

**OKALOOSA COUNTY  
CLERK OF THE CIRCUIT COURT  
AND COMPTROLLER  
DEPARTMENT OF INSPECTOR GENERAL**

**INVESTIGATIVE REPORT:**

**OKALOOSA COUNTY WATER AND SEWER  
CAPACITY EXPANSION BILLING IRREGULARITIES**

**REPORT NO. INV-17-01**

**REPORT ISSUED**

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**ISSUED BY: BRAD E. EMBRY, INSPECTOR GENERAL  
INVESTIGATOR**

## Table of Contents

Executive Summary.....	3
Background .....	4
Investigative Narrative.....	5
Site Specific CECs .....	5
Non-site Specific CECs.....	5
BOCC Settlement with Poldon, Inc. ....	6
Exceptions to Assessment of CEC .....	6
Assessment of CECs .....	6
Additional Complexities in Assessment of CECs .....	7
Trends Among Errant Accounts .....	9
Summary of Errant Accounts .....	11
Allegations / Finding of Fact .....	13
Methodology.....	13
Findings / Recommendations .....	14
1. Assessment of Capacity Expansion Charges Segregation of Duties.....	14
2. Utilizing Existing Software to Full Capability.....	14
3. Documented Employee Review of Written Policies and Procedures. ....	15
4. Software User Rights and Roles. ....	15
5. Utilizing of Defined Transaction Codes in Naviline. ....	16
Attachments	
Management Response	
Exhibit A: Okaloosa County Ordinance 2016-16	
Exhibit B: Summary of Errant Accounts	
Exhibit C: BOCC / Poldon, Inc. Settlement Documents	
Exhibit D: OCWS / Poldon Inc. Documents	

## Executive Summary

On May 11, 2017, our office was notified of the termination of an Okaloosa County Water and Sewer (OCWS) employee, due to billing irregularities. The information we received indicated that OCWS management was notified by an employee of billing irregularities related to the assessment of residential Capacity Expansion Charges (CECs) and Cost of Construction (COCs).

Our office reviewed approximately 347 accounts from 64 separate contractors and individuals over a 9-year period. Our work resulted in the identification of billing irregularities associated with eighty-three locations involving four contractors. The potential negative financial impact to the county is estimated to be between \$204,300.43 and \$255,500.43.

Of this amount, \$21,100.43 has been collected by OCWS since the initiation of the investigation.

Our work confirmed substantiated county ordinance violations committed by a former OCWS employee as well as five findings related to internal control weaknesses, electronic processes, policies and procedures, software user rights and accounting transaction codes.

Our investigation was performed in accordance with Quality Standards for Investigations found within the Principles and Standards for the Office of Inspectors General as published by the Association of Inspectors General.

## Background

On May 11, 2017, our office was notified of the employment termination of a Lead Customer Service Representative (LCSR) at Okaloosa County Water and Sewer (OCWS), due to billing irregularities. In addition, County officials notified the Okaloosa County Sheriff's office. The Okaloosa County Sheriff's Office requested our assistance in determining the scope and magnitude of the billing irregularities. The information we received indicated that OCWS management was notified of billing irregularities related to the assessment of residential Capacity Expansion Charges (CECs) and Cost of Construction (COC). CECs are charged to defray the cost of increased demand on water supply and/or sewer collection, treatment and disposal for new connections. Currently the county charges \$800 for water expansion charges and \$3,200 for sewer expansion charges. The Cost of Construction (COC) represents the county's costs of installing water and/or sewer lines to a parcel. These costs are passed on to the individual or entity requesting the work.

On April 17, 2017, OCWS administration was alerted to suspicious activity involving the assessment of CECs by a concerned employee. At the time, the Senior Customer Service Representative (SCSR) tasked with assessing and collecting CECs. The SCSR noticed three newly established accounts were not assessed CECs totaling \$12,000. The employee questioned Lead Customer Service Representative, Kathy Nelson, about the account. Nelson insisted that account was billed accurately. The employee then noticed fictitious miscellaneous location messages (MLM) notes in the Naviline system, the County's utility billing system. This information was brought to the attention of OCWS Administration.

Preliminary research was conducted by OCWS administration as well as the County's external auditor prior to our involvement. Information shared with our office indicated that the employee had potentially violated county ordinance and state law. The focus of our investigation was to determine if county ordinance had been violated, the scope of the billing irregularities and financial impact to the county.

## Investigative Narrative

OCWS administration provided us with information pertaining to the failure to collect Capacity Expansion Charges on several recent accounts as well as information they discovered during their preliminary research. Capacity Expansion Charges (CECs) are charged for the purpose of defraying the cost of increased demand on water supply and/or sewer collection, treatment and disposal for new connections. Currently the county charges \$800 for water expansion charges and \$3,200 for sewer expansion charges. The actual Cost of Construction of any line required to make water and/or sewer connection is charged to the customer. These charges are referred to as Cost of Construction charges (COC).

### **Site Specific CECs**

Currently any CECs purchased in Okaloosa County must be assigned to a specific site and are not transferrable. CECs are non-refundable, unless physical connection to the system has not been made. Refunds are generally provided at the rate purchased. Refunds are issued to the current property owner for which the CECs are assigned. Okaloosa County Ordinance 2016-16 Sec. 24-172 outlines these provisions (Exhibit A).

### **Non-site Specific CECs**

Okaloosa County Ordinance 2016-16 Sec. 24-173 addresses non-site specific CECs (Exhibit A). Non-site specific CECs were sold in Okaloosa County between March of 1982 and April of 1985. This is the only time that non-site specific CECs were offered to the general public. Non-site specific CEC's could be transferred and used on any site. In addition, once paid, the CEC could be held for years and then applied to new locations with no additional cost. Because the cost of CEC's has increased overtime, a "black market" effect was created. Since 1985, non-site specific CECs have been transferred from one individual/entity to another, sold and traded. Non-site specific CECs can be utilized anywhere in the County where water and / or sewer services are available (excluding municipal service areas). The tracking of multiple transfers involving non-site specific CECs compounded an already complex issue. The passing of time, manual/handwritten record keeping, and lack of supporting documentation served to magnify the issue. We noted, in our sample, that the last transaction

involving the transfer of non-site specific CECs, sold during the 1982 to 1985 time period, occurred in 2012 (Exhibit B, F9).

### **BOCC Settlement with Poldon, Inc.**

In October 1998, the Board of County Commissioners entered into a settlement with Poldon, Inc. The settlement granted Poldon, Inc. forty-three non-site specific taps which could be used anywhere in the Garnier's service area (Exhibit C). Documents show that some of the CECs were transferred to other individuals and entities, such as GLA Properties. We noted several transfers of CECs from Poldon, Inc and GLA Properties during our review. The complexity of this issue mirrors that of the non-site specific CECs sold between 1982 and 1985.

### **Exceptions to Assessment of CEC**

There are situations in which CECs are not assessed. When homes, previously connected to water and/or sewer, where the correct number of CECs have been paid, are razed and rebuilt (utilizing the same number of equivalent residential units "ERUs"), no CECs are due. County Ordinance 2016-16 Sec. 24-212(3) outlines a provision to consider CECs paid if a structure has been connected to sewer for five or more years prior to the adoption of the article, regardless of whether the CECs were actually paid. This is commonly referred to as the "grandfather" clause.

### **Assessment of CECs**

Prior to the initiation of our investigation, for the majority of the 9-year period covered in our analysis, CECs were assessed based on research and analysis conducted by a single Lead Customer Service Representative (LCSR), Kathy Nelson. Customers wishing to build are required to obtain a "builder's letter" from OCWS before obtaining a building permit from the county's Growth Management Department. The builder's letter ensures that all CECs and Costs of Construction (COC) have been paid. This LCSR was tasked with researching CECs for properties in which a builder's letter were sought. The LCSR typically notified OCWS maintenance department of the request. OCWS Maintenance conducts a site visit and produces a written estimate for the Cost of Construction (COC) based on the customer's

needs. The estimate is forwarded to the LCSR who requested the estimate. The COC estimate is combined with the assessment of CECs and a final cost is produced. The customer is required to make payment to the LCSR prior to the issuance of the builder's letter. OCWS is currently using hand written receipts to record the payment of CECs and COC. The hand-written receipts were typically issued by the LCSR. For the majority of this 9-year period, Kathy Nelson was the single LCSR responsible for researching the paid CECs, assessing CECs for new construction, establishing the account in Naviline, assessing COC as determined by maintenance, collecting payment, receipting payment, signing the builder's letter, tracking, and reconciliations.

In 2014, OCWS management made the decision to transfer the majority of these duties away from the single LCSR, and ultimately these tasks were assigned to a single Senior Customer Service Representative (SCSR); the two exceptions being tracking and reconciliations, which were transferred, at the time, to the Utilities Administrative Manager (CEC tracking and reconciliations were later transferred to the OCWS Finance division). These two exceptions were transferred as a result of the 2013 external audit, which identified internal control weaknesses. In addition, the Customer Solutions Supervisor (CSS) was tasked with reviewing and initialing the information on the builder's letter. Despite these changes in 2014, a LCSR, Kathy Nelson, remained involved in the process at times, directing, assisting, and reviewing the work produced by the SCSR.

### **Additional Complexities in Assessment of CECs**

In addition to the primary complexities outlined previously, there are additional issues that further complicate the assessment of CECs.

***Lot Splits / Address Assignment:*** New construction that involves re-development and/or lot splits can be especially challenging. Research of CECs involves reviewing hand-written receipts, often decades old, and analyzing records to determine which exact parcel of land was owned at the time the CECs were paid. Parcels of land are typically receipted by

addresses; however, addresses change over the years, increasing the difficulty of research. Furthermore, addresses are not typically assigned to a parcel until all permits are issued, requiring OCWS personnel, at times, to issue CECs based solely on the parcel number and owner's name.

**Unused CEC Tracking:** Historically, when the cost of CECs are set to increase, numerous builders and citizens purchase Site Specific CECs at the lower rate, to avoid paying the increased rate. This has resulted in a large number of unused "taps", where payment has been made for the CECs, but no construction has occurred to connect to the system. For example, in 2004, Water and Sewer CECs doubled from \$400 for water and \$1,600 for sewer to \$800 for water and \$3,200 for sewer, respectively. When this occurred, hundreds of CECs were purchased by property owners prior to the increase. Unused CECs must be tracked and reconciled yearly, as they represent a liability to OCWS. The tracking of unused CECs is difficult and has potential to create confusion.

**Land Owner Transfer:** The topic of "transfers" can be a semantics issue that can create misunderstandings. As discussed earlier, CECs are assigned to a specific parcel and are not transferrable (with the exception of Non-site Specific CECs). When property is conveyed from one owner to the next, the CECs payments are automatically "transferred" to the next owner, barring any refunds being issued. Site Specific CECs run with the land. In addition, when a larger parcel is re-developed or subdivided into smaller parcels and re-addressed, the past CECs from the larger parcel will be assigned to smaller parcels. This gives the appearance that CECs are "transferred", when in fact, the land was subdivided and an address change occurred. Land owner transfers can potentially create confusion related to the research and assessment of CECs.

**Private Utility Acquisitions:** OCWS has acquired several private utility systems / providers over the years, creating gaps in documentation related to CEC payments. For example, when OCWS acquired the Okaloosa Island service area (from the Okaloosa Island Authority) and the County West service area (from Seashore Village Water System), decades ago, there are little to no records of CECs being paid. Customers with established

connections to the newly acquired system were “grandfathered” into the OCWS system. Any new or post acquisition connections made to the OCWS system were charged CECs as described in County Ordinance. The acquisition of private systems has the potential to create confusion and inconsistencies in the research and assessment of CECs.

### **Trends Among Errant Accounts**

We noticed several reoccurring trends among the errant accounts identified during our review. In some instances, there was no explanation as to why CECs were not collected.

***Improper Utilization of Transaction Codes:*** Previously we discussed that fees for water and sewer expansion can be made up of two components: Cost of Construction (COC) and Capacity Expansion Charges (CECs). The Naviline software allows for the utilization of transactions codes to differentiate the costs of each. Several of the errant accounts were made to appear as if CECs had been collected through the improper utilization of transaction codes in Naviline. The transaction codes allow for the breakdown of charges assessed to a customer’s account. Several errant accounts were assessed fees associated with the Cost of Construction, however these fees were collected and the transaction code associated with CECs was utilized rather than the transaction code for Cost of Construction. In effect, improperly using transaction codes can make it appear as if CECs had actually been charged and paid on the account.

***Reutilization of Location Identification Numbers:*** We noted several accounts in which Location Identification (Loc. ID) numbers were reused. The Naviline system automatically assigns a property location number to addresses as they are created in the system. The numbers follow a programmed format or sequence. The location ID remains the same regardless of the property owner. We located several accounts where old / inactive location IDs were reused. This was accomplished by simply changing the address of an old inactive account to a different address. All accounting information associated with the parcel follows the location ID to the new address. This gives the appearance that all accounting transactions (i.e. payment of CECs or COC) occurred on the new address.

***Transfer of Site Specific CECs:*** We noted several accounts in which the improper transfer of site specific CECs occurred. As discussed earlier, the transfer of site specific CECs is in violation of County ordinance. We also noted that four site specific CEC transfers had been fully refunded prior to the transfer.

***Transfer of Non-Site Specific CECs Without Documentation:*** We noted a pattern involving the transfer of non-site specific CECs without proper documentation. As discussed earlier, there are several issues associated with the transfer of CECs, this issue is compounded when proper documentation is not collected and/or entered into Naviline / Optiview.

***Improper Use of MLM Notes:*** Miscellaneous Location Messages (MLM) is an area in Naviline where notes, assigned to a specific location, are kept. The notes are assigned to the location, not the account holder. We noted several accounts that appeared to have altered or fictitious MLM notes entered into the system. In many instances, the notes attempted to make it appear as if either CECs had been paid in the past or more units were connected to water and /or sewer for a particular parcel than actually existed.

***Lot Splitting:*** The practice of lot splitting is in no way improper. Several errant accounts however, involve the practice known as lot splitting. Contractors or individuals will purchase a single-family dwelling on a large lot. The owner subsequently demolishes the existing structure, splits or subdivides the lot and constructs two or more single family dwellings. A large majority of the errant accounts involve the practice of lot splitting. We noted several accounts which involved lot splitting also involved the reuse of CEC receipt numbers.

***Reuse of Receipt Numbers:*** We noted errant accounts in which the receipt number for CECs previously paid was utilized more than once. This was a common issue among accounts where a lot split occurred. Rather than assessing CECs to the new structure the old receipts numbers were referenced for both the existing structure as well as the new construction.

***Altered Cost of Construction Estimates:*** When a customer is seeking estimates for CECs, OCWS Maintenance is notified and tasked with developing a Cost of Construction estimate. This

information is combined with the assessment of CECs and a total bill is produced and provided to the customer. We noted several accounts in which the Cost of Construction estimates were altered without explanation. We noted what appeared to be whiteout in areas as well as lining out costs typically associated with CECs.

### **Summary of Errant Accounts**

Our office reviewed approximately 347 accounts from approximately 64 separate contractors and individuals over a 9-year period. We initially conducted random samplings of CECs derived from reconciliation spreadsheets maintained by the OCWS finance department. The random samplings occurred for years 2009 thru 2014. We noted a pattern of irregularities occurring with three contractors. At this point, we began focusing on accounts related to these three contractors. A fourth contractor was selected as a control. This method was conducted for fiscal years 2009 thru 2017. No irregularities appeared in the control sample; however, as a result of our inquiry into a reoccurring receipt number appearing in errant accounts, a fourth contractor was identified as having been allowed to transfer site specific CECs to another location. The document detailing errant accounts is attached as (Exhibit B, F24).

Our work resulted in the identification of billing irregularities associated with eighty-three locations involving four contractors. The potential loss to the county was estimated to be between \$204,300.43 and \$255,500.43.

Of this amount, \$21,100.43 has been collected by OCWS since the initiation of the investigation.

The range of the loss of funds to the County stems from the transfer of site specific and non-site specific CECs, a lack of supporting documentation and limited resources to research needed information specifically related to the transfers of CECs. Based on these factors we are unable to draw a firm conclusion as to whether or not some of the transfers are legitimate.

We identified thirty-four locations, in which billing discrepancies existed, that involved the transfer of CECs from either an individual / company or another location. We determined that two of the total transfers originated from the 1983 to 1985 non-site specific tap issue. We were unable to locate any supporting documentation for the most recent transfers of these two CECs and cannot verify their legitimacy (Exhibit B, F2 and F9). The estimated value of these two transfers is \$7,200.

We identified thirteen non-site specific CECs, with an estimated cost of \$52,000, occurring during the analysis period which originated from the BOCC settlement with Poldon, Inc., \$44,000 of which the results are inconclusive. On October 20, 1998, the BOCC approved a settlement with Poldon, Inc. which granted Poldon, Inc. forty-three non-site specific taps which could be used anywhere in the Garnier's service area (Exhibit C). As of September 19, 2000, Poldon, Inc. is believed to have had twenty-one remaining water and sewer CECs to be utilized in the Garnier's sewage service area, as supported in Exhibit D. The Garnier's service area includes Shalimar, the unincorporated areas of Fort Walton Beach and Mary Esther and all of Okaloosa Island. Documents indicate that Poldon, Inc. did transfer five CECs to GLA Properties; therefore, we believe that all of the GLA related transfers stem from the Poldon, Inc. settlement. We are, at this time, unable to determine the number of transfers that occurred between Poldon, Inc. and other entities between September 19, 2000 and September 12, 2012. Of the thirteen transfers associated with Poldon, Inc. and GLA Properties, three lack supporting documentation and two were connected outside the Garnier's sewage treatment area (Exhibit B, F7 and F8). The remaining eight transfers contain supporting documentation of the transfer; however, we cannot say with absolute certainty that any of the transfers are legitimate due to the gap in documentation. Additional work is needed in this area.

Nineteen transfers of site specific CECs were discovered all of which are in violation of county ordinance. The total value of improperly transferred site specific CECs was determined to be \$76,000. Four of the nineteen transfers are known to have occurred after refunds were issued for the original payment of CECs (Exhibit B, F24).

Of the forty-nine remaining locations, forty-eight offer no explanation as to why the CECs were not collected (one account involved the non-collection of construction costs). Many of these accounts are the result of issues described above. The total value of uncollected CECs and construction costs associated with these forty-eight accounts was estimated to be \$120,300.43.

The one remaining location relates to a transfer of CECs from a location where CECs had been paid twice, although improper, there was no financial impact to the county related to this transfer (Exhibit B, F1).

## Allegations / Finding of Fact

Okaloosa County Ordinance 2016-16, Section 24-172 addresses site specific water and sewer capacity expansion charges. The ordinance indicates that CECs shall be for a specific project at a specific site and shall not be transferable, except as noted in section 24-173 of county ordinance (24-173 addresses non-site specific CECs sold only in the 1980's). In addition, the ordinance provides that no CECs that has been physically connected to the system shall be allowed to be moved to any other site. CECs are non-refundable, unless the physical connection to the system has not been made; in that case, any refunds would be for the original charges paid (not necessarily the current rate). Refunds are issued to the current land owner. Capacity expansion charges run with the land.

We identified twenty transfers of site specific CECs during our review, all of which are in violation of county ordinance. The allegation Kathy Nelson violated county ordinance by transferring or allowing the transfer of site specific CECs is **substantiated**.

## Methodology

We conducted interviews, reviewed OCWS electronic records, examined OCWS documents and reviewed accounts containing CEC billings. We reviewed existing Okaloosa County Ordinances. We reviewed internal controls over CEC assessment and collections. Due to an active criminal investigation, we did not conduct or attempt to conduct an interview with the

subject of this investigation. We did not interview or attempt to conduct interviews with other individuals directly related to the criminal investigation.

## Findings / Recommendations

### 1. Assessment of Capacity Expansion Charges Segregation of Duties.

**Finding:** The current process for the assessment of CECs (determining how much is owed by the customer) and collection of residential capacity expansion charges (collection and receipting of funds) is being administered by a single Senior Customer Service Representative (SCSR) within the water and sewer department. At the time of our initial inquiry, the SCSR was responsible for determining the amount owed, if any, for water and sewer CECs on a proposed project, establishing the account in Naviline, collecting funds and receipting funds using manual receipts.

**Recommendation:** The process for the assessment CECs should be segregated from the actual collection and receipting of funds. We recommend documented supervisor review of all CEC assessments prior to any payments being received or builder's letters being issued.

### 2. Utilizing Existing Software to Full Capability.

**Finding:** OCWS is currently issuing hand-written receipts for collection of CECs and COC. The receipts are utilized by the OCWS finance department for reconciliation. The receipts are compared to amounts entered into Naviline (accounting, inventory and billing system utilized by OCWS customer service) and Pentamation (accounting system utilized by OCWS Finance and the Clerk of Court). At the end of the fiscal year, funds collected for CECs that have not been physically connected to the system (receiving service) are moved into a restricted account. OCWS Finance is currently compiling an Excel spreadsheet of all CECs collected, manually tracking accounts to determine if services are being received, and reconciling the information entered in to Pentamation.

**Recommendation:** Steps should be taken to eliminate the current manual process associated with the issuance of hand-written receipts and manual generation of reconciliation spreadsheets. Based on our conversations with OCWS IT staff and review of the Naviline software, we believe OCWS has the capability of generating electronic receipts through Naviline. We also believe that Naviline has the capability to generate electronic reports with all information required by OCWS Finance for reconciliation between the two accounting systems. Hand written receipts should be issued only when the Naviline system is not available. OCWS Management may want to seek the advice of a software consultant to assist in improving the efficiency or operations between customer service and finance.

### **3. Documented Employee Review of Written Policies and Procedures.**

**Finding:** OCWS currently has a loosely organized system of policies and procedures related to the assessment of CECs. The establishment of well-defined policies and procedures is crucial to operations. Ensuring that employees and management have unfettered access to current policies and procedures is imperative.

**Recommendation:** Management should establish a system for electronically organizing and storing policies and procedures related to customer operations. The system should be easily accessible for all employees and include documented employee review of all policies and procedures associated with their position. There are software solutions currently on the market for storing, disseminating, and documenting review of policies and procedures.

### **4. Software User Rights and Roles.**

**Finding:** As discussed earlier in the report, several of the errant accounts involved the utilization of fictitious or altered information in the MLM notes as well as reused location identification numbers. We suspect that there are instances in which existing MLM notes were either altered or deleted. We learned that most of the customer service personnel have the ability to add, delete and edit MLM notes. We also learned

that staff has the ability to change or edit an existing address. We believe that Naviline has the capability to limit user rights.

**Recommendation:** It is imperative that management, with the assistance of Customer Service Supervisors and IT staff, identify and define the various user groups within Naviline and properly limit user rights to the identified groups. The ability to edit and/or delete existing MLM notes should be restricted to management personnel or at a minimum require management approval. Likewise, the reuse of location identification numbers was accomplished by simply changing an address. The ability to edit or alter an address should be restricted.

#### **5. Utilization of Defined Transaction Codes in Naviline.**

**Finding:** We identified several errant accounts in which the Cost of Construction charges were entered into Naviline utilizing transactions codes associated with CECs, giving the appearance of CECs being paid.

**Recommendation:** The utilization of well-defined transactions codes is essential to operations and maintaining accurate accounting records. Administration should work with finance, customer service and IT to establish clearly defined transaction codes to be utilized when billing customer accounts.

## **Attachments**

Management Response

Exhibit A: Okaloosa County Ordinance 2016-16

Exhibit B: Summary of Errant Accounts

Exhibit C: BOCC / Poldon, Inc. Settlement Documents

Exhibit D: OCWS / Poldon Inc. Documents