



New Castle County Auditor's Office **Audit of Sewer Fund: Executive Summary** **September 19, 2018**

Background

New Castle County (NCC) uses an Enterprise Fund to account for activities affiliated with the NCC Sewer System. Enterprise Fund accounting is designed to highlight the extent to which fees and charges are sufficient to cover the cost of providing goods and services. The Fiscal Year 2018 operating budget for the County's Sewer Fund was \$78,319,685, which represented 28% of the total (\$284,759,412) operating budget for all County Funds. The majority of the revenue (\$72,210,859) for the budget was from sewer charges and fees.

Over the last several years, the Sewer Fund has not been collecting enough revenue to cover its expenditures. As a result, the County has been using funds from its Sewer Rate Stabilization Reserve to balance the Sewer Fund's annual operating budget. The Office of Finance's projections, as of 12/31/17, showed future depletions of the Sewer Rate Stabilization Reserve if the County continued to operate the Sewer Fund as it had been (e.g., no increase in sewer rates, estimated increases in payroll/benefit costs). Without some sort of action, the Sewer Rate Stabilization Reserve was expected to reach \$0 in Fiscal Year 2020. (County Council did approve a 12% sewer rate increase in the Fiscal Year 2019 budget. However, given expense projections, this merely delays the depletion of the Rate Stabilization Reserve to Fiscal Year 2022.)

We conducted a "performance audit" of certain aspects of the Sewer Fund. Performance audits, as defined by Generally Accepted Governmental Auditing Standards, are audits that provide findings and conclusions based on an evaluation of sufficient, appropriate evidence against criteria. The full audit report contains a General Comment and then four sections as outlined below. One of the primary objectives of the audit was to provide justification for the County instituting a more scientific/business approach to determining the annual sewer rate. Our audit included examining a few studies concerning how governments in other states have handled the setting of sewer rates, and we included our observations in the audit report.

General Comment – Internal Controls

It is very important for Finance and Public Works to have written policies and procedures to document their internal control activities and, thus, to help mitigate risk. For some of the comments in the audit report (particularly the comment on the under-billing), we believe the lack of written policies and procedures adversely affected a function's internal controls and increased the risk of errors.

Section I: Sewer Fund as Enterprise Fund

We concluded that the Office of Finance has, in all material respects, been properly using Enterprise Fund accounting to highlight the extent to which fees and charges are sufficient to cover the cost of providing services in the Sewer Fund. However, the Executive and Legislative branches of County Government have not always been using the results from Enterprise Fund accounting to ensure the Sewer Fund is self-sufficient, i.e., should not be running at a deficit and should not have to borrow from other funds to cover its costs. In other words, for the most part, the decisions on whether to increase sewer rates have been political decisions – not business ones.

In October 2017, the Administration engaged a consultant to perform a comprehensive study of the County's methodology for assessing sewer service charges, and to suggest alternative rate structures for the County to be able to generate adequate revenues to cover its costs (which will serve to protect the County's existing reserves). The consultant issued its report in May, 2018. The Administration has formed a working group to review the report's recommendations in further detail and to ultimately make decisions on ensuring the Sewer Fund is self-sufficient.

Section II: Areas of Particular Concern

We had six Areas of Particular Concern (five covered below) which we believe warrant management's immediate attention:

- **Under-billing Issue:** The County has a contract with a Pennsylvania municipality to provide transmission and treatment services for the municipality's sewage. The audit revealed that the municipality had been under-billed for several years with a loss to the County of approximately \$250,000. The County is now trying to recoup these funds. Finance informed us that these manual bills are now being calculated correctly and that the calculation of the bills is being checked by a second person. Also, Public Works and Finance have created a Billing Quality Team to review the procedures for all bills that are manually calculated.
- **Concerns with Contract Users:** The County has contracts with five entities to provide sewer services. The contracts are very old with three of them dating back to the 1970's. Along with internal control concerns over the calculation of the entities' bills, we expressed concern over whether the County is adequately covering its costs on these contracts and asked management to evaluate whether the rate being charged to the contract users accurately reflects the costs to the County of providing sewer services. Management has agreed to review each contract and update as needed, and to review the processes involved with these contracts with the goal of standardization and the use of more modern techniques and technology.
- **Compliance with Court of Chancery's Opinions:** We expressed concern on whether the County is in compliance with Court opinions governing the use of the County's sewer reserves. A law firm engaged by the County Auditor's Office in 2015 had opined that the County was not in compliance. Thus, we asked the County's Office of Law to opine on whether the County is currently in compliance. The Office of Law has not yet issued its opinion.
- **Classifications for Industrial/Commercial Customers:** County Code mandates that sewer customers are classified by a User Category according to the principal activity conducted on the user's premise. For non-major industrial and commercial users, the SIC system is used to assign a sewer category. Under this system, there are 15 different subclasses (each having a different cost) of industrial/commercial use. The audit report expressed concern over the assignment of subclasses to certain entities and with the fact that a commercial parcel can only be assigned one subclass even though several different activities may be taking place at the location (e.g., a strip mall). Finance is investigating the potential use of external data sources to improve the accuracy of sewer classifications for parcels that change activities or engage in multiple activities.
- **Review of Account Adjustments:** This was a repeat comment from our 2014 audit report on Sewer Billing. We recommended that the Office of Finance establish a policy that requires all monetary adjustments (and certain critical non-monetary adjustments) to be reviewed and approved by someone other than the person posting the adjustment to ensure the adjustment was properly authorized, was done for legitimate reasons, and was properly posted. The Office of Finance has added a person to the Billing area whose primary responsibility will be to review and approve adjustments to Tax and Sewer accounts.

Section III: Follow-Up: 2014 Sewer Billing Audit Report

This section presents the current status of the comments and recommendations from our Sewer Billing audit report issued in 2014.

Section IV: Opportunities for Improvement

This section of the audit report contains three opportunities for improvement in sewer billing practices, primarily those of the County's "specially-billed" customers.