part, “. . . the FDIC would be able to avoid a perfected security interest if it did not meet the requirements of 12 U.S.C. Section 1823(e).”

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We will ensure that our banks have the required collateral for our deposits.

Manager:

Response is the same as that of the members of the board of commissioners.

14. **FINDING:** **Interest earnings not maximized**

Members of the board of commissioners did not ensure that the district manager maximized the return on all district funds. Although the district’s operating account was interest-bearing, the account appeared to contain excess cash which could have been invested at a higher rate. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 10-4, provides procedures to maximize interest revenue on idle cash.

RECOMMENDATION:

To efficiently manage and protect the district’s cash, members of the board of commissioners should ensure that the manager maintains account balances at the minimum necessary to meet current obligations. Excess idle cash should be invested to

achieve a maximum return, taking into account the utility district's security and liquidity needs.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. We will analyze our cash balances on a monthly basis.

Manager:

Response is the same as that of the members of the board of commissioners.

15. **FINDING: Petty cash fund not correctly operated**

A set amount for the petty cash fund was not established. The fund was always replenished with \$100, regardless of the difference between the amount of cash on hand and the total amount of petty cash disbursements made. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 5-3, establishes guidelines for establishing and using a petty cash fund, which includes requiring a fixed sum of money.

RECOMMENDATION:

To adequately account for petty cash funds, the office manager should set aside a fixed sum of money for the purpose of making small miscellaneous purchases. When the cash has been reduced below a predetermined amount, a check should be issued to replenish the cash for the difference between the set fund amount and the amount of cash on hand. The amount needed to replenish the fund should equal the total of fund expenditures since the last replenishment.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. We will follow the guidelines for using a petty cash fund.

Manager:

Response is the same as that of the members of the board of commissioners.

16. **FINDING: Failure to adopt comprehensive purchasing policy**

Members of the board of commissioners have not officially adopted a comprehensive written purchasing policy. Although the board attempted to pass a policy in June 2002, the only policy documented in the district's records was a policy "model" with blanks which district officials had failed to complete. Furthermore, the "model" policy did not require the use of purchase orders for purchases over a predetermined amount or have a provision for district officials to designate who has the authority to make purchases. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 5-1, requires that the district should adopt a written purchasing policy in accordance with Section 7-82-801, *Tennessee Code Annotated*, which includes designating persons authorized to make purchases, requiring use of prenumbered purchase orders, outlining procedures for emergency and small-item purchases without prior approval, and requiring competitive bids for purchases over a stated amount.

RECOMMENDATION:

To ensure that the district purchases items at the best price and in the most advantageous manner, members of the board of commissioners should adopt and adhere to a written comprehensive purchasing policy which documents limits and authorizations specific to the Castalian Springs-Bethpage Utility District.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. We will adopt a comprehensive purchasing policy.

17. **FINDING: Inadequate supporting documentation**

The district's files did not contain adequate supporting documentation for several disbursements including \$210,000 paid to the maintenance contractor. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 5-2, states, "All disbursements must be supported by adequate documentation."

RECOMMENDATION:

To help ensure all disbursements are for an authorized purpose, members of the board of commissioners should direct the manager to obtain and retain in the district's files adequate supporting documentation.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We will maintain documentation for all expenditures.

Manager:

Response is the same as that of the members of the board of commissioners.

18. **FINDING:** **No documentation goods and services received as ordered**

The district’s records did not contain documentation that goods and services were received as ordered. In most instances, it appeared that pipe and other materials ordered were delivered directly to a site not under the control of the district. (Refer to Finding 6.) The *Uniform Accounting Manual for Tennessee Utility Districts*, Sections 5-1 and 7-4, describe procedures for receiving goods and services, including inspecting items ordered, noting any shortages or damages, signing to document that goods and services were received as ordered, and storing materials received in a designated storage area.

RECOMMENDATION:

To help ensure that disbursements are made only for valid district obligations, members of the board of commissioners should direct the district manager to require the employee responsible for each purchase to verify that the goods or services are received as ordered. The office manager should require documentation of the verification to be on file before the related invoice is paid.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We will improve our procedures in this area.

Manager:

Response is the same as that of the members of the board of commissioners.

19. **FINDING:** **Gasoline invoices signed by persons not employed by the district**

The district paid for the gasoline used in a district truck assigned to the district manager. However, many invoices for this gasoline, which was all charged at the same station,

were signed by a person who was not employed by the district. Therefore, it appears that the district paid invoices without adequate assurance that they were owed by the district. *The Uniform Accounting Manual for Tennessee Utility Districts*, Section 5-2, states that the first procedure for processing cash disbursements is to “[a]pprove invoices for payment.” It appears that these invoices should not have been approved based on the available documentation.

RECOMMENDATION:

District officials should ensure that all invoices provide documentation that the charge is a valid responsibility of the district before disbursements are made.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. This situation has been corrected. We will improve our controls over the use of the vehicle.

Manager:

Response is the same as that of the members of the board of commissioners.

20. **FINDING: Cutoff policy not enforced**

According to district records and personnel, cutoffs for nonpayment of water service charges were not performed during at least five months of the audit period. Per personnel, this was one of the duties of the maintenance contractor, Hodges Backhoe and Trenching, Inc. The district’s cutoff policy, specified in the district’s water contract states, “The consumer agrees to pay the monthly water bill within thirty (30) days after receipt. All accounts not paid within (30) shall be declared delinquent, and District shall have the right to terminate water service five (5) days after mailing notice to consumer’s residence. . . .” *The Uniform Accounting Manual for Tennessee Utility Districts*, Section 4-2, states, “If accounts remain unpaid on the district’s cutoff date, promptly notify the employee responsible for cutting off the service.”

RECOMMENDATION:

To ensure that all customers are treated fairly and that the district is compensated for all service provided, members of the board of commissioners should ensure the district’s cutoff policy is consistently enforced.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We will enforce this policy.

Manager:

Response is the same as that of the members of the board of commissioners.

21. **FINDING:** **No approved adjustment policy, and bill adjustment authorization not documented**

Approval of adjustments to customers’ accounts for water leaks and meter reading errors was not documented by the board of commissioners in the minutes of the board meetings. Although subsequent board minutes indicate that the board adopted an adjustment policy in June 2002, the minutes of that meeting do not document such action, and the district records contain only a draft policy which contained blanks where choices were required to be made by the board, a situation similar to the one noted in Finding 16. Office personnel reported that there did not appear to be a standard method for computing adjustments. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 4-1, states, “All adjustments to customers’ bills should be approved by the board of commissioners.”

RECOMMENDATION:

To help ensure accountability for all billings and to ensure that all customers are treated fairly, members of the board of commissioners should adopt a written policy specifying the method for computing adjustments and all related limitations and regulations. All adjustments should be reviewed and approved by the board. Calculation and approval of adjustments should be properly documented and maintained.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We will have the board approve all adjustments to customer bills. The board of commissioners has adopted a policy. The calculations and approval of adjustments will be documented and maintained.

22. **FINDING: Tap fees not paid**

In at least five instances, tap fees were not paid when access to water was initially obtained at a location. In four of these instances, the explanation given by district personnel was that the tap was “moved” from another location. The district’s maintenance contractor appeared to be involved in two of these instances. According to the district’s water contract, “Consumer further agrees to purchase additional water taps for each additional living unit which is moved into or constructed on the same premises. . . .” Each tap appears to represent access to the district’s water line at a specific location. Therefore, it appears that each time the district’s water line is accessed, a tap fee must be paid, regardless of whether the applicant previously purchased a tap or whether there is access to the district’s water line at another location on that property or on adjacent property.

RECOMMENDATION:

To ensure that all revenue is received by the district, members of the board of commissioners should require the general manager to collect a tap fee each time the district’s water lines are accessed.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We will require payments for all taps.

Manager:

Response is the same as that of the members of the board of commissioners.

23. **FINDING: Violation of board policy regarding installment payments**

Many customers were allowed to pay the fee for a tap in installments. The minutes of the meeting of the board of commissioners dated August 15, 1991, state, “. . . the District would not accept the purchase of taps in installments (sic) payments and that the entire sum would have to be made at the time the customer was purchasing the tap.”

RECOMMENDATION:

Members of the board of commissioners should enforce compliance with the district’s policy which does not allow the payment of tap fees in installments.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. Installment payments will no longer be allowed.

24. **FINDING: Failure to compare water pumped with water sold**

Neither district employees nor the maintenance contractor documented that the district’s master meters were read or that water loss was calculated. Although Gallatin Public Utilities (GPU) sent a monthly water loss report based on cubic feet of water purchased by the district per GPU’s records and sold to district customers per GPU’s records, district personnel did not document any readings from the district’s master meters or any noncustomer uses of water such as fire hydrant flushes or losses from major main line leaks. In addition, the district did not document any losses related to water purchases from the towns of Hartsville and Westmoreland. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 4-1, states:

Compare gallons of water pumped through master meter with tape run on total gallons sold and estimated storage to identify any loss in transit. Investigate unexplained fluctuations to ensure that users are billed with total consumption and that malfunctioning meters and leaks in lines and mains are located promptly and repaired.

RECOMMENDATION:

In order to provide accountability, the district should perform and document a periodic comparison of gallons of water pumped through the master meter with gallons of water sold. The district should locate and repair water leaks and malfunctioning meters.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We will perform this calculation and report the loss percentage to the board each month.

Manager:

Response is the same as that of the members of the board of commissioners.

25. **FINDING: Failure to classify commissioners as employees**

The utility district's commissioners failed to ensure that its members were classified as employees for the purpose of social security and Medicare tax withholding. Section 8-38-101, *Tennessee Code Annotated*, defines a "political subdivision" to include "an instrumentality of a state, or one (1) or more of its political subdivisions . . ." Utility districts appear to be political subdivisions of the state. Section 218(b)(3) of the *Social Security Act* includes as an employee "an officer of a State or political subdivision." In addition, Section 3121 (d)(1) of the *Internal Revenue Code* defines an employee as "any officer of a corporation; . . ." Therefore, it appears that both the Social Security Administration and the Internal Revenue Service (IRS) consider elected officials to be employees of their governmental employer. Chapters 21 through 25 of Subtitle C of the *Internal Revenue Code* address required employment taxes.

RECOMMENDATION:

To comply with federal regulations, members of the board of commissioners should ensure that the district correctly withholds and pays social security and Medicare taxes on all wages. The district may consult IRS Publication 15 for additional information.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. We will start this immediately.

Manager:

Response is the same as that of the members of the board of commissioners.

26. **FINDING: Inadequate personnel records, including lack of documentation of authorization for wages and benefits**

The district failed to require and maintain adequate personnel records, including leave records, W-4s, employee applications, and employee record cards. There was no written authorization for the wages paid to district personnel or authorization approving the Christmas bonus. In addition, although the minutes of a meeting of the board of commissioners in 1988 documented authorization for providing primary health care coverage for the district general manager and his family at the specific rate applicable at the time, authorization for the payment of premiums for separate Medicare supplement policies for the manager and his wife was not documented.

The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 6-1, sets forth required payroll and personnel documentation and procedures necessary for precise maintenance and centralized control of payroll and personnel records. Section 10-1 of the same manual mentioned above states, "Maintain complete minutes of actions taken by the commissioners including: . . . schedules of personnel appointments, salary rates and changes, and leave policies . . ."

RECOMMENDATION:

To decrease the risk of improper payroll payments and to ensure compliance with state and federal regulations, members of the board of commissioners should require that complete payroll and personnel records are established and maintained. All wages and benefits provided to employees should be supported by written authorization.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. We will update our files immediately, and ensure this is performed on an ongoing basis.

Manager:

Response is the same as that of the members of the board of commissioners.

27. **FINDING: Personal use and fuel cost of district-owned vehicle not included on employee's W-2**

The district provided a truck for the general manager and paid for fuel for the vehicle. Although the January 1993 board meeting minutes state that the board "agreed to furnish him a truck," no details of the allowable use of the vehicle were provided. The manager used the vehicle to commute to and from work, and it was available to him for other personal use. Neither the value of the personal use of the truck nor the value of the gasoline used for commuting or other personal use, was included in the employee's income as a fringe benefit as required by *Internal Revenue Code*, Reg. § 1.61-21.

RECOMMENDATION:

To properly report all employee compensation and to avoid possible liability, penalties and interest, members of the board of commissioners should ensure that all compensation to an employee, including the value of personal use of a vehicle and gasoline furnished by the district, is included as part of the employee's gross income.

It appears that the district's manager lacks a bona fide noncompensatory business reason for commuting in the district's vehicle, since the district's maintenance contractor is responsible for being "on call" after business hours to handle all emergencies. As a result, it appears that, if this arrangement continues, strict recordkeeping requirements should be imposed on the manager. The district should employ a method which uses the value of the vehicle and the percentage of personal use to calculate the benefit to be included in the manager's income. District personnel should contact the Internal Revenue Service for additional information.

It should be noted that strict recordkeeping requirements are imposed on employees receiving such benefits unless the district adopts a detailed written policy incorporating IRS rules. As an alternative, officials may elect to adopt a written policy described by the *Internal Revenue Code*, Reg. § 1.274-6T, either prohibiting personal use or prohibiting personal use except for commuting. Under a policy prohibiting personal use, employees would not be allowed to take district-owned vehicles home. Under a policy prohibiting personal use except for commuting, employees would be allowed to drive vehicles home with the commuting value included in the employee's gross income.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. We will implement this immediately.

Manager:

Response is the same as that of the members of the board of commissioners.

28. **FINDING: Board inappropriately assumed potential liability for penalty and interest resulting from nonpayment of sales tax**

District officials violated sound business practice by documenting in the July 15, 1993, minutes of the district's board meetings that they agreed to assume any potential liability of the contractor, "**including any interest and penalty,**" [emphasis added] for sales tax on any materials installed as new lines. Section 67-6-209, *Tennessee Code Annotated*, places the liability for the payment of sales tax for materials used in new construction on the contractor unless the tax was paid at the time the materials were purchased. While it does not appear inappropriate for the board to assume the liability for the payment of the sales tax itself, it is not appropriate for district officials to assume the liability for any penalty and interest associated with nonpayment because any such potential costs could have been avoided had the district paid the sales tax at the time the materials were purchased.

RECOMMENDATION:

District officials should refrain from inappropriately assuming a liability for any potential penalty and interest associated with the nonpayment of sales tax on the purchase of materials for new lines. Rather, in the future, the district should eliminate the potential liability by paying the sales tax at the time the materials are purchased.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. That contractor is no longer associated with the utility district and that agreement is no longer effective. The Board does not plan to guarantee any interest or penalty regarding any third party action in the future.

29. **FINDING: Failure to file unclaimed property report**

District personnel did not file an annual unclaimed property report with the state treasurer. The state treasurer has instructed that an annual unclaimed property report be filed for utility districts whether or not unclaimed property is being held. The “Uniform Disposition of Unclaimed Property Act,” as presented in Sections 66-29-101 through 66-29-152, *Tennessee Code Annotated*, authorizes the state treasurer to make the necessary rules and regulations to carry out the provisions of the act.

RECOMMENDATION:

To comply with state law, an unclaimed property report must be filed annually with the state treasurer. To obtain reporting forms and additional information regarding unclaimed property, district personnel should contact the Treasury Department, Unclaimed Property Division, 9th Floor, Andrew Jackson Building, Nashville, Tennessee 37243-0242, (615) 741-6499.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. We will file this in the current year.

Manager:

Response is the same as that of the members of the board of commissioners.