

**Review of Town of Lee  
Clean Water State Revolving Fund Loan Agreement**

**Division of Water Restoration Assistance**

**Report: A-1516DEP-008**

**Office of Inspector General**

**Internal Audit Section**

**Florida Department of Environmental Protection**

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The Office of Inspector General (OIG) conducted a review of the Town of Lee Clean Water State Revolving Fund Loan Agreement. This review was conducted as a result of a recommendation from the Division of Water Restoration Assistance (Division) and was part of the Fiscal Year (FY) 2015-2016 Annual Audit Plan.

## **Scope & Objectives**

The scope included a review of the Town of Lee's (Town) water related revenues and expenditures during FY 2014-2015, in addition to prior events during planning of the Town's wastewater system funded by a Clean Water State Revolving Fund (CWSRF) Contract WW893010 (Contract).

The objectives of this review were to determine whether:

- the Town, the Division, and Contractors planned the Town's wastewater construction project adequately
- the Town has the ability to continue making loan payments

## **Methodology**

Our methodology included a review of financial records for the Town's wastewater system and a review of documentation and communications regarding planning of the CWSRF project, overseen by the Division, previously included in the Division of Water Resource Management. We also interviewed the current Town Manager, Town Council Members, State Revolving Fund (SRF) Program staff and the Engineer.

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## **Background**

Section 1383 of the Clean Water Act of 1972 established the CWSRF. This section, along with Section 403.1835, Florida Statutes (F.S.), establishes the terms of the CWSRF grants and loans. These terms allow for special exceptions for low-income areas, such as low or negative interest rates and principal forgiveness. In 2009, the Town qualified as a low-income area, which allowed the Division to approve a loan with an interest rate of 2.08% and a 74.75/25.25 grant/loan split.

The Town is located in Madison County, near the City of Madison. In 2009, the Town received a grant to construct a wastewater system, which was completed in 2011. Because the Town could not afford to build a wastewater treatment facility, the wastewater system connects to the City of Madison's wastewater treatment facility. The Engineer who designed this system was Mittauer and Associates (Engineer). As part of the project, the Engineer was responsible for design of the system and the Division was to ensure the project met planning documents and expenditures were eligible for funding. In total, the project cost was \$3,998,200, after the addition of Change Order 1, which increased the total cost by \$401,972.

In 2014, a representative from the Town's Council contacted the Division to indicate that the Town was having difficulty making debt service payments twice each year. The Town had set up a reserve intended for emergency repairs and replacements, but the Town was using it to cover debt service payments. According to the Town Manager, the FY 2015-2016 budget estimated the reserve account to be at a deficit.

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## **Results & Conclusions**

### System Design

The Wastewater Facilities Plan (Plan) Alternative 2, approved by the Town March 2009, estimated 236 Equivalent Residential Connections (ERCs) based on a description of 215 connections. According to the current Town Manager, the actual number connected after construction was 138. According to interviews with the current Town Manager and Town Council Members, part of the project planning efforts included anticipated commercial interest of Nestle Water of North America (Nestle), which is located near the Town. Ultimately, Nestle did not connect to the wastewater system. Nestle was not included in the estimated ERCs.

SRF Program staff indicated that system design and estimated needs were at the discretion of the Engineer designing the system.

### Disbursement

According to the Agreement, the following are required for disbursement of funds:

- 1. A completed disbursement request form signed by the Authorized Representative. Such requests must be accompanied by sufficiently itemized summaries of the materials, labor, or services to identify the nature of work performed; the cost or charges for such work; and the person providing the service or performing the work.*
- 2. A certification signed by the Authorized Representative as to the current estimated costs of the Project; that the materials, labor and services represented by the invoice*

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*have been satisfactorily purchased, performed, or received and applied to the project; that all funds received to date have been applied toward completing the Project; and that under the terms and provision on the contracts, the Local Government is required to make such payments.*

3. *A certification by the engineer responsible for overseeing construction stating that the equipment, materials, labor and services represented by the construction invoices have been satisfactorily purchased, or received, and applied to the Project in accordance with construction contract documents; stating that construction, up to the point of the requisition, is in compliance with the contract documents; and identifying all additions or deletions to the Project which have altered the Project's performance standards, scope, or purpose since the issue of the Department's construction permit.*

These Agreement provisions did not require SRF Program staff to review as-built drawings or inspect actual progress of the project. SRF Program staff relied on certification of the former Town Manager and Engineer that the information included in the disbursement request was accurate.

SRF Program staff performed an interim inspection, which took place before project closeout. The interim inspection checklist included a verification that as-built drawings were maintained, but did not require SRF Program staff to review as-built drawings or inspect actual construction progress of the project. SRF Program staff also performed a closeout inspection. A review of as-built construction drawings and actual project scale was not required for this inspection. SRF Program staff advised that they verify payment of invoices

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submitted for materials, labor, or services reimbursement as part of their final closeout inspection, and for this project, the SRF Program staff verified payment of invoices included in the final disbursement request. According to SRF Program staff, it is standard for the Engineer to provide field inspectors to monitor the Contractor's progress. As a result, if an Engineer or Contractor over-reported the services performed, SRF Program staff would not know.

### Revenue and Cost Projections

According to projection documents and input from the Engineer, project costs were developed and revised throughout the process based on variable factors.

Based on the Town's general ledger, for FY 2014-2015, revenues attributed to the wastewater system were estimated at \$88,693. Costs and debt obligations attributed to the wastewater system totaled \$115,839.

### Financial Limitations

During our review, we identified factors that may have contributed to the Town's inability to continue making loan payments. A summary of each is below:

#### City of Madison Wastewater Treatment Charges

According to the interlocal Agreement between the City of Madison and the Town signed March 24, 2009, the City of Madison may increase the price of treatment by 5% annually on the first day of October each year. It adds, *this five percent (5%) increase in rates shall not begin until the earlier of: (a) one year after Lee's Wastewater Collection System is first connected to*

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*Madison's Wastewater Plant, or (b) two years after the date of this Agreement.* The Town connected to the City of Madison's wastewater treatment facility in 2011, making "two years after the date of this Agreement" the earlier of the two possibilities, and the earliest date the City of Madison could have raised the price would have been October 1, 2011. On October 1, 2014, the price could have only risen four times, according to the Agreement, from \$2.11/1000 gallons to \$2.56/1000 gallons. However, from October 1, 2014 to September 30, 2015, the City of Madison charged the Town \$2.84/1000 gallons. It is estimated that the City of Madison overcharged the Town \$2,489.90 during FY 2014-2015. During our review, we brought this to the attention of the current Town Manager.

#### Financial Responsibility for Lift Station 53 Rebuild

The interlocal agreement between the City of Madison and the Town states, *Madison is able and willing to accept, treat and dispose of Lee's Wastewater (hereinafter called the "Wastewater Services") under the terms of this Agreement.* The lift station was part of the City of Madison's wastewater infrastructure. However, as part of the interlocal agreement, the Town approved the rebuild cost of \$264,132, in Change Order 1. This increased the Town's annual debt service cost by \$3,311.

#### Lack of Rate Increase

During interviews, the current Town Manager indicated there had not been a rate increase since construction was completed. The Town had the opportunity to raise rates by 5% three times, as of October 1, 2014. However, based on demographics, the Town Council believed that the rates were already too high for some residents. According to the current Town Manager, a

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5% rate increase was planned during FY 2015-2016. According to staff from the Southeast Rural Community Assistance Project<sup>1</sup>, the maximum affordable wastewater bill for the Town would be \$55.21. According to revenue records submitted by the current Town Manager, the average wastewater bill for the Town was currently \$52.50.

#### Lack of an Availability Charge

An availability charge is a monthly fee placed on landowners to whom the wastewater system is available but not connected. The current Town Manager indicated that the Town did not charge an availability charge to the owners of uninhabited lots, whose lots are within 350 feet of the system and not connected. According to SRF Program staff, the Town could have charged this fee. We estimated that there were 22 of these lots by subtracting the number of actual connections (138) from the number of potential connections listed in the Southeastern Rural Community Assistance Project's rate study (160). If the Town had charged these owners the base rate, the Town could have increased revenues by approximately \$6,035.

#### Nonfunctional Interchange Meter

According to the Town Manager, the flow meter at the interchange between the City of Madison's wastewater system and the Town's wastewater system did not function properly. Because of this, it was not possible for the current Town Manager to accurately measure the amount to determine the accurate cost of water sent to the City of Madison for treatment. The Town has estimated the amount sent each month by subtracting irrigation and known leakage

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<sup>1</sup>The Southeast Rural Community Assistance Project performed a rate study for the Town in 2010. This rate study provided the basis for the Town's current rates.

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from total water use. Due to the reliance on estimates, the Town risked potential payment errors to the City of Madison.

### Oversight and Communication

According to the Town Council and the current Town Manager, there was little contact between the SRF Program staff and Town Council until 2014. The Program relied mainly on communication with the Engineer and the recipient representative, in this case, the Town Manager.

On April 24, 2009, the Department's Northeast District Office issued the Engineer a permit with the condition that Lift Station 53 had to be rebuilt to accept more flow safely. This rebuild cost \$264,132. According to meeting minutes, the change order that included this work was presented to the Town Council on December 1, 2009.

## **Findings and Recommendations**

### **Finding 1: Division Oversight of the Loan Project**

Based on our review, the Town wastewater system design and estimated needs provided by the Engineer were not independently verified by SRF Program staff. The estimated system design and projected revenues and costs were at the discretion of the Engineer. As such, Project planning may have been at risk of over estimation. Contract requirements for disbursement of funds did not include review or observation of actual work. Additionally, interim and final closeout inspections did not require the SRF Program staff to

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verify work performed, and the SRF Program staff verified payment only for invoices included in the final disbursement request.

The SRF Program staff relied primarily on the Engineer's and former Town Manager's certifications for assurance that work listed in disbursement requests and as-built drawings accurately reflected work performed.

There was little communication between the Town and SRF Program staff. As a result, SRF Program staff did not learn of the Town's concerns regarding the project's overcapacity and their inability to meet debt obligations until after construction was complete.

**Recommendation:**

Due to the inherent risk associated with reliance on an Engineer for the design of systems that the Engineer will financially benefit from, we recommend that the SRF Program staff put controls in place to provide closer independent project oversight, especially during the planning phase when cost projections are estimated and systems are designed. SRF Program staff should actively communicate with recipient Managers and Council Members, as well as review projected revenues and costs to verify the accuracy of projections.

Further, prior to the approval of loan amounts, SRF Program staff should conduct an independent analysis for assurance that debt obligations can reasonably be met by the local government recipient. Lastly, we recommend that SRF Program staff develop and implement standard procedures to verify payment of invoices of work performed under the project prior to approval of disbursement requests.

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## **Finding 2: Ability to Pay**

The Town has been servicing the debt from their financial reserve, which was intended for emergency repairs and replacements. According to documentation reviewed, the Town had \$199,205.89 in their financial reserve, and the FY 2015-2016 budget projected a deficit of \$22,864 with the CWSRF loan being its largest expense. We estimated that without a restructure of the loan, the Town would be unable to service the debt in five to ten years, depending on the frequency and cost of unforeseen emergencies.

## **Recommendation:**

We recommend the SRF Program Management work with the Town to sustain its ability to service its debt.

*To promote accountability, integrity, and efficiency in state government, the OIG completes audits and reviews of agency programs, activities, and functions. Our review was conducted under the authority of section 20.055, F.S., and in conformance with the International Standards for the Professional Practice of Internal Auditing, published by the Institute of Internal Auditors, and Principles and Standards for Offices of Inspector General, published by the Association of Inspectors General. The review was conducted by Tyler Bradford and supervised by Valerie J. Peacock.*

*Please address inquiries regarding this report to the OIG's Audit Director by telephone at (850) 245-3151. Copies of final reports may be viewed and downloaded via the internet at <http://www.dep.state.fl.us/ig/reports.htm>. Copies may also be obtained by telephone (850) 245-3151, by fax (850)245-2994, in person or by mail at Department of Environmental Protection, Office of Inspector General, 3900 Commonwealth Boulevard, Mail Station #41, Tallahassee, FL 32399.*

*Valerie J. Peacock,  
Director of Auditing*

*Candie M. Fuller,  
Inspector General*



# Florida Department of Environmental Protection

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**TO:** Valerie J. Peacock, Director of Auditing  
**FROM:** Trina Vielhauer, Director, Division of Water Restoration Assistance  
**SUBJECT:** Town of Lee State Revolving Fund Audit Response (A-1516DEP-008)  
**DATE:** February 26, 2016

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I appreciate your and your staff's time conducting the review of the Town of Lee's Clean Water State Revolving Fund Loan. I have reviewed the draft report A-1516DEP-008, and provide the following response.

## **Finding 1: Division Oversight of the Loan Project**

The Division and the Program recognize a need for more scrutiny of planning documents for very small systems and is taking steps to improve this process. The Program started sending planning documents for small systems to the Florida Rural Water Association for independent analysis. In addition, the Program recently hired an experienced Professional Engineer (PE) familiar with the Program to review planning and design documents submitted by small disadvantaged communities as part of his job duties. The Program will also have this PE share his knowledge and cross train his colleagues on design and plan review. This review will be conducted in a manner that does not create an appearance of a conflict of interest in scoring, ranking or selecting projects for funding.

The Division is also evaluating options for securing additional financial review of projects that appear to be less financially sound. In addition, the Division is working with Finance and Accounting on procedures regarding documentation and review of invoices prior to approval of disbursement requests.

The Division is in the process of developing and documenting Standard Operating Procedures for the Program across a multitude of topics including those above. This will help formalize the processes and quality control procedures in the Program.

In summary, the Division is committed to improving its training of the engineering staff regarding review of planning documents for small systems, looking at options for improving its financial review for projects that appear to be more marginal, and improving its documentation of procedures for reviewing project proposals, disbursement requests, and confirmation of payment to contractors.

## **Finding 2: Ability to Pay**

The Town of Lee submitted financial documentation with its loan application in accordance with Rule 62-503.430, Florida Administrative Code. Based upon the Program's review of the information provided, the financial requirements for a debt service account and coverage were satisfied. The documentation provided with the loan application demonstrated that the Town's anticipated income sufficiently covered the loan debt service for the proposed loan as well as annual reserve, operation and maintenance and bulk service charges for the City of

Madison's wastewater service. As mentioned above, the Division is evaluating options for securing additional financial review of projects that appear to be less financially sound.

The Town has submitted a \$543,000 funding request to the legislature for the 2016-2017 session. If this request is unsuccessful, the SRF will identify other options to assist the Town of Lee.