



GAO

Government Accountability Office

New Mexico Office of the State Auditor

Risk Advisory Municipal Utilities

The Office of the State Auditor (OSA) has issued this Risk Advisory to alert municipalities of certain risks related to the operation of utilities. The OSA strongly advises municipal management and governing bodies to review their utilities' internal controls to ensure compliance with applicable legal requirements and to prevent and detect fraud, waste and abuse.

Municipal governments may operate water, sewer, electrical, gas and solid waste utilities. This Risk Advisory refers to these operations as "municipal utilities." The OSA's review of Fiscal Year 2015 audits revealed that 22 municipalities (22 percent of municipal audit reports) had one or more findings related to municipal utilities. All of the municipalities with such findings had populations under 15,000, and 68 percent were communities with a population of less than 5,000. Although the findings highlighted in this Risk Advisory arise from mostly smaller, rural communities, these risks and recommendations are applicable to larger municipalities as well.

The OSA identified the following issues in Fiscal Year 2015 municipal utility audits:

- Use of the wrong billing rate or wrong tax rate;
- Over-and under-billings;
- Inadequate cash and payment handling procedures;
- Inaccurate meter reads;
- Account adjustments being made without additional approval and without supporting documentation;
- Failure to collect on customer accounts with outstanding balances;
- Unnecessary delays in returning security deposits;
- Undeliverable customer refund checks not being sent to NM Taxation and Revenue Department as unclaimed property in a timely manner;
- Improper account reconciliation; and
- Problems with the implementation of new automated meter reading systems.

Municipal Utilities in a Nutshell

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Communities may receive utility services from different types of utility companies. The Public Regulation Commission (PRC) regulates some utilities, such as PNM and New Mexico Gas Company. Alternatively, municipal governments may also operate water, sewer, electrical, gas and solid waste utilities. For example, in the City of Santa Fe, water and sewer services are managed by the City's utilities department. This Risk Advisory refers to this latter type as "municipal utilities." Although a municipality may "opt-in" to the Public Utilities Act, since none have currently done so, the PRC does not have authority over the rates and services of municipal utilities. Instead, the rules and regulations related to utility services are prescribed by local ordinances.

Need Help?

Contact your municipal government with questions or concerns regarding municipal utilities. To file a complaint concerning a PRC-regulated utility company, contact the PRC Customer Relations Division at 1-888-427-5772.

"Financial reporting plays a major role in fulfilling government's duty to be publicly accountable in a democratic society." – Governmental Accounting Standards Board, Concept Statement No. 1.

Risks

In a water, sewer, electrical, gas or solid waste operation run by a municipality (a “municipal utility”), the municipal governing body may oversee operations as distinct departments or manage them as a single utility. Governing bodies may directly supervise utility operations or create a board to manage the utilities. Two municipalities may also agree to maintain a joint utility to provide services. NMSA 1978, §§ 3-21-1 to 3-27-9. New Mexicans may also receive utility services from certain counties, cooperatives, mutual domestic water consumers associations and special districts.

The failure to maintain appropriate internal controls over the financial affairs of utilities can result in a number of risks, including, but not limited to:

- *Loss or theft of utility funds and resources.* Failure to protect against intentional wrongdoing or identify unintentional errors may result in significant losses of public funds.
- *Overbilling of customers.* Utility customers should be able to have confidence that the rate being charged is based on an accurate reading of the services being provided.
- *Under-collection of revenue.* Receipts not collected due to fraud, mismanagement or errors are resources not available to support utility services, operations and repairs. This also may result in an undue financial burden on other paying customers, who must then pay more to make up for lost revenue.
- *Misstatements in financial reporting.* Accurate financial reporting is important in determining the appropriate allocation of resources, identifying financial irregularities and providing public accountability and transparency with regard to governmental activities.
- *Increased administrative costs.* Rebilling, processing additional refunds, fixing errors and investigating fraud can impose significant financial and administrative burdens. This can also decrease the efficiency and effectiveness of services being delivered to the community.
- *Legal liability.* Violations of ordinances or state law, the failure to collect revenue due, overbillings, fraud, not returning security deposits and refunds in a timely manner and other shortfalls may result in municipalities incurring legal liability and financial costs, or losing state funding.

Internal Controls

Strong internal controls help ensure the effectiveness and efficiency of operations, the reliability of financial reporting and compliance with applicable laws and regulations. The OSA has identified various recommendations that municipalities may want to consider when assessing their internal controls. These include:

- Use properly monitored billing software, as opposed to manual calculations, to determine the amount due to prevent errors.
- Ensure correct rates are entered into the billing system. In addition to regularly verifying that the system is using the intended rate, verify that there is legal support for the rate being used (that it is in accordance with the relevant ordinance). An evaluation of proper rates should also include the gross receipts tax rate being charged and the amount remitted to the NM

Taxation and Revenue Department. Rates charged should also be reflective of the costs of providing the services.

- Test billing accuracy on a sample basis regularly each billing cycle.
- Routinely conduct meter re-reads, including those digitally monitored, to check accuracy and identify errors. Billing should be based on reliable readings that reflect actual usage.
- Reconcile security deposits to ensure customer refunds are being provided in a timely manner.
- Ensure outstanding balances for services are billed when accounts are “finalized” and closed.
- Segregate duties with respect to the employees who handle payments, record receivables, and make adjustments to customer accounts. This safeguards against potential loss and limits the risk of fraud and errors.
- Require proper documentation for adjustments to customer accounts, indicating why the adjustment was requested and why it is being made. Any exceptions should be documented and be consistent with the municipality’s policies and ordinances. Management should ensure oversight of the adjustment process (e.g., maintain audit trail of transactions, require approval by a supervisor, and block access to own accounts.).
- Regularly review delinquent accounts and take appropriate steps to collect outstanding balances. Not collecting on what is legally due may constitute a violation of New Mexico’s anti-donation clause (N.M. Const. art. IX, § 14), which prohibits a governmental entity from discharging an obligation of a private individual. Unpaid accounts should be deactivated or a lien should be placed on the property in a manner consistent with state law and the municipality’s ordinances and policies.
- Remit undeliverable refund checks to the state in a timely manner. In accordance with the Uniform Unclaimed Property Act, payments due to customers that are over one year old must be forwarded to the NM Taxation and Revenue Department to facilitate the transfer to the rightful owner.
- Monitor accounts receivable to identify outstanding account balances that should be reported as uncollectable in financial statements.
- Track different types of utility activities (water, sewer, etc.) separately. Maintaining reports with breakdowns of each type of activity may help prevent misstatements and detect errors.
- Implement controls designed to prevent and detect errors that impact financial reporting, such as reconciliation of accounts on a monthly basis.
- Ensure staff are properly trained on new meter systems and develop a transition plan prior to converting to radio-read meters.