

**Performance Audit 22-05:
Sewer Fee Collections**

November 2022

City Auditor

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OFFICE OF INTERNAL AUDIT

Stan Sewell, City Auditor

November 23, 2022

To: Mayor Kelly
City Council Members

Subject: Sewer Fee Collections Audit (Report #22-05)

Dear Mayor Kelly and City Council Members:

The attached report contains the results of our audit of Public Works management of sewer fee collections through the ENCO Tennessee, LLC (ENCO) contract. Our audit found the contractor accurately bills city sewer charges to customers but collection processes need improvement. In order to address the noted areas for improvement, we recommended actions to develop formal policies and procedures. We also recommended the contractor develop procedures to ensure late penalty fees and delinquent administrative fees are consistently and accurately charged, as well as recommendations to follow City Code.

We thank the management and staff of the Public Works Department and the staff of ENCO for their cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE
City Auditor

Attachment

cc: Audit Committee Members
Joda Thongnopnua, Chief of Staff
Brent Goldberg, Chief Financial Officer
Ryan Ewalt, Chief Operating Officer
Julia Bursch, Deputy Chief Operating Officer
Mark Heinzer, Deputy Director Wastewater Systems
Jim Arnette, Tennessee Local Government Audit jim.arnette@cot.tn.gov

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AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit’s 2022 Audit Agenda. The objectives of this audit were to determine if:

- ENCO accurately bills city sewer charges to customers; and,
- Sufficient collection efforts are made for delinquent ENCO billed accounts.

BACKGROUND

In 2017, the City of Chattanooga entered into an agreement with ENCO Utility Services to handle the billing and collection of sewer payments on behalf of the City. ENCO Utility (aka ENCO Tennessee, LLC) operates a Sewer Payment Center at the Chattanooga Development Resource Center.

The current contract was signed in February 2022. Per the contract terms, the contractor provides and maintains a utility billing system. The contractor uses meter reading data provided electronically from Tennessee American Water Company to generate sewer bills. Sewer customers make payments in person at the Sewer Payment Center or City Treasurer, by mail, by phone, or via the web payment portal. ENCO reconciles receivables to deposits on a daily basis and performs a monthly bank reconciliation.

City Council sets the sewer service rates by City Ordinance¹. Sewer service charges are based upon the quantity of water used as shown by water meter readings. The dollar amount is derived by applying the total charge in dollars per one thousand gallons as follows:

Exhibit 1: Charge per 1,000 gallon

User Class (gallons)	FY21	FY22
First 100,000	11.99	12.71
Next 650,000	8.92	9.46
Next 1,250,000	7.25	7.69
Next 30,000,000	6.12	6.49
Over 32,000,000	5.95	6.31

Source: City Ordinance 13558 and 13710

¹ Ordinance 13558 includes the rates effective through September 2021. Ordinance 13710 includes the rates in effect as of October 1, 2021.

In addition, the total charges derived from the above chart for residential users is multiplied by ninety (90) percent to compensate for water use not going to the sewer such as lawn and garden watering. Any residential location where a separate water meter has been installed for the purpose of lawn and garden watering is entitled to have the multiplier applied to any water consumed through the primary water meter.

Each residence or apartment unit has a maximum monthly sewer service charge for a volume of no more than 12,000 gallons of water used; unless the minimum charge due to water meter size exceeds the 12,000 gallon limit then the monthly sewer service charge will be at least the minimum for that particular size water meter as follows:

Exhibit 2: Monthly Minimum

Meter Size (inches)	FY21	FY22
5/8	24.63	26.11
3/4	87.87	93.14
1	153.54	162.75
1 1/2	343.64	364.26
2	608.45	644.96
3	1,426.26	1,511.84
4	2,635.76	2,793.91
6	6,277.95	6,654.63
8	11,104.56	11,770.84

Source: City Ordinance 13558 and 13710

As depicted in Exhibit 3, ENCO billing of sewer charges account for 74% of the sewer charge revenues. Other revenues not included in this audit were sewer fees collected by Hixson Utility and Eastside Utility District. In addition, we did not review Public Works' processes for billing and collecting sewer fees for regional and industrial customers, sewer service charges, septic haulers, and industrial permits.

Financial Information

Exhibit 3: Sewer Charge Revenues

Revenues	FY20	FY21	FY22*
ENCO Sewer Billing	58,765,539	60,004,710	59,760,554
Hixson Sewer Billing	8,350,274	8,615,620	7,263,936
Eastside Sewer Billing	491,306	600,832	552,425
Penalties for Delinquent Sewer Service Charges	851,201	386,389	618,226
Sewer Service Reconnection Fee	66,701	56,805	119,595
Misc Sewer Revenue	40,359	4,256	26,258
Sewer Surcharges	3,224,985	2,577,844	1,704,576
Sewer Service Charges	11,508,691	11,030,396	10,964,631
Total Revenues	83,299,055	83,276,852	81,010,200

Source: Oracle Financial

*Revenue through November 2, 2022

FINDINGS AND RECOMMENDATIONS

Penalties for delinquent sewer service charges.

The late payment penalty and disconnect administrative fees were not always billed in accordance with City Code. We selected a statistical sample of 52 customer accounts and reviewed 12 months of billing statements to verify penalties and administrative fees were consistently and accurately billed.

Late payment penalties

Overall, late payment penalties were not properly calculated or charged in 6.75% of the delinquent accounts' billing statements. The discrepancies identified resulted in lost revenues to the City.

City Code Article II – Sewer Service Charges, Sec. 31-36 (e) states “sewer service charges that remain unpaid after the due date on the statement shall be subject to a ten (10) percent late fee.” Part (f) states “sewer charges which have not been paid within fifteen (15) days of the date on the sewer bill shall be subject to a ten (10) percent late fee. This late fee only applies to the most recent month’s sewer charges and shall not be applied to any outstanding balances.”

Our review identified the following factors:

- Thirty-eight percent of the discrepancies were the result of a Public Works’ policy to allow a 7 day grace period. The grace period was instituted during COVID due to delays in mail delivery. However, the policy was not approved by City Council.
- Penalties were not charged if the customer setup a payment plan during the billing period; and,
- A late penalty was not charged when payment was received prior to due date but reversed due to insufficient funds.

Late payment should be consistently applied to all customers in accordance with City Code. Grace periods should be reviewed periodically to ensure the practice is in the best interest of the City. Any deviations from City Code should be approved by City Council prior to implementation.

Recommendation 1:

We recommend ENCO collect late penalty fees in accordance with City Code.

***Auditee Response:** We concur with the audit finding and recommendation. ENCO will create a notification insert to inform*

customers of the late fee policies. The policy will become effective 30 days after the mailing.

Estimated Implementation Date: February 28, 2023

Priority Level: 1

Recommendation 2:

We recommend ENCO develop a procedure to ensure the late penalty fees are accurately charged.

Auditee Response: *We concur with the audit finding and recommendation.*

Estimated Implementation Date: February 28, 2023

Priority Level: 1

Recommendation 3:

We recommend Public Works discontinue the practice of allowing a grace period unless amendments are made to the City Code.

Auditee Response: *We concur with the audit finding and recommendation. ENCO will create a notification insert to inform customers of the late fee policies. The policy will become effective 30 days after the mailing.*

Estimated Implementation Date: February 28, 2023

Priority Level: 1

Delinquent Administrative fees

Disconnect fees were not accurately charged to customers in 9.6% of the accounts sampled. The process to charge a disconnect fee is manual and requires verification of accounts submitted for disconnect. The discrepancies noted included three (3) accounts that were not charged the delinquent administrative fee for disconnect and two (2) accounts that were charged the fee multiple times.

City Code Part II, Chapter 31, Article II, Section 27 (i) states “an applicable disconnect fee may be assessed for delinquent accounts.” Although not documented in Public Works policy manual, a \$15.00 delinquent administrative fee is charged to customers that are disconnected and is based on the amount charged to the City by Tennessee American Water.

Recommendation 4:

We recommend ENCO give credit to customer accounts that were overcharged.

***Auditee Response:** We concur with the finding and recommendation. ENCO has corrected the customer accounts that were overcharged.*

***Estimated Implementation Date:** December 29, 2023*

***Priority Level:** 1*

Recommendation 5:

We recommend ENCO develop a procedure to ensure disconnect administrative fees are consistently charged to customers.

***Auditee Response:** We concur with the finding and recommendation. ENCO has reviewed and updated their related policies and procedures.*

***Estimated Implementation Date:** January 27, 2023*

***Priority Level:** 2*

Recommendation 6:

We recommend Public Works include the delinquent administrative fee amount and related policies in its policy and procedure manual.

***Auditee Response:** We concur with the finding and recommendation.*

***Estimated Implementation Date:** May 31, 2023*

***Priority Level:** 2*

**Contractor's
collection efforts
are not compliant
with contract
terms.**

Our review of collection efforts found discrepancies in three areas: the contractor does not send invoices for 120 days after account closing; the contractor does not timely submit delinquent accounts to the collection agency; and, payments made to the collection agency are not accurately posted in the billing system, BillMaster.

To determine if collection of delinquent accounts were performed in accordance with contract terms, we selected a random sample of 52 customer accounts. For accounts identified as delinquent and closed, we verified billing statements were mailed for 120 days. For accounts identified as more than 120 days delinquent, we verified ENCO submitted the account to the collection agency within 140 days. For

payments received by the collection agency, we verified the collected amount was accurately posted in BillMaster.

Billing Statements

Contractor did not send billing statements on closed accounts for 120 days post-closing as required by contract. Based on our review, 80% of the closed accounts were not provided billing statements for 120 days. Billing statements were mailed between 45 and 161 days after the account closed.

Per the City's contract with ENCO, section 11 states the "contractor will attempt to collect on these accounts until they have been closed for one hundred twenty (120) days." Per the contractor, only three additional billing statements are mailed after the account has closed. Discontinuance of billing statements after 90 days decreases the likelihood the City will receive payment for past due bills.

Recommendation 7:

We recommend ENCO process billing statements for 120 days after the account is closed.

***Auditee Response:** We concur with the finding and recommendation. ENCO has updated BillMaster to process billing statements for 120 days after an account is closed.*

***Estimated Implementation Date:** February 28, 2023*

***Priority Level:** 1*

Submission to Collection Agency

Timely submission of delinquent accounts to the collection agency are needed. Our review found 93% of the accounts were submitted to the collection agency in excess of 140 days² past the closed date. Currently, the contractor's informal policy is to submit delinquent accounts if the balance exceeds \$10.00 and the account is closed 180 days with no payment. However, we found seventy percent of accounts (19 of 27) submitted exceeded the 180 day contractor policy. We found the contractor submitted delinquent accounts to the collection agency between 158 and 258 days after the account is closed.

Section VII (11) of the contract states for closed accounts, "City will provide collection agency for continued collections activity after 120

² Auditor considered up to 140 days as timely submitted to the collection agency.

days from account close.” The contract does not define when the contractor should submit the delinquent accounts to the collection agency. In addition, Public Works has not provided guidance in the form of policies and procedures as to what the City considers timely submission.

As previously stated, customers should receive billing statements for 120 days after the account is closed. Once ENCO stops sending statements, the collection agency should immediately receive the accounts for collection. The current practice has customers not receiving bills for three to seven months before the account is turned over for collections.

Recommendation 8:

We recommend Public Works, with the assistance of Finance, develop comprehensive policies and procedures for the sewer fee accounts receivable collection and write off process.

Auditee Response: We concur with the finding and recommendation.

Estimated Implementation Date: May 31, 2023

Priority Level: 2

Recommendation 9:

We recommend ENCO submit delinquent closed accounts to the collection agency in accordance with policy set by the City.

Auditee Response: We concur with the finding and recommendation. ENCO has updated its procedures to ensure delinquent closed accounts are timely submitted to the collection agency.

Estimated Implementation Date: May 31, 2023

Priority Level: 3

Collection agency receipts on account

Payments received by the City’s collection agency are not accurately posted in BillMaster. Per contract section VII System Requirements & Description part 11, “if payments are received on written off accounts, Contractor will restore these accounts to the Contractor’s billing software [BillMaster] to apply the payment and add to accounts receivable.”

We reviewed Nationwide Recovery Service’s (NRS) invoice number 44243 dated 6/13/2022. Of the forty five payments reported, twenty

one were made to the collection agency and twenty four were paid directly to ENCO.

For payments made to NRS, we verified the amount posted in BillMaster. We found ENCO credited the customer account the customer's payment plus the 15% agency's commission fee. The error created a credit balance on the account. In addition, four of the credit balances were transferred to the customer's new account and were used to offset current usage charges.

When payments received by the collection agency are added to Billmaster, the commission fee is included as part of the payment amount. If a customer has not paid in full, the account balance in BillMaster will be underreported by the agency fee amounts. Once the customer pays in full, the account indicates a credit balance in the amount of the commission fee. Ultimately, the City is losing the commission fee twice.

Recommendation 10:

We recommend ENCO accurately post payments received from the collection agency to customer accounts in BillMaster.

***Auditee Response:** We concur with finding and plan to charge the customer the commission fee.*

***Estimated Implementation Date:** February 28, 2023*

***Priority Level:** 1*

Periodic review of accounts receivable needed.

As of June 30, 2022, ENCO reported customer accounts receivable of \$16,770,846. Sewer accounts receivable included \$9.06 million in agency accounts and \$1.988 million in write-off accounts as shown in Exhibit 4 below. Public Works has not reviewed and verified the accuracy of the write-off accounts.

Exhibit 4: Sewer Accounts Receivable, June 30, 2022

Account Status	Accounts	Total Due
Active	35,886	4,494,227
Agency	25,344	9,062,231
Auto-Closed	512	435,355
Closed	4,063	563,515
Closing	66	12,872
Disconnected	319	141,919
New	742	72,088
Write-Off	15,721	1,988,639
Totals	82,653	16,770,847

Source: BillMaster

The Government Finance Officers Association (GFOA)³ recommends “governments establish invoicing and accounts receivable controls, processes, and procedures for services provided in advance of payment, considering the following: billing timeframe, dollar thresholds, use of outside collection services, write-off of bad debt, receivables aging analysis, and decision-making authority.” Effort should be made to ensure that receivables are collected in a timely fashion.

Public Works has not established a review process to verify and write-off uncollectible accounts. Based on discussion with staff, Public Works has no written policies or procedures.

The lack of review resulted in accounts receiving credits in error (see finding # 2). In addition, without periodic review, the accounts receivable and bad debt expense may not be accurately reflected in the City’s financial statements.

Recommendation 11:

We recommend Public Works implement a procedure to periodically review accounts with the “write-off” status. If an account is determined to be uncollectible, we recommend Public Works request council approval to write-off the uncollectible account.

Auditee Response: *We concur with the finding and recommendation.*

Estimated Implementation Date: *May 31, 2023*

Priority Level: *2*

³ The GFOA, founded in 1906, represents public finance officials throughout the United States and Canada. GFOA’s mission is to advance excellence in public finance.

Recommendation 12:

We recommend Public Works include the new procedures in its comprehensive policy and procedure manual. A policy should be established to provide for ‘write-offs’ of accounts receivable, including timeframe, dollar thresholds and decision-making authority.

***Auditee Response:** We concur with the finding and recommendation.*

***Estimated Implementation Date:** May 31, 2023*

***Priority Level:** 2*

APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS

Based on the work performed during the preliminary survey and the assessment of risk, the audit covers Public Works' management of sewer fee collections through the ENCO Tennessee, LLC (ENCO) contract from July 1, 2021 to June 30, 2022. When appropriate, the scope was expanded to meet the audit objectives. Source documentation was obtained from ENCO and the Public Works department. Original records as well as copies were used as evidence and verified through physical examination.

To meet the audit objectives, we reviewed the contract, city codes related to sewer fees, and a sample of customer accounts. To evaluate the efficiency of the process, we interviewed staff to gain an understanding of the process, identified best practices and reviewed policies and procedures.

The sample size and selection were statistically generated using a desired confidence level of 95 percent, expected error rate of 5 percent, and a desired precision of 5 percent. Statistical sampling was used in order to infer the conclusions of test work performed on a sample to the population from which it was drawn and to obtain estimates of sampling error involved. When appropriate, judgmental sampling was used to improve the overall efficiency of the audit.

To achieve the audit's objectives, reliance was placed on data maintained by ENCO's BillMaster system. We assessed the reliability of the data and conducted sufficient tests of the data. Based on these assessments and tests, we concluded the data was sufficiently reliable to be used in meeting the audit's objectives.

We conducted this performance audit from April 2022 to October 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX B: PRIORITY LEVEL DEFINITIONS

Priority 1: Critical control weakness exists that exposes the City to a high degree of risk. Noncompliance with federal, state or local law, regulation, statute, charter or ordinance will always be considered a priority 1.

Priority 2: Control weakness exists that exposes the City to a moderate degree of risk.

Priority 3: The opportunity for improved efficiency or reduced exposure to risk exists.

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