



REVIEW OF BRISTOL VIRGINIA UTILITIES AUTHORITY

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Auditor of Public Accounts
Martha S. Mavredes, CPA

www.apa.virginia.gov

(804) 225-3350



EXECUTIVE SUMMARY

The Auditor of Public Accounts performed an audit of the Bristol Virginia Utilities Authority (BVU Authority) as directed by Chapters 74 and 75 of the 2016 Acts of Assembly, which stated, “the Auditor of Public Accounts or his legally authorized representative shall examine the accounts and books of the BVU Authority.” This legislation made multiple changes to the Code of Virginia that established the BVU Authority due to an ongoing criminal investigation that began in 2013. This investigation has resulted in the conviction and sentencing of nine individuals on multiple felony charges, including, but not limited to, falsified invoices, kickbacks, bribes, tax evasion, false income tax filings, wire fraud, mail fraud, and perjury.

Fraud occurs when there is opportunity, pressure, rationalization, competence, and arrogance. All of these elements existed at the BVU Authority over the years making the environment ideal for fraud to occur. The element of fraud that entities have the most control over is opportunity. The BVU Authority Board and management created the opportunity for fraud to occur by not developing, implementing, and enforcing good internal controls. In addition, since management was involved in the fraud there was collusion and management override of any existing controls. The BVU Authority needs policies and procedures in the following key areas:

- Board approval of large financial transactions
- Budget development process that ensures compliance with all laws, regulations, and debt requirements
- Purchasing and procurement compliance, processes, and limits
- Travel expense limits for employees, board members, and contractors
- Management of economic development grants/awards
- OptiNet sales activities, including entering into sales contracts, granting discounts to customers, and obtaining the proper approvals for all such activity

The BVU Authority’s OptiNet Division has a potential going concern issue, as it appears that they do not have the resources to continue operating without cross-subsidization, which the Code of Virginia prohibits. The BVU Authority has cross-subsidized services within OptiNet over the years by not properly allocating interest and principle debt payments across OptiNet services, by improperly writing off \$13.7 million of interfund debt between OptiNet and the Electric Division, and by not paying OptiNet’s share of pole attachment fees. Even without correcting these improper cross-subsidization issues, telephone revenues have been cross-subsidizing internet since 2012 and cable since at least 2011. If the BVU Authority does not sell the OptiNet Division under the current proposal, they will need to either put the division up for sale to another entity or find options to make OptiNet profitable so they can continue to operate it. If the BVU Authority continues to operate OptiNet, they should work with the General Assembly to propose legislation to authorize cross-subsidization across its services and divisions.

- TABLE OF CONTENTS -

	<u>Pages</u>
EXECUTIVE SUMMARY	
BACKGROUND	1-23
Introduction	1-8
Why This Fraud, Waste, and Abuse Happened	8-15
Issues with the Transition Agreement	15-18
Organizational Governance	18-22
Audits of the BVU Authority	22-23
UTILITY OPERATIONS	24-39
Funding the Development of the Fiber Optic Network	24-30
Cross-Subsidization	30-34
Bonds	35-39
FISCAL OPERATIONS	40-64
Procurement	40-50
Billing	50-57
Fixed Asset Policy Issues	57-64
MISUSE OF RESOURCES AND AUTHORITY	65-90
Conflict of Interest	65-66
Economic Development	66-70
Donations	70-73
Employee Benefit Programs	73-90
TRANSMITTAL LETTER	91-92
APPENDIX A – CONVICTION SUMMARY	93-106
APPENDIX B – RECOMMENDATION SUMMARY	107-119
MANAGEMENT’S RESPONSE	120
RESPONSIBLE OFFICIALS	121

BACKGROUND

Introduction

The Auditor of Public Accounts performed an audit of the Bristol Virginia Utilities Authority (BVU Authority) as directed by Chapters 74 and 75 of the 2016 Acts of Assembly, which stated, “the Auditor of Public Accounts or his legally authorized representative shall examine the accounts and books of the BVU Authority.” This legislation made multiple changes to the Code of Virginia that established the BVU Authority due to an ongoing criminal investigation that began in 2013. This investigation has resulted in the conviction and sentencing of nine individuals on multiple felony charges, including, but not limited to, falsified invoices, kickbacks, bribes, tax evasion, false income tax filings, wire fraud, mail fraud, and perjury.

Objectives

The objectives of this audit are:

- To examine the financial operations and governance of the BVU Authority.
- To identify and disclose past and/or present deficiencies within the financial and operational practices of the BVU Authority.
- To identify and evaluate corrective actions taken to date and planned for the future.

Scope and Methodology

This audit focused on the financial operations and activity of the BVU Authority that were at increased risk of fraud or error primarily due to recent criminal acts. The audit period was from July 1, 2010, through June 30, 2015; however, the audit also included limited activity before and after this period that was of particular interest or concern. We conducted interviews with various BVU Authority employees and board members, City of Bristol employees, and other related parties. We reviewed legislation, laws, regulations, contracts, policies, processes, procedures, financial transactions, and previous financial statement audits. We reviewed minutes of the BVU Authority Board. We reviewed the bond indentures and other relevant documents related to the BVU Authority’s long-term debt.

Evolution of the BVU Authority

The BVU Authority provides electricity, water, wastewater, and fiber optic telecommunication and information services to the City of Bristol, Washington County, Abingdon, and Scott County. The BVU Authority began as a division of the City of Bristol (City), Virginia. In 1945, the City purchased the electric distribution facilities of the former East Tennessee Light and Power

Company from the Tennessee Valley Authority. The City created the Bristol Virginia Power Board to manage the electric system. In 1951, the Power Board was succeeded by the Utilities Board, created to manage the electric, water, and wastewater systems of the City. The City constructed a water treatment plant in 1954, which serves the City. The City jointly owned the wastewater treatment plant with Bristol, Tennessee. In 2001, the BVU Authority launched the OptiNet Division, which provides telecommunication services, including digital cable, telephone, and high-speed internet to approximately 12,500 customers in Southwest Virginia. On July 1, 2010, the BVU Authority Board succeeded the Utilities Board when the Utilities Board separated from the City to become a separate political subdivision of the Commonwealth of Virginia.

-
- *1945 – Power Board – City of Bristol*
 - *1951 – Utilities Board – City of Bristol*
 - *2010 – BVU Authority Board*
-

The transition from a part of the City to a separate authority came as the result of changes to the Code of Virginia initiated at the request of the City resulting in the BVU Authority Act, Code of Virginia Sections 15.2-7200 et seq. This transition was an entity conversion. In essence, the BVU Authority was the same entity as before when it was a part of the City, except that it was legally separated from the City, eliminating the direct control the City had over the Utilities Board and removing the BVU Authority’s assets, liabilities, and financial activity from the City’s financial statements. All of the powers, assets, and debts of the Utilities Board became those of the BVU Authority.

When the Utilities Board separated from the City and became an authority, they signed a transition agreement with the City stating that the two parties agreed the separation was in the best interest of all parties. The transition agreement established expectations for the relationship between the two entities that would continue into the future. These expectations included the BVU Authority using electric funds for economic development, making payments in lieu of taxes, consulting with the City on selling any parts of the BVU Authority, and changing the Authority’s structure. We discuss these items in detail in the section entitled “Issues with the Transition Agreement.”

In 2016, the General Assembly amended the BVU Authority Act in response to the ongoing criminal investigation to change the structure of the BVU Authority Board and clarify its powers. One of the biggest changes in 2016 was the change in structure of the BVU Authority Board. The number of members was reduced from nine to seven and the City of Bristol’s control of the board was eliminated by reducing the number of individuals they appoint from five to one. Going forward, no individual entity has control of the board. In addition, if the BVU Authority ever sells OptiNet, the BVU Authority Board will be reduced to five members by eliminating the member of the Abingdon Town Council, appointed by the Abingdon Town Council, and the member who is a Scott County citizen and not a member of the Scott County Board of Supervisors, appointed by the Speaker of the House of Delegates, since those areas only have OptiNet services.

BVU Authority Board Structure
July 1, 2010, through June 30, 2016

Table 1

Resident of	Member of	Appointed by	Term Length	Term Limit
City of Bristol	NOT on Bristol City Council	Bristol City Council	4 years	Two consecutive terms. Eligible for reappointment after one full year off.
City of Bristol	NOT on Bristol City Council	Bristol City Council	4 years	Two consecutive terms. Eligible for reappointment after one full year off.
City of Bristol	NOT on Bristol City Council	Bristol City Council	4 years	Two consecutive terms. Eligible for reappointment after one full year off.
City of Bristol	Bristol City Council	Bristol City Council	4 years	Unlimited as long as a Council member. Eligible for replacement at the end of each term.
City of Bristol	Bristol City Council	Bristol City Council	4 years	Unlimited as long as a Council member. Eligible for replacement at the end of each term.
City of Bristol	N/A	BVU Authority Board	4 years	Two consecutive terms. Eligible for reappointment after one full year off.
City of Bristol	N/A	BVU Authority Board	4 years	Two consecutive terms. Eligible for reappointment after one full year off.
City of Bristol	N/A	BVU Authority Board	4 years	Two consecutive terms. Eligible for reappointment after one full year off.
Washington County	Washington County Board of Supervisors	Washington County Board of Supervisors	4 years	Two consecutive terms. Eligible for reappointment after one full year off.

Source: [Code of Virginia](#) Section 15.2-7205

BVU Authority Board Structure
As of July 1, 2016

Table 2

Resident of	Member of	Appointed by	Term Length	Term Limit
City of Bristol	NOT on Bristol City Council	Speaker of the House	4 years	None.
City of Bristol	Bristol City Council	Bristol City Council	4 years	Unlimited as long as a Council member. Eligible for replacement at the end of each term.
Washington County	NOT on Washington County Board of Supervisors	Senate Committee on Rules	4 years	None.
City of Bristol	NOT on Bristol City Council; Engaged in business	Bristol City Council	1 year	This is a one-time appointment until the BVU Authority Board appoints a member or July 1, 2017, whichever occurs first.
City of Bristol	NOT on Bristol City Council; Engaged in business	BVU Authority Board	3 years	This takes the place of the individual appointed by the City Council for one year.
Washington County	Washington County Board of Supervisors	Washington County Board of Supervisors	4 years	Unlimited as long as a Board of Supervisors member. Eligible for replacement at the end of each term.
Town of Abingdon	Abingdon Town Council	Abingdon Town Council	4 years	Unlimited as long as a Council member. Eligible for replacement at the end of each term.
Scott County	NOT on Scott County Board of Supervisors	Speaker of the House of Delegates	4 years	None.

Source: [Code of Virginia](#) Section 15.2-7205

Below are some other key changes resulting from the 2016 [Code of Virginia](#) amendments:

- Board members cannot be compensated, but can receive reimbursement for actual expenses.

- The board must adopt a travel and expense policy that applies to board members and employees.
- The board has to adopt a conflict of interest policy addressing the receipt of gifts from vendors by board members or BVU Authority employees.
- Board members have to file a statement of economic interest with the BVU Authority's president.
- The board appoints and contracts with a president, with a three-year contract limit, renewable annually. Severance payout cannot exceed 12 months of base salary.
- The board may approve a vice-president position to be filled by the president.
- The board must ensure the electric system benefit will be commensurate with the expense for economic development projects funded with electric funds.
- The BVU Authority service area is defined in the Code of Virginia by detailing the specific states and localities in which the BVU Authority can operate each utility.
- The BVU Authority cannot make charitable donations.
- The BVU Authority cannot cross-subsidize telecommunications services, including internet access, broadband, information, and data transmission.
- Any sale or disposition of BVU Authority assets must be in compliance with the transition agreement.

Tennessee Valley Authority

Tennessee Valley Authority (TVA) is a federally owned corporation created by congressional charter in May 1933 to provide navigation, flood control, electricity generation, fertilizer manufacturing, and economic development to the Tennessee Valley, a region particularly affected by the Great Depression. TVA was not only a provider, but also a regional economic development agency. TVA is the largest public power utility in the United States and one of the largest producers of electricity in the country. The BVU Authority purchased power from TVA from 1945 to 1997. Between 1997 and 2008, the BVU Authority purchased power from two other power providers, trying to get better rates, but finally determined that TVA was the most competitive provider.

Effective January 2008, the BVU Authority began purchasing its entire power requirements from TVA again under a twenty-year contract. TVA provides power it generates and does not use in its operations to the BVU Authority. Terms and conditions of the contract include but are not limited to the following:

- Ten years after the effective date, either party can terminate the contract with five years' written notice.
- The BVU Authority must pay a \$5.5 million system reintegration fee plus interest in 240 monthly installments for returning to TVA after 11 years. If the contract is terminated early, the remaining balance will be included on the last monthly bill from TVA.
- TVA and the BVU Authority will jointly set customer rates and charges to ensure the BVU Authority revenues are sufficient without being excessive to make the electric operation self-supporting and financially sound.
- The BVU Authority must use gross revenues from electric operations for electric system operation expenses, payments of interest on system indebtedness, and payment of principal amounts. Any remaining revenues are to be used for reserves adequate to cover operating expenses for a reasonable timeframe, tax equivalent payments into the BVU Authority's general funds, new electric system construction, or the retirement of system indebtedness prior to maturity.
- The BVU Authority should administer, operate, and maintain the electric system as a separate department in all respects, including establishing and maintaining a separate fund. The BVU Authority should not directly or indirectly mingle or otherwise consolidate or combine electric system funds or accounts with any other services or utilities provided under BVU Authority's operations.
- The BVU Authority should maintain the accounting records for the electric system according to the Federal Energy Regulatory Commission Uniform System of Accounts (FERC).
- If additional revenues are available after satisfying the gross revenue requirements above, the BVU Authority may make an annual payment in lieu of taxes of at least \$400,134 from the electric system. For purposes of distributing the \$400,134, the amount should be allocated as follows: \$350,000 to Bristol, VA; \$48,671 to Washington County, VA; \$624 to Bristol, TN; \$722 to Scott County, VA; and \$117 to Sullivan County, TN.
- BVU Authority will not impose any unauthorized tax or other charge on the property or operations of the electric system or electric energy supplied.

- Four times a year, TVA and the BVU Authority may review conditions and costs affecting TVA's operations to determine whether any changes to electric rates are necessary.
- TVA agreed that the transaction on July 1, 2006, where the Utilities Board cancelled debt OptiNet owed the Electric Division did not constitute a breach of the Use of Revenues provision within their contract. However, TVA stipulated that (1) the BVU Authority has not transferred any electric system assets to OptiNet since July 1, 2006, and (2) the BVU Authority agreed that it will not transfer any electric system funds to OptiNet without TVA's agreement.
- The BVU Authority can continue to use the cost allocation method to allocate costs among its Electric, Water, Wastewater, and OptiNet Divisions.
- The BVU Authority may annually spend up to \$500,000 in electric funds for economic development projects that the BVU Authority determines will benefit the electric system equal to the expense.

Federal Energy Regulatory Commission Uniform System of Accounts

The Federal Energy Regulatory Commission (FERC) is an independent agency that regulates the interstate transmission of electricity, natural gas, and oil. TVA requires the BVU Authority to use the FERC Uniform System of Accounts. Under FERC, the BVU Authority is considered a non-major utility, which includes but is not limited to the following accounting requirements:

- Accounting for all other departments the utility operates shall be departmentalized.
- Utilities must use a method of depreciation that allocates in a systematic and rational manner the service value of depreciable property over the service life of the property. Where composite depreciation rates are used, they should be based on the weighted average estimated useful service lives of the depreciable property comprising the composite group.
- Estimated useful lives of depreciable property must be supported by engineering, economic, or other depreciation studies.
- Separate entries are required for the acquisition, transfer, or retirement of each parcel of land, land right, or water right, having a life of more than one year. Records should include the nature of ownership, full legal description, area, map reference, usage purpose, city, county, and tax district on which situated, from whom purchased or to whom sold, payment given or received, other costs,

contract date and number, date of recording of deed, and book and page of record.

- Exclude from equipment accounts hand and other portable tools, which are likely to be lost or stolen or which have relatively small value (for example, \$500 or less) or short life, unless these items are verified by current inventories.
- Each utility shall record all construction and retirements of electric plant by means of work orders or job orders. The work orders or job orders should include the total cost, the source of costs, and the electric plant accounts charged or credited.
- All overhead construction costs shall be charged to particular jobs based on the amount of the overhead that is reasonably applicable to that job.

Why This Fraud, Waste, and Abuse Happened

In 2013, the Washington County Sheriff's Office began an investigation into numerous suspicious financial activities involving BVU Authority Board members, officers, and employees, which eventually involved the United States District Attorney and the Internal Revenue Service. To date, this investigation has resulted in the conviction and sentencing of nine individuals associated with the BVU Authority for offenses including: misuse of public funds, evasion of employment taxes, failure to report employee income to the Internal Revenue Service for income tax purposes, bid-rigging, procurement violations, and State and Local Government Conflict of Interests Act violations, as well as other offenses. As these convictions are in the realm of public knowledge, this report will

not include the details of the convictions. However, [Appendix A](#) has a summary of the individuals, their criminal activity, the charges against them, and the sentence they have received to date.

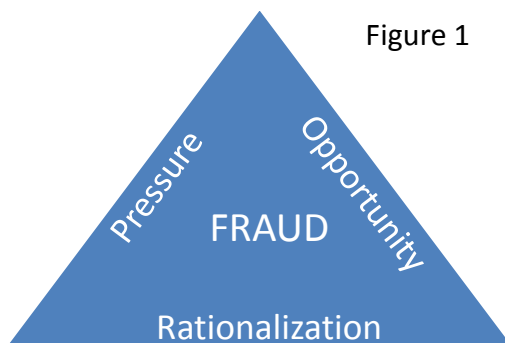


Figure 1

Source: Donald R. Cressey, *Other People's Money*

Fraud occurs when the right circumstances come together. These circumstances include pressure, opportunity, and rationalization as seen in the well-known Fraud Triangle in Figure 1. Pressure comes from many sources, including the internal desire for success, power, and money. Opportunity arises when internal controls are inadequate, policies and procedures do not exist or are not enforced, and collusion occurs. Rationalization is the thought process the individual committing fraud goes through to justify their actions as acceptable.

In conducting the audit of the BVU Authority, the Fraud Triangle was found to be insufficient for fully explaining the BVU Authority’s situation. Instead, a more detailed fraud concept, the Fraud Pentagon (Figure 2), was more appropriate for understanding the BVU Authority’s situation. Including three of the elements of the Fraud Triangle, the Fraud Pentagon shows that committing fraud requires not only pressure, opportunity, and rationalization, it also includes two other elements, competence and arrogance, that we found present in the fraud scheme that has been plaguing the BVU Authority environment for years. Competence entails knowledge of how to override controls and the ability to conceal wrongdoing and control the situation. Arrogance is represented by greed, a sense of entitlement, and an attitude of superiority.

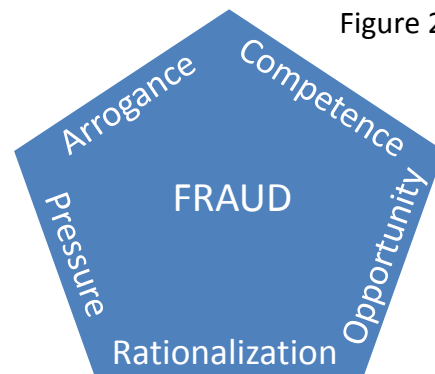


Figure 2

Source: Crowe Horwath

Even without knowing which of the driving forces behind each of these five elements of the Fraud Pentagon motivated each individual to perpetrate fraud, we found that all five of the elements were present and helped contribute to the BVU Authority’s current environment. For the BVU Authority, the work environment created a vicious cycle (Figure 3):

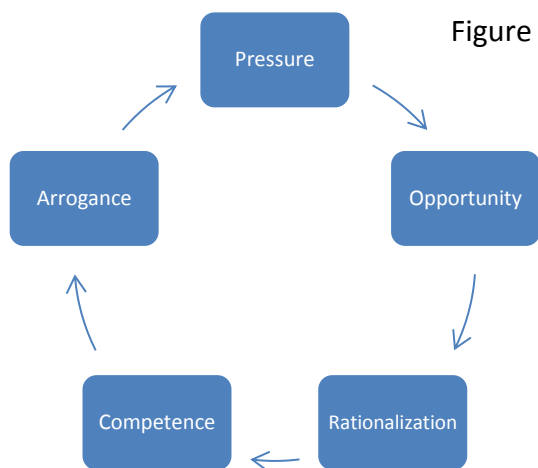


Figure 3 *Policies and Procedures*

Implementing and enforcing strong internal controls is the first step to eliminating the opportunity for fraud to occur. Entities can take this first step by developing, implementing, and documenting controls. Documentation of these controls in current and well-communicated operational and financial policies and procedures is essential.

As reported in the BVU Authority’s 2014 audit, the BVU Authority does not have and has not

had any formal, written, financial and accounting policies and procedures, and they have not updated their personnel policies and procedures since implementation of the employee handbook in 2002. Without adequate policies and procedures documented and in place, employees and management do not have any guidance on how to carry out their responsibilities appropriately and have nothing against which to hold each

The BVU Authority does not have any formal, written financial and accounting policies and procedures.

other accountable. This lack of controls, policies, and procedures contributed to the environment that allowed the fraud and abuse to occur at the BVU Authority over the past several years.

In response to the finding in the 2014 audit report, BVU Authority management hired a CPA firm to develop policies and procedures. The policies developed by the CPA firm did not address all areas needed, were insufficient for those areas it did address, and in some cases did not reflect actual processes pertaining to the operations of the BVU Authority. In addition, management did not disseminate the new policies and procedures or make them accessible to all employees. Therefore, although the newly created policies were documented, since employees were not aware of them, they only existed on paper and not in practice. As we note throughout this report, BVU Authority management should develop, implement, and document policies and procedures over all operational and financial processes. We specifically found that the BVU Authority needs policies and procedures in the following areas due to findings we had in these areas:

- Board approval of large financial transactions
- Procedures to perform materials and supplies inventory
- Budget development process that ensures compliance with all laws, regulations, and debt requirements
- Purchasing processes and limits
- Travel expense limits for employees, board members, and contractors
- Management of economic development grants/awards
- Accounting processes for fixed assets including the determination and periodic re-evaluation of useful lives, processes for completion of periodic physical inventories, processes for additions and deletions of capital assets, identification and write down of impaired assets, and identification and recording of intangible assets
- Collection of delinquent accounts, specifically for pole attachments
- OptiNet sales activities, including entering into sales contracts, granting discounts to customers, and obtaining the proper approvals for all such activity
- Pre-employment screening and verification of qualifications

Recommendation 1:

The BVU Authority should develop, implement, and document detailed policies and procedures over all operational and financial areas. Management and authority personnel should update these policies and procedures periodically and ensure that they are easily accessible and available for all employees. Accounting policies and procedures are necessary in order to reduce the risk of fraud and prevent errors or mistakes from occurring. In addition, well-designed and properly maintained policies and procedures enhance accountability and consistency and serve as a useful training tool for staff.

Employee Handbook

The BVU Authority Employee Handbook, implemented in 2002, is the most comprehensive set of employee policies and procedures the BVU Authority has. However, the BVU Authority has not updated the handbook since its implementation 14 years ago. Even though the contents are outdated and not followed, new employees must read the handbook and verify they understand its content by signing an agreement form.

The BVU Authority has not updated the Employee Handbook in 14 years.

The BVU Authority's 2015 audit report noted that "the employee handbook has not been updated in over ten years. The process to review and update the employee handbook was started but not completed before the end of the fiscal year." The BVU Authority's current President/Chief Executive Officer (CEO) and employees in the Administrative Services Division have been working since January 2015 to revise the handbook. Management's response to the finding stated that all policies in the 2002 handbook had been reviewed and updated, as necessary. In September 2015, the board acknowledged updates made to the handbook but never gave formal approval to implement the revisions.

While management has provided the board with the revised version of the handbook, they have not distributed it to employees or provided them with access to it. Even though they have not distributed the new policies, management has been implementing changes as needed, which is good because many policies needed to be addressed. However, management is not clearly communicating the revisions to the employees, which is causing unnecessary confusion and frustration. The current President/CEO stated that he did not want to implement new personnel policies until all of the criminal cases are complete and the individuals receive their sentence to ensure any changes did not affect the outcome.

Recommendation 2:

Management should make the new policies available to the employees, and all employees should certify that they have read and understood the policies. Management should consider making the policies available electronically to increase employee accessibility and allow management to update the policies whenever change is needed.

Code of Business Conduct and Ethics

The Utilities Board of Directors adopted a Code of Business Conduct and Ethics (Code of Conduct) in February of 2009. The Code of Conduct's introductory section states that it "applies to all representatives of BVU, including officers, full time and temporary employees; as well as others who work with or represent us, directly or indirectly." Regarding accounting, records, and reporting, the Code of Conduct states that an employee is personally responsible for the integrity of information, records, and reports under his or her control. The Code of Conduct also addresses the proper use of the BVU Authority assets, the avoidance of engaging in activities causing conflicts of

interest or the receiving of gifts and entertainment, and the forbiddance of participation in bribery activities, kickbacks, foreign corrupt practices, intimidation tactics, and lobbying activities.

A combination of management override of controls and lack of adequate policies and procedures, among other things (see Fraud Pentagon Figure 2), have made the BVU Authority's Code of Conduct highly ineffective. Executive management, BVU Authority contractors, and some members of the board did not abide by the Code of Conduct or exude even a moderate level of ethical leadership.

When the details of the fraud started coming to light in 2013, the BVU Authority created an Ethics Committee. The committee was comprised of the President/CEO, Executive Vice President/Chief Financial Officer (CFO), General Counsel, and Administrative Services Manager, and was responsible for encouraging and communicating ethical behavior and compliance with all laws, regulations, and BVU Authority policies and procedures to those who represent the BVU Authority, including employees, Board members, and contractors. By default, former Executive Vice President/CFO Stacey Pomrenke and General Counsel Walt Bressler were part of the committee. Based on their convictions (See [Appendix A](#)), it is evident that these two individuals were not functioning properly in their committee role. Since these two have separated from the BVU Authority, their positions have not been filled; therefore, two of the four seats of the BVU Authority's Ethics Committee remain vacant.

The BVU Authority's Code of Conduct encourages employees to report unethical behaviors of any fellow employee or agent of the BVU Authority. One of the most encouraged methods to report unethical behavior is through the BVU Authority's Reporting System, commonly referred to as the "ethics hotline." The ethics hotline is hosted by an independent third party. Anyone, including the public, has access to the hotline through a link to the hotline on the third party's website. In addition, pamphlets and business cards providing different steps employees and the general public can take to report instances of fraud, waste, and abuse are available in the BVU Authority's Administrative Services Department. As noted in the pamphlet, anyone may use the confidential hotline, and employees can report an incident to their immediate supervisor.

Based on interviews conducted with employees of the BVU Authority, many shared that they would not report their concerns to the ethics hotline for fear of retaliation from management. Employees also felt that the hotline was not truly anonymous and had little faith that reports would be investigated in a thorough, fair, and professional manner.

Given these concerns, we reviewed cases submitted to the ethics hotline since its implementation in 2013. The first issue we noted is that the BVU Authority does not have policies or procedures in place or documented over how to handle and investigate hotline reports.

When an employee or customer reports an incident, either by phone or internet, a third-party contractor prepares a case report and forwards it to individuals at the BVU Authority. Only a select few, including the Board Chairman, the President/CEO, and Administrative Services employees, have access to viewing reports in the system. Should someone file a report on any of these individuals, the individual named in the complaint is not able to view the claim.

Typically, the Administrative Services Manager is the first to review reports submitted. Unless the claim is about the President/CEO, the Administrative Services Manager notifies the President/CEO about the report. The President/CEO reviews the report and assigns the case to the appropriate supervisor for further investigation. If a report is filed on the President/CEO, the Board Chairman handles the investigation.

Once the report is in the investigation stage, those with access to viewing the claim have the ability to respond to the anonymous reporter with follow-up questions or to provide a status update. We confirmed that those responding to reports cannot see who receives the response. We also confirmed that the hotline reporter was not identifiable, as all cases were marked “Anonymous.” This is consistent with an agreement between the BVU Authority and the system’s third-party administrator stating that the administrator would not disclose contact information for any person reporting a claim.

Upon review of the cases and investigator responses, we noted another issue that likely stems from the lack of policies and procedures previously noted. Investigator responses seemed accusatory in relation to the party reporting the claim and indicated there was little hope that the case was being properly considered and investigated without bias. For example, a report came in stating that an individual employee was impersonal and not a strong leader. The assigned investigator’s response stated that the person submitting the report should be more open to new leadership and work towards communicating with the employee named in the complaint better. Another example includes an employee reporting that an individual was unloading work on subordinates so the individual could complete college coursework. The report also mentioned the stress other employees experienced from the extra work and that management was aware of the situation and was not addressing it. The investigator addressing this case responded that since the reporting party provided opinions rather than substantial evidence there would be no further investigation.

The BVU Authority Financial Policies and Procedures Manual, implemented June 2015, includes a Whistleblower Protection Policy for employees who would like to voice their concerns without fear of retaliation or biased investigations. The policy states that it is the responsibility of all officers, directors, and BVU Authority employees to report the following items:

- Questionable accounting matters
- Misuse or misappropriation of company assets
- Fraudulent reporting
- Suspected conflicts of interest
- Violation or noncompliance with a state or federal statute, rule, or regulation
- Violation of company policies and procedures

However, management has not communicated this policy or made it accessible to employees. This is another contributing factor as to why employees are not comfortable reporting ethics violations – they are not aware of their rights provided under the policy.

Recommendation 3:

The BVU Authority should re-evaluate its approach to its ethics program. Management should evaluate the current Code of Conduct and Employee Handbook to ensure both accurately depict the BVU Authority's ethical position. This would include developing and implementing processes and procedures over how to investigate any complaints swiftly, thoroughly, and fairly. Management should also communicate these policies to employees in a method that ensures the employees are aware and understand the process and their rights.

To increase the effectiveness of the ethics program, the BVU Authority should consider implementing an Authority Ethics Officer who is separate from management and is responsible for training and enforcing of the BVU Authority's Code of Conduct and Employee Handbook and ensuring investigations of ethics complaints are thorough and impartial. This function would ideally exist within the Administrative Services Department.

Travel Policy

Throughout the course of employment at the BVU Authority, employees and contractors must often travel, in some cases, overnight or for multiple days. This is necessary for them to complete job related duties and to attend trainings and other types of meetings. When employees need to travel, the BVU Authority incurs travel related expenses, either in the form of reimbursement to the employee or contractor, payment on a BVU Authority credit card, or payment directly to the vendor. It is, therefore, critical that the BVU Authority have a documented policy, indicating which expenses the BVU Authority will pay for, the method by which the BVU Authority will pay the travel related expenses, which of these expenses requires prior approval, and the dollar thresholds the employee or contractor is allowed to spend. During our review, we found no existing travel policy with any of these elements and discovered that the BVU Authority often paid excessive amounts for transportation, meals, and hotels for employees, board members, and contractors. These all represent avoidable costs to the BVU Authority. Further, there is no guidance on carpooling, using a personal vehicle versus a rental car, or any definition of what travel is compensable beyond the employee's daily commute and, therefore, to be paid for by the BVU Authority.

The BVU Authority paid excessive amounts for transportation, meals, and hotels for employees, board members, and contractors.

Recommendation 4:

The BVU Authority should develop a policy specific to travel, requiring a pre-approval for all overnight trips. This policy should outline the documentation necessary for the board member or employee to retain to receive reimbursement for travel expenses, such as the receipts and evidence of supervisor approval. The policy should also outline the limits the BVU Authority will allow for these types of expenses. The Commonwealth of Virginia's agencies and other governmental entities have adopted rates from the federal General Services Administration's (GSA's) travel guidelines as this policy has clearly documented thresholds government employees can spend for all different types of travel expenses. Within this policy, these expenses are adjusted for the cost of living in all parts of the country. The BVU Authority could adopt these rates outlined on the GSA's website and include a reference to this as part of their internal policy. The BVU Authority should also require adherence to this policy as an element of all contracts to perform services for the BVU Authority that could involve travel. This will help to reduce the risk of excessive travel expenses and potentially lower the cost to the BVU Authority.

Issues with the Transition Agreement

When the Utilities Board separated from the City of Bristol and became an authority, they signed a transition agreement with the City of Bristol that stated that they agreed it was in the best interest of all parties to separate, and the agreement outlined parts of the relationship between the two entities that would continue after the separation. The City and the Utilities Board signed this agreement before the legislation that established the BVU Authority passed. The agreement stated that once the BVU Authority was created, the City Council would direct its members on the BVU Authority Board to create a duplicate of the agreement with the new Authority. The BVU Authority Board ratified the adoption of the transition agreement in the July 26, 2010, board meeting with unanimous approval. In addition, at the January 25, 2016, board meeting, the board ratified it again.

The transition agreement set out the following items:

1. The BVU Authority will continue to budget \$500,000 for economic development inside the City in accordance with TVA requirements.
2. The BVU Authority will pay the City from electric funds \$350,000 annually in lieu of taxes for electric system property in the City (instead of \$187,000 payable under the TVA formula for in lieu of tax payments) for as long as the BVU Authority has authority from TVA to pay it.
3. The BVU Authority will pay the City from non-electric funds \$100,000 annually in lieu of taxes for ten years starting July 15, 2010, through July 15, 2019.
4. The BVU Authority shall pay the City from BVU OptiNet funds in lieu of tax payments for OptiNet property in the City, starting July 30, 2013, based on the TVA formula for in lieu of tax payments. This first payment will be at least \$100,000. There is no end date for the payments.

5. If the BVU Authority sells all or part of its business:
 - a. The BVU Authority Board and the Bristol City Council will have to approve any sale.
 - b. If all of the BVU Authority is sold, the net proceeds after payment of all of the BVU Authority’s debt and liabilities will belong to the City and the BVU Authority will no longer exist.
 - c. If they sell OptiNet, the proceeds will be used to repay OptiNet debt. Whatever is left of the proceeds and the equity investment will be split evenly between the City and the BVU Authority.
 - d. If they sell the Electric Division, the proceeds will be used to pay all debt of the BVU Authority and whatever proceeds are left will be split evenly between the City and the BVU Authority.
6. The BVU Authority Board and the City Council must approve sale of Wastewater.
7. The City Council must approve any attempt to change the structure of the BVU Authority Board. The BVU Authority will never ask the General Assembly to eliminate the BVU Authority Board.

We reviewed the BVU Authority’s use of electric funds for economic development in the section entitled “Economic Development.”

In Lieu of Tax Payments

The Transition agreement required the BVU Authority to pay in lieu of tax payments from three sources: electric, non-electric (water and wastewater), and OptiNet. However, Code of Virginia Section 15.2-7220 states that “the Authority shall not be required to pay any taxes or assessments upon any facilities” and “the Authority shall continue to pay or impute any taxes presently paid or imputed by Bristol Virginia Utilities.” Prior to the transition, the Utilities Board only paid in lieu of tax payments from electric funds as set out in the agreement with TVA, which required that the BVU Authority pay the following based on a formula set out in the contract:

**In Lieu of Tax Payments Required
by the Tennessee Valley Authority Contract**

Table 3

Locality	In Lieu of Tax Payment
Bristol, VA	\$350,000
Washington, VA	48,671
Scott, VA	722
Bristol, TN	624
Sullivan, TN	117
Total	\$400,134

Source: BVU Authority/TVA Contract

Therefore, since the amount in the transition agreement agrees with the TVA contract, it is reasonable for the BVU Authority to continue paying in lieu of tax payments from electric funds to the City and the other localities. However, since the BVU Authority was not paying any other tax or in lieu of tax payments prior to the transition, the City of Bristol did not have the authority to require the BVU Authority to pay in lieu of taxes from non-electric or OptiNet funds. The City should return any in lieu of tax payments from non-electric and OptiNet funds received to the BVU Authority.

For the in lieu of tax payments from non-electric sources, the transition agreement required the BVU Authority to pay \$100,000 each year for ten years beginning in fiscal year 2011. However, during the first six months of operation as a separate authority, the City requested that the BVU Authority advance the entire \$1 million of in lieu of tax payments to the City because the City was having financial difficulties. The BVU Authority Board approved this request and paid the City the \$1 million in several installments out of wastewater funds between July and December 2010.

For the in lieu of tax payments from OptiNet, the transition agreement required the BVU Authority to pay annually based on the TVA formula used to calculate the electric in lieu of tax payment, with the first payment being at least \$100,000. The BVU Authority paid \$100,000 in fiscal year 2014 and \$57,540 in fiscal year 2015, for a total of \$157,540.

Recommendation 5:

The BVU Authority should work with the City to get a legal opinion as to whether the in lieu of tax payments were legal. If the opinion determines that the payments were illegal, the City should reimburse the BVU Authority for the in lieu of tax payments totaling \$1,157,540 received through the end of fiscal year 2015 plus any additional payments the BVU Authority paid in fiscal years 2016 and 2017.

As noted above, the in lieu of tax payments from electric funds are driven by a formula in the TVA contract that uses depreciated asset values and local real and personal property tax rates. However, the amounts noted in Table 3 are the minimum that the BVU Authority will pay. Each year, the BVU Authority should calculate the formula and compare it to the minimum payment. If the calculation exceeds the minimum payment, the BVU Authority should pay the localities the calculated amount.

The BVU Authority financial records show payment of the electric in lieu of tax payments to each of the localities at the minimum amounts totaling \$400,134 for each fiscal year 2011 through 2015. However, in August 2014, the BVU Authority Controller discovered an error in the in lieu of tax payment calculation spreadsheets. This error involved the amounts for personal and real property being switched in the final calculation spreadsheet. Correcting this error made a significant difference in the amount of the tax, causing the tax calculation to be at least \$750,000 higher than originally calculated. The Controller brought this error to the former CFO, Stacey Pomrenke's, attention looking for direction as to how to handle the error. Even knowing that the error caused the BVU Authority to under calculate and under pay the various localities by at least \$750,000, Stacey

Pomrenke instructed the Controller to continue to use the incorrect calculation since everyone had the opportunity to review the calculation in the past and no one had noticed it. This was just an error, until it was discovered. Once Stacey Pomrenke covered it up, it became fraudulent.

Our audit verified the error discovered by the Controller, but we found numerous additional errors in the methodology and application of the TVA formula. As a result, most of the errors netted out so that the original calculation was not significantly incorrect and the minimum payment was still appropriate.

Recommendation 6:

The BVU Authority needs to correct its in lieu of tax calculation spreadsheet and ensure that it properly calculates this in the future. If the calculation exceeds the minimum amount required, the BVU Authority should begin paying the excess to the localities.

Organizational Governance

BVU Authority Board

The BVU Authority Board of Directors is a supervisory board. All of the powers of the BVU Authority vest in the BVU Authority Board of Directors. The BVU Authority Board appoints and contracts with a President and Chief Executive Officer to manage the day-to-day operations of the BVU Authority. The BVU Authority Board members have a legal and moral responsibility to govern the BVU Authority with integrity and values that inspire confidence and trust by the BVU Authority employees and customers. This has not been the case in the past, as evidenced by [Appendix A](#) and the example below.

Since the [Code of Virginia](#) requires the President to manage the day-to-day operations of the BVU Authority and not the BVU Authority Board, Section 15.2-7206 of the [Code of Virginia](#) requires that the board members deal with BVU Authority employees solely through the President. In addition, BVU Authority Bylaws reference the above section of the [Code of Virginia](#). During the course of this audit, we found multiple instances when board members violated these policies, contacting employees directly to obtain information, to influence or direct activities, or to pay certain expenses. For example, when the BVU Authority Board was interviewing candidates for the President/CEO position in 2014, a BVU Authority Board member drafted and circulated a petition among BVU Authority employees to get support to hire a candidate other than the one being interviewed for the position. This was inappropriate and unethical, pressuring employees to cooperate. This is in direct violation of the [Code of Virginia](#) and BVU Authority Bylaws.

With amendments to Sections 15.2-7205 and 15.2-7206 of the Code of Virginia, the entire BVU Authority Board turned over on July 1, 2016. This new board has the opportunity to move the

The new board has a responsibility to earn back the trust of the employees, customers, and the public by conducting themselves with unquestionable values.

BVU Authority ahead and focus on its future rather than the past. The new board members need to ensure that they understand the laws and regulations they should operate under and what their duties are as a board member. The members should strive to carry out their duty to the BVU Authority and its customers in a moral and ethical manner. The new board has a responsibility to earn

back the trust of the employees, customers, and the general public by conducting themselves with unquestionable values.

Recommendation 7:

Immediately after appointment, the new BVU Authority Board should receive training related to their obligations and duties as board members and training on the laws, rules, and regulations by which they must abide. The new board members should operate under the values below that make boards highly effective:

- *Create a culture of honesty and transparency*
- *Uphold basic fiduciary principles*
- *Cultivate a healthy relationship with the President/CEO*
- *Select an effective board chair*
- *Establish an effective governance committee*
- *Delegate appropriate decision-making authority to committees*
- *Consider strategic risk factors*
- *Provide appropriate oversight of service quality*
- *Develop a commitment to shared governance*
- *Focus on accountability*

Bearing the above items in mind, the new board should focus on the future of the BVU Authority rather than the past and know that tone at the top starts with them and trickles down throughout the BVU Authority.

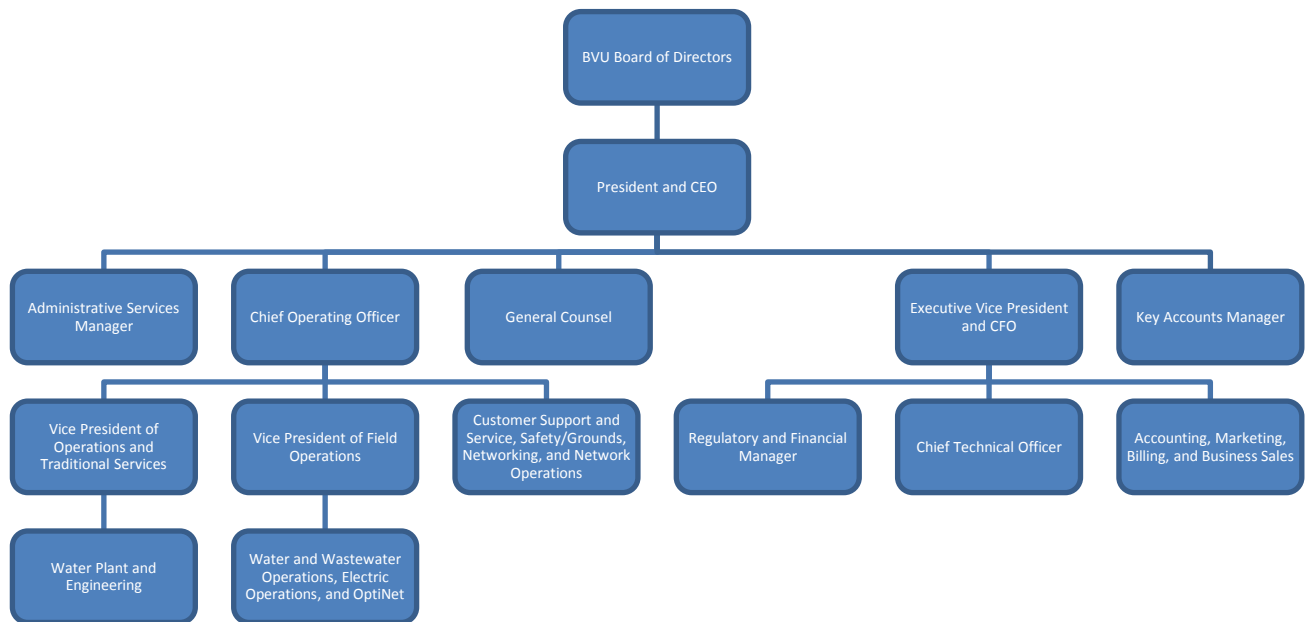
Executive Management

The BVU Authority is a complex entity that is in both the traditional utilities and telecommunications business. A political subdivision of this size and nature requires leaders with industry-specific knowledge, skills, and abilities to run it effectively. With the federal investigation that has been ongoing for years, the BVU Authority's day-to-day operations have suffered. While it is necessary for the BVU Authority to separate itself from the individuals involved in defrauding the BVU Authority, it is equally necessary to ensure that the BVU Authority is adequately staffed with competent, honest, and credible individuals in order to move forward.

As part of this fraud investigation, the BVU Authority has lost its President/CEO, Chief Operating Officer, Executive Vice President/CFO, and General Counsel due to criminal charges and subsequent convictions. The BVU Authority had an Acting President/CEO after former President/CEO Wes Rosenbalm’s resignation and then a permanent one starting in November 2014 that continues to the present. The current President/CEO has not filled the other vacant management positions while their criminal cases were still in process to ensure nothing affected the outcomes of the cases and as a cost saving measure. As a result, the three key functional areas affected are finance, administration, and operations. Because of these vacancies over the last three years, the BVU Authority has not had the proper oversight and leadership in all of these areas to always be successful. Below is a summarized illustration of the BVU Authority’s organization chart prior to former President/CEO Wes Rosenbalm’s resignation in September 2013:

Previous Management Structure (September 2013 before investigation)

Figure 4

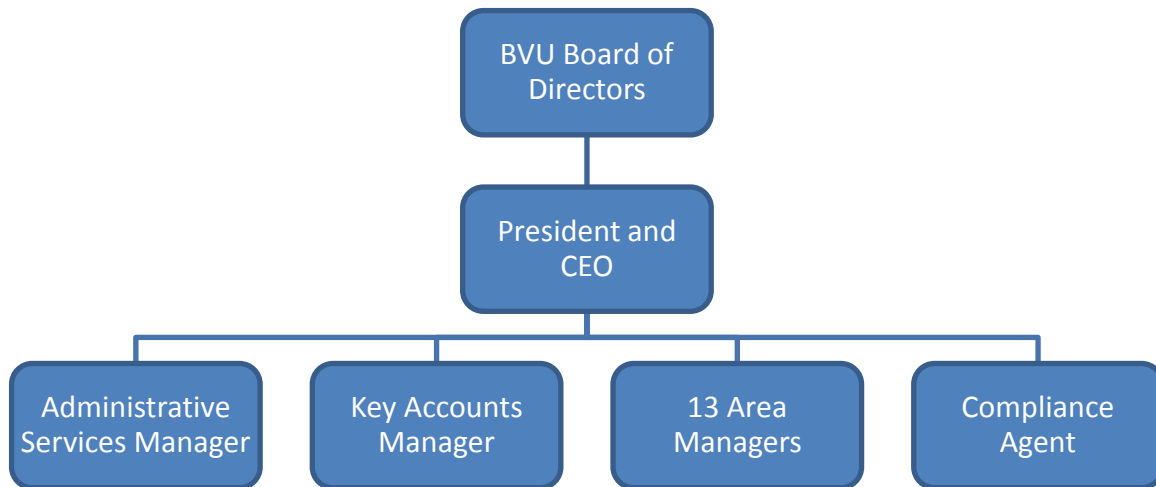


Source: BVU Authority Organization chart

Below is a summarized illustration of the BVU Authority's organization chart as of April 2016:

Current Management Structure

Figure 5



Source: BVU Authority Organization chart

As illustrated in the two graphics above, an entire level of management is now gone, including managers over the finance and operations based departments. The President/CEO has been directly managing all areas of the BVU Authority. Although the current President/CEO is educated and competent in many areas, he does not have the knowledge, background, or time to manage each of these areas effectively on a daily basis. Specifically, given all of the issues surrounding the financial operations of the BVU Authority, the President/CEO needs someone with the proper financial background and education that can lead, manage, and supervise the financial operations.

The BVU Authority employees need leaders who will clearly communicate policies, procedures, and expectations from the top down.

The BVU Authority employees need leaders who will encourage them, ensure they have the knowledge, skills, and abilities to perform their jobs, and clearly communicate policies, procedures, and expectations from the top down. The BVU Authority needs assistance in creating and implementing a strategic operational plan to ensure organizational stability and maximum employee performance. Lastly, there needs to be more focus on building employee morale and trust.

Recommendation 8:

The BVU Authority President/CEO should determine how he wants to structure management of the BVU Authority. He should use this opportunity to determine the best organization of the financial, operational, and administrative areas; what type of leadership each area needs; and what the BVU Authority can afford.

To address inadequacies in the BVU Authority's financial area, the BVU Authority needs individuals with knowledge and experience in applying governmental and FERC accounting standards. Other needs in this area include understanding and properly complying with payroll tax laws, creating and running a balanced budget, procuring goods and services, and overseeing the operations of the accounting department. Regarding the administrative aspects of the BVU Authority, the BVU Authority needs individuals with adequate knowledge of personnel-related laws and regulations related to employment practices, employee benefits, and employee relations. From an operational perspective, the BVU Authority needs individuals that can develop a strategic and operational business plan that incorporates a long-term maintenance and capital plan.

Audits of the BVU Authority

The BVU Authority is required to receive an annual audit of its financial statements from an independent, licensed Certified Public Accounting (CPA) firm and has done so in each of the years of its existence. This is a requirement of Section 9.11 of the master bond indenture between the BVU Authority and its trustee, as well as Section 15.2-7211 of the Code of Virginia. Prior to becoming an authority in 2010, the financial activity of the Utilities Board was audited as part of the City's annual audit.

An audit of an authority, such as the BVU Authority, requires the CPA to conduct the audit in accordance with auditing standards generally accepted in the United States (GAAS), issued by the American Institute of Certified Public Accountants (AICPA), and the standards applicable to financial audits contained in Government Auditing Standards, issued by the U.S. Government Accountability Office. This type of audit must also be conducted within the Specifications for Audits of Authorities, Boards, and Commissions, issued by the Auditor of Public Accounts. According to the AICPA's audit standards, Section AU-C 110, the objective of a financial statement audit is to express an opinion about whether the financial statements are free of material misstatement, whether caused by fraud or error. Therefore, the intended purpose of this audit is simply to know that the financial activity reported by the BVU Authority is reliable and materially correct. According to Section AU-C 200.A49 of the AICPA's standards, there are inherent limitations of an audit, which prevent an auditor from being able to reduce the audit risk to zero and; therefore, an auditor cannot obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. The work of the auditor is largely reliant upon information provided by management of the BVU Authority and no audit procedures exist that would provide absolute assurance that the BVU Authority has provided all relevant information.

A system of internal control reduces the risk that the financial statements are affected by a material misstatement caused by either fraud or error. Management of the BVU Authority is responsible for the design, implementation, and maintenance of internal control to prevent and detect fraud. A proper system of internal control would include a separation of duties between critical functions in each financial operation. A properly designed internal control system ensures that more than one person is required to complete each task so that no one individual is responsible for the entire process. The purpose of an internal control system is to identify and resolve fraud and/or errors of the first individual through a review by the second individual. One of the inherent limitations of internal control is that employees can often overcome them through acts of collusion or management override. Collusion occurs when individuals act collectively to achieve a common interest, which is usually illegal or secretive. In cases of collusion, the two individuals who are responsible for reviewing and approving each other's transactions have agreed to overlook fraudulent transactions. Management override of internal control occurs when a member of management has directed the employees to process erroneous or fraudulent transactions and prevented a proper review from occurring. Collusion or management override of controls can make it very difficult to detect fraud, particularly in an audit where the detection of fraud is not the primary objective.

The auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate, but not for expressing an opinion on the effectiveness of the entity's internal control. Consequently, a financial statement opinion does not provide assurance over the internal controls of that organization. The AICPA's clarified audit standards, Section AU-C 240.05 states that some material misstatements resulting from fraud may not be detected, even though the audit is properly planned and performed in accordance with GAAS. Section AU-C 240.06 goes on to state that "the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error." Fraud detection risk is higher because there are often deliberate efforts to conceal the fraud, whereas efforts to conceal errors are not as likely. With a focus primarily on the material amounts contained within the financial statements, it is unlikely that an external audit from a CPA firm would identify any or all fraudulent acts perpetrated by employees or contractors, even when the audit adheres to all applicable audit standards. The recently prosecuted criminal acts of the BVU Authority Board members, officers, and employees illustrate what can occur when management override and collusion occurs between employees, contractors, or others.

UTILITY OPERATIONS

Funding the Development of the Fiber Optic Network

The Utilities Board launched the OptiNet Division in 2001. Since that time, the Utilities Board and then the BVU Authority has built a fiber optic network in southwest Virginia that provides digital cable, telephone, and high-speed internet service to Bland, Buchanan, Dickenson, Russell, Scott, Smyth, Tazewell, Washington, and Wythe counties. The BVU Authority has funded construction of this network through bonds, cash flow from operations, and state and federal grants from the Virginia Tobacco Region Revitalization Commission (Tobacco Commission), the National Telecommunications and Information Administration Broadband Technology Opportunities Program (NTIA/BTOP), and the U.S. Economic Development Administration (EDA). At June 30, 2015, the BVU Authority had \$132.4 million in OptiNet assets, which include the fiber optic network and all of the infrastructure and other assets required to operate the network.

OptiNet Network Funding

Table 4

Funding Source	Asset Cost
Tobacco Commission	\$ 30,055,863
NTIA/BTOP	22,698,010
Bonds and operating cash flow	79,638,415
Total OptiNet Assets	\$132,392,288

Source: Various grants and depreciation spreadsheets

Tobacco Commission Funding

From fiscal year 2004 through fiscal year 2015, the BVU Authority received multiple grants totaling over \$30 million from the Tobacco Commission to install backbone, middle mile, and last mile fiber optic cable to create the OptiNet network. These were economic development funds with few restrictions and did not require any matching funds. However, the BVU Authority was able to use some of these funds as matching funds for the NTIA/BTOP grant discussed below. The grant did require that all expenses under the grant be capital expenditures, meaning expenses that resulted in a capitalized fixed asset. The grant also had a clawback clause, which states that during the useful life of the assets constructed with the funds, the Tobacco Commission has an undivided equitable reversionary interest. This means the BVU Authority cannot lease, sell, dispose, or use the asset as collateral without the prior written approval of the Tobacco Commission. If they do, the Tobacco Commission may seek recovery of its share of the assets value.

NTIA/BTOP Funding

The BVU Authority received a grant from NTIA/BTOP for \$22.7 million over fiscal years 2011 through 2014 to expand the existing fiber optic network to make the final connection to various educational institutions, businesses, and households. Being a federal grant, it had multiple requirements. It required at least a 20 percent match that could be in the form of cash or in-kind

contributions. The BVU Authority met the match requirement with \$5.7 million in Tobacco Commission funds as a cash match and \$7.9 million of in-kind previously constructed assets. However, the BVU Authority originally undervalued its in-kind match, revaluing it at \$14.4 million so that they more than met the 20 percent match.

Since the grant funded construction of assets, the grant required that the BVU Authority execute and perfect the Federal government's security interest in the assets. The BVU Authority did this through the State Corporation Commission. In addition to the security interest, the BVU Authority may not sell or lease broadband facilities or equipment funded by the grant unless they obtain a waiver from NTIA. NTIA will consider a waiver if (1) the sale or lease is for adequate consideration, (2) the purchaser or lessee agrees to fulfill the terms and conditions of the grant, and (3) the sale or lease would be in the best interests of those served by the project. The BVU Authority may not transfer or assign the grant award to another party without approval from NTIA.

The grant-funded assets, the fiber network, will generate program income in the future. Therefore, the grant requires that BVU Authority account for any program income directly generated by those assets during the funding period. The BVU Authority may use the funds in multiple ways: (1) reinvest in the project facilities, (2) pay BTOP compliance costs, (3) pay operating expenses, or (4) use as matching funds. Once the funding period is over, the BVU Authority does not have to track the use of program income.

Bonds and Cash Flow Funding

Throughout the life of the fiber optic network, the BVU Authority has used bonds issued through the Virginia Resource Authority to fund construction of OptiNet assets. We discuss these bonds, their requirements, and issues related to repayments and cross-subsidization in the section entitled "Bonds." In addition, the BVU Authority reinvests any operating funds available after paying regular operations and maintenance to build, expand, and improve the network.

CPC OptiNet

Funding

The Cumberland Plateau Company (CPC) is a nonprofit corporation that holds title to real and personal property on behalf of the local governments within the Cumberland Plateau Planning District Commission, which includes the counties of Buchanan, Dickenson, Russell, and Tazewell. In 2003, CPC partnered with the Utilities Board to obtain federal grant funds from EDA to expand the OptiNet backbone into the four counties in the Cumberland Plateau Planning District Commission. The Utilities Board and CPC were co-recipients on three grants in 2003, 2007, and 2009 totaling \$4.5 million with matching funds from the Tobacco Commission of \$3.1 million. The Utilities Board/BVU Authority and CPC spent funds from these grants between 2003 and 2012. The portion of the fiber optic network created with these grant funds is called CPC OptiNet.

The requirements in the EDA grants evolved from one grant to another. As EDA awarded each new grant, they clarified certain requirements in the grant documents and the standard terms and conditions. The EDA grants had restrictions over the assets created and the program income generated from the assets. For all three grants, it was clear that title of fiber network created with the grant funds vested in the BVU Authority as long as they used the assets for the intended purpose. However, EDA had an interest in the property, and the BVU Authority had to record a lien for EDA's interest in the property. BVU Authority management could not provide evidence that they had recorded this lien. For all three grants, the Code of Federal Regulations required that when the BVU Authority no longer needs the property, EDA will determine the final disposition, and the BVU Authority must compensate EDA for the federal government's share of the value of the property, plus costs and interest. The 2003 grant did not have any other restrictions on the assets constructed. The 2007 grant specifically stated that ownership of the fiber optic network must stay with the BVU Authority for the useful life of the assets, which was 20 years. The 2009 grant stated that the federal interest period was 20 years and that the BVU Authority must operate the network for 20 years or EDA could require repayment of the grant. The 2009 grant also stated that the BVU Authority could not transfer, pledge, assign, or mortgage the award to other parties, but it says that the EDA must approve any transfer of ownership or operational responsibility.

For all three grants, the Code of Federal Regulations applied consistently requiring program income to net against allowable costs during the grant period. The grant period was the period of construction, so in essence there would not have been much, if any, program income during that time because the fiber optics were not in use yet. The Code of Federal Regulations states that there is no requirement governing program income after the end of the award period unless set out in the agreement or the Federal agency regulations. The EDA standard terms and conditions only addresses program income for projects that created long-term rental revenue. Since the BVU Authority did not develop the fiber optics lines for the purpose of renting or leasing and did not generate rental or lease income, the EDA standard terms and conditions for program income did not apply to any of the grants. The grant agreements for the 2003 and 2007 grants did not address use of program income. Therefore, there was no requirement for using program income after the end of the award period for those two grants. The 2009 grant agreement specifically addressed program income generated from the project facility for the useful life of the project, which EDA set at 20 years. The BVU Authority must use the program income for the operation, maintenance, and administration of the assets or for economic development activities. Therefore, currently the BVU Authority only has to comply with program income requirements for assets created using funds from the 2009 grant.

The BVU Authority has not been tracking program income relative to assets created from the 2009 EDA grant and ensuring that they used it appropriately. The BVU Authority determined that the assets created with the 2009 EDA grant funds generate approximately \$63,000 per year.

Recommendation 9:

As long as the BVU Authority operates CPC OptiNet, they should ensure that this income goes towards administration, operation, maintenance, and repair of the CPC project facilities for the remaining useful life of the assets, which is approximately 2034. In addition, the BVU Authority should record the federal interest in the EDA funded assets.

CPC/BVU Agreement

The Utilities Board and CPC entered in an agreement in 2004 to establish their relationship and define responsibilities and benefits for each party in using the EDA funds to construct the fiber network in the CPC area. This agreement was amended and rewritten over the years. The agreement did not create a separate legal entity. The agreement stated that for accounting and reporting purposes, it created an enterprise called CPC OptiNet through which all funds and payments would flow. The Utilities Board would maintain the transactions in separate accounts and prepare separate financial statements. The Utilities Board would install, maintain, and operate a fiber optic cable backbone with all installation done by contractors acquired through procurement in compliance with the Virginia Public Procurement Act. CPC would provide funds for engineering, acquisition, construction, and operating services obtained through the federal grant with EDA. CPC and the Utilities Board split the net income equally, each receiving half of the net income. CPC and the Utilities Board split the ownership of the assets equally, each owning 50 percent. The Utilities Board leased CPC's assets for \$1 per year so they could operate and maintain the infrastructure. The agreement created a Service Committee to oversee the use and maintenance of OptiNet with two members appointed by each party. The agreement was for 10 years with an automatic renewal for 10 years.

The agreement was amended in 2006 to include additional grant funds and service areas. In addition, it set out that the Utilities Board would provide the last mile infrastructure and services.

In 2010, a new agreement replaced the 2004 agreement with only a few changes. The 2010 agreement specifically states that the agreement does not create a partnership or joint venture; it is an independent contractor relationship. Any revenue generated by BVU Authority owned property will be revenue of CPC OptiNet. CPC and the BVU Authority split the adjusted gross revenue with 10 percent going to CPC and the BVU Authority keeping 90 percent. CPC and the BVU Authority each have first right of refusal if the other party wants to sell its rights to the assets. EDA must approve any sale or transfer. The 2010 agreement does not include the Service Committee. The new agreement was for ten years, with the right to renew.

The last amendment was in 2012 and added fiber optics of the Virginia Coalfield Coalition to the CPC OptiNet network for the BVU Authority to operate and maintain. The amendment also changed the term of the agreement to 20 years, ending August 2030.

The BVU Authority and CPC have interpreted the clause in the agreement that says to create an enterprise to account for the activities of the agreement to mean that the BVU Authority will create a separate enterprise fund from the rest of the BVU Authority's activity. As a result, the BVU Authority has not included the activity and accounts related to CPC OptiNet in its financial statements since the beginning of the relationship in 2004. The BVU Authority includes all of the other OptiNet activity in the BVU OptiNet enterprise fund. The only thing included in the BVU Authority's financial statements is a revenue line item in the BVU OptiNet fund for CPC OptiNet income. This is the net income from the operations left after sending CPC their portion. Since this activity and the accounts have never been included in BVU OptiNet, it has not been audited. In addition, the BVU Authority's financial statements do not include a disclosure explaining the relationship and why the activity is not included.

The BVU Authority has never included CPC OptiNet activity in its financial statements.

To determine why the CPC OptiNet activity has never been included in the BVU Authority's financial statements, we evaluated the relationship to determine if it is a joint venture. Governmental Accounting Standards Board (GASB) Codification Section J50.102 defines a joint venture as a legal entity or other organization that results from a contractual arrangement and that is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control, in which the participants retain (a) an ongoing financial interest or (b) an ongoing financial responsibility. Joint control means that no single participant has the ability to unilaterally control the financial or operating policies of the joint venture. The 2004 agreement had the Service Committee, which appeared to provide joint control. However, there is no evidence that the Utilities Board and CPC ever created this committee, and the Service Committee was not included in the 2010 agreement. More importantly, the 2010 agreement makes it clear that the BVU Authority makes all operating decisions.

“CPC/PPDS shall have no Operating Responsibilities of any kind ... BVU will have the sole right and obligation to perform all Operating Responsibilities and CPC/PPDC will not attempt, directly or indirectly, to perform any Operating Responsibilities ... any attempt by CPC/PPDC employees or agency to participate in Operating Responsibilities shall constitute a breach of this contract for which BVU may immediately terminate this contract.”

Based on this information, the CPC OptiNet assets are jointly owned, but CPC OptiNet operations are solely operated and governed by the BVU Authority and do not meet the criteria for joint control. Therefore, the relationship between the BVU Authority and CPC is not a joint venture for accounting and reporting purposes. Consequently, since operating the CPC OptiNet is part of the BVU Authority, the BVU Authority financial statements should have included the CPC OptiNet activity since the inception of the agreements.

Within their internal financial records, the BVU Authority did not record any of the CPC OptiNet assets. CPC has recorded all of the asset values on their financial statements and the resulting depreciation. In a letter from the former CFO Stacey Pomrenke, she stated, “the entire

[CPC] network has been financed with state and federal grant money, so there is zero capitalization of the business. Every network component owned by the CPC venture is grant-funded. The balance sheet shows the network assets with zero value since the company did not pay for them.” This is completely inaccurate. According to the GASB, Implementation Guide No. 2015-1, question 7.9.7, assets purchased with federal funds should be recorded at historical cost and depreciated while the recipient entity uses the asset even though the federal government retains an interest in the assets. Since the BVU Authority has ownership of 50 percent of the assets, they should at least record their portion of the assets and the related depreciation on their financial statements. However, since all of the assets are used to operate the network and the BVU Authority operates and maintains the network, it would be reasonable for the BVU Authority to record all of the assets and the related depreciation in the enterprise fund that recorded the operation of the network.

Recommendation 10:

The BVU Authority needs to include the CPC OptiNet activity and assets in its financial statements and require their auditor to audit this activity. Without an audit of this activity, there is no accountability or assurance that the BVU Authority has spent these funds appropriately or complied with all federal and state regulations.

Although the agreement between CPC and the BVU Authority states that the relationship is an independent contractor relationship, this is not accurate for accounting and federal reporting purposes. Since the BVU Authority was a co-recipient with CPC on the federal EDA grants and they are responsible for following the federal requirements of the grant, the BVU Authority should have included the receipt and expense of the federal funds on their financial statements and within their Schedule of Expenditures of Federal Awards. In addition, the receipt of these federal funds required the BVU Authority to have them audited as part of their Office of Management and Budget A-133 Single Audit. Since the funds were not included, the BVU Authority auditors have not audited them.

Recommendation 11:

If the BVU Authority obtains any federal grants for the CPC OptiNet operations in the future, they should include these funds and all of the related activity within their financial statements and the Schedule of Expenditures of Federal Awards.

Potential Sale of OptiNet

In the summer of 2015, the BVU Authority received an unsolicited proposal from Sunset Communications to purchase the OptiNet Division, including CPC OptiNet. In February 2016, the BVU Authority and Sunset entered an agreement to negotiate an asset purchase agreement for \$50 million. Below are a few special conditions in the agreement:

- Sunset will assume grant responsibilities, especially in the CPC region.
- Sunset will hire 75-80 BVU Authority employees.

- Sunset will lease part of the BVU Authority building related to OptiNet.
- Sunset will maintain the current rates.
- Sunset must pay the BVU Authority an anti-flip payment if they sell the operations within three years.
- Sunset will continue to support all BVU Authority services that rely on OptiNet services.

Because most of the network was built with state and federal grant funds, there are restrictions surrounding the sale of these assets as outlined in the funding sections above. According to the agreement, it is Sunset’s responsibility to secure its own financing and to secure approvals for the sale from the required entities, including NTIA/BTOP, EDA, Tobacco Commission, CPC, and the City of Bristol.

Cross-Subsidization

The BVU Authority operates multiple utilities – electric, water, wastewater, and telecommunications (OptiNet). Each utility should be self-supporting. The BVU Authority’s contract with TVA requires that electric funds not be cross-subsidized with other utilities. In addition, the Code of Virginia has had different restrictions on cross subsidizing over the years. Prior to fiscal year 2006, the Code of Virginia did not allow cross-subsidization of cable television or any telecommunication funds, including telephone, internet, broadband, information and data transmission services, with other utilities.

In 2006, the General Assembly passed amendments to Code of Virginia Section 56-265.4:4 that allowed the Utilities Board to cross-subsidize funds related to internet, broadband, information, and data transmission services, but not telephone, since telephone was not referenced. In addition, since Code of Virginia Section 15.2-2108.11, which regulates cable services provided by a municipality, has not changed since 2003, the Utilities Board still could not cross-subsidize cable television funds. Finally, in 2016, the General Assembly passed another amendment to Code of Virginia Section 56-265.4:4 that prohibits the BVU Authority from cross-subsidizing any telecommunications funds.

-
- Code of Virginia restrictions on cross-subsidization:
- *Prior to 2006 – all prohibited*
 - *2006 to 2016 – telephone and cable prohibited*
 - *After July 1, 2016 – all prohibited*
-

Interdivisional Transactions

As discussed above, the Code of Virginia and the BVU Authority's contract with TVA prohibits cross-subsidization within the BVU Authority. To prevent cross-subsidization between divisions, the BVU Authority created interdivisional transactions, which are transactions existing or occurring between divisions of an organization. Divisions provide multiple services to each other. The Electric Division provides electric services to Water, Wastewater, and OptiNet Divisions. The Water, Wastewater, and OptiNet Divisions rent their share of the building from the Electric Division. The Water Division provides water service to the Electric and OptiNet Divisions. The OptiNet Division provides phone, internet, and video services to the Electric and Water Divisions. The majority of these transactions have a reduced level of risk and were not part of our review. We reviewed the high-risk transactions that were susceptible to cross-subsidization, which include the Electric and OptiNet Divisions' transactions related to supervisory control and data acquisition (SCADA) and advanced metering infrastructure (AMI).

SCADA refers to industrial control systems used to control infrastructure processes such as water treatment and wastewater treatment or industrial processes such as power generation. AMI is a method for automated, two-way communication between a smart utility meter with an IP address and a utility company. The goal of an AMI is to provide a utility company with real-time data about power consumption and allow customers to make informed choices about energy usage based on the price at the time of use. AMI allows the Electric Division to remotely poll meters located at 16,700 BVU Authority customer sites.

OptiNet charges the Electric Division a monthly fee for 24 hours a day monitoring and maintaining the equipment and fiber network to support the SCADA and AMI networks. This involves employees from the Network Support Center, Network Operations Center, Network Engineering, Fiber Engineering, and Field Services and totals approximately \$1.5 million annually. If the BVU Authority did not have the OptiNet Division, the Electric Division would have to purchase these services from an outside vendor.

Currently the BVU Authority does not maintain written agreements between its divisions for their interdivisional transactions. Management relies on division employees to know the details of the agreements. However, if employee turnover occurs, which is likely with the pending sale of OptiNet, then those details could be lost, thus impacting the knowledge needed to obtain the service from another provider.

Recommendation 12:

The BVU Authority should create and maintain written agreements between divisions for all interdivisional transactions. These agreements should outline details of the services provided by each division, the cost of the services, and payment terms including due dates and penalties assessed for late fees. The maintenance of these agreements will be critical once the decision has been made as to whether or not OptiNet will be sold as these agreements will become contractual obligations if the Electric Division continues to purchase these services from the purchaser of OptiNet.

Elimination of Interdivisional Loan

In fiscal year 2007, the Utilities Board improperly removed from the financial statements all of an interfund receivable/payable in the amount of \$23,393,517 between the Electric Division and the OptiNet Division. The interfund receivable/payable occurred when the Electric Division advanced funds to the OptiNet Division to establish working capital to build the OptiNet network. Prior to fiscal year 2006 when the Utilities Board made the advances, the Code of Virginia did not allow cross-subsidization of cable television or any telecommunication funds with other operations, thus requiring the OptiNet Division to repay the advance. (Code of Virginia Sections 15.2-2108.11 and 56-265.4:4)

In 2006, the General Assembly passed amendments to Code of Virginia Section 56-265.4:4 that allowed the Utilities Board to cross-subsidize funds related to internet, broadband, information, and data transmission services, but not telephone, since telephone was not referenced. In addition, since Code of Virginia Section 15.2-2108.11 has not changed since 2003, the Utilities Board still could not cross-subsidize cable television funds.

In 2007, the Utilities Board, without properly documented approval from the Board, decided to use its new ability to cross-subsidize to eliminate the interfund receivable/payable of \$23,393,517. However, the BVU Authority's methodology to do this was flawed. The BVU Authority allocated the original cost of all of the OptiNet Division assets by telephone, cable television, and internet (internet, broadband, information, and data transmission services). The allocation of the assets resulted in the following percentages:

Cross-Subsidization Allocations

Table 5

Service	Cross-Subsidization	Percentage
Internet	Allowed	61.11%
Telephone	Not Allowed	17.62%
Cable Television	Not Allowed	21.27%

Sources: Technical Associates, Inc. "OptiNet Fully Allocated Cost Study" and Code of Virginia

The Utilities Board determined that the fair market value of the OptiNet Division was \$45 million, applied the 61.11 percent related to internet, which could be cross-subsidized, to the fair market value, and determined that they could eliminate up to \$27.45 million in debt. Since the debt was only \$23 million, the BVU Authority felt they could conservatively eliminate the entire balance through cross-subsidization.

While the percentage used appears reasonable, it was inappropriate to apply the 61.11 percent to the fair market value of the OptiNet Division. Applying the internet percentage to the fair market value does not give you the amount of debt associated with OptiNet. The debt was incurred to create the backbone of the OptiNet network, which is recorded at historical cost not fair market value; therefore, the BVU Authority should have applied the percentage to the actual \$23 million of debt not to the fair market value of the OptiNet Division. Under governmental accounting standards,

it is always preferred to use actual information over estimates when actual information is available. Table 6 below shows the appropriate application of the percentages to the debt, not the fair market value of OptiNet, and the amount of debt that was improperly eliminated:

OptiNet Debt Allocation

Table 6

Service	Cross-Subsidization	Percentage	Portion of debt
Internet	Allowed	61.11%	\$14,295,779
Telephone	Not Allowed	17.62%	4,121,938
Cable Television	Not Allowed	21.27%	4,975,801
Amount of debt improperly eliminated			\$ 9,097,739

Sources: Technical Associates, Inc. "OptiNet Fully Allocated Cost Study" and [Code of Virginia](#)

The Electric and OptiNet Divisions created inter-departmental notes that included the accrual of interest as part of the debt. The notes were designed to be repaid on terms and conditions that were advantageous to the Electric Division, commercially reasonable, and equivalent to terms and conditions imposed if financed by a non-affiliated commercial lender. As a result, we have calculated an interest rate of 4.21 percent based on a weighted average of the prime rate for 2007 through 2016, which we used to calculate the interest foregone over the years the debt was not included on the BVU Authority's financial statements. This amount is \$4,643,549. The BVU Authority should continue to accrue interest on the unpaid balance until it is paid.

There is no evidence that any part of the process for determining the amount to be written off was reviewed or approved by board members. Given the significant dollar amount, the board should have been involved in the decision process. The BVU Authority should not write off debt or conduct any financial transaction of this magnitude without board approval.

Recommendation 13:

The BVU Authority should re-establish an interfund receivable/payable, including foregone interest, between the Electric and OptiNet Divisions in the amount of \$13,741,288.

The re-establishment of the interfund receivable/payable could affect the potential sale of the BVU Authority's OptiNet Division because it will increase the amount of debt that the BVU Authority must pay off with proceeds from the sale and will reduce the amount of funds available to satisfy grantors with claims on the BVU Authority's assets.

The BVU Authority should develop and implement policies and procedures outlining thresholds for transactions needing board approval. These policies and procedures should state the type of documentation to be provided to the board for review and approval of the transaction. The board's decision should be clearly documented and maintained within board meeting minutes.

Ability to Continue as a Going Concern

The BVU Authority’s OptiNet Division has a potential going concern issue, as it appears that they do not have the resources to continue operating without cross-subsidization, which the Code of Virginia prohibits. In fiscal year 2015, the OptiNet Division operated with a net loss of \$673,018. The BVU Authority predicts the OptiNet Division will continue to experience a net loss for fiscal years 2016 and 2017. The cable and internet services of OptiNet are financially unable to support themselves. Telephone revenues have been subsidizing internet since 2012 and cable since at least 2011.

OptiNet Net Income/(Loss) by Service by Fiscal Year

Table 7

	2011	2012	2013	2014	2015
Telephone	\$1,732,576	\$1,994,936	\$2,485,148	\$2,584,310	\$2,224,248
Internet	541,778	(86,086)	(309,157)	(350,137)	(1,195,779)
Cable	(438,593)	(488,640)	(619,079)	(769,705)	(1,701,487)
Net Income/(Loss) prior to Transfers	\$1,835,761	\$1,420,210	\$1,556,912	\$1,464,468	\$(673,018)

Source: BVU Authority internal OptiNet Income Statements

The BVU Authority is considering raising rates for cable, but may not be able to raise them sufficiently to support operations without raising them so high that they lose customers.

In addition to a net loss, OptiNet may not be generating enough cash from operations to pay both the principal and interest owed on its bonds. As mentioned in the “Cross-Subsidization of Debt Service” section later in this report, the BVU Authority has not been properly allocating the interest and principle debt payments across the OptiNet services because they have not updated the allocation percentages since 2005, and they have not been allocating the principle portion at all, just paying it in total from OptiNet. As a result, the BVU Authority likely cross-subsidized services over time within the OptiNet Division. These items along with the reinstatement of the debt and associated interest recommended above only puts OptiNet further into financial detriment. These conditions raise substantial doubt about OptiNet’s ability to continue operating. If the BVU Authority does not sell OptiNet, it will have to determine how it will continue operations. See the section entitled “Funding the Development of the Fiber Optic Network” to see information on the potential sale of OptiNet.

Recommendation 14:

If the BVU Authority does not sell the OptiNet Division, they will need to either put the division up for sale to another entity or find options to make OptiNet, specifically the internet and cable operations, profitable so they can continue to operate it. If the BVU Authority continues to operate OptiNet, they should work with the General Assembly to propose legislation to authorize cross-subsidization across its services and divisions.

Bonds

Bond Financing

In October of 2010, the BVU Authority issued bonds, totaling \$45.45 million, to re-finance existing debt from 2003 and 2007 and to obtain additional needed funds for capital projects and improvements for all of its utilities. It was just prior to this in 2010 when the Utilities Board officially separated from the City of Bristol and became the BVU Authority. This effectively removed debt attributable to the utilities of Bristol from the City's books. The BVU Authority issued this debt through the Virginia Resources Authority, a bond issuing entity intended to fund needed capital projects in the Commonwealth. As part of this issuance, the BVU Authority entered into a master bond indenture with strict covenants as to how to use the bond funds. During our review, we performed an analysis of the requirements set forth in the master bond indenture (indenture) and the supplemental indenture to the bond agreement (supplemental indenture) to determine whether the BVU Authority has complied with the terms. During our review, we noted the following instances of non-compliance.

Section 7.1 of the indenture lists the specific funds that the BVU Authority must establish and how the BVU Authority can use these funds. These funds include subordinate debt service, repair and replacement, and general reserves. The BVU Authority did not set up the correct funds as outlined in the indenture to demonstrate that they set aside the appropriate reserves for their intended purposes. The BVU Authority did establish a reserve fund with internal cash reserve targets, but did not establish separate funds for the subordinate debt service, repair and replacement, and general reserves. Although the BVU Authority has sufficient cash reserves to satisfy the reserve requirement during each year of our review when considering cross-collateralization between utilities, the BVU Authority keeps most of this cash in the general reserve fund, which should be budgeted separately per the indenture. The indenture requires separate accounts for principal and interest within the bond fund. However, during our review, we only noted lump sum payments from one account in the general ledger. Below, we outline how the BVU Authority is required to budget and account for all utilities services separately to prevent any cross-subsidization of funds. For more information on this, refer to the section entitled "Cross-Subsidization of Debt Service."

Section 7.8 of the indenture also requires an analysis of upcoming needs for repair and replacement of capital assets. The indenture goes on to state that the BVU Authority will regularly determine a reserve requirement based on these needs, but "will not allow the reserves in this fund to be reduced below \$850,000 for any reason." This determination should consider major repairs and replacements of system assets, such as the underground water and wastewater infrastructure. The BVU Authority should determine this future need and set aside funds over time to defray these costs. The BVU Authority has budgets for capital projects, which appear to be in excess of the minimum requirement. However, these partially rely upon future cash flows and not an amount already put aside exceeding the \$850,000 requirement at all times. As noted in the "Policies and Procedures" section, the BVU Authority does not prepare long-range maintenance or capital plans for the utilities it provides. These long-term plans would help to assess upcoming needs for repair

and replacement of capital assets and set aside reserves appropriately, as noted in the bond indenture.

Section 7.9 of the indenture requires the establishment of a general reserve fund. The indenture itself does not require a minimum balance within this fund, but the BVU Authority established reserve targets for this fund based on recommendations of an external consultant. There were several instances within the individual utilities when the BVU Authority did not set aside enough cash to meet the cash reserve targets. Within the water utility, cash reserves came up short of their targets in fiscal years 2011, 2012, 2013, and 2014. Within OptiNet, the cash reserves were short of their targets in fiscal years 2013 and 2015.

Section 9.3 of the indenture requires the BVU Authority to create an annual budget by fund based on the funds outlined in Section 7.1 to demonstrate that they would not use monies that should be set aside for reserves or other purposes. The BVU Authority must submit this budget to their trustee in advance of the fiscal year to which it pertains. The BVU Authority prepared and submitted operating and capital budgets to the board each fiscal year. These budgets incorporated operating revenues and expenses as well as upcoming capital expenditures, but did not include cash reserves and did not incorporate all funds outlined in Section 7.1 of the indenture. The BVU Authority could not provide supporting documentation for these historical budgets or evidence that the BVU Authority had considered those reserve funds. Further, the BVU Authority's procedures did not include submitting the annual budgets to the trustee in advance of the appropriate fiscal year.

Section 9.12 of the indenture requires that the BVU Authority "at all times comply with all the laws of the United States of America and of the Commonwealth applicable to it, particularly the provisions of the Virginia Public Procurement Act." As described in [Appendix A](#), employees of the BVU Authority have violated laws of the United States. In addition, as noted in the section entitled "Procurement," employees of the BVU Authority violated numerous provisions of the Virginia Public Procurement Act. Therefore, the BVU Authority has not complied with this section of the indenture.

Section 9.18 of the indenture requires prompt notification to the trustee if material damage or destruction occurs to the BVU Authority's utilities system. However, the BVU Authority does not have policies and procedures to perform an adequate regular physical inventory of assets to identify such damage. In addition, the existing policies and procedures only include guidance on OptiNet supplies and materials impairments. It does not address fixed asset impairments for any of the utilities. Further, there was no documentation of the need to notify the trustee in the event of significant impairments to any asset. This increases the risk that management will not become aware of material damage to the system and be able to notify the trustee in a timely manner, which would result in noncompliance with this section of the indenture.

Utility Rates

Section 9.4 of the indenture requires the BVU Authority to establish, fix, charge, and collect rates, fees, and other charges for the use of and for the services furnished by the system and to revise such rates, fees, and other charges so that in each fiscal year, net revenues achieve certain thresholds

outlined in the indenture. During the budget process each year, the BVU Authority has historically done projections of revenues needed to cover planned expenses. Based on customer counts and expectations of the coming year, the BVU Authority proposed rates, which will exceed the cost of operating and capital expenditures. If these projections identified the need to increase rates, the President/CEO would develop and present this recommendation to the board for approval. Generally, for electric rates, the BVU Authority simply passed the rate increases from TVA through to the customer. However, for the remaining utilities, the BVU Authority developed the rate recommendations. The BVU Authority has used rates consultants in developing these recommendations. We performed a review of the rate setting process throughout the period of July 1, 2010, through June 30, 2015, to determine if the BVU Authority follows a reasonable process for setting rates and includes all pertinent information in this determination.

While the revenues earned did appear to achieve the net revenue thresholds outlined in the indenture, the BVU Authority did not consider all expenses when recommending new rates. For OptiNet products, the BVU Authority had no evidence where they considered discounts, commissions, and other overhead costs when setting profit margins. Not considering these items increases the risk of not achieving revenue and cash reserve targets. A more extensive review of discounts and commissions, as well as the budgeting of different overhead expenses, is in the section entitled “Billing and Discounts.”

The BVU Authority did not consider discounts, commissions, and other overhead costs when setting rates for OptiNet.

In 2003, the Utilities Board entered into a franchise ordinance agreement with the City of Bristol in which the City has the right to approve or disapprove rates charged by the BVU Authority for cable television services. This ordinance agreement requires the BVU Authority to obtain approval for rate increases exceeding four percent per year from the City Council. In fiscal years 2012 and 2013, the cable rate increase exceeded the four percent threshold, but there was no documentation of City Council approval, which violates the franchise ordinance agreement. In addition, since the cable portion of OptiNet has operated at a loss since at least fiscal year 2011, the BVU Authority has not set the cable rates at a level that will cover the necessary operating and debt expenses.

In general, the BVU Authority adopts recommended electric rates and changes from TVA based on what TVA charges the BVU Authority. However, the BVU Authority has the options to 1) pass rates increases through to the customers, 2) absorb the increase in cost and keep rates consistent with the customers, or 3) obtain approval from TVA to increase rates beyond TVA’s recommendation. In October of 2011 and October of 2014, the BVU Authority adopted the increase in electric rates from TVA, but did not have evidence of approval from the board. Although the BVU Authority simply passed through the recommended rate change, without board acknowledgement, there is no evidence that the board considered whether an additional or reduced rate increase was necessary.

Recommendation 15:

The BVU Authority should establish the subordinate debt service, repair and replacement, and general reserve funds as outlined in the indenture and ensure cash within those funds meets minimum reserve requirements and targets. Further, the BVU Authority should develop and implement policies and procedures over the budgeting process to ensure the budget is prepared in accordance with each requirement of the indenture, is provided to the trustee in advance of the fiscal year, and incorporates any anticipated reductions to revenue, such as discounts and commissions. BVU Authority should incorporate cash reserves in the annual budget in addition to operating expenses. This should be a significant consideration when developing recommendations for changes in utility rates. The BVU Authority should set rates that cover all operating and debt expenses to ensure each utility is self-supporting. Finally, the BVU Authority should obtain all necessary approvals for all rate changes prior to the date the changes take effect. Implementing these recommendations will reduce the risk of any event of default of the bonds.

Cross-Subsidization of Debt Service

As noted earlier in this report, the BVU Authority cannot subsidize one utility with funds from another, a process known as cross-subsidization. This means that one utility cannot pay the debts of another if the utility receiving the additional funds does not have sufficient resources on its own. Therefore, it is critical that the BVU Authority properly allocate cash among the different services to ensure that one utility is not paying the debts on behalf of another. The BVU Authority tracks each utility on a separate ledger within the accounting system, including electric, water, wastewater, and OptiNet. However, the BVU Authority relies upon manual allocations between the different services within OptiNet, which include telephone, internet, and cable. We performed a review of the allocations of the different OptiNet services and noted the following items below.

The BVU Authority has not performed a re-allocation of the different fiber optic services it provides in order to show the proper proportions of OptiNet debt attributable to cable, phone, and internet services since 2005. The BVU Authority has relied upon static, or unchanging, utilization percentages to determine how much of certain expenses they allocate to telephone, internet, and cable services. Further, the BVU Authority's allocation only extends to amounts reported on the statement of revenues, expenses, and changes in net position but has not allocated amounts on the statement of net position. This means that assets, liabilities, and net position are not broken out among telephone, internet, or cable through an allocation or separate tracking. This increases the risk that one of these services is not maintaining a sufficient amount of cash to pay its bills and is being subsidized by another service.

The BVU Authority has relied on static utilization percentages to allocate expenses to telephone, internet, and cable services.

According to the BVU Authority's hired consultant's study, which was included within the official statement of the BVU Authority's 2003 bond issuance, "Internal financial control structures and a cost allocation methodology based on usage of services will be implemented so that cross-

subsidization does not occur between the Telephone, CATV, and Internet Services. Because the costs of the Communications Division, which are being financed by bond proceeds, are shared among the Telephone, Internet, and CATV Systems, BVU Authority will allocate operating expenses and debt service based on customer utilization of each System as such utilization changes over time.” It does not appear that the BVU Authority considered these changes in utilization over time. Using current revenue amounts and customer counts, we estimated what the current allocation would be. Based on this estimate, the BVU Authority may not have generated enough cash from operations during fiscal year 2015 and likely cross-subsidized its payment of interest with cash from telephone and internet by as much as \$51,168. Using the allocation methodology from the 2005 study noted above, cable appears to owe \$203,268 in interest expense as this methodology allocates 22.84 percent of this expense to cable. However, using 2015 figures provided by the BVU Authority, cable makes up 34.03 percent of OptiNet operating revenues and 34.76 percent of OptiNet customer counts. By averaging these two percentages and applying them to the interest expense, this would increase cable’s share to about \$306,074. Cable did not generate enough revenue in 2015 to cover this and other cash outflows.

Recommendation 16:

The BVU Authority should track cash balances and cash flows of each OptiNet service separately and should update the allocation percentages used to break out the different OptiNet services more frequently based on more current utilization data for each service. This will reduce the risk of cross-subsidization of debt service and other payments, which does not comply with relevant accounting standards and the Code of Virginia. With the data made available to us during the time of our review, we were unable to go back and historically allocate cash generated by each OptiNet service. Therefore, it is not possible to know how much cash and cash reserves are attributable to each service. As this is a complex allocation, the BVU Authority should determine how they could update this allocation more frequently to allocate revenues, expenses, assets, and liabilities properly based on current usage.

FISCAL OPERATIONS

Procurement

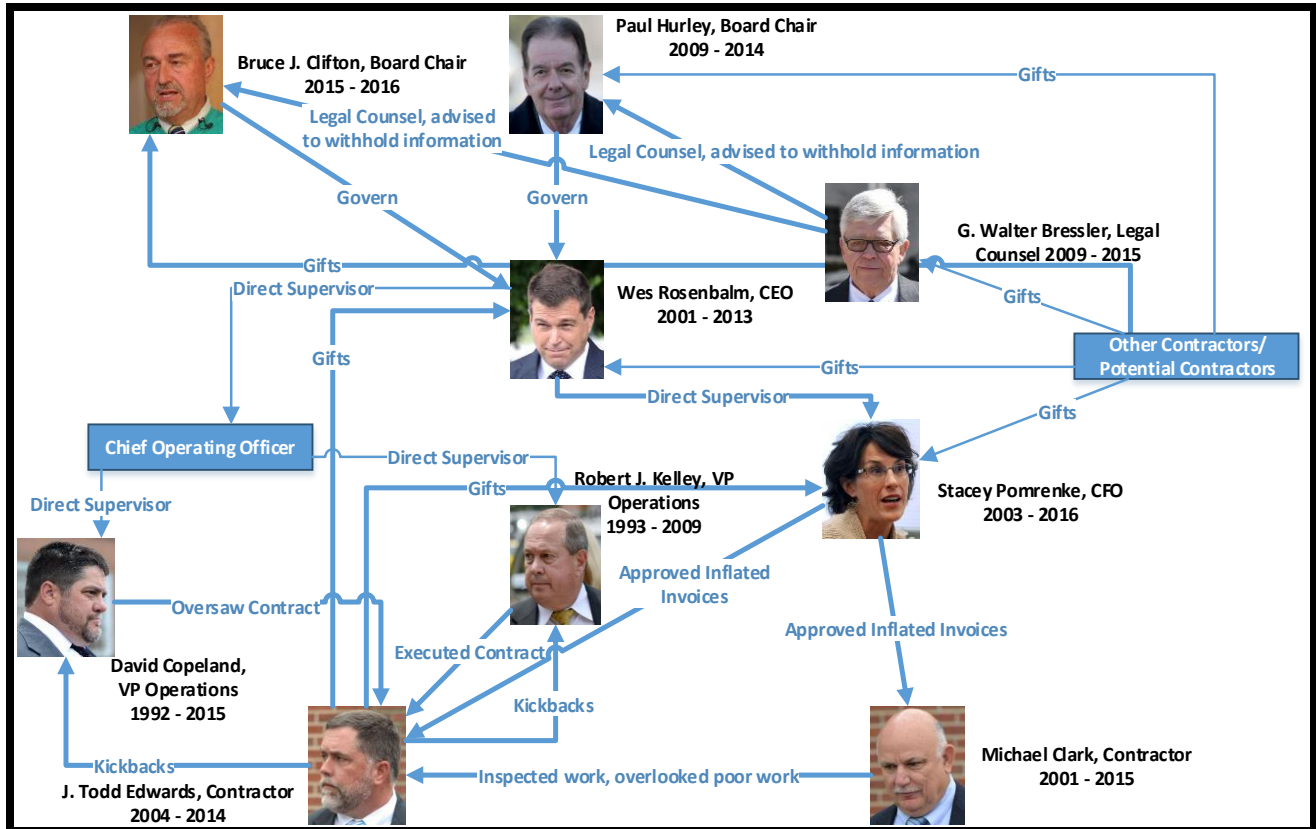
Virginia Public Procurement Act

The BVU Authority relies heavily upon the services of hired contractors to build and maintain its infrastructure—particularly the fiber optic network. This involves spending tens of millions of dollars on contracted goods and services each year. As a political subdivision of the Commonwealth of Virginia, the BVU Authority is subject to the Virginia Public Procurement Act (Act). As a locality and political subdivision of the Commonwealth of Virginia, the City of Bristol is also subject to the Act. Therefore, prior to the BVU Authority Act of 2010, this would still apply to the Utilities Board, as the BVU Authority was then known. It is critical that the BVU Authority implement a system of internal control, which will reasonably ensure compliance with the Act.

As charges brought against BVU Authority employees and contractors pertained to contractual agreements with the BVU Authority, we performed a review of the BVU Authority's compliance with the Act. We reviewed the procurement of all contracts between the BVU Authority and contractors who were convicted of crimes related to their services provided to the BVU Authority as well as contracts in which the BVU Authority is still involved today. The now convicted contractors ran businesses known as Edwards Telecommunications, Inc. (ETI) and R&M Enterprises (R&M). Below is a summary of instances of non-compliance and deficiencies in internal control we found. It is important to note that no system of internal control can fully prevent instances of fraud or error. This is especially difficult in cases of collusion between contractors and employees. However, a proper system of internal control with separation of duties can reduce such risks but can never fully assure an organization that these instances will never occur. As shown in Figure 6, when multiple parties are involved in a system of collusion, even individuals in properly segregated roles can work together to commit fraud.

Network of Collusion

Figure 6



*Sources: Federal Court Documents, including Agreed Statements of Facts and Plea Agreements with each defendant and *Roanoke Times*

Section 2.2-4302.1 of the Act requires a competitive sealed bidding process and lays out the necessary elements this process must contain. During our review, the BVU Authority could provide no evidence of a competitive sealed bidding process for their contracts with ETI or R&M. In addition, there were two other contracts with no evidence of this process, one of which the BVU Authority was still using. There were clippings from newspapers, indicating advertisement of the procurements, but no evidence of any other bids received for the original contracts with ETI or R&M. In 2013, this section of the Act began encouraging local public bodies to post these solicitations to the Department of General Services' centralized procurement website, eVA. The BVU Authority first used the eVA website in fiscal year 2010. For the latest contract with R&M, which was in 2014, there was no evidence where the BVU Authority had posted this solicitation to eVA.

Section 2.2-4302.1 of the Act also requires the BVU Authority to post advertisements of these solicitations at least ten days prior to the date they will receive the bids. This allows more bidders to become aware of these opportunities and facilitates more bidders being involved in the process. In addition, this section requires a public opening or announcement of bids received and a detailed evaluation of the bids based on requirements set forth in the invitation to bid. If the BVU Authority procures these services through a sole source methodology, the BVU Authority must document a justification for this decision and post it publicly. Even if the BVU Authority received only one bid,

they must still evaluate the bidder's qualifications and responsiveness. Our review of contracts with ETI and R&M found no evidence of the dates the BVU Authority posted the advertisements, documentation of a public opening, an evaluation of the bids received, or any justification for a sole source procurement. Without any of this documentation, there is no evidence of compliance with this section of the Act. We reviewed an additional solicitation for bids, which the BVU Authority posted to eVA less than ten days prior to the date of acceptance of the bids. This represents non-compliance with the Act.

Upon review of the procurement of the BVU Authority's contract with TVA, no evidence of competitive negotiation, discussions with two or more offerors meeting all criteria set forth in the Act, or documentation of the scoring of bid proposals was present. These are all requirements of this section of the Act and this contract is still in place today.

Recommendation 17:

The BVU Authority should consistently post all solicitations to the eVA website and post these advertisements at least ten days in advance of the date set for the receipt of bids. While posting solicitations to a bulletin board in the lobby or newspaper may technically satisfy the posting requirement, in the age of electronic communication, posting to the eVA website will help to ensure they receive the best bids possible by increasing access. If they receive only one response to the request for bids or proposals, the BVU Authority should consider re-soliciting the work to ensure the contract is procured in the most competitive manner. If there is only one bidder, the BVU Authority should still document its analysis of whether this bidder was responsive, responsible, and provided a reasonable price. This will provide an opportunity for more bidders to submit proposals and help increase competition. Implementing these recommendations will enable the BVU Authority to comply with the provisions of Section 2.2-4302.1 of the Virginia Public Procurement Act.

Section 2.2-4302.2 of the Act governs the procurement of professional services, which includes professional engineering. The contract in place between the BVU Authority and R&M includes engineering as part of the scope of services, which R&M was to provide. This section of the Act requires that, for professional services, the BVU Authority should have entered into competitive negotiation with this contractor—even if this contractor was the only bidder. However, there was no documentation or evidence of this negotiation. This presents the risk of not obtaining the most favorable pricing and other terms for services of the vendor and does not comply with the Act. This also validates the fact that the BVU Authority did not competitively procure this contract, awarding it directly to R&M at their stated price.

Section 2.2-4303 of the Act sets the guidelines for the methods of procurement, which public entities must follow. All methods of procurement outlined in this section of the Act require some form of competition, whether in the form of competitive sealed bidding, competitive negotiation, or otherwise. Upon review of the current contract with the TVA, the BVU Authority could provide no evidence of any competitive procurement.

Multiple sections of the Act provide examples of activities, which would represent debarment from contracting with the Commonwealth. There was no evidence the BVU Authority reviewed any listing of suspended or debarred vendors for any of the procurements of contracts with ETI or R&M or during the procurement of the current contract with the TVA. Although these vendors were not debarred at the time of these procurements, this would help to ensure that the BVU Authority does not enter into a contract with a vendor on a suspended or debarred vendor listing. In addition, during our review of current contracts, we found no documentation of this type of review in the procurement files.

Section 2.2-4310 of the Act requires the consideration of Small, Women- and Minority- (SWAM) owned businesses. The Act requires that entities consider vendors from the Department of Small Business and Supplier Diversity. During our review of contracts with ETI, R&M, and the current contract with the TVA, we found no documentation of this consideration. In addition, during our review of the procurement of all current contracts, we found no instance where the BVU Authority documented this consideration. Without documentation of this consideration, there is no evidence that the BVU Authority complied with this section of the Act.

Section 2.2-4311 of the Act lays out required provisions of contracts procured by the Commonwealth. One such provision is that the potential contractor is an equal opportunity employer and does not discriminate. The BVU Authority's contracts with ETI and R&M as well as the current contract with the TVA included no evidence of the contractors representing themselves as equal opportunity employers. Further, as ETI was a construction contractor, paid through the NTIA/BTOP federal grant, the contract should have included federal requirements. For instance, the Davis Bacon Act, which is applicable to this grant requires prevailing wage rates paid to employees of the contractor. Although the BVU Authority monitored the actual pay compliance with the Davis Bacon Act, there was no clause in the contract indicating ETI would comply with the Davis Bacon Act. Finally, this section requires a contract provision that contractors should be legal to conduct business in the Commonwealth. The BVU Authority had no evidence that ETI or R&M represented themselves as legal to conduct business in the Commonwealth, or that the BVU Authority had researched this prior to awarding the contract.

Section 2.2-4312 of the Act requires contractors of public bodies within the Commonwealth of Virginia to maintain a drug-free workplace. There was no evidence of the contractors, ETI and R&M, representing themselves as having a drug-free workplace. In addition, there is no such representation within the current contract with the TVA.

Section 2.2-4316 requires every public body awarding contracts to establish procedures whereby comments concerning specifications or other provisions in invitations for bid (IFB's) or requests for proposals (RFP's) can be received and considered prior to the time set for receipt of bids or proposals or awards of contracts. An IFB is a file containing a description of the needed goods or services along with the specifications and contractual terms and conditions applicable to the procurement. Entities send this file out to all potential bidders or post it to a website. In an IFB, the bidders who elect to respond will provide their qualifications, how they will meet the specifications, and the pricing they will offer. From these responses, public bodies evaluate the bidders and select

the lowest responsible bidder. An RFP is a file, which contains general terms about the goods or services sought by the public body along with specifications or qualifications, which will be required. In an RFP, the vendors provide their proposals to satisfy the needs of the public body and compete for the right to enter into a competitive negotiation for these goods or services.

During the time in which the Utilities Board contracted with ETI and R&M, there were no such procedures where the Utilities Board could receive public comment. In addition, Section 2.2-4318 indicates that public bodies should negotiate with the lowest responsive and responsible bidder, but existing procedures did not contain details of how the Utilities Board employees should handle these negotiations. Although the purchasing manual (discussed in the section entitled “Internal Procurement Policy”) did reference the Act where employees could obtain this guidance, there was no specific guidance as to who should perform these negotiations or what terms would be acceptable to the Utilities Board.

Section 2.2-4336 of the Act requires the BVU Authority to ensure that bid bonds accompany the bids for projects exceeding \$500,000. The contract with ETI resulted in payments far exceeding this amount. Although ETI provided bid bonds several years after the first contract was in place, there was no evidence the contractor provided this in any form prior to entering into the contract. Without documentation of these bid bonds, the Utilities Board did not comply with this section of the Act.

Section 2.2-4342 of the Act requires public bodies to make all procurement files available for the public. The BVU Authority did not have any procurement documents other than the contracts themselves and, in some cases, a newspaper ad. In one case, there was a contract currently in place with no evidence of a competitive procurement at all. Therefore, a complete procurement file, showing all other bids received or an evaluation of the proposals would not have been available for public inspection for contracts with ETI or R&M. The BVU Authority did not comply with this section of the Act.

Sections 2.2-4371 and -4372 of the Act forbid the acceptance of gifts or kickbacks by government officials, defined as public employees, from contractors or subcontractors. The Act defines “public employee” as “any person employed by a public body, including elected officials or appointed members of governing bodies.” Therefore, as the BVU Authority is a political subdivision of the Commonwealth of Virginia, this definition would include both employees as well as members of the BVU Authority Board. As described in [Appendix A](#), five employees and two members of the board have been convicted of crimes related to their relationships with contractors and potential contractors. Several of these charges directly relate to soliciting, demanding, or accepting items of value in exchange for influence or favorable treatment. In addition to violating the laws of the United States, for which the individuals have pled guilty, this is also a violation of the Act.

Recommendation 18:

The BVU Authority should competitively procure all goods and services, as the Act requires. The BVU Authority should document the time, location, and attendees of all competitive negotiations pertaining to the awarding of contracts as well as the scoring and tabulations of all bidders. The BVU Authority should perform and document a review of all suspended or debarred vendors, consideration of SWAM-owned businesses, a review of the vendor’s manual, qualifications, insurance, State Corporation Commission registration, and authorization to conduct business in the Commonwealth. Further, the BVU Authority should maintain all documentation in a procurement file throughout the life of the contract. This will provide evidence of compliance with the Act and Commonwealth best practices.

Internal Procurement Policy

During the time in which the Utilities Board procured the services of contractors who have since been convicted of crimes related to their service, the Utilities Board did have an internal purchasing manual in place. The purchasing manual was in effect from 2001 through 2014. The BVU Authority repealed the manual in 2014 because they thought it was redundant of the Act. The policies and procedures manual created in 2015 includes a purchasing section; however, it is very limited and does not provide adequate guidance to BVU Authority employees to ensure compliance with all laws and regulations. It does not speak to specific terms to be included in IFB’s and RFP’s; it does not require a reconciliation of the purchase order, purchase requisition, receiving report, and invoice; and it references the more detailed purchasing manual, which has since been repealed.

Recommendation 19:

The BVU Authority should update its procurement policy and ensure this manual provides reasonable assurance of compliance with the Act. Once finalized, the board should review and approve this policy prior to implementation. This will reduce the risk of non-compliance to the Act and best procurement practices.

During our review, we performed an additional analysis to determine whether employees of the BVU Authority had also violated the BVU Authority’s internal policy and overall best practices when procuring these contracts. Below is a summary of items, which represent potential instances of non-compliance with the purchasing policy in place at the time of procurements with the selected contracts.

Section 3-1 of the BVU Authority’s Purchasing Manual in place during 2001 - 2014 (policy) states “only the purchasing manager or general manager have the authority to perform the function of purchasing for BVU, excepting specially delegated authority...” Operations personnel signed contracts with ETI and R&M and had no documentation of purchasing manager involvement. The BVU Authority could not provide any documentation of a proper delegation of authority for these individuals to procure these contracts. In addition, the newspaper ads present instructed potential

bidders to submit proposals to the attention of the operations personnel as opposed to the purchasing manager, in some cases. This violates this section of the policy.

Section 3-2 of the policy states that the “departmental managers will submit signed requisitions to the purchasing manager for processing.” Further, Section 4-2 of the policy states that “all requisitions shall originate in the department which requires the goods or services.” The BVU Authority could not provide any documentation of purchase requisitions for any of these contracts. This section also states that departmental managers will submit pertinent information concerning requisitioned goods to the purchasing manager. The BVU Authority did not have a pricing schedule or description of work for the original ETI Contract. There was an hourly rate for the R&M contracts, but BVU Authority personnel did not use individual requisitions or purchase orders for individual job orders for these contracts. There was also no documentation of a review of the purchasing manager for these contracts. Without any documentation of purchase requisitions, contractors submitted bills for work without any written request for the work, resulting in noncompliance with this section of the policy.

Section 3-3 of the policy states that the “purchasing manager’s duties shall include the purchase or supervision of the purchase of all goods, services, construction for BVU [Authority].” Further, Section 4-1 of the policy states that “any participation by other employees in this process must be conducted under the auspices and with the full knowledge of the purchasing manager.” The BVU Authority could provide no evidence of purchasing manager’s involvement in any of these selected contracts. This violates these sections of the policy and circumvents the control of the purchasing manager.

Section 4-1 of the policy states that the “purchasing manager has the sole authority to conduct and conclude all negotiations affecting purchase[s]...” However, the BVU Authority could not provide any evidence of negotiating any of these past selected contracts or the involvement of the purchasing manager.

Section 4-3 of the policy states that “the purchasing manager shall have the authority to question the quality and quantity of goods and services requisitioned and to inspect the quality and quantity of goods and services received to protect the best interest of BVU...” Section 4-4 of the policy states that “the purchasing manager shall review requisitions to ensure compliance with departmental budgets...” The BVU Authority could not provide any documentation showing purchasing manager involvement or requisitions or purchase orders for any of these selected contracts. The BVU Authority could not provide any evidence that they sent information about these contracts to the purchasing manager to provide the option to inspect these goods and services.

Sections 5-1 and 5-2 of the policy require the use of a purchase order from the purchasing manager. These sections also require the purchasing manager to forward a copy of the purchase order to accounts payable as well as the warehouse and the vendor. However, the BVU Authority could provide no evidence of purchase orders for these selected contracts, nor any documentation of sending this information to accounts payable or the warehouse. These sections go on to require the use of a receiving report and a reconciliation of the receiving report, packing slip, purchase order,

and requisition. These items, once reconciled are required to be kept in a file, called the “purchase order packet,” and sent to accounting. The BVU Authority had no purchase order packets other than the invoices and the checks paid to these selected contractors.

Recommendation 20:

The BVU Authority should route purchase requisitions and purchase orders through the procurement department. The procurement manager should issue purchase orders based on these requisitions before the vendor provides services and submits invoices. This will help ensure the procurement manager, an individual independent of the contract administrator, is involved with the contract. If the procurement manager becomes aware of employees entering into contracts without procurement manager involvement or purchasing goods or services without the proper use of purchase requisitions and purchase orders, the procurement manager should hold these employees accountable and should correct the matter. In addition, the procurement manager should perform a reconciliation between the purchase requisition, the purchase order, the invoice, and the receiving report. This will help to ensure what the departmental manager needed is the same as what the BVU Authority purchased and what the vendor delivered and invoiced.

Section 6-3 of the policy states that “when multiple vendors of like goods and services are available, they will be rotated, where practicable, to avoid sole sourcing.” For the contractors selected, ETI was retained from 2004 – 2015 and R&M was retained from 2010 – 2015. The BVU Authority extended the terms of the ETI contract with a change order, agreeing to keep the same pricing in place until 2015. The agreement in place with R&M extends services even beyond 2015 if charges had not been brought against this contractor. These lengthy terms indicate no rotation of vendors and a likely violation of this section of the policy. Although the Act may not make it practical to “rotate” vendors as required by the policy, the BVU Authority should put these goods and services out to bid at regular intervals to increase competition and obtain the best value. The BVU Authority did not do this for the contracts with now convicted vendors and relied upon one contractor inspecting the work of another.

Recommendation 21:

The BVU Authority should consider rotating inspectors of work who are independent of the procurement, signing, and administration of the contract and have this person perform regular and random reviews of work while the work is in progress. If this is not possible, the BVU Authority should perform a review of the inspection work done by the inspector. This could potentially reduce the risk of collusion amongst employees, contractors, and inspectors.

The BVU Authority employed contractors from outside the service areas and the states, which they worked. This required the BVU Authority to pay additional time and travel expenses, which may not have been necessary if a contractor from the service area was available. Further, as documented earlier in this report, there was no official travel policy in place for employees or contractors. Therefore, the employees had no guidance on what terms the BVU Authority would agree to pay contractors for their travel expenses. This risks the BVU Authority’s contract administrator agreeing to excessive terms and being charged excessive amounts for travel-related expenses.

Recommendation 22:

The BVU Authority should consider putting a price ceiling on what the BVU Authority will pay the contractor for travel when travel is an element of the contract. The BVU Authority should require contractors to follow the BVU Authority travel policy recommended in the section entitled "Travel Policy." An internal policy pertaining to the travel of contractors should exist advising that any travel expenses exceeding these established thresholds will be the responsibility of the contractor. This could potentially reduce the total contract price and increase the competition of local bidders who would not have to travel.

In general, the BVU Authority had reasonable policies and controls evidenced in its purchasing manual. However, BVU Authority employees ignored and circumvented these controls in procuring and managing the ETI and R&M contracts.

Agency Procurement and Surplus Property Manual – Best Practice

The Commonwealth of Virginia developed guidelines for Executive Branch agencies to follow when procuring contracts for services in accordance with the Act. The Agency Procurement and Surplus Property Manual (APSPM) is published under the authority of Section 2.2-1111 of the Code of Virginia, and establishes the policies and procedures to be followed by state agencies and institutions in fulfilling procurement and related logistical responsibilities within their delegated limits. Although the BVU Authority is not a state agency, but rather a political subdivision of the Commonwealth, and not technically required to follow these guidelines, these policies do provide a summary of best practices generally accepted by the state's governmental entities. During our review, we performed a comparison of the BVU Authority's past and existing contracts to the required contractual terms within this manual. Below is a description of each item found.

Appendix B of the APSPM includes standard terms, which should be included in all contracts for goods and services. The terms of the contracts with ETI and R&M had no clauses indicating the contractor would follow the Immigration Reform and Control Act, disclose the contractors' debarment status, or explain what happens in the event of default by either party. Further, the contracts did not expressly give the BVU Authority the right to audit the contract performance at any time and did not contain a termination clause without penalty to the BVU Authority, citing the best interest of the Commonwealth. Finally, the contract showed no representation of compliance with small business sub-contracting or documentation of registration with the State Corporation Commission. All of these items are requirements of the APSPM.

Recommendation 23:

The BVU Authority should include all relevant and necessary clauses within the IFB's, RFP's, as well as the contracts themselves. These are listed as general and special terms within the APSPM and include, but are not limited to a right to audit clause, termination without penalty citing the best interest of the Commonwealth, the bid acceptance period, and a statement of how the bid will be awarded and the decision will be made. This will hold the contractors accountable and protect the interests of the BVU Authority.

During our review of current contracts, we found one contract, which had not been signed by any representative from the BVU Authority and one contract, which had not been signed by the vendor. Although the BVU Authority was able to request signed copies from the vendors, the BVU Authority did not have the official signed copies of these documents on file at the time of our review. Without a signed copy of the contract, the BVU Authority does not have a legal document with which to hold the vendor accountable. It also increases the risk of a vendor altering the signed copy and the BVU Authority having no baseline to which to compare it. In addition, for two contractual agreements, there were clauses allowing automatic yearly renewals, but no limit of periods, indicating that the contract continues in perpetuity. For the contract with the TVA, the term is 20 years. The APSPM provides the standard of five years as a reasonable amount of time for a contract for goods and services to continue. Although automatic renewals are allowable, the contract should indicate that re-negotiation of pricing and terms should ensue at the time of renewal. The contracts did not contain this clause. Finally, we found one vendor, with whom total services exceeded \$100,000, and no current contract was in place. This is out of compliance with the Act and the APSPM.

During a review of the top vendors of the BVU Authority, we identified an arrangement with the City of Bristol where the City collects its citizens' garbage, but does not have a good mechanism to bill for this service. Therefore, the BVU Authority bills for this service, retains a fee, and remits the balance to the City. While there is low risk of not receiving the proper funds for these set transactions, there is no signed contract or memorandum of understanding in place. This risks either side not honoring the agreement. All contractual agreements should be in writing and signed by both parties.

Recommendation 24:

The procurement manager should perform an analysis of the BVU Authority's top vendors to identify those vendors who should have a contract in place based on total dollar amounts spent with this vendor. This may help reduce cost by locking contractors in to set pricing. This may also identify vendors for which BVU Authority employees are not using purchase requisitions and purchase orders. Once contracts have been entered into, the BVU Authority should maintain all relevant documentation, including a copy of the contract signed by both parties, to ensure the contractor is held accountable to the terms to which they agreed.

A comparison of total payments to the contract value will help to identify vendors who are operating outside the current contract amounts and should be submitting change orders. The procurement manager should be involved in all change orders exceeding a pre-established threshold. As noted above, the BVU Authority approved a change order with ETI, extending the terms of service for an extended period of time with no procurement manager involvement.

Billing

Pole Attachments

The BVU Authority has electric pole attachment agreements with outside vendors as well as their OptiNet Division. These agreements allow the vendor or OptiNet to connect attachments to the BVU Authority's electric poles for an annual fee. The BVU Authority has not ensured that vendors are paying fair and reasonable prices for attaching to poles. They are not properly collecting pole attachment revenues from vendors or OptiNet. In addition, they have not properly maintained contracts for each vendor resulting in delinquent accounts and expired pole attachment agreements.

Including the OptiNet Division, there are currently eight active vendors with pole attachment agreements with the BVU Authority. Six of these vendors pay the BVU Authority to have attachments on BVU Authority poles, the BVU Authority pays one vendor to have attachments on the vendor's poles, and one vendor has a reciprocal pole agreement with the BVU Authority as they each have attachments on the others poles. Seven of the vendors pay a per attachment fee and one vendor pays a per pole fee.

The annual per pole fee ranges from \$12.29 to \$25.50. Based on contract terms, the BVU Authority adjusts some of the fees annually based on the changes in the consumer price index. As seen below, approximately half of the vendors pay fees on the lower end of this range and half the vendors pay fees on the higher end of this range. This fee does not appear to be consistent from vendor to vendor for essentially the same service.

Number of Vendors Paying each Pole Fee

Table 8

Number of Vendors	Fee Charged
One	\$12.29
Three	\$13.00
One	\$15.16
Two	\$25.00
One	\$25.50

Source: Pole attachment agreements

Recommendation 25:

The BVU Authority should ensure that pole attachment fees charged to vendors are fair and reasonable across vendors by performing a high level evaluation of the amounts paid by vendors overall and determining if there is a specific reason why one vendor should be paying more than another. BVU Authority should evaluate the pole attachment fees at least annually to ensure all vendors pay fair and reasonable prices. BVU Authority should update the pole attachment agreements any time they adjust any pole attachment fees.

As mentioned above, the BVU Authority has a reciprocal pole agreement with one vendor. The BVU Authority's Electric Division has four attachments for their electric lines on these poles and OptiNet has one attachment per pole. The Electric Division has paid for all of the attachments on the poles since OptiNet's implementation in 2001. The fee is a per pole agreement and not a per attachment agreement; therefore, the vendor is not expecting any additional payment from the BVU Authority. However, OptiNet should be paying the Electric Division for its portion of the pole attachment agreement, which is twenty percent. Allowing the Electric Division to pay for the entire pole attachment agreement fee is another instance of cross-subsidization, as discussed in the section entitled "Cross-Subsidization."

Recommendation 26:

The BVU Authority should review the pole attachment agreement and determine the dollar amount associated with OptiNet's portion of the bill. They should then record a due to/due from between the Electric Division and OptiNet. Considering the laws on cross-subsidization, the BVU Authority should determine how far in the past they will go back to make correcting entries.

The BVU Authority does not have a responsible person designated to monitor collection of pole attachment fees or to collect delinquent pole attachment accounts. These accounts do not go through the normal third party collection agency. In addition, the BVU Authority has not actively maintained a relationship with the vendors for all pole attachment agreements. The lack of internal controls has resulted in improper collection of pole attachment revenues. One vendor has an agreement that expired at the end of fiscal year 2015 and a delinquent account totaling \$65,936 as of fiscal year end 2016. The vendor has not paid their pole attachment bill for the last two fiscal years. BVU Authority upper management was not aware of the expired contract and delinquent

account until trial proceedings began for the current fraud investigation. Several months later management began trying to locate the proper contact to expedite negotiations for a new agreement and payment on the account.

In addition, the BVU Authority should develop and implement policies and procedures surrounding the collection of delinquent accounts associated with pole attachment agreements. The BVU Authority should consider using their current collection procedures for traditional services as a guide when developing these policies and procedures.

Recommendation 27:

The BVU Authority should ensure that every pole attachment agreement has a designated account manager responsible for monitoring the agreement. Account managers should notify management when agreements are nearing expiration so that they can follow the proper procedures to ensure that the agreement does not expire before a new agreement is in place. In addition, the account managers should notify management as soon as they are aware that an account is delinquent so that they can go through the proper collection procedures. Account managers should also maintain and update contacts for all pole attachment agreements at a minimum annually to ensure that any issues with the agreements including expiration and delinquent accounts can be handled with the proper due diligence.

The BVU Authority has not properly billed its OptiNet Division for all of its pole attachments since 2003. The Electric Division has been billing OptiNet annually for 3,951 pole attachments when there were actually 10,113 pole attachments. In addition, they were billing at a rate of \$13 when the contracted rate was \$25.50 plus annual increases based on the consumer price index. This is a variance of 6,162 poles and at least \$253,443 in annual payments that OptiNet did not make to the Electric Division. Management became aware of the improper billing through the ongoing fraud investigation. The BVU Authority discovered that a contractor, Edwards Telecommunications, Inc., was installing OptiNet attachments on poles without following the proper approval procedures. Therefore, the Electric Division had no way of knowing for certain how many poles had OptiNet attachments. After receiving estimates for a complete pole attachment inventory that were cost prohibitive, the BVU Authority decided to perform an estimate of the number of poles with OptiNet attachments as they were comfortable that they could calculate a reasonable number and save the customers from being impacted by an increase in fees due to the inventory cost. In June 2016, the BVU Authority performed an analysis using AutoCAD of all the electric poles they had installed based on their system and removed any poles that would not have pole attachments given the type of pole. These poles included high line poles, streetlights, or outside vendor poles. This left 10,113 poles that could potentially have OptiNet attachments on them. BVU Authority management decided to be cautious with their estimate and assume that each of these poles had one OptiNet attachment. Prior to fiscal year end 2016, BVU Authority management prepared and sent OptiNet an adjusted pole attachment invoice for the fiscal year for \$253,443.

Recommendation 28:

The BVU Authority should determine the remaining amount of money OptiNet owes the Electric Division due to the improper billing associated with the pole attachments. They should then record a due to/due from between the Electric Division and OptiNet. Considering the guidelines on cross-subsidization, the BVU Authority should determine how far in the past they will go back to make correcting entries. If OptiNet does not pay the Electric Division for this service, it is considered cross-subsidization because OptiNet is getting a service for free that they would have to pay for from an outside vendor.

Edwards Telecommunications, Inc. also installed OptiNet attachments on an outside vendor's poles without following the proper approval procedures. The BVU Authority purchases space on these power poles for their attachments much like the pole attachment agreements that the BVU Authority has for the seven vendors mentioned above. The ongoing fraud investigation revealed that Edwards Telecommunications, Inc. installed OptiNet attachments to the vendor's poles without submitting a proposal prior to installing the attachments as required by the pole attachment agreement. According to the pole attachment agreement, any unauthorized attachments could result in an order to remove the attachment within thirty days or a review at the BVU Authority's expense to determine if the attachment is in compliance and if necessary order compliance through rearrangement or pole replacement. For each unauthorized attachment, the BVU Authority also has to pay for a period of time equal to the greater of five years or the number of years since the last attachment inventory plus a \$25 per attachment fee. The vendor is also entitled to interest at the current interest rate on such fees accruing from the date the attachment is assumed to have been on the pole. The fees have the potential to be costly for the OptiNet Division. The vendor is performing an audit of its poles to determine the unauthorized attachments and will be advising the BVU Authority of their findings in fiscal year 2017.

Recommendation 29:

The BVU Authority should assign contract administrators to oversee all contractors to ensure that they adhere to the contract the BVU Authority has with them as well as the agreements that the BVU Authority has with third parties if their contract requires them to perform work under the third party agreement. These contract administrators should ensure that the contractors follow proper procedures outlined in pole attachment agreements. There should be weekly meetings to discuss the work performed under the pole attachment agreements. The BVU Authority should also consider having the contract administrator review and sign off on all attachments prior to installation. In addition, the BVU Authority should continue to work with the vendor to ensure that the appropriate corrective action is taken for the unauthorized attachments.

Billing and Discounts

Billing for different products is an essential function of the BVU Authority, which drives the collection of necessary revenues. Section 9.6 of the master bond indenture requires the frequent billing of all customers and collection of any overdue charges. Billing and collecting necessary

revenues helps to ensure that cash flows of the BVU Authority are sufficient to pay obligations and achieve all cash reserve targets. Billing for the correct amounts ensures that the BVU Authority is charging appropriate rates approved by the Board of Directors. The OptiNet services the BVU Authority provides to its business customers, including telephone, cable, and internet, are the most volatile as they are affected by discounts, commissions, and other costs not applicable to the other utilities. Electric, water, and wastewater services are based on set prices and are not usually subject to change. Therefore, we performed a detailed review of the OptiNet billing process in order to assess any known deficiencies in internal control or instances of non-compliance with existing policies and regulations. Below is a summary of items we noted during this review.

The existing policies and procedures manual provides no guidance on the sales functions to business customers. The BVU Authority could not provide any documentation indicating how sales people should enter into sales contracts, what discounts they are authorized to provide without obtaining approval from the sales manager, or clear pricing schedules on all OptiNet services available to the BVU Authority's business customers. Although the general practice is that contracts below established prices would require sales manager approval, there is no documented threshold for when this is required. Further, the billing department does not have any clear policy or guidance on pricing and does not know what prices are acceptable. This presents the risk that BVU Authority sales representatives will enter into sales contracts with business customers at rates that are too low resulting in the BVU Authority not achieving profit margin targets laid out in the annual budget. If the billing department had guidance on what amounts are reasonable and what discounts are not reasonable, they could serve as a check on the sales representatives to identify significant discounts when they process these bills.

The annual operating budget does not have an allowance for discounts of services. In addition, the BVU Authority does not clearly track discounts that the BVU Authority currently is providing. In the case of residential customers, there are codes within the system that indicate the customer is receiving a bundle discount or a promotional discount. However, for business customers, the BVU Authority can enter into a contract below the set price without documenting the discount within the billing system. Rates entered for business customers are free-text fields where the sales representative can enter any amount. This presents a risk, as the BVU Authority currently cannot tell which business customers are receiving significant discounts and are; therefore, not profitable customers.

The sales manager performs quarterly audits of new business contracts. The intended purpose for this is to ensure the contract was set up correctly in the billing system by comparing contract amounts to amounts billed. However, there is no comparison of contract amounts to established and approved pricing schedules. Therefore, this audit would identify customers not set up in the billing system according to what their contract stated but would not identify customers who received a contract at an amount significantly below the approved pricing schedule.

Upon review of employees with access to the billing system and those specifically with the ability to alter rates, we noted that sales representatives have the ability to alter rates within the system. This means that a sales representative could enter into a contract with a business customer

and offer them a rate significantly below market value, affecting profit margins. The representative could then go in and enter a reduced rate within the billing system to honor this discounted offer. Then, the quarterly audit may not catch this exception to the pricing schedule unless they identified it as unusual. This would particularly not stand out as much during times of increased volume as there would be many more contracts to review as part of this audit. Finally, the billing department would likely not catch this, as they have no clear guidance on what a reasonable discount is for certain services.

Further, the sales representatives' commissions are based on revenues as opposed to profit margins, so they are incentivized to acquire more customers without respect to the cost of those customers to the BVU Authority. Sales representatives achieve larger commissions, the larger the contracts they obtain.

The BVU Authority has also provided free or discounted services to certain entities in the past, which could constitute donations of these services. As noted in the section entitled "Donations," it is a contradiction to the BVU Authority's legal opinion to make donations. It is also a violation of Section 15.2-953 of the Code of Virginia to provide donations to a church or sectarian society and a violation of Section 2.2-3100 of the Code of Virginia to create the appearance of a conflict of interest. The BVU Authority has provided services to the Fellowship Chapel significantly below market value. The BVU Authority has discounted services to the Mount Rogers Planning District Commission. In addition, the BVU Authority paid \$6,300 to this entity as a donation and received a \$100,000 grant from this entity. This has the appearance of an inducement for this donation. Finally, after obtaining the legal opinion, which recommended against providing charitable donations, an internal memorandum from the former CFO instructed the BVU Authority's staff to discontinue free services to the Bristol Chamber of Commerce, the Virginia State Police, "Believe in Bristol," the Bristol Soccer Association, and the Bristol Housing Authority. It, therefore, appears that the BVU Authority was providing these services as donations to these entities. This means it was costing the BVU Authority to provide these services with no compensating income.

The BVU Authority was also significantly discounting cable rates to employees. A policy approved by the board allowed employees who participated in a beta test of one of the BVU Authority's OptiNet packages to receive discounts of between 50 percent to 59 percent off the price

*The BVU Authority
discounted cable rates for
employees up to 59 percent.*

of this package, depending on high definition options. However, there was no clear guidance on what the BVU Authority expects of the employees in return for this discount. The BVU Authority could not provide guidelines as to what type of feedback the employees were expected to provide and how often they should provide this analysis for any type of marketing or beta testing purposes. Further, there was no documented end to the beta test, indicating

that the employees would receive this discount in perpetuity. According to Publication 15-2 from the Internal Revenue Service (IRS), income tax implications arise when employers provide discounts of greater than 20 percent of the service's value to employees. The BVU Authority did not include this potential benefit as part of the payroll process. In addition to this, at the time of our review, the BVU Authority was providing this benefit to over 60 employees. At discounts of up to \$102 per

month, this could potentially represent over a \$76,000 reduction in revenue each year. There was no evidence of the consideration of this benefit during any budgetary process. Finally, the former CFO, Stacey Pomrenke, and legal counsel, Walter Bressler, received total discounts of 52.5 percent and 56 percent, respectively. According to this employee discount policy, for non-high definition (HD) packages, the discount should only have been 50 percent. This is out of compliance with the policy.

Recommendation 30:

The BVU Authority should perform a review of all business customers of BVU OptiNet services to determine whether they are receiving services discounted below market rates. The BVU Authority should consider whether these could represent donations, as this would be out of compliance with the Code of Virginia. As contracts with these entities conclude, the BVU Authority should ensure these entities pay reasonable rates for OptiNet services that cover the cost of the service and are not considered recipients of donations. This will reduce the risk of non-compliance with the Code of Virginia. This will also help to ensure that the BVU Authority meets profit margin targets and achieves adequate cash flows and reserves.

The BVU Authority should determine how to best track discounts to business customers and how to identify existing business customers receiving rates less than those rates approved by management and the board. The BVU Authority should set budgetary thresholds for discounts of services and ensure revenues are not reduced below these amounts. As part of this discount tracking, the BVU Authority should improve the quarterly contract audit process to compare contract amounts to approved rates not just the billed rate.

Recommendation 31:

The BVU Authority should develop, implement, and enforce policies and procedures on sales activities, including entering into sales contracts, granting discounts to customers, and obtaining the proper approvals for all such activity. The BVU Authority should finalize pricing schedules for all OptiNet services and ensure the billing department is aware of what types of discounts are allowable. The billing department should alert the sales manager if they identify excessive discounts. This will help to ensure accountability to all staff who have the ability to enter into contracts with business customers. This will also reduce the risk of losing money on less profitable customers.

The BVU Authority should perform regular reviews of access to the billing tables and other sensitive functions within the information technology systems. The BVU Authority should perform an analysis of which functions have a direct effect on financial activity to determine which access levels should be restricted and then grant access to new users of the systems in accordance with the principle of least privilege. This means that the BVU Authority should only grant access to functions of the systems, which the users need to perform their core job responsibilities. The BVU Authority should also consider a proper separation of duties when granting such access.

Recommendation 32:

The BVU Authority should review the current policy for employee discounts and obtain the necessary opinions and analyses to determine whether these could possibly represent a taxable benefit to the employees. If this is determined to be taxable, the BVU Authority should amend the policy or withhold the taxes accordingly. This will reduce the risk of non-compliance with IRS and state income tax regulations.

Fixed Asset Policy Issues

Fixed asset is a term used in accounting for assets that are purchased for long-term use and are not likely to be converted quickly into cash, such as land, buildings, and equipment. The BVU Authority fixed assets range from electric utility poles to underground water and wastewater systems to fiber networks to buildings for office space. As of June 30, 2015, these assets had a net depreciated value of \$151.6 million. The construction, use, and maintenance of these assets is critical to the BVU Authority's operations. As mentioned in the "Policies and Procedures" section of this report in June 2015, the BVU Authority developed policies and procedures surrounding fixed assets; however, they were not all-inclusive and management did not disseminate them to everyone within the BVU Authority. Therefore, these policies and procedures only existed on paper and not in practice. During our review, we determined best practices for fixed assets and compared them to the practices at the BVU Authority noting multiple areas that needed improvement.

Best Practices

Our review identified best practices surrounding accounting and reporting of fixed assets using the Commonwealth of Virginia's policies and procedures, recommendations from the Government Finance Officers Association, Code of Federal Regulations requirements, and accounting standards depicted by the Governmental Accounting Standards Board. These best practices indicate:

- Fixed assets should be capitalized if their estimated useful life is over one year and their value is no less than \$5,000. Capitalization thresholds are best applied to individual items and not groups of items that are similar unless the effect of doing so would eliminate a significant portion of total capital assets.
- Useful lives should be determined based on the entities own past experience. If past experience is unreliable, then the entity should rely on experience of other governments and private entities. However, they must ensure that these useful lives are appropriate given their own circumstances. Useful lives must be periodically reviewed to ensure that the useful life is reasonable based on actual usage. Adjustments should be made as appropriate.
- Accounting for fixed assets requires the proper communication and recording of asset additions, deletions, and adjustments. Internal control procedures should be in place to ensure that all assets are acquired using an acceptable method of

acquisition, asset additions/deletions are recorded in a timely manner, and all assets are properly accounted for. Adequate separation of duties should exist between asset physical control and disposal approval. Procedures should exist for the identification and evaluation of disposals of a suspicious nature.

- Capital assets should be inventoried on a periodic basis, anywhere from one to five years, to properly safeguard assets and maintain fiscal accountability. The Code of Federal Regulations requires an inventory every two years of equipment acquired in whole or part with federal grant funds. An effective capital asset inventory review results in an accurate accounting of fixed assets, and indicates the reliability of the system of accountability for the acquisition, use, and disposal of those assets. While well-designed and properly maintained perpetual inventory systems can eliminate the need for an annual inventory of a government's tangible capital assets, no inventory system is so reliable as to eliminate the need for a periodic physical inventory.

In addition, the Government Finance Officers Association recommends that local, state, and provincial governments establish a system for assessing their assets and then appropriately plan and budget for any capital maintenance and replacement needs. This includes developing a policy to require a complete inventory and periodic measurement of the physical condition of all existing capital assets. The assessment should document the established methods of condition assessment, including any that are used to evaluate underground infrastructure, such as wastewater systems. This physical condition inventory and measures used should be kept current, with facility condition ratings updated every one to three years.

BVU Authority Fixed Asset Accounting Procedures

We compared the best practices identified above to the BVU Authority's policies and procedures. We identified multiple best practices and accounting standard requirements that the BVU Authority's policies and procedures do not address. Below is a summary of the inadequacies identified.

The BVU Authority's capitalization threshold is \$1,000, which is \$4,000 less than the lowest amount recommended by the best practices above. As of June 30, 2015, there were \$263 million in assets prior to depreciation for all divisions within the BVU Authority. Approximately, \$249,000 of that amount, or .001 percent, is associated with assets that had an initial value between \$1,000 and \$5,000. Given the time it takes to track the assets; it may be more cost beneficial for the BVU Authority to increase their capitalization threshold to \$5,000 or higher. The BVU Authority should consider, based on a cost benefit analysis, whether it would be in their best interest to increase their capitalization threshold to \$5,000 or higher.

Recommendation 33:

The BVU Authority should consider, based on a cost benefit analysis, whether it would be in their best interest to increase their capitalization threshold to \$5,000 or higher. The cost benefit analysis should consider the cost savings of not tracking those assets, the effect the change in capitalization threshold would have on depreciation expense, and whether these assets need to be tracked for control purposes to determine whether it would be effective to increase the capitalization threshold.

The BVU Authority’s policies mention that depreciation is dependent upon useful lives and that they are set by TVA. However, there are no useful life policies within the TVA contract. The accounting department indicated that they use either the useful life of a similar asset, which may have been set decades ago, or they contact TVA to determine the proper useful life. In addition to this deviating from best practices, this also deviates from FERC accounting policies mentioned earlier in this report in the section entitled “Introduction.” FERC states that estimated useful lives of depreciable property must be supported by engineering, economic, or other depreciation studies. Setting the proper useful life is vital in accounting for capital assets as it affects the depreciation calculated for the asset. Improper useful lives result in improper depreciation and misstatements within capital assets reported in the financial statements. The BVU Authority should develop useful life policies and procedures, which adhere to FERC and best practices. These policies should at a minimum explain how useful lives are set using TVA guidance and include a schedule outlining the useful lives used by the BVU Authority. These policies and procedures should also include a TVA contact for assigning useful lives. Useful lives should be based on actual usage of the asset.

The policies do not include guidance over capital asset physical inventories including how to inventory capital assets and how often the inventories are to occur. The accounting department indicated that they have never performed physical inventories over BVU Authority owned assets. Therefore, the BVU Authority cannot be certain that all items physically exist and are operational. The lack of physical inventories also increases the risk of theft or fraud and may result in inaccurate reporting of the BVU Authority’s capital assets within their financial statements. The BVU Authority should develop policies and procedures outlining the requirements for completing asset inventories, which should include how often they will be performed, the type of inventory performed (100 percent, rotation of certain departments, statistical sample), who will be performing the inventory (fixed asset accountant with the help of responsible persons), how the notations of discrepancies in inventory will be handled, how the results will be relayed to the fixed asset accountant, etc.

The asset acquisitions section of the policies and procedures does not address assets acquired through the procurement process that are not included on job-related work orders. All purchases need to be communicated to the Fixed Asset Accountant to ensure that all assets are properly accounted for within the depreciation schedules. If assets are not properly captured, then it may result in inaccurate reporting of the BVU Authority’s capital assets within their financial statements. The BVU Authority should develop policies and procedures to address how assets can be acquired (all methods) as well as how those assets are communicated to the Fixed Asset Accountant. These procedures should include the information that the purchaser needs to provide the Fixed Asset

Accountant to ensure proper recording (asset description, value, purchase date, useful life) as well as a timeframe for providing this information (within 30 days of purchase).

The capital asset disposal process is not adequately covered within the policies and procedures. The Buildings and Grounds Maintenance Supervisor places assets on the GovDeals website for sale, however there is no mention of how the Building and Grounds Maintenance Supervisor becomes aware of the need to sell an asset. This person also establishes the minimum sale price and arranges for the buyer to pick up the asset. The only time another person is involved in this process is after receipt of revenues. The revenues are sent directly to accounting. There should be a process to inform the Building and Grounds Maintenance Supervisor that there is an asset in need of selling. There should also be another person approving the sale of the item as well as the minimum bid. Not having adequate separation of duties within the fixed asset sale process increases the risk of theft of the asset or the sales revenue received.

Other capital asset disposal procedures within the policies indicate that the remaining assets disposed would be included on a work order if associated with a job. However, there are no policies and procedures for assets disposed of that are not included on a work order or with using the GovDeals website. Policies and procedures should address all methods of disposals including items not included on work orders and items not sold through GovDeals. They should include the use of disposal forms to inform the fixed asset accountant of deletions needed within the fixed asset schedules. These forms should state the asset being disposed and why the asset is being disposed along with the custodian and supervisors sign off. Not having separation of duties or documented processes over disposal increases the risk of theft or fraud as well as inaccurate reporting of the BVU Authority's capital assets within their financial statements.

Impairment of capital assets is addressed in a section of the policies entitled "Identification of Asset Impairment – OptiNet," which speaks more to determining if an asset is to be disposed not impaired, as well as a statement that the Controller monitors fixed assets informally for impairments. Having an informal process and not having a process for reporting potential impairments increases the risk that impaired assets will not be properly identified and written down thus overstating capital assets on the financial statements. Impairment policies and procedures should be formal and outline how the BVU Authority identifies and tests potential impairments across all asset categories at the BVU Authority. In addition, they should be based on the guidelines set out in GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*.

Intangible assets, which can include but are not limited to easements, water rights, timber rights, patents, trademarks, and computer software, are not included in the BVU Authority's policies and procedures. There is no indication that there were intangible assets that the BVU Authority had not identified and capitalized. However, there should be a formal review process to identify intangibles. The BVU Authority should develop policies and procedures to identify intangible assets based on the guidelines within GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*.

Accounting policies and procedures over fixed assets are necessary in order to reduce the risk of fraud and prevent errors or mistakes from occurring. In addition, well-designed and properly maintained policies and procedures enhance accountability and consistency and serve as a useful training tool for staff.

Recommendation 34:

The BVU Authority should develop and implement comprehensive policies and procedures for the accounting and reporting of fixed assets. These policies and procedures should include the determination and periodic re-evaluation of useful lives, processes for completion of periodic physical inventories, processes for additions and deletions of capital assets, identification and write down of impaired assets, and identification and recording of intangible assets. These policies should consider best practices, the requirements of FERC accounting, and GASB standards. The accounting department should review and update these policies and procedures annually to ensure they comply with current standards and reflect the BVU Authorities desired control environment. The accounting department should document any changes in the policies that occur between these annual reviews promptly as they occur. These policies and procedures should be readily available to all employees especially to those responsible for safeguarding and recording capital assets.

The BVU Authority does not maintain long-range maintenance or capital plans for the utilities within its divisions. There is a three-year plan but nothing past that to outline plans for future maintenance or replacements of capital assets. As recommended by the Government Finance Officers Association, the BVU Authority should develop a budget for capital maintenance and replacement needs, including performance of condition assessments every one to three years. It is essential to plan for the maintenance of capital assets and anticipate future replacement needs. Maintenance and capital plans should have a determined budget to ensure that the BVU Authority is proactive and not reactive, thus causing a buildup of deferred maintenance in this area. The BVU Authority should review the requirements of their bonds discussed in the “Bonds” section of this report to guide them in determining the amount of funding they should set aside in a fund for capital maintenance and replacement. The performance and continued use of capital assets within electric, water, and wastewater are essential to the health, safety, and quality of life for the BVU Authority’s customers. A good preventive maintenance program is key to keeping the systems in good working order. It helps preserve capital investment while preventing service interruptions and system failures.

Recommendation 35:

The BVU Authority should develop and maintain long-range maintenance and capital plans for the utilities within its divisions. The plans should include budgets for any capital maintenance and replacement needs. The BVU Authority should perform and document condition assessments for all the utilities, including any that are underground infrastructure, every one to three years. The BVU Authority should use these condition assessments to determine its maintenance and capital needs, therefore, driving the amount of funds to set aside for future use in these areas.

FERC Accounting

In addition to the review of best practices, we compared the BVU Authority's procedures to those required by FERC Accounting. The BVU Authority records assets, non-depreciable and depreciable, within depreciation schedules. However, for the land and building asset categories, the information contained within these schedules is not detailed enough to be able to properly identify the individual assets. The schedules contain merely an account number and a brief description of the asset.

Even though there are separate accounts set up for land and buildings within the accounting system, there is not a separate listing that provides detailed information as required by FERC accounting. Land requirements include the record of the nature of the ownership, full legal description, area, map reference, purpose for which it is used, city, county, and tax district on which situated, from whom purchased or to whom sold, payment given or received, other costs, contract date and number, date of recording of deed, and book and page of record. Building requirements include the cost of all buildings and facilities to house, support, or safeguard property or persons, including all fixtures permanently attached to and made a part of buildings and which cannot be removed. Also included are those costs incurred in connection with the first clearing and grading of land and rights of way and the damage costs associated with construction and installation of plant. While FERC requirements do not specifically state that buildings should be tracked individually, this is standard accounting practice. Therefore, the BVU Authority should maintain this information for each building separately.

Management is currently trying to develop a complete detailed listing of assets for land and buildings. Maintenance of these listings are critical to ensuring that all assets are properly accounted for within the financial statements, which is especially important now that there is a potential sale of OptiNet.

Recommendation 36:

Management should continue to develop a complete listing of assets for land and buildings. When developing these listings, they should ensure that they have proper ownership of the asset. They should also consider best practices and FERC accounting requirements. The Accounting department should maintain and update these listings as they acquire and dispose of assets.

Financial Statement Presentation

As part of the annual audit engagement, the BVU Authority's auditors prepare the financial statements and related footnotes based on system data provided by the BVU Authority. Once prepared, the CPA firm provides these documents to BVU Authority management for review, acceptance, and approval. As the financial statements and related footnotes are management's responsibility, it is imperative that they understand and approve of all preparation done by the auditors. If management does not understand and approve the financial statements and related footnotes, it creates an independence issue for the auditors at which point the BVU Authority would

have to hire a second audit firm to perform the audit. In addition, if management and the accounting department approve the financial statements and related footnotes without understanding them and the transactions supporting them, they risk inaccurate reporting in their financial statements.

During our review, we performed an analysis of the summary of significant accounting policies footnote and the capital asset footnote from fiscal year 2010 through 2015. Below is a summary of the inaccurate reporting methods and weaknesses in internal control that we found.

Summary of Significant Accounting Policies Footnote

The BVU Authority states that capital assets are depreciated using the straight-line method over the estimated useful lives in all of the financial statements published from 2010 to 2015. However, they also use composite depreciation for assets such as the electric poles. Composite depreciation is the application of a straight-line depreciation rate and average useful life to calculate depreciation for a group of fixed assets. According to accounting standards, this variation on the depreciation method should be disclosed within the BVU Authority's financial statements.

Capital Asset Footnote

In fiscal year 2010, the depreciation related to disposed assets was removed from the wrong asset category within the footnote. When assets are disposed, the corresponding depreciation should be removed from the same asset category.

In fiscal years 2012 and 2013, the additions and deletions within the footnote did not properly reflect the actual activity that occurred during the fiscal year. The auditors created the footnote based on data from the BVU Authority's system but did not account for adjustments, which resulted in overstating activity. Information appearing in the footnotes should depict the true activity that occurred during the fiscal year. The Controller did not verify the additions and deletions, but rather just ensured that the beginning and ending balances were correct. The financial statements are management's responsibility and part of that responsibility is to make sure that the auditors have used the data correctly to prepare the financial statements and disclosures.

In fiscal year 2015, an adjustments column was added to the capital asset footnote without any additional disclosure in the financial statements that would provide the reader with information on why the adjustments were needed. The majority of these adjustments were associated with obsolete assets that needed to be written down. The adjustments column was added instead of including the necessary adjustments in the beginning balance. Adjustments that result from prior period adjustments should be included as adjustments to beginning balance and disclosed in a prior period adjustment footnote. If the adjustments are a result of changes in accounting policies, then the proper presentations should be disclosed. Improper financial statement disclosures increase the risk of providing misleading information to the reader.

Recommendation 37:

Management should not rely solely on their auditors to prepare the financial statements and footnotes using data from the system. Specifically, management should ensure that the auditors used the data properly to prepare the fixed asset footnote by verifying the beginning balance, additions, deletions, and ending balance appearing in each footnote. Management should also ensure that the amounts added and disposed in each category of assets including the corresponding depreciation is reasonable and properly supported by their financial system. In addition, if there are significant changes to footnote presentations, management should ensure that proper disclosures are made. Lastly, the BVU Authority should ensure that they have properly disclosed all methods of depreciation used within their financial statements.

MISUSE OF RESOURCES AND AUTHORITY

Conflict of Interest

The BVU Authority’s Employee Handbook includes a policy addressing Conflict of Interest. The policy defines a conflict of interest as an event when “there is a divergence between an individual’s private interests and their professional obligation to the BVU Authority. An actual or potential conflict of interest occurs when an employee is in a position to influence a decision that may result in a direct, or indirect, personal gain for the employee or for their family member, friend, or associate as a result of the BVU Authority’s business dealings.” According to the policy, “Personal gain may not only result in cases where an employee or relative has significant ownership in a firm with which Bristol Virginia Utilities does business, but also when an employee or relative received any kickback, bribe, substantial gift, or special consideration as a result of their employment with Bristol Virginia Utilities.”

While the BVU Authority has included this policy in their Employee Handbook and a section in the Code of Conduct to address conflicts of interest, no other policies and procedures exist to ensure that employees with private interests are actually reporting such conflicts that could potentially interfere with their obligation to the BVU Authority.

Board members, however, have always had to disclose their private interests to the BVU Authority to remain in compliance with the Code of Virginia Section 2.2-3115, which requires filing a disclosure statement of their personal interest with the Virginia Conflict of Interest and Ethics Advisory Council as a condition to assuming office.

However, these disclosures are self-reported. As a result, it is up to the honesty and integrity of each board member to report all interests. In the past, a former board member failed to report the extent of interest in an entity with whom the Authority conducted business. During the member’s service on the board, the BVU Authority made purchases totaling \$22,893 from the entity in which the board member had personal interests. The BVU Authority will always face the risk that board members intentionally or unintentionally do not report a conflicting personal interest. However, the responsibility of ensuring this risk is mitigated as much as possible lies with the BVU Authority by ensuring board members report annually. In addition, the board chair and the President/CEO should review the disclosures to ensure they appear complete.

This report discusses specific conflicts of interest in the section entitled “Donations.”

Recommendation 38:

In 2014, Governor McAuliffe issued Executive Order 33 – Designation of Executive Branch Officers and Employees Required to File Financial Disclosure Statements, addressing the Commonwealth’s commitment to ensuring public officers and employees maintain the highest standards of ethical behavior when conducting business with the Commonwealth, avoiding even the appearance of impropriety arising out of personal economic interests. While the Executive Order does not apply directly to the BVU Authority because the BVU Authority is not an authority established within the Executive Branch, the BVU Authority should use the order as a guideline to create an internal policy related to the reporting of personal interests. As noted in the Executive Order, employees who have effect on legislative policies and rule-making authority and who are involved in decision-making regarding 1) policy, 2) contracts and procurement, 3) audits, 4) licensure, 5) inspections and investigations, and 6) investments or other financial matters should be subject to this policy. In addition, it is good practice for other agents of the BVU Authority (i.e., contractors, outside legal counsel, etc.) to disclose their personal interests that would affect business with the BVU Authority.

Economic Development

Policies and Procedures

As stated in the Introduction section of this report, the TVA contract allows the BVU Authority to budget \$500,000 annually for economic development incentives that will benefit the Electric Division. The transition agreement between the BVU Authority and the City of Bristol further restricts the economic development incentives to projects within the Bristol city limits.

In 2013, the BVU Authority created and the Board approved an economic development incentive policy to provide guidance for distributing funds associated with economic development incentives. Prior to that, they did not have any policies over the use of electric economic development funds. These policies included credits for job creation above the prevailing wage rates, energy incentives, payback periods, a five-year commitment to use OptiNet, and a restriction on retail and restaurant prospects. In addition, management could approve other expenses up to \$10,000 per incident and any unused funds carried over to the BVU Authority’s reserve fund.

However, these policies do not adhere to the TVA contract and transition agreement requirements. The policies are general in nature concerning the types of expenses allowed under the economic development incentive funds. The policies mention the need for job creation and mandatory use of OptiNet, which neither the TVA contract nor Transition agreement stipulates. While job creation is good for the local economy and the use of OptiNet increases the BVU Authority’s revenues, they do not directly provide economic benefit to the Electric Division. BVU Authority policies should directly outline allowable expenses for economic development and should not include travel, advertising, or other expenses, regardless of whether they are approved by management. While there are legitimate conferences or meetings that the BVU Authority could attend to find or attract businesses to the area, the TVA contract does not allow the use of incentive

funds for overall economic development. Lastly, the policies the BVU Authority put in place do not restrict the expenses to projects within the Bristol City limits as the Transition agreement requires.

Recommendation 39:

The BVU Authority should review and revise their economic development incentive policies to ensure that they are in line with the TVA contract and the transition agreement. These policies should specifically describe the allowable types of expenses. The policies should include a clause that requires the recipient to repay the economic development incentive funds if the recipient of the incentives does not continue to operate the business, moves out of the designated area, or does not meet agreed upon conditions for receiving the incentives. The BVU Authority should consider a sliding scale of repayment. In addition, the BVU Authority should consider contacting TVA to negotiate an agreement to allocate a portion of the \$500,000 each year that they can use for overall economic development purposes. If they can reach an agreement with TVA, the BVU Authority should develop policies over the expenses, including adherence to established travel reimbursement requirements.

Incentives by Fiscal Year

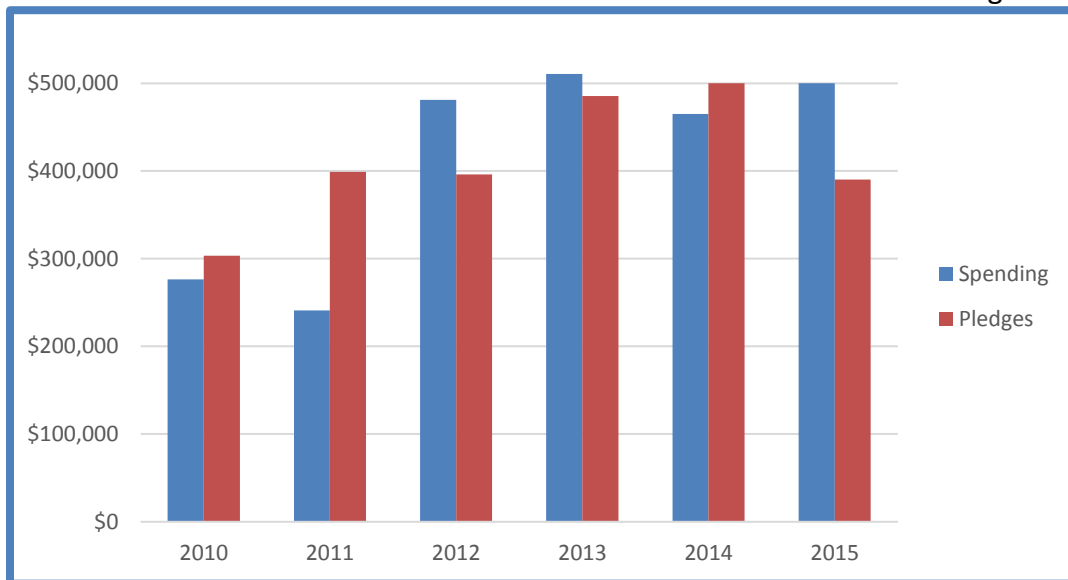
Even though the BVU Authority developed policies for distributing the economic development incentives in 2013, they have not adhered to these policies since implementation and had no policies or documented processes over the awarding of economic development funds prior to 2013. In addition, these policies and procedures do not adequately address best practices surrounding selection and distribution of the incentives nor do they include the one requirement of the Transition agreement, which is to keep projects in the City of Bristol.

The BVU Authority has never had their own recognized or documented process prior to 2013 for interested parties to apply for economic development funds. The BVU Authority did not maintain evidence that they performed economic benefit analysis for projects to which they granted funds. They did not maintain evidence that interested vendors submitted applications to receive economic development incentives or written performance agreements outlining terms and conditions and the responsibilities of each party. In addition, the BVU Authority granted incentives to retail and restaurant prospects even though the policies implemented in 2013 restricted granting funds to those businesses. It appears the BVU Authority randomly awarded funds throughout the year without weighing one request against another request or against any type of criteria. Requiring applications and developing written performance agreements sets standards and allows the BVU Authority to hold the vendors accountable for the outcomes of the use of the incentives.

During fiscal year 2010 through 2015, the BVU Authority granted approximately \$2.5 million in economic development incentives. As depicted in the chart below, the pledges associated with each fiscal year do not necessarily equal the spending that occurred during the year. The variation is due to incentives that the BVU Authority pledged in one year but did not pay until future years.

Economic Development Incentives by Fiscal Year

Figure 7



Source: BVU Authority's CSA Financial System

The spending associated with economic development incentives increased sharply in fiscal year 2012 and continued to increase until fiscal year 2014. The increase in fiscal year 2012 is due to two \$200,000 payments to vendors. Payments to one of these vendors, which has since filed for bankruptcy, totaled \$1.1 million or forty-six percent of the total spending for the six fiscal years reviewed. However, the BVU Authority does not have documentation that these vendors submitted applications for receiving economic development incentives or that the BVU Authority performed an economic benefit analysis to prove that these projects benefited the Electric Division. In fact, out of the various types of economic development incentives made over the six fiscal years, only three had documentation for economic benefit analysis. There were multiple calculations for each of these expenses, which included various numbers of new jobs created and various rates for BVU Authority provided incentives. There was no way to determine which calculation the BVU Authority used to prove that there was an economic benefit for the Electric Division. Therefore, as it was unclear which of the various calculations was actually relied on by the BVU Authority to inform their decision in awarding incentives, the BVU Authority would not be able to use any of them to verify that the Electric Division would directly benefit from the incentive funded project. The BVU Authority should perform and maintain calculations that support the determination that a project will have an economic benefit for the Electric Division. If there is a future agreement between TVA and the BVU Authority to use some of the economic development funding for overall economic development, then the BVU Authority should maintain supporting documentation to show that the funds are for overall economic development and therefore do not need to have an electric benefit.

In addition to the lack of documentation for the economic development analysis, the BVU Authority lacks documentation of performance agreements between themselves and the vendors receiving economic development incentives. The BVU Authority only maintained performance

agreements for two vendors in the six-year period under review. Performance agreements ensure the objectives established in the economic development policy are accomplished.

Recommendation 40:

The BVU Authority should develop its own application and review process to evaluate and award economic development funds. As part of the application review process, the BVU Authority should perform and maintain an economic benefit analysis on each vendor. For each vendor receiving funds, the BVU Authority should develop and maintain written performance agreements that outline responsibilities for each party as well as the requirements the recipient must fulfill as a condition of receiving the economic development incentives. The BVU Authority should implement an ongoing monitoring process for each project receiving incentives to ensure that the project is meeting the conditions of the performance agreement, and if not, the BVU Authority should take the appropriate steps to remedy or invoke the reversion process or penalty provisions as outlined in the performance agreement. The BVU Authority should maintain copies of the application, the economic benefit analysis, and the performance agreement for the life of the performance agreement and beyond as required by retention policies and procedures. If there is a future agreement between TVA and the BVU Authority wherein the BVU Authority can use some of the economic development funding for overall economic development, the BVU Authority should maintain documentation to support its use of incentive funds for overall economic development and therefore validate the use of funding which does not provide a direct benefit to the electric utility.

Another factor to consider prior to granting economic development funds to a vendor is whether the project will be located within the Bristol City limits, as the transition Agreement requires. Approximately half of the projects occurring during the six-year period under review took place outside of the City's limits. Therefore, to comply with the transition agreement, the BVU Authority should not have granted these projects economic development funding. The BVU Authority provides services outside of the City of Bristol; therefore, there is no need to restrict economic development just to the city. The BVU Authority should consider entering into negotiations with the City to get the terms of the transition agreement modified so that the BVU Authority would be allowed to grant economic development incentives to projects within the BVU Authority's service area, and not just the City. The intent of the TVA contract with the BVU Authority for economic incentives was to provide economic incentives wherever BVU provided services, not limited just to the City of Bristol.

Recommendation 41:

The BVU Authority should ensure that all incentives given for economic development meet the requirements outlined in the TVA contract, transition agreement, and their updated policies and procedures. The BVU Authority should consider negotiating with the City of Bristol to get the terms of the transition agreement adjusted so that they can grant economic development incentives to projects anywhere within the BVU Authority's service area, not just the City, which was the intent of the TVA contract.

Despite the issues noted above, the BVU Authority Board and upper management still approved payment for twenty-two out of the twenty-seven expenses we evaluated. Improper approval of payments increases the potential for fraudulent transactions to occur. The board and management should not approve payment for projects that do not meet the requirements to receive economic incentives or without the proper supporting documentation. The board should not approve any more grants until there is an adequate process and proper evaluation and documentation for each project considered for a grant.

Recommendation 42:

The BVU Authority and board should not approve payment of incentives for projects that do not meet the requirements to receive economic incentives or without the proper supporting documentation and should not approve any new grants until an adequate application, review, and monitoring process is in place.

Donations

Prior to when the BVU Authority became its own entity, an Authority separate from the City of Bristol, the Utilities Board, made charitable donations to various non-profit entities in the community. During that time, the Utilities Board was governed by Section 15.2-953 of the Code of Virginia, which provides guidance on how localities make charitable donations. However, after 2010, the BVU Authority Board became its own Authority and became subject to the BVU Authority Act, which is Section 15.2-7212 of the Code of Virginia. The original enactment did not address whether donations were allowable. However, the latest amendment to this section of the Code of Virginia, effective April 8, 2016, expressly prohibits the BVU Authority from making charitable donations.

In 2015, the new President/CEO of the BVU Authority requested a legal opinion on the BVU Authority's ability to make charitable donations after 2010. This legal opinion from the BVU Authority's general counsel reported that as the Code of Virginia relevant to the BVU Authority did not expressly allow them the ability to make these donations, they should assume that no such authority exists. The opinion went on to state that Section 15.2-953 of the Code of Virginia pertains to localities, which the Code of Virginia defines as a City, County, or Town. As the BVU Authority does not fall within this definition, they would not fall under this section of the Code of Virginia. During our review, we performed an assessment of the donations made by the BVU Authority from 2010 to 2015. We noted a total of at least \$205,000 in charitable donations during this time, which were prohibited based on this legal opinion regarding Section 15.2-7200 of the Code of Virginia. Since the BVU Authority was making donations under the assumption that section 15.2-953 still applied to them, we then reviewed the donations to determine whether any of these violated this or any other section of the Code of Virginia.

If Section 15.2-953 did apply to the BVU Authority, as was thought to be the case, this law precluded them from making donations outside their respective limits, to organizations that did not benefit citizens within its limits, and to any institutions considered to be a church, controlled by a church, or any sectarian society. During fiscal years 2011 through 2015, the BVU Authority made

\$14,069 in donations to churches, organizations controlled by churches, and faith-based organizations. In addition, the BVU Authority made \$3,815 in donations outside its service area. There were \$12,663 in donations to entities located outside the service areas for all services except telephone. While the BVU Authority can technically provide services up to a 75-mile radius from the City of Bristol, these entities were closer to the Tennessee service provider and these charitable organizations would likely have benefited the Tennessee service provider's customers before those of the BVU Authority. These donations do not comply with Section 15.2-953 of the Code of Virginia.

Section 2.2-3100 of the Code of Virginia provides a definition of a conflict of interest. This section of the Code of Virginia indicates that a personal interest in a transaction exists when an officer, employee, or family member "may realize a reasonably foreseeable direct or indirect benefit or detriment as a result of the action of the agency considering the transaction." An example of a conflict of interest includes donations the BVU Authority made to the Tri-Cities Christian School, which totaled \$10,313 during the period under review. The former President/CEO, Wes Rosenbalm was the Chairman of the Board of Directors of this entity. In addition, his wife was the Chief Financial Officer (CFO) at the school, and they paid tuition for their children to attend this private school. This indicates that Wes Rosenbalm had a financial interest in the school. Directing the BVU Authority to make cash donations to this school represents a conflict of interest, which is a violation of Section 2.2-3100 of the Code of Virginia. In addition, this school is located in Blountville, Tennessee, over 40 miles from the BVU Authority. While this is technically within the 75-mile radius of the telephone service area, this is closer to the Tennessee service provider and would likely benefit customers of this provider before any customers of the BVU Authority. Donations to organizations outside the BVU Authority's service area represent a violation of Section 15.2-953 of the Code of Virginia. Further, the BVU Authority provides no services to Blountville, Tennessee, so there is little apparent public relations value in donating to this entity. Finally, this is also a faith-based organization as documented in the school's website, to which donations are a violation of Section 15.2-953 of the Code of Virginia.

Former President/CEO, Wes Rosenbalm also occupied a seat on the Boards of Directors for the Barter Theatre, the Bristol Chamber of Commerce, and the United Way of Bristol. The BVU Authority made several donations to these entities, collectively totaling \$45,193. Former Chief Financial Officer (CFO), Stacey Pomrenke occupied a seat on the Boards of Directors for the United Way of Southwest Virginia and the Virginia Highlands Community College Foundation. Donations to these entities were \$16,943. In addition, the BVU Authority made regular donations to the local YWCA, totaling \$18,154 during the period under review. This organization included the former CFO as well as a former board member within its annual "Women in Leadership" award. Data from the BVU Authority's general ledger revealed that the BVU Authority made donations to the YWCA while the YWCA considered these individuals for this award.

Section 2.2-3103 of the Code of Virginia outlines conduct considered prohibited by employees of a public body. One such prohibition of this section includes accepting any business or professional opportunity when the individual knows the opportunity being afforded him is to influence him in the performance of his official duties. The BVU Authority paid a total of \$80,291 in donations, as outlined above, to organizations in which the former CEO or the former CFO of the BVU

Authority occupied seats on the organizations’ Boards of Directors or were being considered for an individual award from the entity. An industry award or a seat on the Board of Directors is a professional opportunity as described by this section of the Code of Virginia. Further, offering such opportunities has the appearance of an attempt to influence the individual into providing donations. Therefore, all of these donations were inappropriate.

Considering donations of cash made by the BVU Authority, we determined that no donations should have been made, as by the BVU Authority Act of the Code of Virginia does not expressly allow it. We also determined that certain donations of cash violated additional sections of the Code of Virginia as noted above. Below is a table, which summarizes this information.

**Inappropriate Donations to Outside Organizations
Fiscal Years 2011 through 2015**

Table 9

Description*	Total
Conflict of Interest	\$ 99,616
Faith-based	3,756
Other Un-allowed Donation	95,848
Outside Service Area	6,165
Total	\$205,385

Source: BVU Authority’s CSA Financial System

*Some donations violated multiple prohibitions; however, the expense is included in only one area. In these cases, we assigned the donation to each category based on the order we reviewed the categories.

Finally, in addition to the above donations, which could represent conflicts of interest or prohibited conduct, representatives of the BVU Authority also instructed its contractors to make donations or increase donation amounts to some of these entities. Communication with these contractors and potential contractors revealed that former President/CEO Wes Rosenbalm asked a significant contractor of the BVU Authority, ETI, to provide a scoreboard, valued at \$4,125 to the Tri-Cities Christian School. Not only does this represent a conflict of interest, based on the former CEO’s relationship with the school, but this also represents a violation of Section 2.2-4372 of the Virginia Public Procurement Act, which prohibits demanding or receiving anything of value as an inducement for the award of a contract or order, services or anything, present or promised, unless consideration of substantially equal or greater value is exchanged. Communications also revealed that BVU Authority representatives asked contractors to increase their contributions to the Chamber of Commerce when the former CEO became a member of the Board of Directors for this organization. This violates the same Code of Virginia Section as well as the Act.

In addition to the above donations, we identified instances of spending for private or personal purposes. According to Section 18.2-112.1 of the Code of Virginia, public assets used for private or personal purposes unrelated to the duties and office of the individual can be considered a misdemeanor. Although this section of the Code of Virginia relates to localities, the BVU Authority

should consider the guidance it provides regarding the expenditures of public assets for personal purposes representing a misuse of public funds. In addition, the Office of the State Inspector General (OSIG) provides examples of fraud, waste, and abuse, of which conducting personal business on state time, inappropriate expenditures, and unnecessary purchases are included. Although the OSIG's focus is on deterring such instances from state agencies, this definition can be applied to the BVU Authority as its assets are considered public funds. Finally, the Commonwealth Accounting Policies and Procedures Manual (CAPP), topic 20310 indicates that "agency purchases must be considered essential to the operation of the agency in support of their mission." Although the CAPP Manual is also primarily focused on the operations of state agencies, the BVU Authority's assets are considered public funds and should consider this definition as the BVU Authority's expenditures are subject to public scrutiny.

During our review, we noted invoices, totaling \$3,834, to a public relations firm in exchange for resume updates, biographies, and applications submitted on behalf of the former CEO, the former Chief Technology Officer, the former CFO, and a former board member for award nominations. Although the receipt of an industry award may have some marketing value to the BVU Authority, this would more likely benefit the individual personally. Therefore, these expenses are for personal business, are not essential to the BVU Authority's operations, and are not a proper use of public funds.

Recommendation 43:

As the latest amendment to Section 15.2-7212 of the Code of Virginia expressly prohibits the BVU Authority from making charitable donations of any kind, the BVU Authority should include this prohibition in its policies and clearly communicate the prohibition to all BVU Authority staff in the form of a policy statement, approved by the board. In addition, the BVU Authority should include a policy stating that employees should only spend BVU Authority funds on items essential to operations.

Employee Benefit Programs

Employment Contracts

During our audit, we reviewed terms of employment contracts for executive managers, significant salary increases for employees, the BVU Authority's vehicle allowance process, commission pay for both sales and non-sales employees, and employee bonuses.

Employment Contract Terms for Executive Managers

The BVU Authority had contracts with former members of management and general counsel that were inappropriate for a governmental entity. The contracts for Wes Rosenbalm, former President/CEO, and Stacey Pomrenke, former Executive Vice President/CFO, had a rolling 10-year term from the contract date upon a positive annual evaluation. If either employee did not receive a positive evaluation in any year, the contract would cease to roll and become a single 10-year contract commencing the next July 1 after the evaluation. However, if either employee received a positive

evaluation during the non-rolling period subsequent to a negative evaluation, the rolling contract term would be reinstated. Essentially, both employees could have nine negative annual evaluations and one positive evaluation on the tenth year and have the rolling contract reinstated. Walt Bressler, general counsel, also had a rolling contract term, except his term was five years.

In addition to their existing salaries, the BVU Authority agreed to pay Wes Rosenbalm and Stacey Pomrenke 70 percent of 1 percent of OptiNet EBIDA (Earnings Before Interest, Depreciation and Amortization), as long as OptiNet monthly EBIDA was \$200,000 or more. The monthly compensation would range from \$1,800 to \$2,800, or \$21,600 to \$33,600 annually.

In addition, the BVU Authority procured and paid for an additional life insurance policy for Wes Rosenbalm in the amount of \$2 million. The BVU Authority purchased the policy from Cincinnati Insurance Company, and it was a 20-year term policy with a guaranteed level premium payment of \$1,015 per year. The BVU Authority also purchased and paid for an additional 20-year term life insurance policy for Stacey Pomrenke in the amount of \$1 million.

The employment contracts for these former members of executive management were generous to the employee, but did not mutually benefit the BVU Authority. The rolling term of the contract prevented the BVU Authority from ever cutting ties with these three individuals. By agreeing to their contracts, they were essentially lifetime employees. This is never a best practice, as the BVU Authority's financial, operational, and strategic needs could change and require new leadership, ideas, and perspectives.

Recommendation 44:

Employment contracts should be a tool to persuade the best employees to want to work for the BVU Authority. Not only should contracts be geared towards providing benefits and incentives for the most talented, knowledgeable, skilled, and experienced worker, they should keep the BVU Authority's best interests in mind. In the future, the BVU Authority should write employment contracts that clearly define all expectations of the employee and BVU Authority. In addition, the BVU Authority should not enter into rolling contract terms that do not allow the potential for turnover at the BVU Authority's request. Lastly, the BVU Authority should ensure that employment contracts explicitly address all internal and external policies and procedures, standards, and laws and regulations.

Salary Increases and Bonuses

During the annual budget process, the BVU Authority Board approved merit raises, performance bonuses, and Christmas bonuses totaling from zero to five percent for fiscal years 2011 through 2015. Based on these approved percentages, we developed expectations of what each employee's salary increase should be each fiscal year. Each year, employees received raises ranging from nothing to \$41,000 and nothing to 40 percent. During this time, the BVU Authority would budget money for merit raises and Christmas and performance bonuses by department and let the department managers determine how to allocate the raise and bonus funds among employees. This

is a very biased practice considering the manager had no guidance or official policy or procedure to follow to ensure distribution of the funds in the least subjective method possible.

The BVU Authority had little documented justification for the majority of raises and bonuses that exceeded the amounts approved by the board. For example, Wes Rosenbalm and Stacey Pomrenke had significant salary increases. Aside from company-wide salary adjustments, increases in pay for Wes Rosenbalm and Stacey Pomrenke were tied to their performance. The BVU Authority Board conducted performance-based evaluations for Wes Rosenbalm during closed session in December board meetings. With the exception of two years (2010 and 2011) under review, there is no documentation of the board's discussion regarding Wes Rosenbalm's performance in board meeting minutes. For these undocumented years, we saw no evidence of the board returning to open session and announcing salary increases or bonuses for him. For Wes Rosenbalm and Stacey Pomrenke, the only indication of board approval for salary increases was documented on employee payroll change forms, including a conversion of OptiNet bonus (see "Employment Contracts" section) of \$33,600 to salary in 2011.

Recommendation 45:

A compensation plan defines how an organization views and manages employee pay and benefits. The intent of a compensation plan is to clearly document an organization's approach to compensation management. When creating a compensation plan, one would consider the following:

- *Annual budget,*
- *Appropriate job market statistics for all positions (i.e., average salary range, knowledge, skills, and experience),*
- *Employee benefits,*
- *Performance management and associated incentives, and*
- *Compliance with internal and external policies and procedures, standards, and laws and regulations.*

The BVU Authority should consider creating a compensation plan that includes guidance for the structure of employee pay and benefits. In this plan, the BVU Authority should also consider a more formal employee performance evaluation process that is in line with the compensation plan, especially for justifying raises or bonuses based on merit.

Vehicle Allowances

As part of Wes Rosenbalm and Stacey Pomrenke's employment contracts, BVU Authority provided sport utility vehicles for both business and personal use. The BVU Authority agreed to pay all operating and maintenance costs on the vehicle except for fuel purchases whenever the vehicle was operated outside of the BVU Authority's service territory and the greater tri-cities area for purposes unrelated to BVU Authority activities. The contract clause also gave the option of a vehicle allowance should they choose to drive their personal vehicles instead of BVU Authority-owned vehicles.

In 2012, Wes Rosenbalm and Stacey Pomrenke elected to use their personal vehicles instead of BVU Authority vehicles and collect the monthly vehicle allowance. Per the contracts, the vehicle allowance was to be \$589 per month, or \$7,069 per year. Below is a comparison of the vehicle allowance per the contract to the actual amount paid to them through payroll:

Vehicle Allowances

Table 10

	Fiscal Years			
	2012	2013	2014	2015
Wes Rosenbalm*				
Actual (per payroll)	\$9,513	\$15,750	\$ 5,250	\$ -
Per Contract	7,069	7,069	7,069	-
Excess of Contract	\$2,444	\$ 8,681	\$(1,819)	\$ -
Stacey Pomrenke				
Actual (per payroll)	\$9,065	\$22,366	\$22,450	\$22,500
Per Contract	7,069	7,069	7,069	7,069
Excess of Contract	\$1,996	\$15,297	\$15,381	\$15,431

Source: Employment contracts and BVU Authority's CSA Payroll System

*Wes Rosenbalm resigned September 25, 2013

As shown above, the BVU Authority paid more than the agreed upon annual amount for Wes Rosenbalm and Stacey Pomrenke's vehicle allowances. The BVU Authority could not provide evidence that the BVU Authority Board approved these additional vehicle allowance payments.

In addition to Wes Rosenbalm and Stacey Pomrenke, other employees received vehicle allowances totaling \$98,394 during fiscal years 2012 through 2015. The BVU Authority provided email documentation showing when BVU Authority discontinued vehicle allowances for these employees. However, they could not provide anything supporting how/why it started, how much allowance the employee was to be paid, or the terms and conditions of the vehicle allowance agreement.

Another issue that surfaced during Stacey Pomrenke's trial was her excessive personal use of her assigned BVU Authority-owned vehicle. Stacey Pomrenke self-reported her ratio of personal to business use on the BVU Authority provided vehicle as 50/50. However, it became evident that Stacey Pomrenke falsely reported her personal and business use of the vehicle with the personal use at a much higher ratio than originally reported. Therefore, the tax reported for this fringe benefit was not correctly included on her W-2.

To use an allowance method for reimbursing employees for business use of a personal vehicle, the employee must keep track of the actual mileage used on the car for business purposes, calculate the reimbursement based on the per mileage rate, and then compare to the allowance. The employer should report any allowance in excess of the allowed reimbursement for actual

mileage as income. If the actual is more than the reimbursement, the employee may claim the business expense on their federal tax return.

Recommendation 46:

Regardless of what type of vehicle benefit the BVU Authority chooses for its employees, it should develop a policy that conforms to the IRS requirements for vehicle allowances set out in IRS Publication 463. In addition, the BVU Authority should ensure that it is correctly reporting the taxable benefit on employee W-2 forms.

Commissions

The BVU Authority's internal Sales Compensation Plan is based on monthly contract amounts. For example, commission is equal to a percentage of one month's revenue for a contract. In 2015, the Sales Compensation Plan included two parts. The first part is based on the contract length:

- Commission for 12-month contracts is 50 percent of one month's revenue.
- Commission for renewed contracts is 50 percent of one month's revenue, unless renewed contract term is 12 months, then the commission is only 25 percent.
- Any contract under 12 months is considered month-to-month and will not be paid commission.
- Commission for 24 month contracts is 100 percent of one month's revenue.
- Contract terms greater than 36 months will earn commission at 150 percent of one month's revenue with the exception of renewals, which will be paid at 50 percent regardless of the term.
- No commission will be paid on long-distance contracts.

The second part of the commission is based on the monthly price of the contract. For monthly contract amounts between \$0 and \$2,000, the commission is 25 percent of one month's revenue; \$2,001 to \$4,000 is 50 percent; \$4,001 to \$4,999 is 75 percent; and \$5,000 and above is 100 percent. Therefore, total commission for a 24-month contract with a monthly value of \$5,000 (total contract value of \$120,000) would be equal to \$10,000, \$5,000 for the term length and \$5,000 for the value.

Employees in the sales department earn both a base salary plus commissions. From fiscal year 2011 to 2015, the Authority's three main sales employees received \$1,105,268 in commissions, in addition to their \$728,268 in base salary.

**Compensation for BVU Authority Sales Force
Fiscal Years 2011 through 2015**

Table 11

	Base Salary	Commission	Total Compensation
2011	\$137,165	\$ 148,543	\$ 285,708
2012	135,515	192,913	328,428
2013	148,973	250,458	399,431
2014	149,162	216,714	365,876
2015	157,453	296,640	454,093
Total	\$728,268	\$1,105,268	\$1,833,536

Source: BVU Authority's CSA Financial and Payroll System

We also noted that the BVU Authority paid \$283,837 in commissions to employees who were not sales employees. This would typically happen when one of the salespeople would inform Stacey Pomrenke (or other BVU Authority management) that another employee assisted on a sales call and should receive commission. Stacey Pomrenke and the salesperson would determine the amount given to the employee. The BVU Authority could not provide official documentation showing adequate justification or approval of commission pay to non-sales employees.

Finally, one non-sales employee in particular regularly assisted in the sale of wholesale contracts. This employee received commission based on a compensation structure separate from the official Sales Compensation Plan. Stacey Pomrenke communicated this separate compensation structure in an email between the employee and herself, but it was not formally approved or justified.

Recommendation 47:

The BVU Authority should develop a compensation plan for all employees that provides a fair and equitable method to giving raises, commissions, and bonuses. This would include payment of commissions that are reasonable, not excessive, and balances the commission with the salary paid so that the entire compensation package for sales representatives is fair and reasonable given their knowledge, skills, abilities, and experience.

Employee Benefits

VRS Retirement Accounts

BVU Authority employees participate in the Virginia Retirement System (VRS). Effective July 1, 2010, VRS required members to contribute up to five percent of monthly employee compensation through a pre-tax salary reduction. Table 12 explains retirement contributions for members under Plan 1, Plan 2, and the Hybrid Plan:

Virginia Retirement System Plans

Table 12

Plan 1	Plan 2	Hybrid Plan
<p>Plan 1 is a defined benefit plan. The retirement benefit is based on a member’s age, creditable service, and average final compensation at the retirement using a formula. Employees are eligible for Plan 1 if their membership date is before July 1, 2010, and they were vested as of January 1, 2013. Member contributions are tax-deferred until they are withdrawn as part of a retirement benefit or as a refund. The employer makes a separate actuarially determined contribution to VRS for all covered employees. VRS invests both member and employer contributions to provide funding for the future benefit payment.</p>	<p>Plan 2 is a defined benefit plan. The retirement benefit is based on a member’s age, creditable service, and average final compensation at the retirement using a formula. Employees are eligible for Plan 2 if their membership date is on or before July 1, 2010, or their membership date is before July 1, 2010, and they were not vested as of January 1, 2013. Member contributions are tax-deferred until they are withdrawn as part of a retirement benefit or as a refund. The employer makes a separate actuarially determined contribution to VRS for all covered employees. VRS invests both member and employer contributions to provide funding for the future benefit payment.</p>	<p>A Hybrid Plan member’s retirement benefit is funded through mandatory and voluntary contributions made by the member and the employer to both the defined benefit and the defined contribution components of the plan. The member’s employer is required to match those voluntary contributions according to specified percentages. Employees are in the Hybrid Plan if their membership date is on or after January 1, 2014. This includes State employees and members in Plan 1 or Plan 2 who elected to opt into the Hybrid Plan during the election window held January 1 – April 30, 2014. The plan’s effective date for opt-in members was July 1, 2014. Mandatory contributions are based on a percentage of the employee’s creditable compensation and are required from both the member and the employer.</p>

Source: www.varetire.org

Contributions were to come out of employees’ paycheck as a pre-tax deduction. The BVU Authority assumed this meant the deduction was to be taken pre-tax of everything, therefore, they did not properly deduct Social Security and Medicare taxes from the employee contribution.

The BVU Authority’s Board contracted for an audit of payroll and benefits in December 2015 and January 2016 to ensure sound operations within payroll and that benefits were being properly reported. This review included reviewing tax forms to ensure the BVU Authority was compliant with the Internal Revenue Code. The audit reviewed unissued employee W-2 forms for the 2015 tax year to ensure the BVU Authority was correctly reporting income and benefits. The audit discovered that

employees had deferred funds in their retirement plans that were not subjected to Social Security and Medicare withholding. This is in direct violation of the IRS requirement:

“Retirement plans that feature a salary reduction or cash-deferred arrangement allow employees to choose to defer some income from tax by electing to place it in a trust account for retirement. By making such an election, the amount deferred is not subject to income tax at the time it was placed in the trust. The deferred amounts are subject to social security and Medicare (FICA) tax.”

The audit recommended the BVU Authority elect one of the following options: (1) deduct the tax withholdings from the employees’ paychecks or (2) pay the withholdings on behalf of the employee, which could potentially create a taxable benefit for the employees. The BVU Authority amended the 2015 W-2s and decided to pay the withholdings to the IRS up front. Then the BVU Authority deducted the 2015 uncollected taxes from employee paychecks over six pay periods as a reimbursement for what the BVU Authority paid on the employees’ behalf. The BVU Authority did not use any official guidance to decide how/for how long the BVU Authority would take to deduct the uncollected tax reimbursements.

Not only were employees having an entire year’s worth of withholdings deducted in five pay periods, 2016 withholdings were also being deducted at the same time. Management clearly communicated the issue to employees; however, this communication was after the issue was discussed at a public board meeting and only days before the deductions began coming out of employees’ paychecks, giving them little time to prepare for the impact.

While the 2015 withholdings have been settled and the BVU Authority is deducting 2016 withholdings moving forward, the BVU Authority is unsure of whether it will owe the IRS for the 2010-2014 withholdings that were not deducted. The BVU Authority does not have an idea of how much they owe for this time frame should the IRS decide to collect on the withholdings not deducted, because interest could potentially be applied. However, the Controller did say that he has purposely set aside \$150,000 received from fraud restitution in case the BVU Authority owes the IRS for the 2010-2014 withholdings not deducted. His plan is for the BVU Authority to pay the taxes on behalf of the employees.

Recommendation 48:

According to the Internal Revenue Bulletin 2008-32, employees may be subject to interest payments on the underpayment of FICA taxes not withheld from paychecks during the years of 2010 to 2014. The BVU Authority should seek guidance from the IRS once the IRS completes its criminal investigation. The BVU Authority should also research and determine the tax implications on employees should the BVU Authority choose to pay the underpaid FICA taxes on behalf of employees. In addition, the BVU Authority should inform employees with salary levels greater than the Social Security threshold of \$118,500 that the deduction of 2015 withholdings in 2016 may affect how they file personal tax returns.

Non-VRS Retirement Accounts

As part of the fiscal year 2002 budget approval process documented in the June 2001 board meeting minutes, the Utilities Board agreed to enter into a plan services agreement with J.D. Benefits to administer 401(a) and 457 retirement plans for the Utilities Board employees. The 401(a) plan was a money-purchase retirement savings plan set up to allow for employee and/or employer contributions. The 457 plan was a type of nonqualified, tax advantaged deferred-compensation plan provided to allow employees to defer compensation into the plan on a pre-tax basis. Because these plans were not replacing employer contribution plans through VRS, the board chairman requested in a September 2002 board meeting that the Utilities Board stop the matching company portion (401(a) plan) immediately, but allow deferred compensation to remain in place. This would allow employees to continue to contribute on a pre-tax basis.

In July 2003, without competitively procuring the service, former Executive Vice President/CFO Stacey Pomrenke transferred the Utilities Board employee 401(a) and 457 plans with J.D. Benefits to 457 plans with Lord Abbett through Edward Jones even though former President/CEO, Wes Rosenbalm refused to approve the transfer because there was too much difference in returns. This was a self-serving transaction for Stacey Pomrenke. She benefitted from the transaction by doing business with personal friends – a benefit that may have cost employees additional money in administration fees for Lord Abbett and less investment plan options. No analysis has been done to determine if investment returns offset the increase in administrative fees. However, the potential exists that employees did not get the returns they might have in their previous plans.

Recommendation 49:

The BVU Authority continues to use Edward Jones and Lord Abbett to manage supplemental employee 457 retirement plans. To ensure employees are truly benefitting from the services provided, the BVU Authority should research other retirement plan service providers and compare other providers' services to those of Edward Jones and Lord Abbett. Should Lord Abbett fall in the rankings, the BVU Authority should terminate the contract with Lord Abbett and follow the Virginia Public Procurement Act to seek services elsewhere.

Retiree Healthcare

The BVU Authority does not use the Commonwealth's healthcare plan. Instead, they have their own group health plan through Anthem Blue Cross Blue Shield. In 2006, the former Manager of Administrative Services drafted a memo detailing the Utilities Board's Health and Dental Care Coverage Program for Retirees. This memo was never an official policy and was only drafted to help the newly-hired Controller understand how the Utilities Board handles healthcare benefits for retirees. Per the memo, the BVU Authority pays the following for retiree healthcare coverage until they are eligible for Medicare:

1. One hundred percent of health insurance premiums for retired employees (and spouse) with 30 or more years of service.
2. Three percent per year of service toward the premium for retired employees (and spouse) with 20-29 years of service. The retiree will pay the remainder of the premium.
3. Sixty percent of the premium for whatever plan a disabled retiree, with less than 20 years of service, has until the retiree reaches normal retirement age.
4. Three percent per year of service towards health premiums for disabled retirees with 20 or more years of service.
5. Zero percent of the premium for retired employees with less than 20 years of service who take a normal service retirement. However, the retiree is allowed to stay on the BVU Authority's healthcare plan, they just have to pay the entire premium.

Dependent children are also covered until age 19, or 25 if a full-time student. In regards to dental insurance, the memo states that the BVU Authority pays 100 percent of premiums until age 65, at which time the retiree would take over paying the entire premium. This applies to all of the above scenarios.

Article V, Sections 66:121-123 of the City of Bristol's Code of Ordinances documents the City's retirement health insurance benefit program. The benefits of this program are:

1. Any mid-term employees (at least 25 years of employment) shall receive \$100 per month toward the cost of their health insurance, or if their insurance cost is less than \$100 per month, the actual cost of their monthly premium, until they shall have attained Medicare eligibility.
2. All long-term employees (at least 30 years of employment) shall receive \$200 per month toward the cost of their health insurance, or if their insurance cost is less than \$200 per month, the actual cost of their monthly premium, until they have attained Medicare eligibility.
3. All career employees (at least 35 years of employment) shall receive \$300 per month toward the cost of their health insurance, or if their insurance cost is less than \$300 per month, the actual cost of their monthly premium, until they have attained Medicare eligibility.
4. There will be no cost-of-living increase to this benefit.

This ordinance was in effect during the time the Utilities Board was part of the City of Bristol. Therefore, we expected that the Utilities Board would have followed this ordinance before becoming an authority in 2010. However, as evidenced above, the Utilities Board’s health and dental care coverage program for retirees did not follow the terms and conditions of the City’s retirement health insurance benefit program.

As of August 2016, the BVU Authority pays \$8,158 a month, or \$97,896 annually, in healthcare coverage for retirees (including spouses and dependents). The BVU Authority pays approximately \$7,530 a year for each retiree healthcare plan. Below is a hypothetical situation showing the amount the BVU Authority would pay per year for one non-Medicare retiree with a \$7,530 annual healthcare premium compared to the City’s healthcare plan:

Retiree Healthcare Plan Premium Comparison

Table 13

	Years of Service				
	<20 - disabled retiree	20-24*	25-29**	30-34	35
Employer's (BVU) obligation:					
Under BVU's Plan	\$4,518	\$4,970	\$6,099	\$7,530	\$7,530
Under City of Bristol's Plan	-	-	1,200	2,400	3,600
Difference	\$4,518	\$4,970	\$4,899	\$5,130	\$3,930

* Assuming 22 years of service (arbitrary number for purpose of illustration)

** Assuming 27 years of service (arbitrary number for purpose of illustration)

As illustrated above, the BVU Authority’s payment for retiree healthcare is greater under the current program than it would have been under the City’s plan. Using this plan instead of the City’s plan is costing BVU Authority between \$3,930 and \$4,970 more per year per employee. The BVU Authority currently has 13 retirees on this plan, which is estimated to cost the BVU Authority between \$51,090 and \$64,610 per year more for the retiree to be on the BVU Authority’s plan than the City’s plan. We did not perform additional analysis to determine what the BVU Authority would continue to pay for spouse and dependent coverage in the event of a retiree’s death. The funding policy for retiree healthcare is to contribute to the plan the premiums assessed each year.

In addition, there is no record showing that the board, President/CEO, or Executive Vice President/CFO ever approved the retiree healthcare plan. In the February 1986 BVU Board meeting minutes, the board approved renewing the contract for healthcare insurance with Blue Cross-Blue Shield of Virginia. The contract included plan types for employees, employees and family, and employees with one minor. Retiree coverage plans were not included in the contract. However, in the June 2001 board meeting minutes, the budget, approved by the board, referenced that the BVU Authority already paid for retiree health insurance and proposed adding the retiree’s spouse to the plan. Therefore, at that time, the retiree healthcare plan was already included even though there was never any evidence of the approval of that plan.

Recommendation 50:

The BVU Authority should reevaluate its current retiree healthcare program and determine what post-employment benefits it can afford to provide to retirees. In considering potential changes, the BVU Authority should consider whether changes should apply to all employees, only employees who have not vested in the program yet, or only new employees. The BVU Authority Board of Directors should review and approve this plan before it takes effect. In addition, management should communicate with all employees before the program takes effect. Finally, the BVU Authority should seek the opinion of a tax expert to determine the tax implications on the retiree, if any, and ensure it is complying with the Internal Revenue Code for retirees obtaining healthcare benefits.

Employee Loan Programs

Program Overview

The BVU Authority's Employee Handbook, issued in 2002, has a policy detailing the BVU Authority's interest-free loan program offered to employees for personal computer purchases. The loan program was created in 1992 to encourage familiarity and proficiency with technology. In more recent years, employees used the loan program to purchase electronics other than computers (i.e., tablets, cell phones, etc.)

According to the policy, any full-time employee is eligible for the interest-free loan up to a maximum of \$3,000 with repayment made through bi-weekly payroll deduction over a term of up to three years. The program works to the loan-participating employee's advantage because the BVU Authority makes the purchase on behalf of the employee, meaning the employee does not have to front any money, and the purchase is exempt from regular sales tax because the BVU Authority is a political subdivision not subject to paying tax.

The former President/CEO Wes Rosenbalm, former Executive Vice President/CFO Stacey Pomrenke, and former General Counsel Walt Bressler used this loan program inappropriately to pay for at least \$70,260 in personal expenses such as electronics, home improvements, and meals. These individuals used their BVU Authority issued credit cards to make personal purchases. When the BVU Authority paid the credit card bills, they added the personal expenses of each individual to their existing employee loan. The BVU Authority did not have adequate records supporting these transactions. This was not the intended purpose of this loan program.

The BVU former President/CEO, Vice President/CFO, and General Counsel inappropriately used the loan program to fund \$70,260 in personal expenses.

Loan Forgiveness

BVU Authority residential customers are eligible for energy savings loans to assist with the costs of a heat pump and water heater replacement, home insulation and weatherization, energy-efficient doors and windows, electrical service upgrades, and exterior main water and wastewater

line replacements. Currently, the TVA provides financing through a third-party lender for residential heat pumps with repayment on the customer's electric bill and a term of up to ten years. Local power companies served by TVA independently administer the programs. Customers rarely take advantage of this program.

Prior to joining back with TVA in January 2009, the Utilities Board used Cinergy Utility (now Duke Energy) from December 1997 to December 2004 and American Electric Power (AEP) from January 2005 to December 2008 to provide electricity. During the time the Utilities Board was not with TVA, it created a committee of three employees, known as the Residential Loan Program Committee, to manage, approve, and maintain loans to customers.

The Residential Loan Program provides loans up to \$34,500 dependent on the customer's credit rating. The maximum term for loans greater than \$5,000 was ten years. The interest rate on all loan programs, with the exception of the Water Heater Replacement Program, was a fixed, simple interest rate of 9.25 percent. The Utilities Board carried this percentage over from the 1980s when TVA owned the rights to the loans. The Utilities Board did not evaluate this interest rate to determine whether it was appropriate and competitive against banks and loan companies.

Former President/CEO Wes Rosenbalm took advantage of this customer loan opportunity in 2006 to finance major home improvements. He entered into the first loan in November 2006 to finance a heat pump replacement. In March 2009, Wes Rosenbalm financed a garage door installation through a second residential loan. The terms and conditions of Wes Rosenbalm's residential loan did not match the standard terms, including:

- The loan was interest free. Therefore, the BVU Authority did not collect over \$16,000 in interest on his residential loans. Other employees may have benefitted from interest-free residential loans as well; however, the BVU Authority was unable to provide documentation on past loans.
- The loan term was 20 years.
- There was no evidence of the BVU Authority performing a credit check prior to extending Wes Rosenbalm his residential home loan.

The terms and conditions of the loan state, "Any request by a customer to deviate from the above loan criteria is subject to approval by the Residential Loan Program Committee." The terms and conditions of Wes Rosenbalm's loan deviated from the norm in at least three terms. Since the Utilities Board's Residential Loan Committee consisted of three Utilities Board employees who worked under Wes Rosenbalm, they most likely felt obligated when approving the deviating loan terms.

When the current President/CEO joined the BVU Authority, he repealed all of the loan programs. He encouraged employees with outstanding balances to pay the remainder of their balance as soon as possible; however, some employees chose to continue with their loan payment

plan. As of March 31, 2016, there were 16 employees with outstanding loans, totaling \$3,320. All loans will be satisfied in February 2017.

Recommendation 51:

Currently, TVA manages the BVU Authority's Residential Loan Program. The BVU Authority's only involvement in the loan program is ensuring TVA has all the necessary paperwork to administer the loan properly. If the BVU Authority ever reverts to operating their own residential loan program, it must have clearly defined policies and procedures on how to properly approve and manage the loans. In addition, the BVU Authority should periodically review loan terms and conditions to ensure competitive loans are advantageous to the employee. Ideally, the BVU Authority should outsource residential loans to a third-party provider to remove any conflicting interests (i.e., subordinate employee approving manager's loan).

Finally, regarding interest-free and below-market-interest-rate loans, IRS Publication 15-A states:

"In general, if an employer lends an employee more than \$10,000 at an interest rate less than the current applicable federal rate (AFR), the difference between the interest paid and the interest that would be paid under the AFR is considered additional compensation to the employee. This rule applies to a loan of \$10,000 or less if one of its principal purposes is the avoidance of federal tax.

This additional compensation to the employee is subject to social security, Medicare, and FUTA taxes, but not to federal income tax withholding. Include it in compensation on Form W-2 (or Form 1099-MISC for an independent contractor)..."

The BVU Authority never calculated the difference between the interest paid and the interest that would have been paid under the AFR to include as additional compensation on the loan-participating employee's W-2. Based on our understanding and interpretation of the IRS Publication, we find this reasonable *if* an employee's loan did not exceed the \$10,000 threshold AND if it was not one of the loan's principal purposes to avoid federal tax. However, Wes Rosenbalm's loan was greater than \$10,000 with no interest and the BVU Authority did not report the loan as a benefit on Wes Rosenbalm's income tax forms.

Recommendation 52:

The BVU Authority should seek the opinion of a tax expert to determine if revising the W-2 forms for employees who received interest-free loans is necessary.

Cash, Gift Card, and Check Payments to Employees

Dating back as early as 2003, the Utilities Board gifted employees with cash, checks, and gift cards as compensation or incentive for various accomplishments and events. Such accomplishments and events include service and safety awards, exceptional customer service, business sales

incentives, retirement gifts, volunteer service reward, and birthday and Christmas presents. The purpose was to build employee morale and retention.

On three separate occasions (September 2009, 2010, and 2011), Stacey Pomrenke purchased at least \$2,000 worth of Visa gift cards from the Johnson City Mall using BVU Authority money. The intent in doing so was to participate in the mall’s Earning for Learning contest, an event held to benefit local schools, including her children’s private school.

The mall awarded the school with the most retail purchases at the mall with monetary prizes. Visa gift cards were worth triple points in the contest because the gift cards could be used at the mall to purchase additional merchandise. Stacey Pomrenke purchased the gift cards in bulk and turned in the receipts to the mall to benefit her children’s school, a non-profit, sectarian entity. The BVU Authority then used the gift cards throughout the year to reward employees. This was inappropriate because Stacey Pomrenke used BVU Authority money to provide a personal benefit and the BVU Authority then used those cards to provide compensation to employees that they did not report to the federal government.

In addition, Stacey Pomrenke would request money from petty cash so that she could give it to department managers to disburse to employees in their departments as performance and incentive bonuses. Management distributed these bonuses at their discretion, with no guidance provided on how to disburse them among employees. None of these bonuses flowed through the payroll department. Therefore, the BVU Authority did not report these as income for tax purposes.

Since 2009, the Utilities Board/BVU Authority has paid employees in checks, cash, and gift cards as follows:

Payments to Employees

Table 14

Method of Payment	Calendar Year					Grand Total
	2009	2010	2011	2012	2013	
Check	\$ -	\$ -	\$1,135	\$ 310	\$ -	\$ 1,445
Cash	5,400	4,200	4,150	10,775	2,021	26,546
Gift Card	1,000	-	775	13,875	6,185	21,835
Grand Total	\$6,400	\$4,200	\$6,060	\$24,960	\$8,206	\$49,826

Source: BVU Authority internal spreadsheet

The BVU Authority did not include the above payments in employee W-2 forms. Section 132(a)(4) of the Internal Revenue Code (IRC) speaks to the treatment of employee taxes for de minimis fringe benefits. Per the IRC, a de minimis fringe benefit is “one for which, considering its value and the frequency with which it is provided, is so small as to make accounting for it unreasonable or impractical.” Such items include:

- Controlled, occasional use of photocopier
- Occasional snacks, coffee, doughnuts, etc.
- Occasional tickets for entertainment events
- Holiday gifts
- Occasional meal money or transportation expense for working overtime
- Group-term life insurance for employee spouse or dependent with face value not more than \$2,000
- Flowers, fruit, books, etc., provided under special circumstances
- Personal use of a cell phone provided by an employer primarily for business purposes

An essential element of a de minimis benefit is that it is occasional or unusual in frequency. The IRS previously ruled that items exceeding \$100 in value could not be considered de minimis, even under unusual circumstances. According to the IRC, cash or cash equivalent items provided by the employer to an employee are never excludable from income. Gift certificates that are redeemable for general merchandise or have a cash equivalent value are ***not*** de minimis benefits and are taxable.

Reporting de minimis benefits is not necessary if they qualify for exclusion. However, if they do not qualify for exclusion, they are taxable, should be included in wages on employee W-2 forms, and are subject to income tax withholding. If the employees are covered for Social Security and Medicare, the value of the benefits are also subject to withholding for these taxes.

The BVU Authority should have reported these payments as income to the employee. The BVU Authority has corrected the W-2s for 2012 and 2013. It is possible that the BVU Authority will have to amend employee W-2 forms for those who received these payments in other years. This could also increase employee withholding, as the BVU Authority employees will likely owe taxes not previously withheld for this income. The BVU Authority is facing a similar tax situation of incorrectly not withholding employee Social Security and Medicare related to employee retirement plans discussed earlier.

Recommendation 53:

The BVU Authority should develop policies over rewards and bonuses for employees. This policy should be part of the BVU Authority’s overall compensation plan. The policy should include criteria that employees must meet to qualify for rewards and bonuses. The policy should comply with all Internal Revenue Code requirements and ensure proper reporting of rewards and bonuses for tax purposes.

Pre-employment Hiring Procedures

In the 2002 version of the Employee Handbook, the Utilities Board had a policy addressing pre-employment conditions. The revised version of this policy, which has yet to be implemented, includes performing background checks, credit checks, and review of driving records. In addition to checks and balances performed as part of the policy, the Administrative Services Department uses a

pre-employment checklist once they send an applicant a conditional offer of employment. The checklist includes drug screenings, physical examinations, review of driving records, and performing online background and credit checks – all of which are consistent with procedures included in the revised policy. However, the BVU Authority does not currently have a process in place to verify candidate education and certifications.

During the criminal trial, it became known that former Executive Vice President/CFO Stacey Pomrenke falsified information on the resume she used to obtain her position at the BVU Authority. Her resume stated that she received a Master of Business Administration from Virginia Tech. However, she did not receive her degree because she was released from Virginia Tech on an honors violation before graduating. Therefore, the BVU Authority hired Stacey Pomrenke under false pretenses. This would have been determined in the pre-employment process had the BVU Authority reviewed Stacey Pomrenke’s transcripts or verified her education some other way.

Recommendation 54:

The BVU Authority should revise its existing pre-employment policies and procedures to include verification of candidate education and certifications that relate to the job for which they are applying. Pre-employment screenings are critical to hiring the best possible candidate for a position.

Nepotism

Nepotism is defined as “the unfair practice by a powerful person of giving jobs and other favors to relatives.” In the past, there has been the appearance of nepotism in the hiring process. The BVU Authority’s Employee Handbook has a policy addressing nepotism that states the BVU Authority will not hire the relatives or persons of board members that live in the same household. Part-time and seasonal employees are currently exempt from this policy. The policy, however, does not address instances where a relative or close friend of a current employee is hired by the BVU Authority. The revised policy (not yet implemented) also only addresses board members, not employees.

Recommendation 55:

The BVU Authority should implement a policy to avoid the appearance or actual occurrence of nepotism. The Code of Virginia Section 2.2-3106 prohibits (as a conflict of interest) supervision, evaluation, or the making of personnel decisions by an employee of a member of his or her immediate family. Immediate family includes the spouse and any other person residing in the same household as the employee who is a dependent of the employee or of whom the employee is a dependent. While this Code of Virginia section does not apply directly to the BVU Authority, they should use it as a best practice when developing the policy. In addition, the policy should apply to both the board and employees of the BVU Authority and should not exempt any type of employee for consideration.

Lobbyist

In July of 2002, the Utilities Board agreed to contract with a firm to lobby on its behalf for the ability of localities to deliver telecommunication services and cable television services. The contract did not define a contract end date. However, the Utilities Board contracted with the firm for an annual cost of \$60,000. At this time, the Utilities Board was still part of the City of Bristol.

From 2002 to 2010 while still part of the City, the Utilities Board paid the firm \$497,259 for lobbying services. Table 11 shows the total amount the BVU Authority paid to the lobbying firm for fiscal year 2011 to fiscal year 2015.

**Funds Paid to Lobbyist
Fiscal Years 2011 through 2015**

Table 15

Fiscal Year	Electric Funds	OptiNet Funds	Total
2011	\$ -	\$ 86,077	\$ 86,077
2012	50,126	77,642	127,768
2013	85,876	22,191	108,067
2014	18,000	42,000	60,000
2015	7,000	-	7,000
Total	\$161,002	\$227,910	\$388,912

Source: BVU Authority's CSA Financial System

Based on the Secretary of the Commonwealth's Lobbyist Registration Database, the lobbying firm was registered to lobby for the "City of Bristol, D/B/A Bristol Virginia Utilities Board" in 2010 and 2011. There is no record of lobbyist registrations for the "City of Bristol, D/B/A Bristol Virginia Utilities Board" or the BVU Authority in the database after 2011. From 2011 forward, the lobbyist is registered under the City of Bristol, not the BVU Authority.

The invoices paid came from the Bristol City Manager asking the BVU Authority to pay the lobbyist firm on the City's behalf. Some of the payments from the Electric Division (\$86,834) were from economic development funds discussed earlier in this report. The rest were from Electric and OptiNet operating funds. It is inappropriate and unreasonable that the BVU Authority paid for the City's lobbying activities, as it was no longer a component of the City. Even using economic development funds was inappropriate, as these expenses did not have a direct benefit to the Electric system.

Recommendation 56:

The BVU Authority inappropriately paid for lobbyist activities performed for the City of Bristol from 2011 to 2015. The BVU Authority should discontinue paying a lobbyist for work done on behalf of the City of Bristol, as it is not the BVU Authority's responsibility to pay the City's expenses.



Martha S. Mavredes, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

September 15, 2016

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable Robert D. Orrock, Sr.
Chairman, Joint Legislative Audit
and Review Commission

We have audited the Bristol Virginia Utilities Authority (BVU Authority) and are pleased to submit our report entitled *Review of Bristol Virginia Utilities Authority*. We conducted this performance audit 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.

Objectives

The objectives of this audit are as follows:

- To examine the financial operations and governance of the BVU Authority.
- To identify and disclose past and/or present deficiencies within the financial and operational practices of the BVU Authority.
- To identify and evaluate corrective actions taken to date and planned for the future.

Scope and Methodology

This audit focused on the financial operations and activity of the BVU Authority that were at increased risk of fraud or error primarily due to recent criminal acts. The audit period was from July 1, 2010, through June 30, 2015. However, the audit also included limited activity before and after this period that was of particular interest or concern. We conducted interviews with various BVU Authority employees and board members, City of Bristol employees, and other related parties. We reviewed legislation, laws, regulations, contracts, policies, processes, procedures, financial transactions, and previous financial statement audits. We reviewed minutes for the BVU Authority Board. We reviewed the bond indentures and other relevant documents related to the BVU Authority's long-term debt.

Conclusions

We found an overall lack of internal controls, policies, and procedures that contributed to the manifestation of a series of fraudulent acts that lead to the prosecution and conviction of nine individuals, including BVU Authority Board members, contractors, and upper management. We made 56 recommendations for the BVU Authority to consider as they develop and implement internal controls, policies, and procedures. These recommendations are included throughout the report and summarized in [Appendix B](#).

Going Concern

The BVU Authority's OptiNet Division has a potential going concern issue, as it appears that they do not have the resources to continue operating without cross-subsidization, which is prohibited by the [Code of Virginia](#). In fiscal year 2015, the OptiNet Division operated with a net loss that is expected to continue. In addition, OptiNet may not be generating enough cash from operations to pay both the principal and interest owed on their bonds. These items along with the reinstatement of the interdivisional debt and associated interest only puts OptiNet further into financial detriment. These conditions raise substantial doubt about OptiNet's ability to continue as a going concern.

Exit Conference and Report Distribution

We discussed this report with management and the BVU Authority Board on September 16, 2016. Management's response to the findings identified in our audit is included in the section entitled "Management's Response." We did not audit management's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

DBC/clj

APPENDIX A – CONVICTION SUMMARY

Walter Bressler, BVU Authority Attorney, 2009 - 2015

Misconduct

- Walter sent an email soliciting the BVU Authority Board Member's participation in a Dallas trip acknowledging that the BVU Authority asked for the trip as part of consideration for a contract and that they would be attending an NFL Dallas game. BVU Authority Board Members and Executives, including Walter, then traveled to Dallas, TX, at the expense of the Company, which exceeded \$10,000.
- Allegations of misconduct on the part of Wes Rosenbalm were brought to the BVU Authority Board and Walter's attention. The Board and Walter discussed these allegations in multiple meetings held in executive session. They decided not to contact law enforcement or the National Telecommunications and Information Administration with the information that state and federal law had been violated but instead offered Wes Rosenbalm a \$269,240 severance package to keep allegations from becoming public.

Charges

- Conspired to (1) having knowledge of the actual commission of a felony, knowingly and willfully conceal and not as soon as possible make known the same to some judge or other person in civil or military authority; and (2) corruptly solicit or demand for the benefit of any person, or accept or agree to accept, anything of value from any person, intending to be influenced or rewarded in connection with any business, transaction, or series of transactions of such organization, government, or agency involving anything of value of \$5,000 or more, while being an agency and officer of a state or local government agency that received in excess of \$10,000 in federal funding from a Federal program involving a grant, contract, or other form of Federal assistance in any one year.

Plea

- Plea of guilty to conspiracy to commit program fraud and misprision of a felony.

Sentence/Restitution

- Six months in prison and six months home detention.
- Forfeiture of money judgement \$10,000.

Michael Clark, BVU Authority Contractor, 2001-2015

Misconduct

- Along with co-conspirators, committed and caused to be committed overt acts including: Submitted false invoices to Robert Kelley for work not actually completed resulting in at least \$110,065 in fraudulent billing; Robert received at least \$105,000 in kickbacks; and Michael filed false and fraudulent income tax returns with the IRS for tax years 2006, 2007, 2008, and 2009 by deducting payments to Robert as “Contract Labor” when they were illegal kickbacks resulting in knowingly and willfully failing to pay income taxes of more than \$12,500.

Charges

- Conspired to file false income tax returns and willfully evade income taxes.

Plea

- Plea of guilty to engaging in a conspiracy to defraud the IRS.

Sentence/Restitution

- Eight months in prison.
- Restitution of \$110,065.
- \$2,000 fine.

Misconduct

- The BVU Authority entered into an agreement with a Company that if they signed a contract with them they would pay to entertain executives and Board Members in Dallas, TX. BVU Authority Board members and executives then traveled to Dallas, TX, at the expense of the Company, which exceeded \$10,000. The total value of things provided to Bruce was approximately \$2,500. Bruce did not disclose these amounts on the Virginia state mandated financial disclosure form for the year 2011 as required.
- Bruce, General Sales Manager at an automobile dealership, provided the BVU Authority bids for automobile purchases. He entered into an agreement with a BVU Authority employee that the employee would provide him with information regarding other bids so that he could alter his bid to be the lowest bidder. This employee would also notify him if his bid was not the lowest so that he could resubmit a lower bid thus securing the contract for the purchase of automobiles.
- Bruce used his position as a board member to influence Wes Rosenbalm and others to accept two two-wheel drive vans that were supposed to be all-wheel drive. A return would reflect negatively on his employment.
- Allegations of misconduct on the part of Wes Rosenbalm were brought to the BVU Authority Board and Walter's attention. The board discussed these allegations in multiple meetings held in executive session. They decided not to contact law enforcement or the National Telecommunications and Information Administration with the information that state and federal law had been violated but instead offered Wes Rosenbalm a \$269,240 severance package to keep allegations from becoming public.

Charges

- Conspired to (1) having knowledge of the actual commission of a felony, knowingly and willfully conceal and not as soon as possible make known the same to some judge or other person in civil or military authority; and (2) corruptly solicit or demand for the benefit of any person, or accept or agree to accept, anything of value from any person, intending to be influenced or rewarded in connection with any business, transaction, or series of transactions of such organization, government, or agency involving anything of value of \$5,000 or more, while being an agency and officer of a state or local government agency that received in excess of \$10,000 in federal funding from a Federal program involving a grant, contract, or other form of Federal assistance in any one year.

Plea

- Plea of guilty to conspiracy to commit program fraud and misprision of a felony.

Sentence/Restitution

- Five months in prison and five months home detention.
- Forfeiture of money judgement of \$5,000.

David Copeland, BVU Authority Vice President of Field Operations, 1992-2015

Misconduct

- Along with co-conspirators, committed and caused to be committed overt acts including: Knowingly approving false invoices a contractor submitted for work not actually completed resulting in at least \$144,000 in fraudulent billing associated with Virginia Tobacco Commission grant funds. The contractor converted portions of the funds they received as a result of the fraudulent billing into cash and paid it to David. David was paid at least \$40,000. The contractor and David communicated the details of the fraudulent activity and fraudulent billing, in part, via email that traveled in interstate commerce.

Charges

- Conspired to devise a scheme to defraud and obtain money and property by means of false and fraudulent pretenses and representations. For the purpose of executing this scheme transmitted and caused to be transmitted by means of wire communication in interstate commerce, any writing, signs, signals, pictures, or sounds.
- Conduct and attempt to conduct a financial transaction, which involved the proceeds of specified unlawful activity, namely, wire fraud, knowing the transaction was designed in whole or part to conceal and disguise the nature, location, source, ownership, and control of the proceeds of the specified unlawful activity and knowing that the property involved in the financial transaction represented the proceeds of the unlawful activity.

Plea

- Plea of guilty to engaging in a multi-object conspiracy to commit wire fraud and money laundering.

Sentence/Restitution

- Twenty-four months in prison; reduced to eighteen months in prison.
- Forfeiture of money judgement of \$50,000.
- Restitution for the entire scope of his criminal conduct for at least \$144,000.
- The Parties agreed to recommend that the court should order that all restitution in this case be imposed joint and severally with James Todd Edwards.

James Todd Edwards, President & CEO of Edwards Telecommunications, Inc., BVU Authority Contractor, 2004-2014

Misconduct

- Along with co-conspirators, committed and caused to be committed overt acts including: Submitted false invoices to Robert James Kelley, Jr. for work not actually completed by Edwards Telecommunications, Inc. (ETI) resulting in at least \$330,510 in fraudulent billing. Approved false consulting invoices (RJK Consulting) Robert prepared even though no consulting work was performed. Robert received at least \$160,000 in kickback checks through the mail. James caused ETI to file false and fraudulent income tax returns with the IRS for tax years 2007, 2008, and 2009 by deducting payments to Robert as “Professional Fees” when they were illegal kickbacks resulting in knowingly and willfully failing to pay income taxes of more than \$44,905. Submitted false invoices to David Copeland for work not actually completed by ETI resulting in at least \$143,000 in fraudulent billing associated with Virginia Tobacco Commission grants funds between January 2010 and July 2010. James and David communicated the details of fraudulent billing, in part, via email that traveled in interstate commerce. James converted portions of the funds ETI received as a result of the fraudulent billing into cash and paid it to David. David received kickbacks including \$40,000 cash, a backhoe, and hunting trips outside the continental United States.

Charges

- Conspired to (1) file false income tax returns and willfully evade income taxes; (2) devise and execute a scheme to defraud and obtain money by means of false and fraudulent pretenses, representations, and promises, knowing that any matter or thing would be delivered by the Postal Service; (3) devise a scheme to defraud and obtain money/property by means of false and fraudulent pretenses and representations, and for the purpose of executing such scheme transmit and cause to be transmitted by means of wire communication in interest commerce, any writing, signs, signals, pictures, or sounds; and (4) conduct and attempt to conduct a financial transaction, which involved proceeds of unlawful activity (mail fraud) knowing that the transaction was designed to conceal and disguise the nature, location, source, ownership, and control of the proceeds of the unlawful activity and knowing that the property involved in the financial transaction represented the proceeds of the unlawful activity.

Plea

- Plea of guilty to engaging in a multi-object conspiracy to commit wire fraud, mail fraud, tax fraud, and money laundering.

- If James complied with his obligations under the plea agreement, no other employee of ETI would be prosecuted for any conduct described in the Information to which he agreed to plead guilty.

Sentence/Restitution

- Twelve months and one day in prison.
- Forfeiture of money judgement of \$550,000.
- Restitution of \$460,053.
- The parties agreed to recommend that the court should order that all restitution in this case be imposed joint and severally with Robert James Kelley, Jr. and David Copeland.

Paul Hurley, BVU Authority Board Chairman, 2009-2014 and Member of Bristol, VA Economic Development Committee

Misconduct

- Obtained tickets to NASCAR races purchased by the BVU Authority. Falsely represented to persons at BVU Authority that these tickets were to be used for “economic development” purposes, specifically these tickets were to be given free of charge to representatives of businesses who showed an interest in locating businesses in Bristol, VA. Actually, Paul sold at least 50 of these tickets to friends, ticket scalpers, and others for his own personal benefit. The value of these tickets was over \$5,000.
- Knowingly caused to be delivered by the Postal Service or private or commercial interstate carrier (1) invoices for NASCAR tickets and NASCAR tickets mailed from Bristol Motor Speedway in Bristol, TN to BVU Authority, and (2) checks from purchasers of NASCAR tickets mailed and delivered to his residence in Bristol, VA; and caused deposits (checks made payable to Bristol Motor Speedway) to be sent or delivered via Postal Service or private or commercial interstate carrier from BVU Authority to Bristol Motor Speedway in Bristol, TN.
- Appeared as a witness under oath before the grand jury and knowingly made false material declarations in response to questions with respect to the practice of BVU Authority purchasing and distributing NASCAR tickets.

Charges

- Devised a scheme to defraud and obtain money by false and fraudulent pretenses, for the purpose of executing such scheme and attempting to do so, knowingly cause to be delivered by the Postal Service or private or commercial interstate carrier any matter or thing, or caused to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier.
- While under oath and testifying in a proceeding before a grand jury of the United States in Abingdon, VA, knowingly made false material declarations.

Plea

- Plea of guilty to mail fraud and knowingly making a false declaration while under oath in a proceeding before or ancillary to a court or grand jury of the United States.

Sentence/Restitution

- Six months in prison, six months home detention.
- Forfeiture of money judgement of \$10,000.
- Restitution for the entire scope of his criminal conduct in the amount of at least \$5,000.
- \$2,500 fine.

Robert James Kelley, Jr., BVU Authority Vice President of Field Operations, 1993-2009

Misconduct

- Along with co-conspirators, committed and caused to be committed overt acts including: Edwards Telecommunications, Inc. (ETI) submitted false invoices to Robert James Kelley, Jr. for work not actually completed resulting in at least \$330,510 in fraudulent billing; Robert prepared and submitted false consulting invoices (RJK Consulting) sent to ETI, which were approved even though no consulting work was performed. Robert received at least \$160,000 in kickback checks through the mail. Robert filed false and fraudulent income tax returns with the IRS for tax years 2006, 2007, 2008, and 2009 and did not disclose the income received from ETI.

Charges

- Conspired to (1) file false income tax returns and willfully evade income taxes; (2) devise and execute a scheme to defraud and obtain money by means of false and fraudulent pretenses, representations, and promises, knowing that any matter or thing would be delivered by the Postal Service; and (3) conduct and attempt to conduct a financial transaction, which involved proceeds of unlawful activity (mail fraud) knowing that the transaction was designed to conceal and disguise the nature, location, source, ownership, and control of the proceeds of the unlawful activity and knowing that the property involved in the financial transaction represented the proceeds of the unlawful activity.

Plea

- Plea of guilty to engaging in a multi-object conspiracy to commit mail fraud, money laundering, and to defraud the IRS.

Sentence/Restitution

- Thirty months in prison.
- Forfeiture of money judgement of \$165,375.
- Restitution for the entire scope of his criminal conduct in the amount of at least \$330,510.
- The parties agreed to recommend that the court should order that all restitution in this case be imposed joint and severally with James Todd Edwards.

Misconduct

- At the direction of Wes Rosenbalm, Chairperson of the Bristol Chamber of Commerce, Stacey Pomrenke sent an email to a BVU Authority vendor to ask them to increase their membership of the Bristol Chamber of Commerce to a Gold Member in return for the significant amounts of money received by the vendor from BVU Authority's Board.
- While in preliminary contract negotiations with a vendor, in anticipation of a Request for Proposal for services being issued by BVU Authority, Stacey Pomrenke, emailed, a representative of the vendor and requested that the vendor provide tickets to a University of Kentucky basketball or football game for Wes Rosenbalm and his five children. Prior to the signing of a contract, Stacey also received a Christmas gift from the same vendor.
- Directed a BVU Authority employee to: 1) send an email to a vendor soliciting funding for BVU Authority's Thanksgiving Luncheon; 2) send an email to a vendor soliciting funding for BVU Authority's Children's Christmas Party; 3) contact a vendor and ask them to pay an invoice from the Foundation Event Facility in the amount of \$12,297, which reflected the cost for BVU Authority's 2012 Employee Christmas Party held on December 15, 2012, to be paid directly to the Foundation Event Facility; 4) solicited a vendor to sponsor alcohol purchases for a customer appreciation event hosted by BVU Authority; 5) send emails to multiple BVU Authority vendors soliciting the funding of a luncheon for BVU Authority employees after the naming of BVU Authority as a finalist for an award. A vendor provided a check for \$1,000; and 6) electronically file IRS forms W-2 for the BVU Authority and its employees for the 2010, 2011, and 2012 tax years with the Social Security Administration, which underreported compensation and benefits provided to the employees.
- Between March 2003 and April 2013, the BVU Authority paid bonuses to employees by way of cash and gift cards. These bonuses were not reported to the IRS. Payroll withholdings were not made from these bonuses. They knowingly and intentionally did not report these bonuses to the IRS in the form of a W-2 or 1099.
- In July 2006 and August 2012, Stacey Pomrenke and at least five other employees of BVU Authority used the government owned vehicles for personal use. The value of this taxable benefit was at least \$6,000 per employee per year.
- In December 2007 and April 2015, BVU Authority paid for memberships at the Bristol Country Club for Stacey Pomrenke, Wes Rosenbalm, and two other employees. In total, more than \$69,748 was paid on behalf of these individuals. This taxable benefit was not reported to the IRS and W-2 forms submitted to the IRS for these four individuals contained false and fraudulent information regarding the compensation provided by BVU Authority.

- Between January 2008 and December 2013, Stacey Pomrenke received gift cards and gift certificates to stores, spas, and restaurants from a BVU Authority vendor as Christmas gifts.
- In September 2012, Stacey Pomrenke solicited and received thoroughbred horse racing tickets and National Football League tickets from a BVU Authority vendor.
- In 2009, 2010, and 2012 Stacey Pomrenke solicited thoroughbred horse racing tickets and Major League Baseball tickets from BVU Authority vendors.
- In June 2006, the BVU Authority purchased a vehicle from Stacey Pomrenke and her husband to be put into official use and paid \$31,000 to a bank in order to pay off an auto loan to benefit Stacey Pomrenke and her husband.

Charges

- Conspired to (1) defraud the United States by impeding, impairing, obstructing, and defeating the lawful functions of the IRS in the ascertainment, computation, assessment, and collection of taxes; (2) in a matter within the jurisdiction of the executive branch of the Government of the United States, knowingly and willingly make a materially false statement and representation and make or use any false writing or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry; and (3) corruptly solicit or demand for the benefit of any person, or accept or agree to accept, anything of value from any person, intending to be influenced or rewarded in connection with any business, transaction, or series of transactions of such organization, government, or agency involving anything of value of \$5,000 or more, while being an agent and officer of a state or local government agency that receives \$10,000 or more in federal funding from a Federal program involving a grant, contract, or other form of Federal assistance, in any one year period.
- Knowingly and willfully caused the making of a materially false statement and representation and caused to be made or used any false writing or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry. (2010, 2011, and 2012 - 3 counts)
- Conspired to obstruct, delay, and affect commerce and the movement of articles and commodities in commerce by extortion, namely, conspired to obtain the property of multiple victims, with the victims' consent, induced by the wrongful use of fear of economic loss and under color of official right.

Plea

- Plea of not guilty resulting in a jury trial.
- Found guilty of 14 of the 15 charges.
- Also, found guilty of criminal contempt of court, after a judge said she ignored a ruling to not contact possible witnesses.

Sentence/Restitution

- Thirty-four months in prison.
- Forfeiture and restitution of approximately \$60,000.

Wes Rosenbalm, BVU Authority President & Chief Executive Officer, 2001-2013

Misconduct

- As Chairperson of the Bristol Chamber of Commerce, Wes Rosenbalm sent an email to a Co-conspirator and other BVU Authority employees directing them to contact BVU Authority vendors and contractors to tell them to become members of the Bristol Chamber of Commerce in return for the significant amounts of money received by these vendors and contractors from BVU Authority's Board.
- While in preliminary contract negotiations with a vendor, in anticipation of a Request for Proposal for services being issued by BVU Authority, a Co-conspirator, via email, contacted a representative of the vendor and requested that the vendor provide tickets to a University of Kentucky basketball or football game for Wes Rosenbalm and his five children.
- Directed a BVU Authority employee to: 1) send an email to a vendor soliciting funding for BVU Authority's Christmas Dinner; 2) send an email to a vendor soliciting funding for BVU Authority's Thanksgiving Luncheon; 3) send an email to a vendor soliciting funding for BVU Authority's Children's Christmas Party; 4) contact a vendor and ask them to pay an invoice from the Foundation Event Facility in the amount of \$12,297, which reflected the cost for BVU Authority's 2012 Employee Christmas Party held on December 15, 2012 to be paid directly to the Foundation Event Facility; 5) solicit a vendor to sponsor alcohol purchases for a customer appreciation event hosted by BVU Authority; 6) send emails to multiple BVU Authority vendors soliciting the funding of a luncheon for BVU Authority employees after the naming of BVU Authority as a finalist for an award. A vendor provided a check for \$1,000 and another vendor gave them \$1,000 credit on their bill; and 7) contact a vendor and asked them to pay \$4,125 for a basketball scorer's table for his child's school.
- In January 2010 and December 2012, Wes Rosenbalm, his co-conspirator, and other high-level management at BVU Authority received gift cards from a vendor.
- Between March 2003 and April 2013, BVU Authority paid bonuses to employees by way of cash and gift cards. These bonuses were not reported to the IRS. Payroll withholdings were not made from these bonuses. They knowingly and intentionally did not report these bonuses to the IRS in the form of a W-2 or 1099.
- In July 2006 and August 2012, Stacey Pomrenke and at least five other employees of BVU Authority used the government owned vehicles for personal use. In July 2006 and January 2012, Wes Rosenbalm knew that this taxable benefit was not reported to the IRS and that BVU Authority provided false information regarding the compensation provided to the employees. The value of this taxable benefit was at least \$6,000 per employee per year.
- In December 2007 and April 2015, BVU Authority paid for memberships at the Bristol Country Club for Wes Rosenbalm, his Co-conspirator, and two other employees. In total,

more than \$69,748 was paid on behalf of these individuals. This taxable benefit was not reported to the IRS and W-2 forms submitted to the IRS for these four individuals contained false and fraudulent information regarding the compensation provided by BVU Authority.

Charges

- Conspired to (1) defraud the United States, namely, the IRS by willfully evading income taxes; and (2) corruptly solicit or demand for the benefit of any person, or accept or agree to accept, anything of value from any person, intending to be influenced or rewarded in connection with any business, transaction, or series of transactions of such organization, government, or agency involving anything of value of \$5,000 or more, while being an agency and officer of a state or local government agency that received \$10,000 or more in federal funding from a Federal program involving a grant, contract, or other form of Federal assistance, in any one year period.

Plea

- Plea of guilty to conspiracy to defraud the IRS and to corruptly solicit or demand for the benefit of any person intending to be influenced or rewarded in connection with any business of an organization, government, or agency involving a thing of value of \$5,000 or more.

Sentence/Restitution

- Thirty-three months in prison; reduced to twenty-four months in prison.
- Forfeiture of money judgement of \$50,000.
- Restitution of \$150,000.

APPENDIX B – RECOMMENDATION SUMMARY

Recommendation 1:

The BVU Authority should develop, implement, and document detailed policies and procedures over all operational and financial areas. Management and authority personnel should update these policies and procedures periodically and ensure that they are easily accessible and available for all employees. Accounting policies and procedures are necessary in order to reduce the risk of fraud and prevent errors or mistakes from occurring. In addition, well-designed and properly maintained policies and procedures enhance accountability and consistency and serve as a useful training tool for staff.

Recommendation 2:

Management should make the new policies available to the employees, and all employees should certify that they have read and understood the policies. Management should consider making the policies available electronically to increase employee accessibility and allow management to update the policies whenever change is needed.

Recommendation 3:

The BVU Authority should re-evaluate its approach to its ethics program. Management should evaluate the current Code of Conduct and Employee Handbook to ensure both accurately depict the BVU Authority's ethical position. This would include developing and implementing processes and procedures over how to investigate any complaints swiftly, thoroughly, and fairly. Management should also communicate these policies to employees in a method that ensures the employees are aware and understand the process and their rights.

To increase the effectiveness of the ethics program, the BVU Authority should consider implementing an Authority Ethics Officer who is separate from management and is responsible for training and enforcing of the BVU Authority's Code of Conduct and Employee Handbook and ensuring investigations of ethics complaints are thorough and impartial. This function would ideally exist within the Administrative Services Department.

Recommendation 4:

The BVU Authority should develop a policy specific to travel, requiring a pre-approval for all overnight trips. This policy should outline the documentation necessary for the board member or employee to retain to receive reimbursement for travel expenses, such as the receipts and evidence of supervisor approval. The policy should also outline the limits the BVU Authority will allow for these types of expenses. The Commonwealth of Virginia's agencies and other governmental entities have adopted rates from the federal General Services Administration's (GSA's) travel guidelines as this policy has clearly documented thresholds government employees can spend for all different types of travel expenses. Within this policy, these expenses are adjusted for the cost of living in all parts of the country. The BVU Authority could adopt these rates outlined on the GSA's website and include a reference to this as part of their internal policy. The BVU Authority should also require adherence to this policy as an element of all contracts to perform services for the BVU Authority that could involve

travel. This will help to reduce the risk of excessive travel expenses and potentially lower the cost to the BVU Authority.

Recommendation 5:

The BVU Authority should work with the City to get a legal opinion as to whether the in lieu of tax payments were legal. If the opinion determines that the payments were illegal, the City should reimburse the BVU Authority for the in lieu of tax payments totaling \$1,157,540 received through the end of fiscal year 2015 plus any additional payments the BVU Authority paid in fiscal years 2016 and 2017.

Recommendation 6:

The BVU Authority needs to correct its in lieu of tax calculation spreadsheet and ensure that it properly calculates this in the future. If the calculation exceeds the minimum amount required, the BVU Authority should begin paying the excess to the localities.

Recommendation 7:

Immediately after appointment, the new BVU Authority Board should receive training related to their obligations and duties as board members and training on the laws, rules, and regulations by which they must abide. The new board members should operate under the values below that make boards highly effective:

- *Create a culture of honesty and transparency*
- *Uphold basic fiduciary principles*
- *Cultivate a healthy relationship with the President/CEO*
- *Select an effective board chair*
- *Establish an effective governance committee*
- *Delegate appropriate decision-making authority to committees*
- *Consider strategic risk factors*
- *Provide appropriate oversight of service quality*
- *Develop a commitment to shared governance*
- *Focus on accountability*

Bearing the above items in mind, the new board should focus on the future of the BVU Authority rather than the past and know that tone at the top starts with them and trickles down throughout the BVU Authority.

Recommendation 8:

The BVU Authority President/CEO should determine how he wants to structure management of the BVU Authority. He should use this opportunity to determine the best organization of the financial, operational, and administrative areas; what type of leadership each area needs; and what the BVU Authority can afford.

To address inadequacies in the BVU Authority's financial area, the BVU Authority needs individuals with knowledge and experience in applying governmental and FERC accounting standards. Other needs in this area include understanding and properly complying with payroll tax laws, creating and running a balanced budget, procuring goods and services, and overseeing the operations of the accounting department. Regarding the administrative aspects of the BVU Authority, the BVU Authority needs individuals with adequate knowledge of personnel-related laws and regulations related to employment practices, employee benefits, and employee relations. From an operational perspective, the BVU Authority needs individuals that can develop a strategic and operational business plan that incorporates a long-term maintenance and capital plan.

Recommendation 9:

As long as the BVU Authority operates CPC OptiNet, they should ensure that this income goes towards administration, operation, maintenance, and repair of the CPC project facilities for the remaining useful life of the assets, which is approximately 2034. In addition, the BVU Authority should record the federal interest in the EDA funded assets.

Recommendation 10:

The BVU Authority needs to include the CPC OptiNet activity and assets in its financial statements and require their auditor to audit this activity. Without an audit of this activity, there is no accountability or assurance that the BVU Authority has spent these funds appropriately or complied with all federal and state regulations.

Recommendation 11:

If the BVU Authority obtains any federal grants for the CPC OptiNet operations in the future, they should include these funds and all of the related activity within their financial statements and the Schedule of Expenditures of Federal Awards.

Recommendation 12:

The BVU Authority should create and maintain written agreements between divisions for all interdivisional transactions. These agreements should outline details of the services provided by each division, the cost of the services, and payment terms including due dates and penalties assessed for late fees. The maintenance of these agreements will be critical once the decision has been made as to whether or not OptiNet will be sold as these agreements will become contractual obligations if the Electric Division continues to purchase these services from the purchaser of OptiNet.

Recommendation 13:

The BVU Authority should re-establish an interfund receivable/payable, including foregone interest, between the Electric and OptiNet Divisions in the amount of \$13,741,288.

The re-establishment of the interfund receivable/payable could affect the potential sale of the BVU Authority's OptiNet Division because it will increase the amount of debt that the BVU Authority must pay off with proceeds from the sale and will reduce the amount of funds available to satisfy grantors with claims on the BVU Authority's assets.

The BVU Authority should develop and implement policies and procedures outlining thresholds for transactions needing board approval. These policies and procedures should state the type of documentation to be provided to the board for review and approval of the transaction. The board's decision should be clearly documented and maintained within board meeting minutes.

Recommendation 14:

If the BVU Authority does not sell the OptiNet Division, they will need to either put the division up for sale to another entity or find options to make OptiNet, specifically the internet and cable operations, profitable so they can continue to operate it. If the BVU Authority continues to operate OptiNet, they should work with the General Assembly to propose legislation to authorize cross-subsidization across its services and divisions.

Recommendation 15:

The BVU Authority should establish the subordinate debt service, repair and replacement, and general reserve funds as outlined in the indenture and ensure cash within those funds meets minimum reserve requirements and targets. Further, the BVU Authority should develop and implement policies and procedures over the budgeting process to ensure the budget is prepared in accordance with each requirement of the indenture, is provided to the trustee in advance of the fiscal year, and incorporates any anticipated reductions to revenue, such as discounts and commissions. BVU Authority should incorporate cash reserves in the annual budget in addition to operating expenses. This should be a significant consideration when developing recommendations for changes in utility rates. The BVU Authority should set rates that cover all operating and debt expenses to ensure each utility is self-supporting. Finally, the BVU Authority should obtain all necessary approvals for all rate changes prior to the date the changes take effect. Implementing these recommendations will reduce the risk of any event of default of the bonds.

Recommendation 16:

The BVU Authority should track cash balances and cash flows of each OptiNet service separately and should update the allocation percentages used to break out the different OptiNet services more frequently based on more current utilization data for each service. This will reduce the risk of cross-subsidization of debt service and other payments, which does not comply with relevant accounting standards and the Code of Virginia. With the data made available to us during the time of our review, we were unable to go back and historically allocate cash generated by each OptiNet service. Therefore, it is not possible to know how much cash and cash reserves are attributable to each service. As this is a complex allocation, the BVU Authority should determine how they could update this allocation more frequently to allocate revenues, expenses, assets, and liabilities properly based on current usage.

Recommendation 17:

The BVU Authority should consistently post all solicitations to the eVA website and post these advertisements at least ten days in advance of the date set for the receipt of bids. While posting solicitations to a bulletin board in the lobby or newspaper may technically satisfy the posting requirement, in the age of electronic communication, posting to the eVA website will help to ensure they receive the best bids possible by increasing access. If they receive only one response to the

request for bids or proposals, the BVU Authority should consider re-soliciting the work to ensure the contract is procured in the most competitive manner. If there is only one bidder, the BVU Authority should still document its analysis of whether this bidder was responsive, responsible, and provided a reasonable price. This will provide an opportunity for more bidders to submit proposals and help increase competition. Implementing these recommendations will enable the BVU Authority to comply with the provisions of Section 2.2-4302.1 of the Virginia Public Procurement Act.

Recommendation 18:

The BVU Authority should competitively procure all goods and services, as the Act requires. The BVU Authority should document the time, location, and attendees of all competitive negotiations pertaining to the awarding of contracts as well as the scoring and tabulations of all bidders. The BVU Authority should perform and document a review of all suspended or debarred vendors, consideration of SWAM-owned businesses, a review of the vendor's manual, qualifications, insurance, State Corporation Commission registration, and authorization to conduct business in the Commonwealth. Further, the BVU Authority should maintain all documentation in a procurement file throughout the life of the contract. This will provide evidence of compliance with the Act and Commonwealth best practices.

Recommendation 19:

The BVU Authority should update its procurement policy and ensure this manual provides reasonable assurance of compliance with the Act. Once finalized, the board should review and approve this policy prior to implementation. This will reduce the risk of non-compliance to the Act and best procurement practices.

Recommendation 20:

The BVU Authority should route purchase requisitions and purchase orders through the procurement department. The procurement manager should issue purchase orders based on these requisitions before the vendor provides services and submits invoices. This will help ensure the procurement manager, an individual independent of the contract administrator, is involved with the contract. If the procurement manager becomes aware of employees entering into contracts without procurement manager involvement or purchasing goods or services without the proper use of purchase requisitions and purchase orders, the procurement manager should hold these employees accountable and should correct the matter. In addition, the procurement manager should perform a reconciliation between the purchase requisition, the purchase order, the invoice, and the receiving report. This will help to ensure what the departmental manager needed is the same as what the BVU Authority purchased and what the vendor delivered and invoiced.

Recommendation 21:

The BVU Authority should consider rotating inspectors of work who are independent of the procurement, signing, and administration of the contract and have this person perform regular and random reviews of work while the work is in progress. If this is not possible, the BVU Authority should perform a review of the inspection work done by the inspector. This could potentially reduce the risk of collusion amongst employees, contractors, and inspectors.

Recommendation 22:

The BVU Authority should consider putting a price ceiling on what the BVU Authority will pay the contractor for travel when travel is an element of the contract. The BVU Authority should require contractors to follow the BVU Authority travel policy recommended in the section entitled "Travel Policy." An internal policy pertaining to the travel of contractors should exist advising that any travel expenses exceeding these established thresholds will be the responsibility of the contractor. This could potentially reduce the total contract price and increase the competition of local bidders who would not have to travel.

Recommendation 23:

The BVU Authority should include all relevant and necessary clauses within the IFB's, RFP's, as well as the contracts themselves. These are listed as general and special terms within the APSPM and include, but are not limited to a right to audit clause, termination without penalty citing the best interest of the Commonwealth, the bid acceptance period, and a statement of how the bid will be awarded and the decision will be made. This will hold the contractors accountable and protect the interests of the BVU Authority.

Recommendation 24:

The procurement manager should perform an analysis of the BVU Authority's top vendors to identify those vendors who should have a contract in place based on total dollar amounts spent with this vendor. This may help reduce cost by locking contractors in to set pricing. This may also identify vendors for which BVU Authority employees are not using purchase requisitions and purchase orders. Once contracts have been entered into, the BVU Authority should maintain all relevant documentation, including a copy of the contract signed by both parties, to ensure the contractor is held accountable to the terms to which they agreed.

A comparison of total payments to the contract value will help to identify vendors who are operating outside the current contract amounts and should be submitting change orders. The procurement manager should be involved in all change orders exceeding a pre-established threshold. As noted above, the BVU Authority approved a change order with ETI, extending the terms of service for an extended period of time with no procurement manager involvement.

Recommendation 25:

The BVU Authority should ensure that pole attachment fees charged to vendors are fair and reasonable across vendors by performing a high level evaluation of the amounts paid by vendors overall and determining if there is a specific reason why one vendor should be paying more than another. BVU Authority should evaluate the pole attachment fees at least annually to ensure all vendors pay fair and reasonable prices. BVU Authority should update the pole attachment agreements any time they adjust any pole attachment fees.

Recommendation 26:

The BVU Authority should review the pole attachment agreement and determine the dollar amount associated with OptiNet's portion of the bill. They should then record a due to/due from between the

Electric Division and OptiNet. Considering the laws on cross-subsidization, the BVU Authority should determine how far in the past they will go back to make correcting entries.

Recommendation 27:

The BVU Authority should ensure that every pole attachment agreement has a designated account manager responsible for monitoring the agreement. Account managers should notify management when agreements are nearing expiration so that they can follow the proper procedures to ensure that the agreement does not expire before a new agreement is in place. In addition, the account managers should notify management as soon as they are aware that an account is delinquent so that they can go through the proper collection procedures. Account managers should also maintain and update contacts for all pole attachment agreements at a minimum annually to ensure that any issues with the agreements including expiration and delinquent accounts can be handled with the proper due diligence.

Recommendation 28:

The BVU Authority should determine the remaining amount of money OptiNet owes the Electric Division due to the improper billing associated with the pole attachments. They should then record a due to/due from between the Electric Division and OptiNet. Considering the guidelines on cross-subsidization, the BVU Authority should determine how far in the past they will go back to make correcting entries. If OptiNet does not pay the Electric Division for this service, it is considered cross-subsidization because OptiNet is getting a service for free that they would have to pay for from an outside vendor.

Recommendation 29:

The BVU Authority should assign contract administrators to oversee all contractors to ensure that they adhere to the contract the BVU Authority has with them as well as the agreements that the BVU Authority has with third parties if their contract requires them to perform work under the third party agreement. These contract administrators should ensure that the contractors follow proper procedures outlined in pole attachment agreements. There should be weekly meetings to discuss the work performed under the pole attachment agreements. The BVU Authority should also consider having the contract administrator review and sign off on all attachments prior to installation. In addition, the BVU Authority should continue to work with the vendor to ensure that the appropriate corrective action is taken for the unauthorized attachments.

Recommendation 30:

The BVU Authority should perform a review of all business customers of BVU OptiNet services to determine whether they are receiving services discounted below market rates. The BVU Authority should consider whether these could represent donations, as this would be out of compliance with the Code of Virginia. As contracts with these entities conclude, the BVU Authority should ensure these entities pay reasonable rates for OptiNet services that cover the cost of the service and are not considered recipients of donations. This will reduce the risk of non-compliance with the Code of Virginia. This will also help to ensure that the BVU Authority meets profit margin targets and achieves adequate cash flows and reserves.

The BVU Authority should determine how to best track discounts to business customers and how to identify existing business customers receiving rates less than those rates approved by management and the board. The BVU Authority should set budgetary thresholds for discounts of services and ensure revenues are not reduced below these amounts. As part of this discount tracking, the BVU Authority should improve the quarterly contract audit process to compare contract amounts to approved rates not just the billed rate.

Recommendation 31:

The BVU Authority should develop, implement, and enforce policies and procedures on sales activities, including entering into sales contracts, granting discounts to customers, and obtaining the proper approvals for all such activity. The BVU Authority should finalize pricing schedules for all OptiNet services and ensure the billing department is aware of what types of discounts are allowable. The billing department should alert the sales manager if they identify excessive discounts. This will help to ensure accountability to all staff who have the ability to enter into contracts with business customers. This will also reduce the risk of losing money on less profitable customers.

The BVU Authority should perform regular reviews of access to the billing tables and other sensitive functions within the information technology systems. The BVU Authority should perform an analysis of which functions have a direct effect on financial activity to determine which access levels should be restricted and then grant access to new users of the systems in accordance with the principle of least privilege. This means that the BVU Authority should only grant access to functions of the systems, which the users need to perform their core job responsibilities. The BVU Authority should also consider a proper separation of duties when granting such access.

Recommendation 32:

The BVU Authority should review the current policy for employee discounts and obtain the necessary opinions and analyses to determine whether these could possibly represent a taxable benefit to the employees. If this is determined to be taxable, the BVU Authority should amend the policy or withhold the taxes accordingly. This will reduce the risk of non-compliance with IRS and state income tax regulations.

Recommendation 33:

The BVU Authority should consider, based on a cost benefit analysis, whether it would be in their best interest to increase their capitalization threshold to \$5,000 or higher. The cost benefit analysis should consider the cost savings of not tracking those assets, the effect the change in capitalization threshold would have on depreciation expense, and whether these assets need to be tracked for control purposes to determine whether it would be effective to increase the capitalization threshold.

Recommendation 34:

The BVU Authority should develop and implement comprehensive policies and procedures for the accounting and reporting of fixed assets. These policies and procedures should include the determination and periodic re-evaluation of useful lives, processes for completion of periodic physical inventories, processes for additions and deletions of capital assets, identification and write down of impaired assets, and identification and recording of intangible assets. These policies should consider

best practices, the requirements of FERC accounting, and GASB standards. The accounting department should review and update these policies and procedures annually to ensure they comply with current standards and reflect the BVU Authorities desired control environment. The accounting department should document any changes in the policies that occur between these annual reviews promptly as they occur. These policies and procedures should be readily available to all employees especially to those responsible for safeguarding and recording capital assets.

Recommendation 35:

The BVU Authority should develop and maintain long-range maintenance and capital plans for the utilities within its divisions. The plans should include budgets for any capital maintenance and replacement needs. The BVU Authority should perform and document condition assessments for all the utilities, including any that are underground infrastructure, every one to three years. The BVU Authority should use these condition assessments to determine its maintenance and capital needs, therefore, driving the amount of funds to set aside for future use in these areas.

Recommendation 36:

Management should continue to develop a complete listing of assets for land and buildings. When developing these listings, they should ensure that they have proper ownership of the asset. They should also consider best practices and FERC accounting requirements. The Accounting department should maintain and update these listings as they acquire and dispose of assets.

Recommendation 37:

Management should not rely solely on their auditors to prepare the financial statements and footnotes using data from the system. Specifically, management should ensure that the auditors used the data properly to prepare the fixed asset footnote by verifying the beginning balance, additions, deletions, and ending balance appearing in each footnote. Management should also ensure that the amounts added and disposed in each category of assets including the corresponding depreciation is reasonable and properly supported by their financial system. In addition, if there are significant changes to footnote presentations, management should ensure that proper disclosures are made. Lastly, the BVU Authority should ensure that they have properly disclosed all methods of depreciation used within their financial statements.

Recommendation 38:

In 2014, Governor McAuliffe issued Executive Order 33 – Designation of Executive Branch Officers and Employees Required to File Financial Disclosure Statements, addressing the Commonwealth’s commitment to ensuring public officers and employees maintain the highest standards of ethical behavior when conducting business with the Commonwealth, avoiding even the appearance of impropriety arising out of personal economic interests. While the Executive Order does not apply directly to the BVU Authority because the BVU Authority is not an authority established within the Executive Branch, the BVU Authority should use the order as a guideline to create an internal policy related to the reporting of personal interests. As noted in the Executive Order, employees who have effect on legislative policies and rule-making authority and who are involved in decision-making regarding 1) policy, 2) contracts and procurement, 3) audits, 4) licensure, 5) inspections and investigations, and 6) investments or other financial matters should be subject to this policy. In

addition, it is good practice for other agents of the BVU Authority (i.e., contractors, outside legal counsel, etc.) to disclose their personal interests that would affect business with the BVU Authority.

Recommendation 39:

The BVU Authority should review and revise their economic development incentive policies to ensure that they are in line with the TVA contract and the transition agreement. These policies should specifically describe the allowable types of expenses. The policies should include a clause that requires the recipient to repay the economic development incentive funds if the recipient of the incentives does not continue to operate the business, moves out of the designated area, or does not meet agreed upon conditions for receiving the incentives. The BVU Authority should consider a sliding scale of repayment. In addition, the BVU Authority should consider contacting TVA to negotiate an agreement to allocate a portion of the \$500,000 each year that they can use for overall economic development purposes. If they can reach an agreement with TVA, the BVU Authority should develop policies over the expenses, including adherence to established travel reimbursement requirements.

Recommendation 40:

The BVU Authority should develop its own application and review process to evaluate and award economic development funds. As part of the application review process, the BVU Authority should perform and maintain an economic benefit analysis on each vendor. For each vendor receiving funds, the BVU Authority should develop and maintain written performance agreements that outline responsibilities for each party as well as the requirements the recipient must fulfill as a condition of receiving the economic development incentives. The BVU Authority should implement an ongoing monitoring process for each project receiving incentives to ensure that the project is meeting the conditions of the performance agreement, and if not, the BVU Authority should take the appropriate steps to remedy or invoke the reversion process or penalty provisions as outlined in the performance agreement. The BVU Authority should maintain copies of the application, the economic benefit analysis, and the performance agreement for the life of the performance agreement and beyond as required by retention policies and procedures. If there is a future agreement between TVA and the BVU Authority wherein the BVU Authority can use some of the economic development funding for overall economic development, the BVU Authority should maintain documentation to support its use of incentive funds for overall economic development and therefore validate the use of funding which does not provide a direct benefit to the electric utility.

Recommendation 41:

The BVU Authority should ensure that all incentives given for economic development meet the requirements outlined in the TVA contract, Transition Agreement, and their updated policies and procedures. The BVU Authority should consider negotiating with the City of Bristol to get the terms of the transition agreement adjusted so that they can grant economic development incentives to projects anywhere within the BVU Authority's service area, not just the City, which was the intent of the TVA contract.

Recommendation 42:

The BVU Authority and board should not approve payment of incentives for projects that do not meet the requirements to receive economic incentives or without the proper supporting documentation

and should not approve any new grants until an adequate application, review, and monitoring process is in place.

Recommendation 43:

As the latest amendment to Section 15.2-7212 of the Code of Virginia expressly prohibits the BVU Authority from making charitable donations of any kind, the BVU Authority should include this prohibition in its policies and clearly communicate the prohibition to all BVU Authority staff in the form of a policy statement, approved by the board. In addition, the BVU Authority should include a policy stating that employees should only spend BVU Authority funds on items essential to operations.

Recommendation 44:

Employment contracts should be a tool to persuade the best employees to want to work for the BVU Authority. Not only should contracts be geared towards providing benefits and incentives for the most talented, knowledgeable, skilled, and experienced worker, they should keep the BVU Authority's best interests in mind. In the future, the BVU Authority should write employment contracts that clearly define all expectations of the employee and BVU Authority. In addition, the BVU Authority should not enter into rolling contract terms that do not allow the potential for turnover at the BVU Authority's request. Lastly, the BVU Authority should ensure that employment contracts explicitly address all internal and external policies and procedures, standards, and laws and regulations.

Recommendation 45:

A compensation plan defines how an organization views and manages employee pay and benefits. The intent of a compensation plan is to clearly document an organization's approach to compensation management. When creating a compensation plan, one would consider the following:

- *Annual budget,*
- *Appropriate job market statistics for all positions (i.e., average salary range, knowledge, skills, and experience),*
- *Employee benefits,*
- *Performance management and associated incentives, and*
- *Compliance with internal and external policies and procedures, standards, and laws and regulations.*

The BVU Authority should consider creating a compensation plan that includes guidance for the structure of employee pay and benefits. In this plan, the BVU Authority should also consider a more formal employee performance evaluation process that is in line with the compensation plan, especially for justifying raises or bonuses based on merit.

Recommendation 46:

Regardless of what type of vehicle benefit the BVU Authority chooses for its employees, it should develop a policy that conforms to the IRS requirements for vehicle allowances set out in IRS Publication 463. In addition, the BVU Authority should ensure that it is correctly reporting the taxable benefit on employee W-2 forms.

Recommendation 47:

The BVU Authority should develop a compensation plan for all employees that provides a fair and equitable method to giving raises, commissions, and bonuses. This would include payment of commissions that are reasonable, not excessive, and balances the commission with the salary paid so that the entire compensation package for sales representatives is fair and reasonable given their knowledge, skills, abilities, and experience.

Recommendation 48:

According to the Internal Revenue Bulletin 2008-32, employees may be subject to interest payments on the underpayment of FICA taxes not withheld from paychecks during the years of 2010 to 2014. The BVU Authority should seek guidance from the IRS once the IRS completes its criminal investigation. The BVU Authority should also research and determine the tax implications on employees should the BVU Authority choose to pay the underpaid FICA taxes on behalf of employees. In addition, the BVU Authority should inform employees with salary levels greater than the Social Security threshold of \$118,500 that the deduction of 2015 withholdings in 2016 may affect how they file personal tax returns.

Recommendation 49:

The BVU Authority continues to use Edward Jones and Lord Abbett to manage supplemental employee 457 retirement plans. To ensure employees are truly benefitting from the services provided, the BVU Authority should research other retirement plan service providers and compare other providers' services to those of Edward Jones and Lord Abbett. Should Lord Abbett fall in the rankings, the BVU Authority should terminate the contract with Lord Abbett and follow the Virginia Public Procurement Act to seek services elsewhere.

Recommendation 50:

The BVU Authority should reevaluate its current retiree healthcare program and determine what post-employment benefits it can afford to provide to retirees. In considering potential changes, the BVU Authority should consider whether changes should apply to all employees, only employees who have not vested in the program yet, or only new employees. The BVU Authority Board of Directors should review and approve this plan before it takes effect. In addition, management should communicate with all employees before the program takes effect. Finally, the BVU Authority should seek the opinion of a tax expert to determine the tax implications on the retiree, if any, and ensure it is complying with the Internal Revenue Code for retirees obtaining healthcare benefits.

Recommendation 51:

Currently, TVA manages the BVU Authority's Residential Loan Program. The BVU Authority's only involvement in the loan program is ensuring TVA has all the necessary paperwork to administer the loan properly. If the BVU Authority ever reverts to operating their own residential loan program, it must have clearly defined policies and procedures on how to properly approve and manage the loans. In addition, the BVU Authority should periodically review loan terms and conditions to ensure competitive loans are advantageous to the employee. Ideally, the BVU Authority should outsource residential loans to a third-party provider to remove any conflicting interests (i.e., subordinate employee approving manager's loan).

Recommendation 52:

The BVU Authority should seek the opinion of a tax expert to determine if revising the W-2 forms for employees who received interest-free loans is necessary.

Recommendation 53:

The BVU Authority should develop policies over rewards and bonuses for employees. This policy should be part of the BVU Authority's overall compensation plan. The policy should include criteria that employees must meet to qualify for rewards and bonuses. The policy should comply with all Internal Revenue Code requirements and ensure proper reporting of rewards and bonuses for tax purposes.

Recommendation 54:

The BVU Authority should revise its existing pre-employment policies and procedures to include verification of candidate education and certifications that relate to the job for which they are applying. Pre-employment screenings are critical to hiring the best possible candidate for a position.

Recommendation 55:

The BVU Authority should implement a policy to avoid the appearance or actual occurrence of nepotism. The Code of Virginia Section 2.2-3106 prohibits (as a conflict of interest) supervision, evaluation, or the making of personnel decisions by an employee of a member of his or her immediate family. Immediate family includes the spouse and any other person residing in the same household as the employee who is a dependent of the employee or of whom the employee is a dependent. While this Code of Virginia section does not apply directly to the BVU Authority, they should use it as a best practice when developing the policy. In addition, the policy should apply to both the board and employees of the BVU Authority and should not exempt any type of employee for consideration.

Recommendation 56:

The BVU Authority inappropriately paid for lobbyist activities performed for the City of Bristol from 2011 to 2015. The BVU Authority should discontinue paying a lobbyist for work done on behalf of the City of Bristol, as it is not the BVU Authority's responsibility to pay the City's expenses.



October 12, 2016

Martha S. Mavredes, CPA
The Auditor of Public Accounts
P.O. Box 1295
Richmond, VA 23218

Dear Ms. Mavredes,

Thank you for the opportunity to review the Auditor of Public Accounts (APA), Audit of the Bristol Virginia Utilities (BVU) Authority.

BVU appreciates the time and effort the APA staff reviewing BVU records and preparing the report. BVU generally agrees with the comments and recommendations in the report.

The APA prepared this report while BVU was under federal criminal investigation. So far, the investigation has resulted in the conviction of two former board chairs, along with several BVU executives and outside contractors. BVU believes the hard work the APA staff put into preparing this report provides a solid foundation and roadmap for BVU to rebuild the public's trust and confidence in this organization. This trust is essential as BVU provides a variety of services to Virginia citizens in ten counties and one city.

Thank you again for identify keys areas where BVU can improve its organizational structure, operations, and financial management and reporting.

Sincerely,

A handwritten signature in black ink that reads "Donald L. Bowman". The signature is written in a cursive style with a horizontal line at the end.

Donald L. Bowman, P.E.
President and CEO

15022 Lee Highway Bristol, Virginia 24202

BRISTOL VIRGINIA UTILITIES AUTHORITY

Board of Directors

(prior to July 1, 2016)

Don W. Ashley, Chairman
Guy Odom, Vice-Chairman

Catherine Brillhart
Shari Brown
J. Douglas Fleenor
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Board of Directors

(after July 1, 2016)

Saul A. Hernandez, Chairman
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Donald L. Bowman, President and CEO