

PERFORMANCE AUDIT  
OF

**Newport Utilities**

**Edwina-Bridgeport Water  
Improvements Project**

**GRANT: TN-16336**

**OIG REPORT NUMBER: 14-10**

**GRANT PERIOD: SEPTEMBER 2009 – APRIL 2013**

# WATKINS | MEEGAN

Appalachian Regional Commission  
1666 Connecticut Avenue, N.W.  
Suite 700  
Washington, DC 20009-1068

Mr. Hubert N. Sparks  
Inspector General

Transmitted herewith is a report of Watkins Meegan LLC, a Performance Audit of the Newport Utilities Edwina-Bridgeport Water Improvements Project Grant TN-16336. The report is in response to Contract No. BPA 11-01-B.



Tysons, Virginia  
February 22, 2014

Newport Utilities

Edwina-Bridgeport Water Improvements Project

TN-16336

**Background**

The Appalachian Regional Commission (ARC) is a regional economic development agency that represents a partnership of federal, state and local governments. Established by an act of Congress in 1965, ARC is composed of the governors of the 13 Appalachian states and a federal co-chair who is appointed by the President. Local participation is provided through multi-county local development districts (LDDs). Each year, ARC provides funding for several hundred projects in the Appalachian Region, in areas such as business development, education and job training, telecommunications, infrastructure, community development, housing and transportation. These projects help create new jobs; improve local water and sewer systems; increase school readiness; expand access to health care; assist local communities with strategic planning; and provide technical and managerial assistance to emerging businesses.

Newport Utilities (NU) was established in 1939 when the City of Newport, Tennessee (TN) acquired the electrical system from the Tennessee Valley Authority. NU subsequently added water delivery and wastewater treatment to its portfolio of services. NU serves residential and commercial customers in Eastern Tennessee, primarily in Cocke County, TN, with small pockets of service areas in neighboring counties. Cocke County is classified as a distressed county.

NU requested grant funding from ARC to support the construction of a 300,000-gallon water reservoir and to construct approximately 14,800 linear feet of six-inch ductile iron pipe to extend water service to an unserved area of the Edwina and Bridgeport communities. The new tank would be built in an area best suited to serve anticipated growth, adjacent to the existing 22,000-gallon tank which would be decommissioned. The six-inch pipe would be used to extend water service to areas in the Edwina-Bridgeport communities, areas with a significant population of low-to-moderate income residents.

On September 16, 2009, ARC approved the Edwina-Bridgeport Water Improvement Project Grant, number TN-16336 (Grant), in the amount of \$500,000 to NU. The project was finalized and closed by ARC on April 10, 2013. Required matching funds in the original ARC Grant award from other federal, state and local sources totaled \$351,000. The final agreement between the Grantee and the Basic Agency administering funds on behalf of ARC included an additional \$21,000 in local match contributions for a total funding amount of \$872,000. The sources of funding are shown in the table below:

<b>Funding Source</b>	<b>Amount</b>	<b>Percentage</b>
Appalachian Regional Commission (ARC)	\$500,000	57%
USDA – Rural Development (RD) Loan	\$351,000	40%
Newport Utilities – Local Match	\$ 21,000	3%
<b>Total</b>	<b>\$872,000</b>	<b>100%</b>

Newport Utilities

Edwina-Bridgeport Water Improvements Project

TN-16336

**Background (Continued)**

The U.S. Department of Agriculture (USDA) Rural Development division (RD) administered the Grant on behalf of ARC in accordance with the terms of a memorandum of understanding between ARC and USDA. RD financial programs support public facilities and services such as water and sewer systems, housing, health clinics, emergency service facilities and electric and telephone service. RD promotes economic development by supporting loans and providing technical assistance to businesses and community organizations. RD provided support to the Grantee during the application and assessment phases, reviewed and approved expenditures, and reimbursed the Grantee with Grant funds obtained from ARC. The Grantee was responsible for managing the application process, approving financial transactions, documenting project outcomes and otherwise monitoring project activity to ensure successful completion.

**Objective**

Watkins Meegan LLC was engaged to conduct a performance audit of the Newport Utilities Edwina-Bridgeport Water Improvements Project Grant for the period September 16, 2009 to April 10, 2013. The purpose of our performance audit was to determine the following:

- Funds expended and claimed for reimbursement from ARC and matching funds reported to ARC were valid program expenses and in accordance with the ARC Grant requirements;
- Internal controls were in place to ensure compliance with the Grant requirements and
- Goals and objectives of the Grant had been, or would be achieved.

**Executive Summary**

Grant funds were used to assist in the construction of a new 300,000-gallon water reservoir, decommissioning of the existing 22,000-gallon tank in the same location and installation of six-inch ductile iron pipe to extend water service to an unserved area of the Edwina and Bridgeport communities in Cocke County, TN.

On behalf of ARC, RD reimbursed \$500,000 in ARC funds to the Grantee during the period of the Grant. Matching contributions of \$372,000 were reported, comprising \$351,000 from RD in the form of a low-interest loan to the Grantee and \$21,000 contributed by the Grantee. Total expenditures for the Grant were \$872,000.

Through review of reported expenditures, we noted \$47,200 of expenses that appear to be outside the scope of the original project and may be invalid. With the exception of these expense items, expenditures reviewed during the audit appeared to be valid, adequately supported and in direct relation to supporting the Grant and its objectives. Additional findings were noted relating to the Grantee financial record-keeping and monitoring processes to ensure compliance with Davis-Bacon Act fair wage requirements.

Through inquiry and observation, we determined that the construction work covered by the Grant had been completed and confirmed that the stated performance objectives of the Grant had been met or were in the process of being met.

Newport Utilities

Edwina-Bridgeport Water Improvements Project

TN-16336

**Scope**

We completed a performance audit of the Newport Utilities Edwina-Bridgeport Water Improvements Project Grant TN-16336 at the Newport Utilities office from December 9-11, 2013, as described under this section and under the audit methodology section. Our audit was based on the terms of the Grant agreement and on the application of procedures in the modified ARC Audit Program.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

**Audit Methodology**

Our procedures were based on the Audit Program guidelines provided by the ARC Office of the Inspector General and included suggested procedures over the Grantee's accounting and internal control systems affecting the Grant. We met with the Grantee's General Manager, Manager of Accounting and Finance, and Manager of the Water Department to discuss the Grantee's overall structure and processes around Grant administration and monitoring. We also discussed and reviewed other financial and operational elements related to the conduct of the program.

Our review of background material included the Grantee's application, other Grant-related documentation from ARC's Grant management system, and the Grantee's external audit report for the fiscal years ended June 30, 2011 and 2012.

We reviewed controls in place for recording, accumulating and reporting costs under the Grant and observed and made inquiries regarding whether the goals and objectives of the project had been met, including physically inspecting the construction work supported by the Grant.

**Results**

**Compliance with Grant Conditions**

Grant funds were used to assist in the construction of a new 300,000-gallon water reservoir, decommissioning of the existing 22,000-gallon tank in the same location and installation of approximately 14,800 linear feet of six-inch ductile iron pipe to extend water service to an unserved area of the Edwina and Bridgeport communities in Cocke County, TN.

RD reimbursed \$500,000 in ARC funds to the Grantee during the period of the Grant. Matching contributions of \$372,000 were reported, comprising \$351,000 from RD in the form of a low interest loan to the Grantee and \$21,000 contributed by the Grantee to cover Grant-related expenditures. Total expenditures for the Grant were \$872,000.

Newport Utilities

Edwina-Bridgeport Water Improvements Project

TN-16336

**Results (Continued)**

**Compliance with Grant Conditions (Continued)**

We examined supporting documentation for all of the expenses incurred against the Grant. We noted \$47,200 of expenses appear to be outside the scope of the original project and may be invalid. With the exception of these expense items, expenditures reviewed during the audit appeared to be valid, adequately supported and in direct relation to supporting the Grant and its objectives. Additional findings were noted relating to the Grantee financial record-keeping and monitoring processes to ensure compliance with Davis-Bacon Act fair wage requirements. Additional information for each of these findings is provided below.

Through inquiry, review and observation, we sought to validate the outputs and outcomes expected from the Grant award as detailed in the Grant application. Anticipated outputs were the construction of a 300,000-gallon water storage tower and the installation of approximately 14,800 linear feet of distribution lines. The anticipated outcome measure included in the Grant application was enabling Newport Utilities to supply potable water to 109 properties which were previously unserved.

During fieldwork for the audit, we physically inspected the new water storage tower alongside the decommissioned legacy storage tower. In addition, we surveyed the route of the newly installed distribution pipes, noting the roadside markings indicating the start and end of the construction supported by the Grant. The route driven was validated against a map of the proposed pipe work included in the original Grant application.

We also requested evidence from the Grantee to determine the number of new residents now being supplied as a result of the line extension. The Grantee provided a summary schedule indicating that a total of 43 new customers had connected to the Newport Utilities water service since the completion of the line extension. While this represents only 39 percent of the 109 possible population cited in the Grant application, it was noted that the Grant funds did not cover the cost for individual customers to connect their property water lines to the main supply lines. This connection cost varies depending on the distance from the property to the water main, but could be prohibitively expensive for property owners, particularly in the low-income areas through which service was extended. ARC should continue to monitor the subsequent customer additions through the ARC validation process.

At the conclusion of the audit, we noted and discussed the following items with Management, who generally agreed with the finding and recommendation as described below:

**Finding – Expenses Outside Scope of Project**

During the Grant application process the Grantee signed a “Memorandum of Understanding for ARC Projects” form which included an acknowledgement that any changes in the scope of the project required approval from both ARC and the Basic Agency (Rural Development). A change in scope was defined as: “any major change to the project design, the type of project to be completed, capacity of the system, size of project, the number and/or type of customers served or equipment items purchased.” Through review of the expenditures and reimbursements associated with the Grant, we noted that the final invoices for the construction and engineering services covered by the Grant were submitted by the Grantee to RD in November 2011, and were processed for reimbursement in January 2012. After this reimbursement \$47,200 in unused Grant funds remained.

Newport Utilities

Edwina-Bridgeport Water Improvements Project

TN-16336

**Finding – Expenses Outside Scope of Project (Continued)**

Based on information obtained from the Grantee and the RD, in July 2012, RD authorized the Grantee to use the remaining funds to acquire additional materials (pipe) for future use in similar or related projects. The Grantee was reimbursed with the remaining \$47,200 in Grant funds to close out the Grant. No evidence was provided by the Grantee or Basic Agency to indicate that ARC was consulted or involved in the decision to approve this change in scope.

**Recommendation:**

ARC should review the expenditures in question with the Grantee and Basic Agency to determine the validity and appropriateness of the use of funds, clarify the required approval and authorization steps for future decisions on similar projects, and the appropriate treatment for the funds in question, which may include refunding money to ARC.

**Finding – Davis-Bacon Act Compliance Monitoring**

During the Grant application process, the Grantee signed both an “Assurances for Construction Projects” form and a “Memorandum of Understanding for ARC Projects” form, both of which include commitments to comply with the requirements of the Davis-Bacon Act (DBA). Through discussion with the Grantee, we noted that they had no formal process in place to directly monitor compliance with DBA requirements. The Grantee assumed that this monitoring was being performed by RD. Through discussion with the construction contractors, we determined that the contractors submitted weekly certified payrolls to RD for review to ensure compliance with DBA requirements. However, neither the Grantee nor RD could provide any evidence to support the performance of this monitoring. We were able to obtain examples of certified payroll submissions sent by contractors to RD and confirmed that the pay rates were in compliance with DBA rates disclosed in the contract agreements.

**Recommendation:**

The Grantee agreed to follow the requirements of DBA during the application process with ARC. Even if this administrative monitoring obligation was delegated to RD as the Basic Agency, the Grantee should still obtain and retain support for the performance of this monitoring during the course of the construction project.

**Finding – Financial Records**

The Grantee agreement with RD included a requirement for the Grantee to maintain financial systems and records which identify adequately the source and application of funds for Grant-supported activities and contain information pertaining to grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays and income.



Newport Utilities

Edwina-Bridgeport Water Improvements Project

TN-16336

**Finding – Financial Records (Continued)**

We requested support for all Grantee costs charged to the grant and were provided with general ledger reports and copies of invoice approval packets submitted to RD in support of reimbursement requests. Through the process of reconciling this data, we noted that Grant-related costs were not consistently charged to the Grant project code in the general ledger. In total, we noted \$99,847 of the \$872,000 in Grant-related costs incurred that were not directly booked to the Grant project code in the Grantee general ledger. In addition, through our review of expenditures we noted \$7,550 in valid expenses that were overlooked by the Grantee and not submitted for reimbursement as a result of being recorded to a generic cost center in the General Ledger rather than the Grant-specific project code.

**Recommendation:**

In order to ensure completeness and accuracy of the Grant-related expenses the Grantee should ensure that for any future grants all Grant-related expenses are booked to the same project code or cost center within the financial systems.



