



Thomas A. Schweich
Missouri State Auditor

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Missouri Public
Service Commission

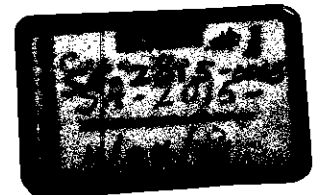
Benton County Sewer District No.1



November 2014
Report No. 2014-101

<http://auditor.mo.gov>

Exhibit No. 1
Date 11-24-14 Reporter _____
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CITIZENS SUMMARY

Findings in the audit of the Benton County Sewer District No. 1

Background

The Benton County Sewer District No. 1 was formed in November 1994, and the voters authorized issuance of \$2 million in revenue bonds for the construction of the sewer treatment plant and collection system. The district's financial condition began to decline as early as 2004. The district was also experiencing problems with collection of accounts receivable, increasing operational costs, and increasing maintenance and repair needs. In April 2013 the voters approved the dissolution of the district, and in July 2013 the district was ordered into receivership, which transferred all responsibilities, functions, duties, powers and authority of the district to a Department of Natural Resources (DNR) employee. On August 25, 2014, the court authorized the receiver to sell the district's assets and wind down the district's affairs. Following this sale, the district was dissolved. Since it ceased to be a political subdivision, we no longer had authority to audit the district and we terminated our audit but we provide some observations.

Observations

We noted a significant turnover of board members since 2010. The district filed inaccurate financial reports with regulatory agencies, did not ensure required annual audits were completed, and failed to file annual financial reports with the State Auditor's office. The district and the receiver both changed user rates without completing any financial or usage analysis or using the rate methodology available from the DNR. The district's accounts receivable listing may be inaccurate, and Board meeting minutes did not demonstrate compliance with the Sunshine Law. The Missouri Ethics Commission determined 2 board members had violated state law and also reviewed and dismissed 8 additional allegations. The district faced numerous legal battles and spent \$55,727 for legal services during 2013 and 2012, and the DNR issued a notice of violation to the district citing non-compliance with the Missouri Clean Water Law, which resulted in a consent judgment against the district.

The overall performance of this entity was Poor.*

*The rating(s) cover only audited areas and do not reflect an opinion on the overall operation of the entity. Within that context, the rating scale indicates the following:

- Excellent:** The audit results indicate this entity is very well managed. The report contains no findings. In addition, if applicable, prior recommendations have been implemented.
- Good:** The audit results indicate this entity is well managed. The report contains few findings, and the entity has indicated most or all recommendations have already been, or will be, implemented. In addition, if applicable, many of the prior recommendations have been implemented.
- Fair:** The audit results indicate this entity needs to improve operations in several areas. The report contains several findings, or one or more findings that require management's immediate attention, and/or the entity has indicated several recommendations will not be implemented. In addition, if applicable, several prior recommendations have not been implemented.
- Poor:** The audit results indicate this entity needs to significantly improve operations. The report contains numerous findings that require management's immediate attention, and/or the entity has indicated most recommendations will not be implemented. In addition, if applicable, most prior recommendations have not been implemented.

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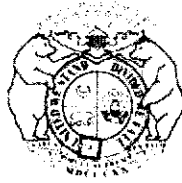
Benton County Sewer District No. 1

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THOMAS A. SCHWEICH
Missouri State Auditor

To the Board of Trustees
Benton County Sewer District No. 1

The State Auditor was petitioned under Section 29.230, RSMo, to audit the Benton County Sewer District No. 1. We initiated our audit of certain operations of the Benton County Sewer District No. 1 on July 21, 2014. The scope of our audit included but was not limited to year ended December 31, 2013. The objectives of our audit were to:

1. Evaluate the district's internal controls over significant management and financial functions.
2. Evaluate the district's compliance with certain legal provisions.
3. Evaluate the economy and efficiency of certain management practices and operations, including certain financial transactions.

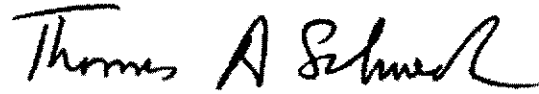
Our methodology included reviewing minutes of meetings, financial records, and other pertinent documents; interviewing various personnel of the district, as well as certain external parties.

On April 1, 2013, the U.S. Department of Agriculture requested the United States District Court for the Western District of Missouri (Court) for an injunction prohibiting the district from dissolving. On April 2, 2013, the voters of the district approved the dissolution of the district under Section 67.955, RSMo. On July 2, 2013, the Court ordered the district into receivership, left the Board of Trustees intact, but removed its authority to act, and appointed a receiver to operate the district. On August 25, 2014, the Court ordered the sale of the district's collection system, treatment plant, and real and personal property and instructed the receiver to wind down the district's affairs. When the Court issued its order approving the sale, the district ceased to exist as a political subdivision pursuant to Section 67.955, RSMo, thereby revoking our authority to audit this district under Section 29.230, RSMo.

As a result of the work performed prior to termination of the audit, we made certain observations and identified certain concerns related to the district's internal controls, compliance with legal provisions and management practices and operations which are discussed in the observation section of our report.

The accompanying Organization and Statistical Information is presented for informational purposes. This information was obtained from the district's management and was unaudited.

The accompanying Report presents our observations noted during the review of the Benton County Sewer District No. 1.



Thomas A. Schweich
State Auditor

The following auditors participated in the preparation of this report:

Deputy State Auditor: Harry J. Otto, CPA
Director of Audits: Regina Pruitt, CPA
Audit Manager: Dennis Lockwood, CPA
In-Charge Auditor: Natalie B. McNish, CGAP

Benton County Sewer District No. 1

State Auditor's Observations

Background

The Benton County Sewer District No. 1 (district) was formed by a vote of the people in November 1994, under Sections 204.250 through 204.470, RSMo. In November 1995, the voters authorized issuance of \$2 million in revenue bonds for the construction of the sewer treatment plant and collection system. In April 1998, the district received a grant from the United States Department of Agriculture (USDA) totaling \$913,000 for the construction of the facility, and in November 1998, the district received a loan from the USDA for \$1,529,600, which was collateralized by a revenue bond issued for the same amount. The district also received a grant from the Department of Natural Resources (DNR) totaling \$1,376,329 for the construction of this facility. Construction of the plant and collection system was completed in 1999.

As early as 2004, officials of the USDA and the district noted a declining financial condition, increasing problems in the collection of accounts receivables, increasing operational costs, as well as rapidly increasing costs for maintenance and repair of system components. In 2012, due to lack of sufficient operating revenue, the district began using its \$90,000 debt service fund to meet debt obligations. The following table shows the decline of the district's available cash balances:

| As of December 31, | Amount |
|--------------------|-------------------------|
| 2007 | \$ 173,562 ¹ |
| 2008 | 159,542 ¹ |
| 2009 | 119,064 ¹ |
| 2010 | 112,427 ² |
| 2011 | 112,964 ² |
| 2012 | 86,369 ² |

¹ Information obtained from district audited financial statements.

² Information obtained from district financial reports.

At July 10, 2013, when the receiver assumed responsibility of the district, the available cash balance had declined to \$52,999.

The Board of Trustees (Board) attempted to address the declining financial condition by increasing the sewer rates by more than 300 percent between 2007 and 2013. Residential rates in 2007 were \$35 per month. The rate was increased to \$45 per month in April 2010, \$54 per month in January 2011, \$64 per month in July 2012, \$101 per month in October 2012, and \$116 in February 2013. Commercial rates experienced similar increases. The Board also changed late fees and interest charges and how those charges were assessed many times during this span of time.



Benton County Sewer District No.1
Observations

As rates increased, accounts receivable balances also increased. According to district financial records, accounts receivable balances were as follows:

| As of December 31, | Amount |
|--------------------|-----------------------|
| 2007 | \$ 8,578 ¹ |
| 2008 | 26,870 ¹ |
| 2009 | 11,387 ¹ |
| 2010 | 29,410 ² |
| 2011 | 66,518 ² |
| 2012 | 106,789 ² |

¹ Information obtained from district audited financial statements.

² Information obtained from district accounts receivable aging reports.

At June 30, 2013, just prior to the district being placed into receivership, the accounts receivable balance had increased to \$146,286.

Dissolution

District citizens filed a petition with sufficient signatures for placing a question on the April 2013 ballot to dissolve the district. On April 1, 2013, the United States District Court for the Western District of Missouri (Court) issued a temporary restraining order prohibiting the district from dissolving pending further court action. On April 2, 2013, the voters approved the dissolution of the district. On May 1, 2013, the Court issued a preliminary injunction prohibiting the dissolution of the district, citing concerns that the dissolution of the district may leave residents of Benton County without an adequate means of disposing of their sewage and residents of surrounding counties may be harmed by the dissolution without representation of their interests. On July 2, 2013, the Court ordered the district into receivership, thereby transferring all responsibilities, functions, duties, powers and authority of the district to a DNR employee as receiver. The receiver's purpose was to operate the facility as required by the order and the consent agreement until a sale of the district assets could be negotiated and approved by the courts. On August 25, 2014, the Court authorized the receiver to sell the district's collection system, treatment plant, and real and personal property assets to a private utility and to wind down the district's affairs. According to the asset purchase agreement, the private utility company will pay \$750,000 for the system and acquired assets. This amount will be paid to the USDA in satisfaction of the related debt of over \$1.2 million. The sale did not include district monies collected up to the time the sale is finalized or any past due accounts receivable. Those funds will be used by the receiver to operate the system until the private utility company assumes control. The private utility company has made application to the Missouri Public Service Commission for authority to operate the sewer system.



Benton County Sewer District No.1
Observations

Following the Court's order for sale of the district, the district was dissolved as a political subdivision pursuant to the election of April 2, 2013, and Section 67.955, RSMo.

Receivership

The receiver provided our auditors several financial and court required reports covering the district's activities from July 10, 2013, through June 30, 2014. During that period, collections totaled approximately \$306,000, the receiver used \$72,295 from the depreciation and reserve funds, and disbursements totaled approximately \$387,000. As of June 30, 2014, the district's available cash balance had declined to \$17,725, and the district's accounts receivable balance had increased to \$242,577. The receiver retained the services of an attorney to pursue collections against many of the customer accounts with larger overdue balances. The receiver is required to continue efforts to collect the accounts receivable balances and keep the system operating until the private utility is approved by the Public Service Commission to operate the collection and treatment system. The DNR also provided administrative services to the receivership including accounting services for the district's financial activity and supervision of the receiver's activities.

Observations

During our review of documentation obtained and interviews completed, we made the following observations.

Board membership

We noted a significant turnover of board members particularly since 2010. Twelve different members served on the Board from January 2012 through July 2, 2013. This turnover resulted in members having little or no experience making important decisions on the operations of the district and contributed to the inability of the Board to take positive actions to address the financial and operational problems of the district.

We also noted some board members were elected, some board members were appointed by the Benton County Commission, and some board members were appointed by the remaining members of the Board.

When a vacancy is created by resignation or end of term, Chapter 204, RSMo, requires the district Board to notify the County Commission of the vacancy and allow the County Commission 60 days from the notification to appoint a new member. If the County Commission does not appoint a new member, the Board may appoint the replacement to fill the vacancy. There is no provision for election of the members of the Board.

We noted one member, elected in April 2013, was improperly denied his seat by the Board and the Board then appointed the citizen who had lost the election to serve on the Board.



Benton County Sewer District No.1
Observations

**Financial reports, audits,
and budgets**

The district filed inaccurate financial reports with regulatory agencies and budgetary information and management reports used by the Board were inaccurate, incomplete, or failed to comply with statutory provisions. District budgets did not comply with Section 67.010 to 67.040, RSMo. Budgets did not include a budget message or budget summary, actual beginning and ending or estimated ending fund balances, or a schedule of indebtedness. In addition, actual receipts and disbursements reported did not agree to information pulled from the district's accounting software, cash balances reported could not be traced to either the bank balances or the reconciled bank balances for the same accounting period, and budgets included accrual estimates for items such as depreciation expense, which do not affect cash position. In addition, no audit of the district has been completed since the year ended 2009 and no financial transactions report has been filed with the State Auditor's office for 2009, 2010, 2011, or 2013.

Sections 67.010 to 67.040, RSMo, provide specific items required for budgets of all political subdivisions. Section 250.150(3), RSMo, requires the district to be audited at least once a year and an annual audit is required by the district's revenue bond covenants and USDA loan requirements. Section 105.145, RSMo, requires all political subdivisions to file annual reports of financial transactions with the State Auditor's office.

Rate analysis and changes

The district and the receiver both changed user rates without completing any documented financial or usage analysis, or utilizing the rate methodology available from the DNR. The only documented rate analysis found was completed in July 2012 by a third party; however, source financial information provided by the district for that analysis was inaccurate and therefore, the suggested rates developed from the study were likely inaccurate as well. The Board was unable to provide any other documented review of rates. Between July 2010, and July 2013, the Board increased residential user rates five times from \$35 per month to \$116 per month. After the receivership was established, the receiver lowered the residential user rate to \$80 per month as of August 2013. Similar changes were noted for commercial user rates.

Also, a comparison of Board actions to changes in customer account billings found some discrepancies in the application and timing of rate changes and late charges. For example, a Board resolution indicating a rate increase should have been effective August 2012 was not applied to customer accounts until October 2012. Also, we found no Board vote, resolution or ordinance to support the rate of \$45 charged between April and December 2010.

Section 204.440, RSMo, requires charges to be fixed at a rate sufficient for the operations and maintenance of the system and the payment of related debt.



Benton County Sewer District No.1
Observations

Accounts receivable

Amounts identified on the district's accounts receivable listing may be inaccurate. Numerous changes in rates, late fees, and the inconsistency in which these items were applied to user accounts, as discussed above, contributed to this observation. In addition, the Board occasionally negotiated the amounts due without maintaining appropriate documentation to support changes to account balances. Due to these issues, it is unclear whether the account balances in the financial system for some customers are accurate.

Section 204.455(1), RSMo, requires the district to charge interest on any account becoming delinquent and provides authority to place a lien upon the land charged.

Conflicts of interest

We identified the appearance of conflicts of interest while completing a review of minutes. Board member, Ted Seek, voted in favor of the district accepting a legal settlement agreement for improper warranty claims he had submitted. During part of the time frame in which these claims were submitted, Mr. Seek also served as the Sewer District Superintendent. The district had retained Mr. Seek's son to make repairs including repairs under warranty to the system and Mr. Seek on occasion assisted his son in completing the warranty work. Mr. Seek submitted the warranty claims. In addition, he was reimbursed approximately \$2,700 for mileage and stolen tools during the 2 years ended December 31, 2013. However, he failed to abstain from the vote approving the reimbursement. Mr. Seek also entered a closed session meeting with other board members to discuss his son's sewer account. While the minutes document he left the closed session prior to participating in the vote to waive fees on his son's account, the minutes show he read a letter prior to leaving the room requesting waiver of fees in exchange for work his son previously performed for the district.

We also noted another board member, George Hall, served as the Sewer District Superintendent for several months. The Missouri Ethics Commission investigated these 2 board members and determined they had violated state law because the district had not solicited bids for sewer superintendent services and each board member had received more than \$500 per month while serving as Sewer District Superintendent.

Board members serve in a fiduciary capacity. Personal interests in business matters of the district could create the appearance of conflicts of interest. Sections 105.454 and 105.458, RSMo, prohibit financial transactions between the district and elected or appointed officials that involve more than \$500 per month or \$5,000 per year unless there has been public notice to solicit proposals and competitive bidding, provided the bid or offer accepted is the lowest received.



Benton County Sewer District No.1
Observations

Ethics investigations

Between July 2011 and December 2013, the Missouri Ethics Commission reviewed and dismissed 8 additional allegations of conflict of interest, nepotism, or campaign finance improprieties involving 6 board members.

Meeting minutes

Board meeting minutes did not document compliance with the Sunshine Law and were not signed by the preparer or any member of the Board to attest to accuracy. During our review of meeting minutes for the 2 years ended December 31, 2013, numerous unallowable discussions were documented in closed meeting minutes including changes to late fees; opening and approving bids for pump repair, plant operator, and billing services; discontinuance of accepting cash payments; hiring legal counsel; and adjustments to specific customer accounts.

In addition, open meeting minutes were not maintained for meetings when a closed meeting was the only agenda item. Open meeting minutes did not always record a roll call vote of the Board to enter into the closed meeting. Votes taken while in closed meetings were not always recorded as roll call votes. Further, closed meeting minutes did not document discussion of some specific reasons for closing a meeting documented in open meeting minutes, and some allowable discussion documented in closed meeting minutes was not cited as specific reasons for closing the meeting in open meeting minutes. Also, some minutes did not document at least three votes for the passage of a motion.

The Sunshine Law, Chapter 610, RSMo, requires minutes be kept for all open and closed meetings, and that before any meeting may be closed, the question of holding the closed meeting and the reason for the closed meeting shall be voted on at an open session by roll call vote and documented in the open session minutes.

Legal costs

The district faced numerous legal battles in 2011, 2012, and 2013, including customer debts, employment issues, warranty issues, and environmental non-compliance. Costs incurred for legal representation and filing of liens during the 2 years ended December 31, 2013, totaled \$55,727. Examples of some litigation faced by the district are summarized below.

Vendor settlement agreement

In late 2010, the district's pump vendor claimed the district owed it more than \$80,000 for the district's pro rata share of pumps and parts provided for warranty claims. Other issues regarding the validity of warranty claims were later brought to the attention of the district. In response to these claims, the district asked the Benton County Sheriff to investigate improprieties in the warranty repair claim process. This investigation was turned over to the Federal Bureau of Investigations (FBI) in early 2011. The FBI provided information to the Benton County Prosecuting Attorney's office. No civil or criminal charges were filed as a result of these investigations. In June 2011, following negotiation with the district, the vendor agreed to lower the



Benton County Sewer District No.1 Observations

amount due to \$78,603; however, the Board voted in December 2011 to not negotiate any settlement with the vendor and wait for the vendor to file legal action against the district. The Board reviewed the issue again in 2012 and negotiated a settlement agreement with the vendor on August 13, 2012, for \$76,864.

Notice of violation

On February 29, 2012, the DNR issued a notice of violation to the district citing non-compliance with the Missouri Clean Water Law. The district hired a wastewater services company to address the areas of non-compliance in March 2012, and the company started work immediately. On May 4, 2012, the company terminated the agreement with the district, citing lack of support from the Board to complete necessary repairs and maintenance required. Repairs and maintenance completed by this company cost the district \$9,611, and minutes documented an estimated \$52,000 in additional repairs were still needed. The district was unable to get the system into compliance within the given timeframe. The Benton County Circuit Court issued a consent judgment against the district citing violation of the Missouri Clean Water Law on October 3, 2012. This consent judgment included an extensive list of corrective actions for the district to complete within specific timeframes and stipulated monetary penalties if the district failed to comply with these deadlines or requirements.

Audit Termination

A petition for audit was submitted to our office containing 109 valid signatures, 4 more than the 105 needed to obtain a petition audit. The petition with signatures was certified in February 2014, and auditors began work in July 2014. During July and August 2014, auditors collected preliminary information from the petitioners, district offices, and various outside sources including the DNR and the Attorney General's office, regarding the formation, construction, operations, financing, and pending dissolution of the district. Following the Court's order for sale of the district, the district was dissolved as a political subdivision pursuant to the election of April 2, 2013, and Section 67.955, RSMo. This action revoked our authority to audit this district since Section 29.230, RSMo, only provides us the authority to audit a political subdivision. The preceding observations are provided for information only.

Benton County Sewer District No. 1

Organization and Statistical Information

The Benton County Sewer District No. 1 was a common sewer district organized and governed under Section 204.250 through Section 204.470, RSMo. The district was located in Warsaw, Missouri. The district began operating in 1999, was placed into receivership in 2013, and most assets will be sold to a private entity in 2014. The district served approximately 350 customers.

Board of Trustees and Personnel

The five-member Board acted as the policy and decision making body for the district's operations until July 2, 2013, at which point the Board remained intact but ongoing operations of the district were assigned to a court-appointed receiver. Board members were not compensated. The Treasurer's salary was set by the Board. Members of the Board and personnel at December 31, 2013, were:

Ted Seek, President
Gerald Duvall, Vice President
Joe Gualco, Director
Bob Vedder, Director
Ida Cold, Director

Rodney Meyer, Treasurer

Receivership

The United States District Court for the Western District of Missouri placed the district into receivership and named Scott Totten, an employee of the Department of Natural Resources, as the receiver on July 2, 2013. Under this order, all responsibilities, functions, duties, powers and authority of the district Board were transferred to the receiver.