

CITY OF PASCAGOULA, MISSISSIPPI

FORENSIC AUDIT REPORT

January 18, 2019



COLLINS, BARR & HEMBREE, LTD.

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

To the Honorable Mayor and Members of the City Council
City of Pascagoula, Mississippi

We were engaged to provide forensic auditing and accounting services to the City of Pascagoula, Mississippi (the City). The scope of our work was determined by the Mayor and City Council. Our work was focused on the City's Utilities Funds, and the procedures performed were requested by the City to provide additional information with respect to matters included in our report to the City dated July 2, 2018. This report sets forth the procedures performed in connection with this engagement and related findings and recommendations.

Interfund Transfers

In our prior report, we noted a \$1,250,000 interfund transfer out of the Utilities Funds was presented in the audit report for fiscal year 2012. This interfund transfer was made to the general fund; however, no interfund transfer into the general fund was presented in the Statement of Revenues, Expenditures and Changes in Fund Balances for the year ended September 30, 2012. The \$1,250,000 received by the general fund was recorded as revenue by that fund. During our current engagement, we noted the same situation occurred during the year ended September 30, 2011. The amount transferred during fiscal year 2011 was also \$1,250,000.

Governmental Accounting Standards Board (GASB) Statement 34 states that interfund transfers are a type of nonreciprocal transaction that represents interfund activities where the two parties to the events do not receive equivalent cash, goods, or services. Governmental funds should report transfers of this nature in their fund operating statements as other financing uses and other financial sources of funds. Proprietary funds should report this type of transfer in their activity statements after nonoperating revenues and nonoperating expenses. The transfers noted were properly recorded by the Utilities Funds but had not been properly reported by the General Fund.

In our prior report, we also noted that interfund transfers between the Utilities Funds and the General Fund were not being recorded in a predictable manner. This referred to the nonreciprocal nature of the \$1,250,000 transfers. In addition to the nonreciprocal transfers, the Utilities Funds have also made additional transfers to the General Fund each year. These transfers were characterized by the City as administrative reimbursements and were made in a predictable manner based on the administrative support provided to the Utilities Funds.

With respect to the nonreciprocal transfers, our prior report included a recommendation that the City pay special attention to these type transfers and that the rationale for any transfers of this nature be documented. Transfers of this nature are allowed by state statute; however, in the absence of proper documentation, operating transfers from the Utilities Funds to the General Fund can be construed to be an unauthorized tax. During our current engagement, we were unable to locate proper documentation of the consideration and purpose of the transfers recorded in fiscal years 2011 and 2012 as required by Miss. Code Ann. Section 21-27-61. We understand the City has suspended all transfers from the Utilities Funds until such time as the justification of any amounts transferred has been fully and properly documented. This action includes the transfer of monies for administrative reimbursements.

Customer Deposits

In our prior report, we included a schedule of utilities receivables at various dates. In the report, we noted the amount of utilities receivables outstanding over 120 days had significantly increased between September 30, 2016, and May 31, 2018. Receivables outstanding for this length of time are generally considered to be 100% uncollectible by the City.

At that time, we discussed the matter with the comptroller and the utilities billing manager, and they believed that most of the increase would be attributed to final billings for customers that move out of the area. Many of these customers have not paid their final billings, and the amount of each final billing generally exceeds the deposit amount being held by the City. It was our opinion that the amount of the increase in uncollectible accounts was larger than this factor alone would explain, and we recommended the City review this matter to determine if there are additional factors that could be contributing to this problem. In addition, we recommended the City evaluate the adequacy of the utility deposits collected from customers at the time service is connected.

During our current engagement, we followed up on the issue of customer deposits. Per review of the billing records, we noted that many final billings were aging beyond 120 days, and the amount of the deposits were not sufficient to settle the final billings of customers. We discussed the matter further with the comptroller. She indicated the City was undergoing a review of customer deposits and intended to revise the deposit amounts as considered necessary. In October 2018, the City Council adopted revised customer deposits. The amounts of these deposits are much more reasonable and should significantly mitigate the risk of future losses from final billings.

Policies and Procedures Manual

In order to determine if there had been additional factors contributing to the increase in utilities receivables outstanding over 120 days, we met with various personnel in order to obtain an understanding of the City's utilities billing and collection procedures. During the meetings, it came to our attention that the City has no written policies and procedures outside of the ordinances governing the utilities function. The Utilities Funds operate through the use of informal policies and procedures that have been carried forward through on the job training of employees. We discussed this issue with the comptroller and the city manager. They indicated the City intended to complete a policies and procedures manual. Based on consideration of the following discussion, we recommend the City place due emphasis on the design and implementation of a written policies and procedures manual for the utilities department.

The policies and procedures manual should include the City's best practices for the administrative, billing and collection procedures, a thorough description of the various processes within the department and standards for how the work is expected to be performed. The Mayor and City Council will be valuable resources in the process of creating and reviewing policies and procedures and updating them in the future to ensure that they meet the City's organizational and compliance needs.

Designing and implementing a policies and procedures manual provides several benefits to the City. A well-designed policies and procedures manual is essential to the effective and efficient operations of the utilities department. Clear communication is the first step in creating good internal control. The manual will serve as an effective training and reference tool for employees, and the utilities department will be able to operate with greater consistency. The City should expect employee morale to improve because guidelines will be available on how to accomplish the various tasks. Finally, the documentation of set policies and procedures and compliance with those policies and procedures can be an effective process in avoiding certain legal issues.

Creating written policies and procedures will not be the end of the process. The City will need to ensure that current employees are thoroughly trained to comply with the manual. In addition, a periodic assessment of compliance should be completed by management. An annual review of the policies and procedures is also recommended in order to evaluate their continued appropriateness and to update as considered necessary.

Utilities Billing Plans

In obtaining our understanding of the City's billing and collection procedures, we noted one issue of particular concern related to billing plans made outside of the utility billing system for past due accounts. Numerous utility customers have been placed on billing plans for past due balances. The City's ordinance does not include a provision establishing guidelines for such billing plans. The customer service representatives have been authorized to make billing plan arrangements with customers without any independent review or approval. The billing plans are filed in folders, and each customer service representative maintains a separate folder of these billing plans.

The City does not generate billings in accordance with the individualized plans agreed upon by the customer service representatives. In addition, there is no centralized file that contains all such billing plans. We noted that billing plans did not exist for some of the City's past due accounts. Due to the lack of appropriate documentation, we were not able to establish the number of accounts that should be on a billing plan, and we were not able to obtain an accurate listing of all accounts and anticipated payments under the current billing plans. In connection with establishing a written policies and procedures manual, we recommend the City address the issue of past due amounts and the authority, if any, to establish billing plans with past due customers.

In the course of assessing the use of billing plans, we noted commercial accounts associated with two separate individual customers that were considered problematic. These accounts comprised large outstanding balances, and the customers were not making regular periodic payments on these accounts in accordance with an agreed upon schedule of payments. As a result, the customer accounts had become significantly delinquent. The total outstanding balance for these two customers was approximately \$190,000 as of August 2018. Of this balance, approximately \$145,000 was outstanding from previous billing cycles. These customers were not being assessed a late charge on each of the past due amounts. The late charge was only being assessed on the new charges each month. In addition, we could not locate any written agreements with these two customers.

These accounts were discussed with the City's management. One of the customers had maintained a past due balance with the City since June 2014, and the past due amount as of August 2018 was approximately \$64,000. In October 2018, the City took action to cut off water and sewer service to four apartment complexes owned by this customer due to the past due amount of approximately \$81,000 at that time. The customer filed for bankruptcy protection which has delayed the efforts of the City to collect the past due amounts. The City is currently working through the bankruptcy proceedings in order to pursue the collection of any amounts due.

The second customer had a past due amount as of August 2018 of approximately \$126,000. This customer has maintained a past due balance with the City since July 2017. Per discussion with various personnel, periodic payments have been received from this customer. At the date of this report, the past due balance on this customer's accounts has been reduced to approximately \$40,000. No action has been taken by the City to cut off water and sewer service to this customer. We recommend the City exercise diligence in their efforts to bring this account into a current status in order to mitigate the risk of loss to the City.

The problems that can arise in the absence of uniform guidelines regarding billing plans for past due customers are highlighted by these two accounts. The City Council and Mayor should work with management to establish authority and guidelines for such billing plans and to implement the necessary internal control to ensure that any billing plans comply with the approved delegation of authority and guidelines. The internal control procedures should provide for appropriate monitoring of any billing plans and the reporting of any management override of the established guidelines to the City Council.

Financial Position

In our prior report, we noted the City was in an unstable financial position and currently had a significant deficit fund balance in the General Fund of approximately \$14 million. The procedures performed in our current engagement did not reveal any significant concerns regarding the financial position of the Utilities Funds. The funds reported unrestricted net position of approximately \$1.5 million as of September 30, 2017, and an increase of \$623,740 for the year then ended. In addition, the City has recently approved utility rate increases and negotiated the sale of the natural gas operations. These actions should provide additional stability to the Utilities Funds. The only item we would note is related to liquidity. As a result of maintaining a commingled cash account, the Utilities Funds have been exposed to liquidity concerns by the deficit operation of the General Fund; however, these concerns are currently being mitigated by the City's efforts to correct the problems in the General Fund operations. The City has made a substantial amount of progress in addressing those problems.

Other Items

In obtaining our understanding of the City's billing and collection procedures, we also noted various other items that are reported in the following discussion. The first of these regards the reconciliation of subsidiary ledgers to the general ledger. We noted the subsidiary ledgers for accounts receivable and customer deposits are not being reconciled to the general ledger on a periodic basis. We recommend these reconciliations be performed on a monthly basis. The reconciliation of subsidiary ledgers to the general ledger is an integral part of financial reporting and should be completed as part of the monthly procedures leading up to approval of the monthly financial reports. Any necessary adjustments noted during the reconciliation process should be recorded each month prior to approval of the monthly financial reports.

Our procedures revealed that under the current practice, adjustments are being made to customer accounts for various reasons including leaks and meter malfunctions. Any employee with access to the utility billing system can make adjustments to an account. These adjustments are not being independently reviewed and approved by another employee. This practice does not provide for an adequate segregation of duties between cash collections and posting adjustments to customer accounts. We recommend all adjustments to customer accounts be reviewed and approved by someone independent of the billing and cash collection functions. In addition, access to adjust customer accounts should be restricted and adjustments should only be posted after the appropriate documentation has been obtained.

We noted the City does not suspend service to utility customers until two billing cycles remain unpaid. The City designates accounts for cutoff after the second due date for an account passes without receipt of any payment. This cutoff cycle provides customers with 90 days of usage before accounts are designated for cutoff and exposes the City to an increased risk of collection problems. The City's ordinance indicates that a customer's service may be suspended upon nonpayment of one billing cycle. We recommend the City consider establishing their policy to provide for cutoff of service at the earlier time provided for in the ordinance.

The accuracy of the report used by the City for locking off service to customers is questionable. Several issues can occur that cause the report to be inaccurate, and we do not believe the report supports a reliable cutoff process. We noted the cutoff process is currently a cumbersome, extremely manual and labor-intensive process. We recommend the City work on developing a reliable cutoff report that will facilitate a more efficient process each month and develop procedures to document all efforts undertaken from cutoff through collection of the past amounts.

In addition, the City should consider mailing cutoff notices reiterating the past due balances and indicating the date on which service to the customers will be suspended. This procedure would eliminate the number of trips that are required to service addresses and would result in a more efficient process. Suspension of service could begin on the date indicated without further notification to the customers.

In reviewing the cutoff process, we noted the fees charged to suspend and resume service are not adequate to cover the City's costs for these efforts. The amount of the cutoff fees being charged by the City has not served as a deterrent for delinquent accounts. In addition, the fees charged to suspend and resume service are billed forward on a customer's account and are not collected prior to resuming service. We discussed these matters with the comptroller. She indicated the cutoff fees were being increased by the City in October 2018. She noted that the fees had never been collected prior to reconnecting service because the fees are not billed to the accounts until the billing cycle during which the reconnection occurs. The City did not want the customer service representatives collecting amounts that had not been billed to the customer accounts. We recommend the City consider billing the reconnection fees at the time service is suspended as part of processing the cutoff instructions and collecting these fees prior to resuming service.

During our onsite work, we noted access to the customer service representatives' space is unlocked and not adequately restricted. In addition, preparation of the daily cash deposit was being performed in an office which was unlocked and away from the security cameras. We understand the comptroller has had discussions with the utilities business manager about the importance of security regarding the daily cash deposit. In addition, glass panels have been installed in the customer service representatives' area between the customers and the customer service representatives. We recommend the City implement a system of locked access to the customer service representatives' area in order to appropriately restrict access to this space.

In obtaining an understanding of the City's procedures regarding the preparation of final bills for customers that have terminated utilities service, we noted the utility billing system will automatically apply meter deposits to final bills for all customers except for business accounts that have the code 258B. Meter deposits must be manually applied to these accounts. We discussed this matter with the comptroller, and she indicated the City is working to address this situation.

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We were not engaged to, and did not, conduct an audit, the objective of which would be the expression of an opinion on the financial statements. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Mayor and City Council of the City of Pascagoula, Mississippi and is not intended to be and should not be used by anyone other than these specified parties.

Collins, Barr & Hembree, LLP

January 18, 2019