

INVESTIGATIVE AUDIT REPORT

ELIZABETHTON ELECTRIC SYSTEM

JULY 1, 2003, THROUGH SEPTEMBER 30,
2004



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
Department of Audit
Division of Municipal Audit



STATE OF TENNESSEE

John G. Morgan
Comptroller

C O M P T R O L L E R O F T H E T R E A S U R Y

STATE CAPITOL

NASHVILLE, TENNESSEE 37243-0260

PHONE (615) 741-2501

February 15, 2005

Members of the Board
Elizabethton Electric System
P. O. Box 790
Elizabethton, TN 37644-0790

Members of the Board:

Presented herewith is the report on our investigative audit of selected records of the Elizabethton Electric System. This examination focused on the period July 1, 2003, through September 30, 2004. However, when the examination warranted, this scope was expanded.

Section 9-2-102, *Tennessee Code Annotated*, requires that the Comptroller of the Treasury prescribe a uniform system of bookkeeping designating the character of books, reports, receipts and records, and the method of keeping same, in all state, county and municipal offices, including utility districts, which handle public funds. This code section also requires that all officials adopt and use the prescribed system. The Comptroller has prescribed a minimum system of recordkeeping for municipalities, which is detailed in the *Internal Control and Compliance Manual for Tennessee Municipalities* combined with Chapters 1-13 of *Governmental Accounting, Auditing and Financial Reporting*. The purpose of our examination was to determine the extent of the entity's compliance with certain laws and regulations, including those in the above-mentioned manuals.

The findings and recommendations in this report relate to those conditions that we believe warrant your attention. All responses to each of the findings and recommendations are included in the report.

Members of the Board
Elizabethton Electric System
February 15, 2005

Copies of this report are being forwarded to Governor Phil Bredesen, the State Attorney General, the District Attorney General, certain state legislators, and various other interested parties. A copy is available for public inspection in our office.

Very truly yours,

John G. Morgan
Comptroller of the Treasury



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF MUNICIPAL AUDIT**

John G. Morgan
Comptroller of the Treasury

SUITE 1600
JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-0271
PHONE (615) 401-7871
FAX (615) 741-1551

Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

February 15, 2005

Mr. John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, TN 37243-0260

Dear Mr. Morgan:

As part of our on-going process of examining the records of municipalities, we have completed our investigative audit of selected records of the Elizabethton Electric System. This examination focused on the period July 1, 2003, through September 30, 2004. However, when the examination warranted, this scope was expanded.

Section 9-2-102, *Tennessee Code Annotated*, requires that the Comptroller of the Treasury prescribe a uniform system of bookkeeping designating the character of books, reports, receipts and records, and the method of keeping same, in all state, county and municipal offices, including utility districts, which handle public funds. This code section also requires that all officials adopt and use the prescribed system. The Comptroller has prescribed a minimum system of recordkeeping for municipalities, which is detailed in the *Internal Control and Compliance Manual for Tennessee Municipalities* combined with Chapters 1-13 of *Governmental Accounting, Auditing and Financial Reporting*. The purpose of our examination was to determine the extent of the entity's compliance with certain laws and regulations, including those in the above-mentioned manuals.

Our examination resulted in findings and recommendations related to the following:

1. Personal use of system equipment and supplies
2. Contribution in aid of construction fee settled without documentation of board approval

Mr. John G. Morgan
Comptroller of the Treasury
February 15, 2005

3. Unauthorized negotiated contract
4. Personal use of vehicle is a fringe benefit that had not been adequately reflected on the manager's Form W-2
5. Nonmunicipal travel expenditures
6. Unauthorized travel and reimbursement policy
7. Delinquent customers are not treated uniformly
8. Improper disposal of scrap

In addition to our findings and recommendations, we are also providing management's response. If after your review, you have any questions, I will be happy to supply any additional information which you may request.

Sincerely,

Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

**INVESTIGATIVE AUDIT OF SELECTED RECORDS OF THE
ELIZABETHTON ELECTRIC SYSTEM
FOR THE PERIOD JULY 1, 2003, THROUGH SEPTEMBER 30, 2004**

FINDINGS AND RECOMMENDATIONS

1. **FINDING: Personal use of system equipment and supplies**

Our audit revealed that the general manager used Elizabethton Electric System's (EES) equipment, including a backhoe, dump truck, and pole truck, for his own personal benefit in 2000 and 2001. The manager indicated that there had been no policy prohibiting that use, and that other employees used system equipment. We also noted that EES cell phones were apparently used by the general manager's wife as well as an employee of a private firm contracting with the system. Finally, we found that in November 2001, the general manager charged to EES gravel costing \$441.17 purchased for use on his private property. However, he did not reimburse EES for this purchase until October 2004, which in effect created a loan to the general manager.

Section 6-56-112, *Tennessee Code Annotated*, states, "All expenditures of money made by a municipality must be made for a lawful municipal purpose."

EES officials should consider all the implications of employees making purchases using the system's name, including the possibility of jeopardizing the system's tax-exempt status and the propriety of obligating the system for nonmunicipal purposes.

Section 39-16-402, *Tennessee Code Annotated*, states, "A public servant commits an offense who, with intent to obtain a benefit . . . intentionally or knowingly . . . receives any benefit not otherwise authorized by law."

RECOMMENDATION:

The power board should establish written policies that prohibit the private use of EES equipment, including heavy machinery and cell phones, by system employees or officials. In addition, the policy should prohibit employees from purchasing through the system. The board should consider what actions are necessary to resolve these issues.

MANAGEMENT'S RESPONSE:

Members of the Utility Board:

We concur with the finding. We require and expect management to ensure that all expenditures of money made by EES be made for lawful municipal purposes. We are informed that the practice of permitting EES employees to utilize company equipment during nonbusiness hours for purposes other than business was terminated after October

2003, and it is our information that no equipment has been used for that purpose since that time. We understand reimbursement was made in full for the specific items (gravel and cell phone usage) mentioned in Finding 1.

We have been presented with and are considering a vehicle/equipment use policy and a telephone/cellular phone usage policy.

General Manager:

I concur with the response of the members of the utility board. The cell phone usage was of short duration, and was due in great part to the fact that one of the phones was misplaced, and I got another phone to use. When the misplaced phone was located, for a short time both phones were used. The purchase of gravel was also a combination of unforeseen circumstances. The invoice for gravel was immediately issued, and I was not aware that reimbursement for the gravel expense had not been promptly made. When I found out, the reimbursement was immediately made.

AUDITOR'S CLARIFICATION TO GENERAL MANAGER'S RESPONSE:

Although the general manager notes a number of circumstances which he contends combined to allow improper transactions to occur, our recommendation was that the system establish policies and procedures to prohibit these actions *under any circumstance*.

Regarding the cell phone, the issue is not that the general manager possessed two phones, but that his wife used one of them. Documentation of cell phone usage indicates that there were calls made between the two phones Mr. Isaacs had taken possession of. He acknowledged to auditors that his wife used the cell phone. This practice is inappropriate under any circumstance.

Regarding the gravel purchase, when employees are allowed to purchase items through the system, the system is exposed to the risk of never recovering the cost. Had there not been additional scrutiny of the general manager and others because of the state investigation, it is unlikely that the general manager's failure to pay for the gravel would have been discovered. Regardless, the system should not allow personal purchases under any circumstance.

We reiterate our finding and recommendation.

2. **FINDING:** **Contribution in aid of construction fee settled without documentation of board approval**

In 1998, EES agreed to provide an underground line extension to a new development. One of the developers was an EES power board member. At that time, the system had no written line extension policy. Apparently, after consultation between the system's general manager and engineer, EES charged the developers \$35,000 for the extension. However, contrary to normal practice, the developers did not pay the fee in advance and did not pay any of this charge for over two years. In April 2001, the general manager accepted \$20,000 as payment in full without board approval.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 1, Chapter 1, Section 4, states:

Municipal officials should ensure that . . . complete minutes of actions taken by the legislative body are maintained. The minutes should include the following . . . (i) copies of contracts entered into by officials, who must obtain a written contract for all agreements with other entities or individuals for services received or provided, regardless of whether payment is involved. . . .

RECOMMENDATION:

The board should develop and adhere to written policies for line extensions. Any deviation from the policy should be brought before the board for their consideration. To avoid misunderstanding, agreements to perform line extensions should be put in writing and presented to the power board.

MANAGEMENT'S RESPONSE:

Members of the Utility Board:

We concur with the finding. The events which occurred in 1998 took place before the appointments of all of the current board members. In 2001, the board approved a Line Extension Policy which we require to be strictly followed. We also have been presented with and are considering the adoption of a Policy on Approval of Contracts.

General Manager:

I concur with the response of the board members. I became general manager in November of 1995. The board had no policy on line extensions until 2001. The subdivision mentioned in Finding 2 was the first time EES had been asked to do underground service since I had been hired as manager. The lack of a policy made it difficult to know how to proceed, and the annual amount owed ended up in dispute. I became firmly convinced that EES needed a policy to prevent a repeat of this incident,

and I put together the Line Extension Policy which the board passed in 2001. This policy has been a tremendous help. EES has strictly followed it since it was passed.

3. **FINDING: Unauthorized negotiated contract**

Our audit revealed that in 2002, the EES and the International Brotherhood of Electric Workers Local Union 934 entered into a collective bargaining agreement. However, current state law does not authorize the system to enter into a collective bargaining agreement. In two cases, *Weakley County Municipal Electric System v. Vick*, 43 Tenn. App. 524, 309 S.W.2d 792 (Tenn. Ct. App.1957) and *Local Union 760 of the Int'l Bhd. Of Elec. Workers. v. City of Harriman*, No. E200-0367-COA-R3-CV, 2000 WL 1801856 (Tenn. Ct. App. May 14, 2001), the Tennessee Court of Appeals has ruled that municipal electric systems could not lawfully enter into contracts with labor unions.

RECOMMENDATION:

Since state law appears to make the contract between the EES and Local 934 null and void, members of the board should consult with legal counsel as to how to resolve this issue.

MANAGEMENT'S RESPONSE:

Members of the Utility Board:

We concur with this finding. The current collective bargaining agreement between the Elizabethton Electric System and International Brotherhood of Electrical Workers Local Union 934 was negotiated in the spring of 2002 and its expiration date is June 30, 2005. The members of the utility board do not intend to enter into negotiations nor to enter into or renew a collective bargaining agreement.

4. **FINDING: Personal use of vehicle is a fringe benefit that had not been adequately reflected on the manager's Form W-2**

The system provided a vehicle to the general manager for both business and personal use. However, for tax purposes, the system reported this fringe benefit as though the vehicle could only be used for business purposes and commuting. The Internal Revenue Service (IRS) considers use of an employer-provided vehicle to be taxable as personal use of the vehicle unless personnel policies specifically prohibit such use. IRS Publication 15-B states that the value of this fringe benefit is the annual lease value of the vehicle. Applying the requirements of IRS Publication 15-B, the unreported fringe benefit realized by the general manager during calendar year 2003 totaled \$6,452.88.

RECOMMENDATION:

EES board should require that the general manager's compensation is accurately and properly reported on IRS Form W-2. In addition, they should review system-wide vehicle use to determine if other employees are receiving an unrecognized fringe benefit.

MANAGEMENT'S RESPONSE:

Members of the Utility Board:

We require that the personal use of a vehicle as a fringe benefit be adequately reflected on W-2 forms. It is our understanding that the appropriate W-2 form has now been issued.

General Manager:

I concur with the board's response.

5. **FINDING: Nonmunicipal travel expenditures**

Some expenses paid by EES did not appear to be for a municipal purpose. Our audit revealed that a board commissioner took his wife to a conference in Savannah, Georgia, at the system's expense. The commissioner and his wife arrived two days prior to the conference at a cost to the system of at least \$557.19. In addition, the commissioner's wife apparently attended several meals that were paid for with system funds.

Section 6-56-112, *Tennessee Code Annotated*, requires that "All expenditures of money made by a municipality must be made for a lawful municipal purpose."

Attorney General Opinion 90-12 states:

It is the opinion of this Office that the expenditure of municipal funds to pay the travel expenses for spouses of city officials and employees does not appear to further a valid municipal purpose.

RECOMMENDATION:

The general manager, or his designee, should examine supporting documentation to determine if the disbursement is for a valid municipal purchase before authorizing payment. The board should seek reimbursement for any nonmunicipal purchases made on the behalf of another individual.

MANAGEMENT'S RESPONSE:

Members of the Utility Board (except for Commissioner Jim Jones):

We concur with the finding that all expenditures of money made by a municipality must be made for a lawful municipal purpose. We are informed that reimbursement has been made in the amount of \$557.19 as to the incident mentioned in the finding. We expect and require the general manager or his designee to examine supporting documentation to determine if disbursement is for a valid municipal purpose before authorizing payment.

Commissioner Jim Jones:

I attended the TVPPA Annual Conference in Savannah, Georgia, in the spring of 2004. I was a new board member. The conference started on Sunday. I was informed that it would be a good idea to arrive a day earlier for preconference activities and to make the acquaintance of TVPPA staff and to find out more about the services which TVPPA has to offer. I took my wife. My registration fee included my spouse at no additional expense. (In other words, one registration fee for a board member entitled the spouse to attend the conference free of charge.) The room rate at the hotel was the same for one person or two.

I arrived in Savannah on Friday afternoon, which I felt was one day early. It would have been extremely inconvenient to have attempted the trip by leaving very early on Sunday which probably would have caused us to arrive Sunday evening after the conference activities had already started, and I thought I was supposed to be there a day early.

I believe the only questionable expense is one half of the cost of meals for which I was reimbursed. The total cost of the meals for May 21, May 22, and May 23, 2004, was \$228.94, and one half for Mrs. Jones would be \$114.47. I don't wish to even have the appearance of misusing my position, and I have paid the Elizabethton Electric System \$557.19, which is the figure set forth in Finding 5 of the findings and recommendations of the Comptroller, even though I do not understand how this figure can be correct. If any other reimbursement is due, I am willing to pay it, although I would appreciate it very much if some explanation could be given to me as why I owe the money I have paid to the Elizabethton Electric System.

General Manager:

I agree with the response of the utility board.

AUDITOR'S CLARIFICATION TO COMMISSIONER JIM JONES' RESPONSE:

Our audit questioned the system paying for lodging and meals for an *authorized* traveler for *two days prior* to a conference. It also questions *any* additional cost to the system for an *unauthorized* traveler, in this case, a board member's spouse. The figure in the audit finding is made up of \$339.60 for two nights lodging and \$217.59 for meals for the board member and his wife prior to the conference. Since we could not identify any specific meal costs for the unauthorized traveler, (the board member's spouse) during the conference, we did not include that in the finding. However, if Mr. Jones were able to identify those costs, they would be questioned by our office as well.

We reiterate our finding and recommendation.

6. **FINDING: Unauthorized travel and reimbursement policy**

In 1995, the EES adopted and put into practice the travel and reimbursement policy adopted by the mayor and board of alderman. That policy allowed reimbursement of reasonable meal expenses to the authorized traveler. Our audit revealed that in 2002, the mayor and board of alderman adopted a more strict travel and reimbursement policy that paid the authorized traveler a defined per diem meal allowance instead of the subjective "reasonable" meal expenses. However, the system apparently continued to use the 1995 policy. In accordance with that policy, our audit revealed that in 2004, the system paid for a \$250 meal for six.

However, Section 6-54-901, *Tennessee Code Annotated*, states:

The municipal legislative body shall by ordinance determine whether or not to pay the expenses of the mayor or any member of the local governing body, and any board or committee member elected or appointed by the mayor or local governing body, and any official or employee of the municipality whose salary is set by charter or general law; and if it is determined that the municipality will reimburse expenses, shall enact a written policy as to how expenses will be reimbursed and determine what expenses are reimbursable.

Therefore, it appears that the elected body of a city has sole and exclusive authority to adopt a travel and reimbursement policy.

RECOMMENDATION:

To implement the authorized travel and reimbursement policy, EES should advise all officials and employees of the city-wide policy. The general manager, or his designee, should ensure strict compliance with the policy.

MANAGEMENT’S RESPONSE:

Members of the Utility Board:

We concur with this finding. In 1995, the EES adopted the travel and reimbursement policy of the City of Elizabethton. In 2002, the city adopted a different travel policy. Most of us were not aware of the change and none of us were aware that the board’s travel policy needed to conform to the city’s travel and reimbursement policy. EES will follow the city-wide policy, and the general manager is charged with ensuring strict compliance with the policy. We have been presented with and are considering an amended travel policy, which we understand conforms to the city travel policy.

General Manager:

I concur with the response of the members of the utility board.

7. **FINDING: Delinquent customers are not treated uniformly**

EES personnel did not consistently enforce the system’s cutoff policy. The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 3, Section 9, states, “Municipal officials should ensure that . . . if accounts remain unpaid on the municipality’s cutoff date, service is discontinued in compliance with the municipality’s policy.”

RECOMMENDATION:

Out of fairness to customers who pay their electric bills promptly, EES officials should insist that the system’s cutoff policy is strictly and consistently enforced.

MANAGEMENT’S RESPONSE:

Members of the Utility Board:

We concur that delinquent customers must be treated uniformly. We require and expect that the EES termination of service policy be strictly and uniformly enforced.

General Manager:

I concur with the board members' response. I believe that delinquent account customers are now and have been treated uniformly. I am not aware of any preferential treatment. Our statement bills sent to customers include all mandated wordings and meet all legal requirements. We do not disconnect on days when the locally predicted weather forecast predicts that temperatures will go below 32 degrees Fahrenheit or above 90 degrees Fahrenheit at any time with the 24-hour period following the 8:00 a.m. start of day. We do not disconnect on a weekend or on an EES paid holiday, because we have no workers on the job to disconnect on these days. At times, we are swamped with involuntary disconnections. We have two customer order workers to handle disconnections, and if we have a high number of disconnections, we take them in the order of availability. We also take into account hardship cases, such as medical requirements for power, in which we take into consideration such factors such as the customer's payment history and the length of time requested for an extension. We keep close track of our write-offs due to nonpayment of electric bills. We are informed that we manage our customer accounts extremely well, as our percentage of write-offs is very low for the industry. I feel that our handling of customer accounts, including disconnections, is one of the strengths of the system.

EES treats both residential and commercial customers the same with one distinction. Depending upon the size of the business, we often required extra deposit or security, such as a TVA program which secures the payment of a large customer's bill. Depending on the circumstances and the amount of deposit, bond or security for service, extensions are made on occasion to businesses because cutting off power is equivalent to closing the business.

AUDITOR'S CLARIFICATION TO GENERAL MANAGER'S RESPONSE:

Our test work indicated that in July 2004, 25 customers had bills delinquent more than 31 days and 13 customers had bills delinquent more than 61 days. There was no explanation as to why these customers received different treatment. In addition, additional test work of bad debt accounts indicated that several customers, some of whom owed the system over \$2,000, had not been cut off according to policy.

We reiterate our finding and recommendation.

8. FINDING: Improper disposal of scrap

The system gave away used meters and electrical poles. The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 1, Chapter 4, Section 1, states:

Municipal officials should adopt policies and procedures that provide safeguards for inventories of materials and supplies. These policies and procedures should, at a minimum, include the following . . . a requirement that scrap materials that have a known salvage value are stored until sold and that the proceeds from the sale of scrap are handled in the same manner as other cash receipts.

RECOMMENDATION:

To ensure that all revenue due the system is collected, the general manager should ensure that scrap materials with a known value are stored until they are sold. The proceeds of such a sale should be handled as with all other collections.

MANAGEMENT'S RESPONSE:

Members of the Utility Board:

We concur with the finding that scrap materials with a known value should be stored until they are sold, and the proceeds of such a sale should be handled as with all other collections. We further believe that no employee or official associated with EES should receive surplus or scrap material by purchase or gift, even if the scrap material has no value.

General Manager:

I concur with the response of the board members.