

SOUTHWEST AVOUELLES WATERWORKS DISTRICT



COMPLIANCE AUDIT
ISSUED JULY 11, 2012

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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

July 11, 2012

**MR. BYRNS EVES, PRESIDENT,
AND MEMBERS OF THE BOARD OF DIRECTORS
SOUTHWEST AVOYELLES WATERWORKS DISTRICT**
Bunkie, Louisiana

We have audited certain transactions of the Southwest Avoyelles Waterworks District (District). Our audit was conducted in accordance with Title 24 of the Louisiana Revised Statutes to determine the propriety of certain allegations made against the District's management.

Our audit consisted primarily of inquiries and the examination of selected financial records and other documentation. The scope of our audit was significantly less than that required by *Government Auditing Standards*.

The accompanying report presents our findings as well as management's response. This is a public report. Copies of this report have been delivered to the District Attorney for the Twelfth Judicial District of Louisiana, the Louisiana Attorney General, and others as required by law.

Respectfully submitted,

Daryl G. Purpera, CPA, CFE
Legislative Auditor

DD/ch

SAWD 2012

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EXECUTIVE SUMMARY

Customer Cash Payments Not Recorded and Not Deposited

Available records of the Southwest Avoyelles Waterworks District (District) from January 2009 through March 2011 indicate that former Superintendent Frank Palermo should have collected \$305,151 from District customers; however, bank deposits made during this time period totaled \$266,503, a difference/shortage of \$38,648. According to Mr. Palermo, he was responsible for all administrative and operational duties of the District, including recording customer water usage and collecting, recording, and depositing all customer payments. Customers made payments to the District through cash, checks, or money orders. Customer payments made with cash were rarely deposited (only \$685 during this time) in the District's bank account, but rather kept in a safe located in Mr. Palermo's personal residence. According to Mr. Palermo, he does not know what happened to the additional \$38,648 in cash receipts. Furthermore, Mr. Palermo admitted to having arranged to receive something of value from one of the District's customers in exchange for the customer not paying his monthly water bill. Based on the above actions, Mr. Palermo may have violated state laws.

Violation of Federal Loan Agreement

Mr. Palermo did not deposit all cash revenues earned from the operation of the District; therefore, the District violated Section 20 of its agreement with the Farmers Home Administration, an agency of the United States Department of Agriculture.

BACKGROUND AND METHODOLOGY

The Southwest Avoyelles Waterworks District (District) was created on March 23, 1973 as a nonprofit corporation as defined in Louisiana Revised Statutes (1950) 12:010 (8). The District operates under a Board of Directors consisting of four members, all of whom are appointed by the Avoyelles Parish Police Jury. The District is a component unit of the Avoyelles Parish Police Jury and is responsible for delivering water to approximately 363 customers located inside and near the town of Bunkie. The District currently contracts with one individual to perform all of its daily operations. In September 2011, Mr. Burt Leonard replaced Mr. Frank Palermo as Superintendent for the District, who was employed with the District from 1990 to September 2011.

The Farmers Home Administration (FmHA) is an agency of the United States Department of Agriculture created to assist farmers and families living in rural areas by financing and insuring loans for housing and other farming-related needs. The FmHA provides credit and technical assistance to rural families and communities through four major programs: a housing program, utilities program, business program, and community development program. On December 8, 1975, the District entered into an agreement with FmHA whereby the District issued a \$225,000 revenue bond that was purchased by FmHA. The proceeds were used to construct and acquire a waterworks district for the area, pursuant to the provisions of Article VI, Section 37 of the Constitution of the State of Louisiana of 1974.

Customers of the District met with the Louisiana Legislative Auditor (LLA) to provide information and concerns relating to the former superintendent of the District and to request assistance from the LLA. The LLA reviewed available District records to determine the propriety of the information. The procedures performed during this audit included:

- (1) interviewing board members and the employee of the District;
- (2) interviewing other persons as appropriate;
- (3) examining selected documents and records of the District;
- (4) gathering documents from external parties; and
- (5) reviewing applicable state laws and regulations.

FINDINGS

Customer Cash Payments Not Recorded and Not Deposited

We examined available District records for the years 2009 through 2011 and records indicate that \$39,333 in cash should have been collected during that time period; however, only \$685 was deposited into District bank accounts. Because the former superintendent could not account for the difference of \$38,648, his actions may have violated state laws.¹

Our audit revealed the following discrepancies:

1. Customers with active water meter readings who were not recorded in the ledger as customers
2. Customer payments that were recorded in the ledgers but not deposited into the District's bank account
3. Cash payments not recorded or accounted for in the District's records or deposited into the District's bank account

District Duties, Practices, and Policies

District Board President, Mr. Byrns Eves, stated that former Superintendent Frank Palermo was the only District employee and had 100% control of the daily operations of the District and reported all financial information to the board. Mr. Palermo also stated that he was responsible for all administrative and operational duties of the District, including:

1. Recording water usage from the customers' water meters
2. Calculating the monthly water bills and mailing them to the customers
3. Collecting all customer payments

¹ **R.S. 14:67** provides, in part, that theft is the misappropriation or taking of anything of value which belongs to another, either without the consent of the other to the misappropriation or taking, or by means of fraudulent conduct, practices, or representations. An intent to deprive the other permanently of whatever may be the subject of the misappropriation or taking is essential.

R.S. 14:118(A) provides, in part, that public bribery is the giving or offering to give, directly or indirectly, anything of apparent present or prospective value to any public officer, public employee, or person in a position of public authority with the intent to influence his conduct in relation to his position, employment, or duty. The acceptance of, or the offer to accept, directly or indirectly, anything of apparent present or prospective value, under such circumstances, by any public officer, public employee, or person in a position of public authority shall also constitute public bribery.

R.S. 14:133 provides, in part, that filing false public records is the filing or depositing for record in any public office or with any public official, or the maintaining as required by law, regulation, or rule, with knowledge of its falsity, any forged document, any wrongfully altered document, or any document containing a false statement or false representation of a material fact.

4. Making bank deposits
5. Refunding customer deposits when they discontinue water service

Mr. Palermo and his wife, Mrs. Rosalie Palermo, stated that although she was not a paid employee, she performed the bookkeeping and helped with preparing bank deposits.

According to Mr. Palermo, as a means of ensuring the District was operating properly and responsibly, District practice was to reconcile the amount of water the plant produced to the amount of water used by customers and enforce the disconnect policy for delinquent customers. Mr. Palermo stated that he never had a problem reconciling water production to usage, and that delinquent customer accounts were minimal. Mr. Palermo also stated that his normal practice was to deposit all customer payments made by check into the District's bank account and keep cash payments in a safe located in his personal residence. According to Mr. Palermo, the cash was used to reimburse \$50 security deposits back to customers who discontinued water service, to purchase postage stamps, and to pay for certified mailings. Mr. Palermo stated that at the end of each year, he deposited the leftover cash from his safe into the District's bank account.

As of March 31, 2011, the Board voted to discontinue accepting cash as payment for water bills. According to Mr. Palermo, the board's decision was based on their suspicion that he was keeping some of the cash payments for his personal use.

We examined available District records for the years 2009 through 2011. Our examination consisted of reviewing and comparing water meter logs (prepared by Mr. Palermo), which recorded the water usage for active customers; the ledgers (also prepared by Mr. Palermo), which recorded the amounts billed and collected for active customers and the balances owed for each customer; the bank deposits made by Mr. and Mrs. Palermo; and checks issued by the District during the audit period. The comparison of these documents and Mr. Palermo's cash management practice revealed discrepancies, including (1) customers with active water meter readings who were not recorded in the ledger as customers, (2) customer payments that were recorded in the ledger but not deposited into the District's bank account, and (3) cash payments not recorded or accounted for in the District's records.

1. Active Customers Not Recorded in the Ledgers

The District's ledgers that account for customer billings, payments, and balances did not include all active customers of the District. District records indicate that in 2009 and 2010, 50 and 48 customers (14% and 13% respectively) were not recorded as customers in the ledgers; however, once the decision was made in March 2011 to not accept cash, 98% (363 total customers in 2011) of the active customers were recorded in the District's ledger.

Our review of the ledgers revealed that 50 active customers in 2009 and 48 active customers in 2010 recorded in meter logs by Mr. Palermo were not recorded in the ledgers or were missing from the ledgers; therefore, these customers did not appear as customers in the accounting records. When we asked why some customers did not appear in the ledgers, Mr. Palermo stated that when he was superintendent all customers, including those we noted as missing, were recorded in the ledgers. Mr. Palermo further stated that all of the District's

customers were mailed water bills each month, including the customers that were missing from the ledgers.

Mr. Palermo stated that about 10% of customers routinely paid their monthly water bills in cash and specifically named seven of these customers. According to the District records for 2009 and 2010, of the seven customers named by Mr. Palermo, six were not recorded in the ledgers and none of the seven customers appeared on deposit slip detail as paying their water bills.

Upon attempting to interview 40 of these customers (referred to in the first paragraph), we were able to speak with 11 customers. All stated that they were active customers in the District during 2009, 2010, and 2011. Seven customers stated that they paid Mr. Palermo in cash for their water services; five of the seven were the same customers Mr. Palermo named as paying cash. Two examples are as follows:

- Mr. Shannon LeDoux stated that he paid Mr. Palermo approximately \$300 to \$400 in cash each month for his water services. He stated that Mr. Palermo would come to him each month to collect his cash payment. According to Mr. LeDoux, he paid Mr. Palermo \$500 and \$400 in cash for his final two months' bills (July and August 2011) in order to give him a \$0 balance for his accounts. However, in September 2011 when Mr. Burt Leonard replaced Mr. Palermo as superintendent, Mr. LeDoux received an estimated \$1,000 bill for a past due balance. Prior to March 2011, Mr. LeDoux was not listed as a customer in the District's ledgers.
- Mr. Morris Voorhies stated that he had an agreement with Mr. Palermo in 2011, where Mr. Palermo would "take care" of his (Mr. Voorhies's) water bill for two years in exchange for him giving Mr. Palermo (personally, not the District) two electric light posts that Mr. Voorhies had owned. Mr. Palermo confirmed this agreement, and stated that he paid Mr. Voorhies's water bills for one year until he resigned as superintendent. However, we could not locate any record of Mr. Palermo paying or recording payments for Mr. Voorhies's 2011 water bills, and we did not find Mr. Voorhies listed as a customer in the ledgers. According to Mr. Voorhies, he did not receive any bills from the District for several months, until September of 2011 when Mr. Leonard became Superintendent, and then his account had a past due balance of \$341.

Mr. Palermo stated that Mr. LeDoux and Mr. Voorhies routinely paid their water bills in cash. He stated that he collected Mr. LeDoux's water payments and personally paid Mr. Voorhies's water bills for 2011. However, there is no District documentation of such payments recorded on their accounts. According to District records and Mr. Palermo: (1) he did not issue receipts to Mr. LeDoux or Mr. Voorhies for the cash payments, (2) there were no payments recorded in the ledgers for these customers, and (3) there was no record of cash or check deposits made for these customers' payments.

Also, although the board voted to discontinue accepting cash as payment for water bills effective March 31, 2011, Mr. Leonard named three additional District customers that were still paying in cash in September 2011, when he became superintendent.

2. Customer Payments Recorded But Not Deposited

Our analysis of the District's 2010 records indicate that there were 15 customers recorded in the ledgers who paid cash for their water bills whose payments were not deposited into the District's bank account. These payments for the 27-month audit period totaled \$8,768.

During a subsequent meeting with Mr. Palermo, we provided him with a partial list of customers recorded in the 2010 ledger and asked him to identify which customers paid by check and which paid with cash. Mr. Palermo reviewed our list and indicated on the list that only two customers paid their water bills in cash. Because of the difficulty in analyzing District records, we only analyzed deposit detail records for 2010 (not 2009 and 2011). We compared the deposits to the list of customers to determine the number of customers who did not have payments deposited into the District's bank account. Based on Mr. Palermo's previous statement that he did not deposit cash payments, this analysis should show that only two customers were cash paying customers. However, our analysis indicated that Mr. Palermo's statement that two customers paid in cash was not correct. We identified 15 customers recorded in the 2010 ledger as paying cash for their water bills for which no payments were included in any bank deposits for that year. Therefore, our analysis of the 2010 year records indicated that the total number of cash paying customers, both recorded and not recorded in the ledgers, were 63 [48 not recorded (see item 1 above) + 15 recorded] or 18% of all customers.

3. Cash Payments Not Deposited

Our analysis of water meter logs and the prevailing water usage rates over a 27-month period indicate that \$38,648 of cash was not deposited into the District's bank account.

During the period January 2009 through March 31, 2011 (27 months), water meter logs and the prevailing water usage rates indicate that Mr. Palermo should have collected \$305,151 from District customers. However, according to District bank deposits, \$266,503 was deposited, which is \$38,648 less than the amount Mr. Palermo should have collected. Of the amount deposited, \$265,818 was comprised of customer checks and \$685 was customer cash.

According to Mr. Palermo, he typically collected between \$500 and \$700 a month in cash which he kept in a safe located in his personal residence. Based on this statement, if we consider \$600 to be the average amount of cash he collected each month, Mr. Palermo should have collected a total of \$16,200 in cash over the 27-month period. However, based on District records, \$39,333 (\$38,648 unaccounted for + \$685 cash actually deposited) should have been collected in cash.

We noted that revenues collected and deposited from April 1, 2011 to December 31, 2011 (after cash payments were no longer accepted), increased an average of \$12,387 or 14% compared to the same time periods in 2009 and 2010.

Mr. Ken Rachal, the District's auditor, stated that during the course of his audit of the District, he asked Mr. Palermo why cash was not being deposited. He said Mr. Palermo claimed that all cash collected from monthly customer billings was used to pay for expenses of the District, and was never reported in the ledger as customer payments or deposited into the District's bank account. Mr. Rachal told us he then asked Mr. Palermo for receipts or supporting documents for the cash expenditures and that Mr. Palermo could not produce any documentation.

During our first meeting with Mr. Palermo, he denied making the statement to Mr. Rachal regarding cash being used for District expenses and not being recorded in the ledgers. According to Mr. Palermo, he again stated that he only used cash to reimburse \$50 security deposits back to customers that discontinued water service (two or three per month), to purchase postage stamps, and to pay for certified mailings. Mr. Palermo further stated that at the end of each year, he would take the remaining cash from his personal safe and deposit it into the District's bank account. However, our review of the bank deposits in December and January of each year revealed that no cash was deposited during this time. In fact, only \$685 in cash was deposited during the 27-month period. In addition, our review of expenditures revealed that District checks were used to pay (1) security deposits back to customers; (2) postal expenditures; and (3) other normal operating expenses of the District. When confronted with this information, Mr. Palermo recanted his statement regarding refunding customer security deposits and stated that if former customers left forwarding addresses he would mail checks to the forwarding addresses rather than reimbursing them in cash.

During a second interview with Mr. Palermo, we again explained to him that the amount of cash deposited into the District's bank account was much less than what should have been deposited based on his statement that he deposited the remaining cash at the end of each year. Mr. Palermo then recanted his previous statements and decreased the amount of cash he collected and increased the amount of cash he deposited. Mr. Palermo stated that he only collected between \$400 and \$500 a month in cash (approximately \$12,150 over the 27-month period). He stated that he used the cash to pay for postage, which totaled approximately \$55 per month and to reimburse/pay \$50 security deposits back to customers that discontinued water service, which totaled approximately \$125 per month (approximately 2.5 customers on average per month). Mr. Palermo further stated that part of the cash he collected was deposited into a second District bank account (Water Meter Deposit account), which was used for "saving" customer security deposits until such time that the deposits had to be reimbursed to the customers. Mr. Palermo stated that at the end of each year, he would transfer the remaining balance in the Water Meter Deposit account (between \$2,000 and \$4,000) into the Revenue Fund bank account. By the end of the interview with Mr. Palermo, he changed his statement a third time and said that in the summer of 2010 (and not March 2011), he quit accepting cash payments from customers.

Based on Mr. Palermo's revised statements regarding his cash management and expenditures and our review of the activity in the Water Meter Deposit account, we determined that over the 27-month period:

- (1) \$675 of an unknown combination of checks and cash was deposited into the Water Meter Deposit account;
- (2) no cash was transferred out of the Water Meter Deposit account into the Revenue Fund account;
- (3) reimbursement checks for security deposits were issued only from the Revenue Fund account to former customers; and
- (4) Mr. Palermo still cannot account for \$9,980 (\$12,150 collected [based on his own estimate of \$400 to \$500 in cash each month] - \$1,485 for postage - \$685 cash deposited in bank) in cash he collected.

Conclusion

According to Mr. Palermo and District records, he was responsible for recording all active customers in the ledgers and for the disposition of all cash collections from District customers. Mr. Palermo admitted to keeping cash collections in his personal safe. However, Mr. Palermo changed his statements several times on how much cash he collected, his management of the cash, and his use of the cash. Mr. Palermo's two estimates of how much cash he collected and kept in his personal safe during the 27-month period totaled \$16,200 and \$12,150. However, from 2009 through March 2011, District records indicate that \$39,333 in cash should have been collected and accounted for by Mr. Palermo. Since only \$685 of cash was deposited into the District's bank account, there appears to be \$38,648 of cash missing. Mr. Palermo could not account for the cash he admitted to keeping in his personal safe nor could he account for the \$38,648 that appears to have been collected. When we confronted him with this information, Mr. Palermo's response was that he does not know what happened to the \$38,648 in cash payments.

In addition, Mr. Palermo admitted to having arranged to receive something of value (two electric light fixtures) from one of the District's customers in exchange for the customer not paying his monthly water bill.

Based on the actions referred to items 1, 2, and 3, Mr. Palermo may have violated state laws.¹

Violation of Federal Loan Agreement

Mr. Palermo did not deposit all cash revenues earned from the operation of the District; therefore, the District violated Section 20 of its agreement with the Farmers Home Administration (FmHA), an agency of the United States Department of Agriculture.

On December 8, 1975, the District entered into an agreement with FmHA whereby the District issued a \$225,000 revenue bond that was purchased by FmHA. The proceeds were used to construct and acquire a waterworks district for the area, pursuant to the provisions of Article VI, Section 37 of the Constitution of the State of Louisiana of 1974. According to the agreement with the FmHA, the District is required to deposit all income and revenues as follows:

Section 20: ...all of the income and revenues to be earned from the operation of the System shall be deposited promptly as provided in Section 11 hereof in the Waterworks Revenue Fund, which shall be maintained with the regularly designated fiscal agent bank of the borrower, separate and apart from all other funds of the borrower.

APPENDIX A

Management's Response

Southwest Avoyelles Waterworks
P O Box 389
Bunkie, LA 71322

June 27, 2012

Eric Sloan, CPA
Louisiana Legislative Auditor
P O Box 94397
Baton Rouge, LA 70804-9397

RE: Compliance Audit Report
Southwest Avoyelles Waterworks District

Dear Mr. Sloan:

We are in receipt of your compliance audit report on the Southwest Avoyelles Waterworks District. Please be advised that the Board of Commissioners of the Southwest Avoyelles Waterworks District has enacted several policy changes and will take further action with regards to the findings in the reports, as discussed below.

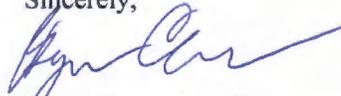
Upon receipt of the official release of the report, the Southwest Avoyelles Waterworks District will forward said report to District Attorney Charles Riddle III, Avoyelles Parish 12th Judicial District, along with a request that he review the report for potential grand jury investigation.

The Southwest Avoyelles Waterworks District has obtained and implemented a computerized billing system specifically tailored for small utility providers. The billing system provides for more accurate billing and usage data and makes available certain reports which can be used to reconcile water usage, billings, and collections.

The Board of Commissioners of the Southwest Avoyelles Waterworks District will continue to review our policies and implement internal controls such as reviews of billing system audit and reconciliation reports and reviews of monthly bank statements by Commissioners as well as our independent CPA.

Please contact me if you need any further information.

Sincerely,



Byrns Eves, President
Southwest Avoyelles Waterworks

George L. Higgins III

Attorney At Law

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Pineville, LA 71360

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June 27, 2012

Mr. Eric Sloan, CPA
Assistant Legislative Auditor and
Director of Compliance Audit and Advisory Services
P.O. Box 94397
Baton Rouge, LA 70804-9397

via facsimile: (225) 339-3987

RE: Frank Palermo

Dear Mr. Sloan:

This letter is to inform you that I have been retained to represent Mr. Frank Palermo on any and all matters related to his position as Superintendent at Southwest Avoyelles Waterworks District.

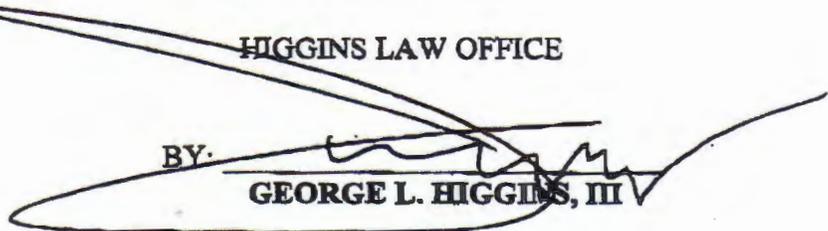
Mr. Palermo is over eighty years of age. He has served Avoyelles Waterworks District with dignity and devotion since 1985. Mr. Palermo adamantly denies any and all allegations of wrong doing.

I would welcome the opportunity to meet with you with or without my client at your convenience.

With kindest regards, I remain;

HIGGINS LAW OFFICE

BY:


GEORGE L. HIGGINS, III

GLH/kms