

PERFORMANCE AUDIT  
OF

**Rattlesnake Ridge Water  
District**

**Rattlesnake Ridge Water  
System Improvement –  
Phase VIII B**

**Grant: KY-16285**

**OIG Report Number: 14-33**

GRANT PERIOD: AUGUST 2009 – NOVEMBER 2013

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Mr. Hubert N. Sparks  
Inspector General

Transmitted herewith is a report of Watkins Meegan LLC, a Performance Audit of the Rattlesnake Ridge Water System Improvement – Phase VIII B Grant KY-16285. The report is in response to Contract No. BPA 11-01-B.

*Watkins Meegan LLC*

Tysons, Virginia  
July 17, 2014

Rattlesnake Ridge Water District

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**Background**

The Appalachian Regional Commission (ARC) is a regional economic development agency that represents a partnership of federal, state and local governments. Established by an act of Congress in 1965, ARC is composed of the governors of the 13 Appalachian states and a federal co-chair who is appointed by the President. Local participation is provided through multi-county local development districts (LDDs). Each year, ARC provides funding for several hundred projects in the Appalachian Region, in areas such as business development, education and job training, telecommunications, infrastructure, community development, housing and transportation. These projects help create new jobs; improve local water and sewer systems; increase school readiness; expand access to health care; assist local communities with strategic planning; and provide technical and managerial assistance to emerging businesses.

Rattlesnake Ridge Water District (RRWD or Grantee) is located in Carter County, Kentucky. Carter County is classified as a distressed county. RRWD is the largest drinking water provider in Carter County and currently purifies lake water for nearly 4,100 households in Carter, Elliott, Lawrence and Morgan counties. Organized in 1985, RRWD has more than 700 miles of water lines, 10 pump stations and 11 storage tanks. The Grantee requested grant funding from ARC to support expansion of its water treatment plant and other major improvements needed for enhancing service to customers in Carter, Elliott, Lawrence and Morgan counties. The project was to expand the existing water treatment plant's capacity from 1.6 to 3.1 Million Gallons per Day (MGD). Other elements of the project were to construct one 300,000-gallon water storage tank, one 150,000-gallon tank and one new pump station and to upgrade an existing pump station.

On August 31, 2009, ARC approved the Rattlesnake Ridge Water System Improvement – Phase VIII B Grant, number KY-16285 (Grant), in the amount of \$400,000 to Rattlesnake Ridge Water District. Matching funds from other sources were to total \$3,950,000, for a total funding amount of \$4,350,000. The sources of funding and amounts noted in the ARC Grant approval memo are shown in Table 1 below:

Table 1: Analysis of Budgeted Project Funding Sources

<b>Funding Source</b>	<b>Amount</b>	<b>Percentage</b>
Appalachian Regional Commission (ARC)	\$ 400,000	9%
Other Federal (RD Grant)	\$ 736,000	17%
State (CDBG Grant – \$1M; Coal Fund – \$1M)	\$ 2,000,000	46%
Local (RD Loan – \$1.2M; Grantee – \$14K)	\$ 1,214,000	28%
<b>Total</b>	<b>\$ 4,350,000</b>	<b>100%</b>

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**Background (Continued)**

The U.S. Department of Agriculture (USDA) Rural Development division (RD) administered the Grant on behalf of ARC in accordance with the terms of a memorandum of agreement between ARC and USDA. RD financial programs support public facilities and services such as water and sewer systems, housing, health clinics, emergency service facilities, and electric and telephone service. RD promotes economic development by supporting loans and providing technical assistance to businesses and community organizations. In construction projects such as the one supported by this Grant, RD provides contract oversight and technical advice as needed to assure compliance with applicable standards of work. RD provided support to the Grantee during the application and assessment phases, reviewed and approved expenditures, and reimbursed the Grantee with Grant funds obtained from ARC.

In addition, the Grantee engaged Community & Economic Development Associates, Inc. (CEDA) to manage the project on its behalf. CEDA is a consulting firm with over three decades of experience in providing administrative and technical assistance to help manage projects efficiently. RD and CEDA worked with the Grantee to ensure all project activities were undertaken in accordance with local, state and federal regulations.

**Executive Summary**

Grant funds were used to support construction for expansion of the water treatment plant and other major improvements needed for enhancing water service to customers in Carter, Elliott, Lawrence and Morgan counties. The project was completed with reported cost of \$6,213,939, approximately 43 percent higher than the original budgeted cost; however, the ARC award amount was not impacted by the budget overrun and the \$400,000 awarded was expended in full.

Through review of reported expenditures, we noted that all expenditures tested appeared to be valid, adequately supported and in direct relation to supporting the Grant and its objectives. In addition, through inquiry and observation, we determined that the water treatment plant expansion had been completed. However, findings were noted relating to the Grantee not maintaining adequate accounting records and the failure to obtain advanced ARC approval for changes in the project scope.

**Objective**

Watkins Meegan LLC was engaged to conduct a performance audit of the Rattlesnake Ridge Water System Improvement – Phase VIII B Grant for the period August 31, 2009 to November 30, 2013. The purpose of our performance audit was to determine the following:

- Funds expended and claimed for reimbursement from ARC and matching funds reported to ARC were valid program expenses and in accordance with the ARC Grant requirements;
- Internal controls were in place to ensure compliance with the Grant requirements; and
- Goals and objectives of the Grant had been, or would be, achieved.

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**Scope**

We completed a performance audit of the Rattlesnake Ridge Water System Improvement – Phase VIII B Grant KY-16285, including fieldwork at the Rattlesnake Ridge Water District office from May 4-7, 2014, as described under this section and under the audit methodology section. Our audit was based on the terms of the Grant agreement and on the application of procedures in the modified ARC Audit Program.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). 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 observations and conclusions based on our audit objectives.

**Audit Methodology**

Our procedures were based on the Audit Program guidelines provided by the ARC Office of the Inspector General and included suggested procedures over the Grantee's accounting and internal control systems affecting the Grant. We met with the RRWD General Manager and Superintendent, conducted interviews with parties from RD and CEDA, and reviewed documentation provided by each of these entities to determine the overall structure and processes around Grant administration and monitoring and other financial and operational elements related to the conduct of the project.

Our review of background material included the Grantee's application, other Grant-related documentation from ARC's Grant management system, and the Grantee's audited financial statements for the years ended December 31, 2011 and 2012. It should be noted the audited financial statements for year ended December 31, 2013 had not been finalized and issued at the time of this audit.

We reviewed controls in place for recording, accumulating and reporting costs under the Grant, reviewed documentation supporting competitive bidding procedures related to the project, and observed and made inquiries regarding whether the goals and objectives of the project had been met, including physically inspecting the construction and site improvement work supported by the Grant.

**Results**

Compliance with Grant Provisions

Grant funds were used to assist in the payment of construction costs of a single new 500,000-gallon water storage tank, the refurbishment of an existing pump station and the expansion of the existing water treatment plant's capacity from 1.6 MGD to 3.1 MGD.

The project was closed by ARC on November 20, 2013. On behalf of ARC, RD reimbursed \$400,000 in ARC funds to the Grantee during the period of the Grant. Matching contributions of \$5,813,939 were reported by RD, for a total reported cost of \$6,213,939, approximately 43 percent higher than the original budgeted cost of \$4,350,000. In response to our inquiries, Grantee and RD points of contact represented that the root cause for the variance was that the bids received for the construction work associated with the Grant was significantly higher than originally estimated, driving up the overall cost. The ARC award was not directly impacted by the increase in cost and additional federal, state and local funds were obtained by the Grantee to cover the additional costs.

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**Results (Continued)**

Compliance with Grant Provisions (Continued)

We requested and examined supporting documentation for all of the expenses incurred against the Grant, as well as a sample of the matching expenses, and noted that all tested appeared to be valid, adequately supported and in direct relation to supporting the Grant and its objectives. A substantial portion of the documentation and information obtained for our review was not readily accessible from the Grantee due to record-keeping issues stemming back to the Grant period and information had to be provided by the RD point of contact. A finding was noted below related to the Grantee not maintaining adequate accounting records for the Grant.

Through inquiry and review, we validated the competitive bidding processes utilized by the Grantee in selecting contractors for the project and also confirmed that appropriate procedures were established to monitor contractor compliance with Davis-Bacon Act fair wage requirements.

Through inquiry, review and observation, we sought to validate the outputs and outcomes expected from the Grant award as detailed in the Grant Approval Memo. The anticipated outputs were:

- i) The expansion of the water treatment plant;
- ii) Construction of one 300,000-gallon and one 150,000-gallon water storage tank; and
- iii) Construction of one new pump station and upgrade of one existing pump station.

During fieldwork for the audit, we physically observed the expanded water treatment plant and a newly constructed 500,000-gallon water storage tank and the upgrades of one existing pump station. While the overall scope of the project remained unchanged, the project design was not consistent with the original project design approved by ARC. A finding was noted below because this change in project design was not reported to ARC for advanced approval.

The anticipated outcome measures included in the Approval Memo were to:

- i) Improve service for approximately 4,218 households and 124 commercial customers;
- ii) Provide capacity needed to serve future customers; and
- iii) Improve ability to backup supply for neighboring systems.

We requested and obtained evidence from the Grantee regarding the number of customers currently being serviced by the expanded water treatment plant. Through discussion, plant engineers confirmed that the plant capacity was increased from 1.6 MGD to 3.1 MGD, that the RRWD water treatment plant has the ability to act as a backup supply for neighboring systems through the aforementioned expansion, and that the plant was positioned for future expansion, if necessary, with additional space and unused plant footings available.

At the conclusion of the audit, we noted and discussed the following items with Management, who generally agreed with the findings and recommendations as described below:

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**Finding: Grantee Record-Keeping**

The Grantee agreement with RD included a requirement for the Grantee to “provide Financial Management Systems which will include:

- 1) Accurate, current, and complete disclosure of the financial results of each grant. Financial reporting will be on an accrual basis.
- 2) Records which identify adequately the source and application of funds for grant-supported activities. Those records shall contain information pertaining to grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays, and income.
- 3) Effective control over and accountability for all funds, property and other assets. Grantees shall adequately safeguard all such assets and shall assure that they are used solely for authorized purposes.
- 4) Accounting records supported by source documentation.”

Also, during the Grant application process, the Grantee signed an “Assurances for Construction Projects” form, which states that the Grantee will establish a proper accounting system in accordance with generally accepted accounting standards or agency directives. During the audit, we requested support for all Grant-reimbursement payments and receipts received and made by the Grantee. The Grantee was unable to furnish any type of general ledger or financial report and we had to rely on project cost schedules maintained by RD to support our review.

**Recommendation:**

In order to ensure completeness and accuracy of the financial records, the Grantee should ensure that all Grant-related expenses and deposits are accounted for and recorded in a financial system. In addition, regular account reconciliation procedures should be established to ensure that the Grant-related transactions have been recorded in a complete and accurate manner.

**Finding: Changes in Project Scope**

As part of the ARC Grant application process, the Grantee signed a Memorandum of Understanding that states, in part:

“It is understood that a change in scope may not be implemented without prior written approval from the ARC and the Basic Federal Agency, if any. A change in scope is any major change to the project design, the type of project to be completed, capacity of the system, size of project, the number and/or type of customers served or equipment items purchased.”

After the Grant award and prior to construction commencing, the project engineer determined that the project objectives could be achieved with the construction of a larger single water storage tank rather than the two originally proposed and eliminated the need for construction of a new pump station as included in the original design. The revised design was expected to result in more efficient future operating costs for the expanded plant.

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**Finding: Changes in Project Scope (Continued)**

Prior written approval was not obtained from ARC for the changes in project design noted above. Through discussion with Grantee and RD points of contact, we noted that the Basic Agency (RD) was fully cognizant of the change in project design, but believed that the changes proposed represented a change in the project approach rather than scope. As a result, neither the Grantee nor RD determined a need to communicate the changes to, and obtain approval from, ARC.

**Recommendation:**

The Grantee and RD should ensure that, in the future, all necessary approvals are obtained for changes in scope, as defined by ARC, of future projects.

In addition, if deemed necessary after review and analysis of the current issue, ARC should provide clarification of its instructions as referenced above.



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