Comptroller's Investigative Report

Newport Utilities

November 30, 2022

Jason E. Mumpower
Comptroller of the Treasury

Division of Investigations

TENNESSEE
COMPTROLLER
OF THE TREASURY

JASON E. MUMPOWER
Comptroller

November 30, 2022

General Manager Michael Williford
and Board of Directors
170 Cope Boulevard
Newport, TN 37821

Newport Utilities Management:

The Office of the Comptroller of the Treasury conducted an investigation of selected records of the Newport Utilities, and the results are presented herein.

Copies of this report are being forwarded to Governor Bill Lee, the State Attorney General, the District Attorney General of the 4th Judicial District, certain state legislators, and various other interested parties. A copy of the report is available for public inspection in our Office and may be viewed at http://www.comptroller.tn.gov/ia/.

Sincerely,

Jason E. Mumpower
Comptroller of the Treasury

JEM/MLC

INVESTIGATIVE REPORT

NEWPORT UTILITIES

The Office of the Comptroller of the Treasury, in conjunction with the Tennessee Valley Authority Office of Inspector General, investigated allegations of malfeasance related to Newport Utilities. The investigation was initiated after Newport Utilities officials identified and reported the use of utilities funds for questionable purchases and work on private property, as well as deficiencies associated with the installation of broadband. The investigation was limited to selected records for the period January 2015, through March 2020. The results of the investigation were communicated with the Office of the District Attorney General of the 4th Judicial District and the United States Attorney's Office for the Eastern District of Tennessee.

BACKGROUND

The Newport Utilities (utilities), a division of the City of Newport, Tennessee in Cocke County, provides electric, water, wastewater, and broadband services to residents of the city and surrounding areas. A five-member board of directors (board), appointed to six-year terms by the Newport City Council, governs the utilities. The utilities general manager oversees day-to-day operations.

During the period 2016 through 2020, the utilities approved and installed a broadband system in its service area. The Office of the Comptroller of the Treasury's Division of Local Government Finance (LGF), in accordance with Section 7-52-602, *Tennessee Code Annotated*, reviewed a detailed business plan for the utilities to provide internet services. In May 2017, LGF found that, due to certain assumptions and methodologies in the plan, including failing to consider the impact of market competition, they could not determine if the plan was feasible.

The utilities purchased electricity for resale through a power contract with the Tennessee Valley Authority (TVA), a federal public utility. The power contract with TVA prohibited the use of electric utilities revenue for non-electric purposes. On November 26, 2019, the utilities general manager was put on administrative leave, and he resigned on January 22, 2020.

Much of this report addresses questionable decisions and transactions related to the planning, approval, and installation of the broadband system by the utilities. This report also more broadly addresses the operations of the entire utilities department. ***All references in this report to "manager" refer to the former utilities general manager who served during most of the period investigated and resigned on January 22, 2020. All references to "utilities management" refer to both the utilities board of directors, who provide oversight and set policy, and the utilities general manager, to whom the board delegates authority to implement their policies.***

RESULTS OF INVESTIGATION

1. UTILITIES MANAGEMENT BREACHED THEIR POWER CONTRACT AND EXCEEDED THEIR AUTHORIZED INTERDIVISION LOAN AGREEMENT BY AT LEAST $4,692,654

Utilities management breached their power contract with the TVA and violated their interdivision loan agreement, exceeding the authorized interdivisional loan amount by at least $4,692,654.

As part of the original business plan, utilities management planned to fund some initial broadband construction and maintenance costs with an interdivisional loan from the electric division. Utilities management and the TVA executed an "Interdivisional Loan Agreement" on September 21, 2017, which amended the power contract allowing the utilities' electric division to loan the broadband division up to $3.3 million for capital expenditures associated with the construction and maintenance of a fiber optic network and provide working capital. The loan stated, "Electric division will not furnish any other credit, guarantee, or other financial accommodations, including joint debt issuance, to or on behalf of the broadband division."

The TVA issued a letter dated April 10, 2020, to the utilities and the City of Newport's mayor asserting that the utilities had exceeded the $3.3 million approved loan amount, which was a breach of the power contract and interdivisional loan agreement. Based on their review of the annual financial report for the period ending June 30, 2019, the TVA identified a $9.5 million receivable from the broadband division to the electric division. The letter also revealed that the utilities had reported to them a $12.5 million outstanding loan from the electric division as of January 2020.

After this notification, utilities management paid an accounting firm $65,000 to determine the amount of electric funds that had been used for broadband and to suggest the necessary accounting corrections to properly set up the receivables and payables. The accounting firm determined that as of September 30, 2020, the broadband division had a net interdivisional loan balance of $7,992,654, exceeding the authorized interdivisional loan agreement amount by at least $4,692,654.

The manager advised investigators he was aware of the prohibition of overspending in the TVA interdivisional loan agreement and was aware the broadband accounts had not been established to properly account for the spending.

2. UTILITIES MANAGEMENT FAILED TO CREATE A SEPARATE ACCOUNTING UNIT FOR THE BROADBAND SYSTEM

Utilities management failed to establish a separate accounting unit for the broadband division to track revenues and expenses efficiently and accurately. During the period 2016 through 2020, the utilities was advised by consultants, regulators, and its external auditing firm that a separate accounting unit for the broadband division must be established so expenses could be properly identified. In addition, Section 7-52-603, *Tennessee Code Annotated*, requires that a municipal electric system maintain a separate accounting and record keeping system for internet services.

On April 10, 2020, the utilities received a letter from the TVA asserting significant regulatory concerns including the lack of a separate accounting unit for broadband. The manager advised investigators he was aware a separate broadband division had not been set up under his watch. Board members stated they were unaware a separate accounting unit had not been established until the external auditors advised them on August 27, 2019.

3. THE BOARD'S EMPLOYMENT DECISIONS RESULTED IN AVOIDABLE SETTLEMENT PAYMENTS TOTALING $900,000

The manager initially resigned in 2014, and the board replaced him with a newly hired manager. The manager subsequently filed a lawsuit against the utilities. Although the board's legal counsel advised them in January 2015 to contest the lawsuit, the board ultimately terminated the employment of the newly hired manager and re-hired the manager. The manager came to an agreement with the board to no longer pursue his lawsuit in September 2015 and was awarded $60,000 in back pay and $65,000 for non-wage compensatory damages. The newly hired manager, whose employment was terminated when the manager was re-hired, subsequently filed a lawsuit against the board and in June 2017 was awarded $775,000, paid in a lump sum of $450,000 with the remainder paid in monthly installments of $12,500.

Summary – Settlement Payments

Settlement Payments	Payment Amounts
Settlement with manager who resigned in 2014 and was rehired in September 2015	$ 125,000.00
Settlement with newly hired manager whose employment was terminated in September 2015	$ 775,000.00
Total	**$ 900,000.00**

4. THE MANAGER APPROVED UNALLOWABLE WORK OF AT LEAST $160,739.36 ON AN APPALACHIAN REGIONAL COMMISSION GRANT

In November 2018, the utilities began construction and installation of a broadband project for the Hartford and Grassy Fork communities in Cocke County, funded by a $467,827 Appalachian Regional Commission (ARC) grant. The purpose of this project was to establish a network route spanning 10.73 miles through mountainous terrain near the interconnection point of Cosby, Tennessee, through the Harford Community and to Grassy Fork School. The utilities made four separate requests and received four separate payments for this work; however, investigators found the utilities requested and received grant fund payments in September and October 2019, totaling $160,739.36, for construction costs outside the 10.73-mile grant-approved route. Representatives from the ARC stated a request for deviation from the original installation region detailed in the grant was neither submitted to them for approval nor granted. In addition, ARC personnel were never alerted that a significant amount of construction was being conducted outside of the narrowly identified and authorized route.

5. UTILITIES PAID INFLATED RENTAL FEES AND AVOIDABLE ADMINISTRATIVE FEES TOTALING AT LEAST $102,175

The utilities paid inflated rental fees and avoidable administrative fees totaling at least $102,175 to the company installing fiber. In April 2018, the utilities began paying $1,500 a month to rent a portion of a commercial building to be used as a warehouse for installation supplies by the company installing fiber **(Refer to Exhibit 1)**. In July 2018, the installation company began directly paying the building owner $1,500 per month in rental payments, yet inexplicably began billing the utilities $500 per week, or $2,000 per month for rent. The installation company also began billing the utilities $1,500 weekly for a warehouse administrative fee. Not until November 2019 did the utilities begin storing and managing installation supplies at their own operations center saving approximately $8,000 per month in rental and administrative fees. Between the months of July 2018 and October 2019, the utilities paid an additional $10,000 more in rent to the installation company than if it had paid the landlord directly. Furthermore, the utilities paid the installation company $92,175 for warehouse administrative fees for tasks that could have been, and eventually were, performed by utilities employees.

Summary – Inflated Rental Fees and Avoidable Administrative Fees

Avoidable Fees	Payment Amounts
Warehouse provisioning and administrative costs	$ 92,175.00
Excess rent payments	$ 10,000.00
Total	**$ 102,175.00**

Exhibit 1

Utilities paid the installation company $500 rent per week for a portion of this building as well as a $1,500 warehouse administrative fee per week

6. THE BOARD APPROVED AND PAID QUESTIONABLE LEAVE TO THE MANAGER TOTALING $93,678.95

The board approved and paid the manager for questionable vacation and sick leave balances totaling $93,678.95. The manager failed to accurately record leave on his time records, and he entered and approved his own time in the payroll system. Time records indicated the manager did not request or record any vacation or sick leave from July 2018 through December 2019. After reviewing the manager's emails, other records, and interviewing utilities staff, investigators determined the manager, on some occasions, was away from the office on family vacations and medical appointments during this period. The manager told investigators he always worked more than 40 hours per week; therefore, he did not use any vacation or sick leave hours.

The utilities policy and manager's contract allowed for payment of any unused leave both periodically and as end of employment pay. On November 23, 2018, the manager requested and was paid for 400 hours of vacation leave totaling $28,844. When the manager resigned from his position with the board in January 2020, he requested and was paid for 379.72 hours of vacation leave totaling $31,433.22 and 403.5 hours of sick leave totaling $33,401.73.

Since the manager failed to accurately record and reflect his leave status on his time records, investigators could not determine the legitimacy of the vacation and sick leave payments the manager requested and received.

Questionable Payments for Leave

Date Paid	Leave Balance Type	Hours	Amount
11/23/2018	Vacation	400.00	$ 28,844.00
1/31/2020	Vacation	379.72	$ 31,433.22
1/31/2020	Sick	403.50	$ 33,401.73
Total		**1183.22**	**$ 93,678.95**

7. THE MANAGER MADE QUESTIONABLE PURCHASES TOTALING AT LEAST $9,914.18

For the period April 2018 through November 2019, the manager improperly used the utilities' credit card to make questionable purchases totaling at least $9,914.18 as noted below:

1) The manager improperly used the utilities' credit card to make personal purchases totaling at least $2,828.29, including charges for airfare, dry cleaning, and items from various retail stores. Although he reimbursed the utilities for these personal charges, these charges were prohibited by the credit card user agreement he signed, which stated, in part, "I understand that I may not use the Corporate Card for personal purchases."

2) The manager made purchases totaling $2,571.74 using the utilities' credit card for meals, coffee, candy, snacks, subscription services, and dry cleaning, which were inadequately documented to determine the utilities benefit. Some purchases were made on weekends and/or days the manager's time records reflected he was not working **(Refer to Exhibit 2)**. At other times, the purchase documentation was inconsistent with other utilities records, including purchases noted as work lunches with employees off work or with individuals no longer employed by the utilities. Due to issues concerning the integrity of the manager's documentation, investigators could not conclusively determine whether these credit card purchases were exclusively for the benefit of the utilities.

Exhibit 2

te: 07/01/18 Time: 12:59 pm
der #: 5082
erver: [redacted]
uest: 5
able #: 11
ame:
INING

1	WATER	$0.00
2	SWEET TEA	[illegible]
1	CHEESE STIC..	$6.99
1	BBQ PORK SANDWICH	$7.99
1	BBQ PORK PLATE	$9.99
1	WOODSHED BURGER	$13.99
1	MOUNTAIN DEW	$1.99
1	PORK SLIDERS	$8.99
1	POTATO SALAD	$2.99
1	CHICKEN CHUNKS	$9.99

Sub-total: $66.90
Tax: $6.52
al: $73.42
This Amount: [illegible]

Meal charged to the utilities credit card on a Sunday

Server: [redacted] 03/23/2019
210/1 2:50 PM
Guests: 1
#10032

Reprint #: 1
Order Type: RDER

Water (3 @0.00)	0.00
Artichoke Spinach Dip	9.99
Chicken Quesadilla	8.99
Strawberry Short Cake	6.49
Deluxe Burger	8.49
No Cheese	

[illegible] 33.[illegible]
3.[illegible]
37.[illegible]
XXXXXXXX XXXX8158 37.9
:023691
ance Due 0.00

Meal charged to the utilities credit card on a Saturday

3) The manager failed to retain detailed documentation for purchases totaling at least $4,514.15. This includes numerous meals purchased within the City of Newport with no indication of a benefit to the utilities. Investigators could not determine if these expenses were exclusively for the benefit of the utilities.

Questionable Credit Card Charges by the Manager

Type	Amount
Personal expenses reimbursed	$ 2,828.29
Charges with questionable documentation	$ 2,571.74
Expenses without detailed documentation	$ 4,514.15
Total	**$ 9,914.18**

8. THE MANAGER AUTHORIZED PAYMENTS TOTALING $3,635 FOR LANDSCAPING AND PAINTING OF A PRIVATELY OWNED BUILDING WITHOUT BOARD APPROVAL

In March 2018, the manager authorized payments totaling $3,635 for landscaping and painting the building adjacent to the utilities' main office building without board approval **(Refer to Exhibit 3)**. The building was not owned by the utilities. The back wall of the building that faced the utilities' parking area was washed and painted costing the utilities $1,500. Landscaping, including river rock, edging, and plants cost the utilities $2,135. The manager stated he authorized this work because the building and property facing the utilities property was an "eye sore". Board members stated they did not approve and were not aware of utilities funds being used to improve this private property.

Exhibit 3

Landscaping and painting of privately owned business adjacent to the utilities' parking lot authorized by manager and paid with utilities funds

9. UTILITIES MANAGEMENT DID NOT DOCUMENT THAT COMPETITIVE BIDS WERE SOLICITED FOR CERTAIN BROADBAND RELATED CONSTRUCTION, SUPPLIES, AND OTHER SERVICES

Utilities management failed to document that they complied with utilities requirements and sought out the best supplies and services at the best price by soliciting competitive bids for the broadband project.

1) Utilities management did not maintain documentation that competitive bids were solicitated for broadband construction and supplies. The utilities hired an advisory company in 2016 to plan and organize the broadband project. The advisory

company hired two companies to install broadband in Cocke County: one that installed the major infrastructure, or the "backbone" of the fiber network, and another that installed fiber from the major infrastructure to the individual homes and businesses, the so called "last mile." According to the contract the utilities had with the advisory company, bids were to be solicited by the advisory company, and all documentation would be provided to the utilities. Utilities management had no documentation on file that competitive bids were properly solicited for the construction companies.

2) The "last mile" company ordered fiber and installation supplies from a vendor of their choosing; however, this vendor billed the utilities directly. During the broadband installation, the utilities paid this vendor at least $519,545.80. Utilities management could not demonstrate they had either a contract with this vendor or that supplies had been competitively bid. Internal communications and interviews with employees indicated the utilities' purchasing department was not included in the decision of purchasing from this vendor. A subsequent analysis performed by the utilities concluded this vendor charged more than double the price of its competitors in some instances.

3) The manager contracted with an individual to provide tracking of the broadband critical path installation progress without soliciting bids. During the broadband installation, the utilities paid this individual $126,427.61. The manager told investigators the board had given him authority to procure any service contract without competitive bids. Section 12-4-107, *Tennessee Code Annotated*, which exempts local governments from contracting professional services using competitive bidding, applies to specific services provided by professional persons or groups of high ethical standards. Tracking broadband installation progress does not meet that exemption.

INTERNAL CONTROL AND COMPLIANCE DEFICIENCIES

Our investigation revealed internal control and compliance deficiencies, some of which contributed to the previously mentioned investigative findings without prompt detection. These deficiencies included:

<u>Deficiency 1</u>: The board did not sufficiently oversee broadband projects, manager decisions, and expenses

The board failed in its fiduciary responsibility to ensure the best use of public funds for broadband projects and failed to provide adequate oversight of manager decisions and expenses. Due to these failures, investigators noted numerous instances of noncompliance with state law, grant agreements, and contract provisions, as well as substantial wasteful purchases. Governing boards of entities responsible for expending public funds must sufficiently oversee management and hold them accountable for their decisions. Governing boards must sufficiently educate themselves about pertinent public fund requirements to ensure compliance and reduce risks of fraud, waste, and abuse.

Deficiency 2: The manager did not present the annual financial audit to the board in a timely manner

The manager did not present the 2018 Annual Financial Audit to the board in a timely manner. The 2018 audit, which was completed and delivered to the manager in December 2018, disclosed deficiencies that were material weaknesses. The manager was made aware and signed a management representation letter in December 2018. Board members stated they were unaware of the problems until August 27, 2019, when a representative from the accounting firm came to a meeting to present the audit. Additionally, an executive session was held, and the representative from the accounting firm presented examples of possible misuse of credit cards, work on private property, leave policy violations, and lack of separate accounting systems for broadband and electrical divisions.

Newport Utilities officials indicated that they have corrected or intend to correct these deficiencies.