



Timothy M. Keller
State Auditor

Sanjay Bhakta, CPA, CGFM, CFE, CGMA
Deputy State Auditor

State of New Mexico
OFFICE OF THE STATE AUDITOR

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Via Email and U.S. Mail

Laura Breed, Acting Secretary
Hanover Mutual Domestic Water Consumer Association
106 Fierro Road
Hanover, New Mexico 88041

Re: Hanover Mutual Domestic Water Consumer Association

Dear Ms. Breed:

On June 1, 2015, the Office of the State Auditor (OSA) released Agreed-Upon Procedures (AUP) reports for the Hanover Mutual Domestic Water Consumer Association (Hanover) for fiscal years 2010-2014. These reports noted substantial activity that was not properly included in the general ledger and an overall lack of supporting documentation for expenditures. Specifically, during this period, the OSA found approximately \$1,096,000 in expenditures without supporting documentation, such as receipts or invoices, and numerous payments by former President Eddie Evatt, as the check signer, to himself and immediate family members. As a result of these findings (2010-004), the OSA performed additional procedures in regard to these payment and other transactions. The purpose of this letter is to notify you of the results of these additional procedures.

I. Summary

The OSA's concerns relate to three major issues:

(A) Former President Evatt made payments totaling at least \$122,567.41 to himself and immediate family members between January 2009 and December 2014. These Hanover checks were signed solely by Mr. Evatt. The OSA found no evidence that any actual or apparent conflicts of interest involving these transactions were disclosed to the full Board of Directors (Board). Furthermore, in most of these instances there were inadequate supporting documentation for the expenditures. As a result, OSA was unable to confirm compliance with applicable procurement rules or the extent that goods or services were actually provided.

(B) Former President Evatt and family members received payments totaling \$28,786.94 directly from the New Mexico Finance Authority (NMFA). These payments did not pass through the Hanover financial books and the OSA has no evidence that they were disclosed to the Board.

(C) An Evatt family business, Evatt Construction, benefitted from agreements in 2011 between Souder Miller & Associates (SMA) and Freeport-McMoRan (Freeport) for the

establishment of a Hanover water fill station adjacent to Mr. Evatt's home. The fill station is not in service. Specifically, Evatt Construction received \$6,000 from a subcontract through the SMA engineering firm. It is unclear whether the Board was made aware of the sub-consulting contract when considering this project.

The OSA's review of these matters highlight serious shortcomings in Hanover's internal controls during this period. The control environment, including the lack of segregation of duties and off-book transactions, created a setting that was conducive to fraud, waste and abuse. Due to the lack of supporting documentation for many expenditures, the OSA was unable to determine the appropriateness of the expenditures and the goods and services that were provided. However, the review did find that large sums of money were paid to the former President and family members through non-disclosed transactions and non-competitive purchases. As a result of a lack of compliance with conflict of interest disclosure requirements, checks being signed solely by Mr. Evatt, and the fact that bids to perform work often came exclusively from related parties, at a minimum it is likely that Hanover did not receive the best possible price through these purchases. Some of these transactions may have also violated the Government Conduct Act and Association Bylaws regarding conflicts of interest and ethical principles of public service.

To prevent these types of occurrences in the future, the Hanover Board needs to take concrete steps to strengthen its financial controls, including:

- Active Board involvement in capital funding processes, in addition to the operational funding, to ensure that there are adequate controls over receipts and disbursements.
- Considering obtaining a fiscal agent to help monitor capital funding.
- Active monitoring of bank statements and the accounting prepared by the newly hired independent CPA in order to ensure compliance with laws and regulations including payments to tax authorities.
- Performing timely review of bank statements and closely tracking Association funds.
- Maintaining detailed records supporting revenues and expenditures.
- Ensuring compliance with conflict of interest requirements in a manner consistent with the Association Bylaws and the Government Conduct Act.
- Establishing clear policies and procedures, in conjunction with training, that reflect strong controls over procurement.
- Verification of loan balances payable and grant awards receivable in order to effectively plan future projects.

The OSA recognizes that the new leadership of the Association has implemented some of these reforms through its adoption of resolution 2015-05 and we appreciate your commitment to safeguarding Association funds. In addition to implementing the recommendations above, in the future it is also critical that Hanover ensure the timely completion of Agreed-Upon Procedures reports, as required by the Audit Act. The problems discussed herein would have been identified much sooner had the Association complied with annual auditing requirements.

II. Analysis

(A) Former President Eddie Evatt made payments to himself and family members without adequately disclosing the transactions to the full Board or ensuring competitive purchases. As a result President Evatt may have violated Article VI, Section 5 of Hanover Bylaws (Conflicts of Interest) and Section 10-16-7 of the Governmental Conduct Act.

Article VI, Section 5, of the Hanover Bylaws, which were signed by former President Evatt in 2007, state that directors must avoid actual or apparent conflicts of interest. This prohibition includes situations where a director has a direct, indirect or material interest in a transaction between the Association and another entity, and the director or his immediate family members might benefit financially or personally. A conflict also exists when the director is in a position to influence a decision that may result in direct or indirect personal gain for the director or his/her family. Where a conflict exists, a conflict must be disclosed and a board member must be excused from the discussion and any vote.

Pursuant to Section 10-16-7 (B) of the Governmental Conduct Act, an employee or public officer (receives compensation in the form of a salary or eligible for per diem/mileage) of a local governmental agency (a political subdivision of the state) is prohibited from entering into a contract (over \$1,000 for goods, services, etc.) with the employee or public officer or his/her family members unless the contact is publicly disclosed and awarded through a competitive process.

OSA identified payments totaling \$151,354.35 to former President Evatt and family members (sons and spouse) between March 13, 2009 and October 4, 2014. Of these, \$122,567.41 were payments made through Hanover checks signed solely by former President Evatt. The OSA did not find evidence indicating that these transactions were disclosed and in many instances payments were made to family members based on a single quote or invoice. Payments to former President Evatt primarily related to reimbursements and the payments to his family members were for goods and services. Of the \$122,567.41 in Hanover checks, \$49,034.73 was not accounted for with a requisition for reimbursement, which implies scrutiny of the transaction by a funding entity, or any documents other than a check and/or invoice.

Payee	Grand Total	Hanover Check Payments	Direct Payments from NMFA
Claudine Evatt	\$ 519.45	519.45	
Eddie Evatt	4,765.15	4,765.15	
ERC Construction	19,312.48	15,595.92	3,716.56
Evatt Contracting	83,278.42	58,208.04	25,070.38
Evatt Construction	29,693.70	29,243.70	
Evatt Excavating	4,083.71	4,083.71	
Mike Evatt	150.00	150.00	
Mike/ERC Construction	1,710.00	1,710.00	

Phil Evatt Construction	3,650.00	3,650.00	
Phil Evatt	4,460.54	4,460.54	
Total	\$ 151,354.35	122,567.41	28,786.94

The OSA identified another \$28,786.94 paid through the NMFA with five requisitions in 2010 and 2011 directly to former President Evatt or family members. These payments did not pass through the Hanover books and the OSA has no evidence that they were disclosed to other Board members

(B) The OSA observed that former President Evatt overrode internal controls over procurement and expense reimbursement processes which may violate the ethical principles of public service identified in Section 10-16-3 of the Governmental Conduct Act.

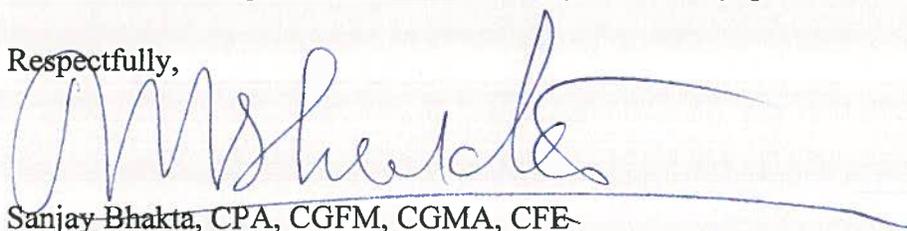
OSA is concerned that former President Evatt may have asserted improper influence over the procurement and expense reimbursement processes. By virtue of his position, former President Evatt entered into agreements with family members without obtaining quotes or the formal written approval of any Board member. President Evatt personally signed checks to family members without obtaining the signature of the Treasurer. These transactions raise concerns that Mr. Evatt exercised his powers in a manner to pursue private interests possibly at the public's expense.

III. Conclusion

In summary, the OSA views the past operating environment as having had a high risk for fraud waste and abuse at a time when the Board was actively engaged in major infrastructure improvements. The OSA is required to remind you of the respective roles of those charged with governance and management in ensuring financial accountability. Hanover's Board should be actively involved in overseeing the capital outlay and procurement processes and should ensure that the corrective actions under way are effective and that they remedy all the issues raised.

The OSA appreciates your continued consideration of these issues and appreciates the cooperation of both staff and the Board in bringing these matters to our attention and assisting us in preparing this report. Please do not hesitate to contact Kevin Sourisseau at 505-476-3820 or Kevin.Sourisseau@osa.state.nm.us should you have any questions.

Respectfully,



Sanjay Bhakta, CPA, CGFM, CGMA, CFE
Deputy State Auditor

cc: Pauline Dempster, Board Member
Millie Santistevan, Hanover Administrator
District Attorney Francesca Martinez-Estevez, 6th Judicial District