



**OFFICE OF THE
STATE AUDITOR**

Case # KCWC21SP

May 10, 2022

Ben Clarkson, Chair
Kane County Water Conservancy Board
725 East Kaneplex Drive
Kanab, UT 84741

Dear Kane County Water Conservancy Board:

The Office of the State Auditor (Office) offers a hotline program through which we receive complaints with financial or compliance implications related to state or local governments. The Office received a complaint alleging conflicts of interest and mismanagement at the Kane County Water Conservancy District (District). The complaint of mismanagement also involved the District's intention to establish a golf course. We considered matters related to the District's proposed golf course to be outside our scope of review, at this time.

As the oversight body, the District Board (Board) is ultimately responsible for the success of the District. An effective, engaged board is essential to ensure effective operation and to prevent fraud, waste, abuse, and noncompliance.

We reviewed relevant District documents, and made inquiries with certain District personnel for the period of July 2019 through June 2021 (Test Period), unless otherwise noted. We identified key internal control weaknesses and noncompliance with statute. We also identified best practices the Board and District management should implement to improve its oversight.

Key Internal Controls and Noncompliance Findings and Recommendations

1. Inadequate Separation of Duties

Proper separation of duties is one of the most effective internal control measures any organization can take to increase the chances of detecting errors and reduce the risk of fraud. When any single person has excessive control over transactions or critical functions, it creates a significant risk that errors, misappropriation, or fraud could occur without detection. To properly safeguard public funds, separate individuals should perform the duties of: 1) authorizing transactions; 2) record keeping; 3) custody of funds; and 4) reconciliation to bank records. When separation is not possible, the entity must implement additional review and reconciliation controls to compensate for the weaknesses.

The Board and District management have not adequately separated District financial duties. The Office Manager has the following responsibilities:

- Access to cash and checks received (custody of funds)
- Prepares and makes the deposit (custody of funds)
- Custody of blank check stock (custody of funds)
- Mails signed checks (custody of funds)
- Custody of a District credit card (custody of funds and authorization)

- Signs District checks (authorization)
- Records and modifies transactions in the accounting system (record keeping)
- Prepares reports and documents for District and Board review (reconciliation)
- Performs bank account reconciliation (reconciliation)

In very small entities, it may be impractical to separate conflicting duties with existing employees. When an entity does not have enough employees to ensure a separation, it may be necessary for the Board to appoint a board member to a role, such as treasurer or clerk, to implement additional controls. At a minimum, these key controls include:

- *An independent reconciliation of expenditures to the bank account.* In order to be independent, a reconciliation cannot be performed or prepared by someone who has custody of funds or records transactions (record keeping). The reconciliation process should include matching recorded transactions to original bank records, such as images of processed checks and original bank statements. If an independent reconciliation is not possible, the Board should ensure that there is a detailed review of the bank account reconciliation that incorporates reviewing images of processed checks and the original bank statement.
- *A review to ensure that all funds received were recorded and deposited to the bank.* Currently the Administrative Assistant opens the mail and totals the payments received (checks/cash) while the Office Manager observes and records the payments in the accounting system. The Office Manager then prepares the deposit and takes the deposit to the bank. However, there is no independent review to ensure that all funds received were properly recorded and deposited. The District should implement a procedure that creates a reliable and independent record of payments received that is independently compared to the validated deposit slip and the accounting records to ensure all payments received are recorded and deposited.

The concentration of financial duties with the Office Manager creates a significant risk that erroneous or unauthorized activity could occur without detection. Since the risk is significant, the Board should review past transactions to detect any possible instances of errors, misappropriation or fraud.

Recommendation:

We recommend the Board ensure adequate separation of duties or implement adequate compensating controls. The Board should implement procedures that provide key internal controls such as those described above. We also recommend the Board perform an independent retroactive review and reconciliation of expenditures to original documents for a period of time.

2. Inadequate Disclosure of Potential Conflicts of Interest

Board and District officials must disclose conflicts of interest when in their official capacity they participate in or receive compensation from a transaction with an entity in which they have a personal interest.¹ That disclosure needs to be a written, sworn statement filed with the Board.² The District had no such statements filed with the Board, however, during the Test Period, we found certain Board and District officials had potential conflicts of interest as follows:

¹ Utah Code 67-16-8

² Utah Code 67-16-7(2)

- The District made purchases totaling \$2,219.63 from a vendor in which the Director has a substantial interest. According to the Director, he was not directly involved in the decision to make those purchases, but it appears that those who did make the decision likely knew of his part ownership of that vendor.
- The District does business with a telecommunication business where a member of the Board is an executive. The District paid that business a total of \$26,051. While there was not a competitive procurement process for these services, that business appears to be a sole provider of those service within the city where the District is located.
- The District made two payments totaling \$20,000 for the option to purchase more than 74 acres of land for \$1.24 million. A District board member has a substantial interest in the entity selling that land. According to the audio of the meeting, the Director disclosed the board member's ownership interest before the board member voted in favor of the land purchase. However, verbal disclosure of the conflict does not satisfy statutory requirements. The land purchase option appeared reasonable given the District's intent to build a golf course.

It appears the intent of the statute is to provide transparency to the public and supports disclosing potential conflicts.³ Disclosure in the manner required by statute, even if District officials consider the conflict to be generally known, increases transparency.

Recommendation:

We recommend the Board ensure Board members and District officials disclose all conflicts of interest as required by State Code.

3. Gift Cards Not Reported as Taxable Income

The District provided each Board member with a \$100 gift card each year. However, the District does not report the gift cards as taxable income. The IRS requires employers to report any gift that can easily be exchanged for cash as income.⁴ Therefore, the gift cards provided to board members should have been reported as taxable income.

Recommendation:

We recommend District management ensure it reports any cash equivalent gifts, such as gift cards, as taxable income.

The findings and recommendations above represent areas of internal control weakness and noncompliance at the District. The remainder of the Letter represents findings and recommendations the Board and District management should consider to improve their oversight and governance of the District. They represent best practice recommendations implemented by various government entities throughout Utah.

Best Practice Findings and Recommendations

4. Establish a Conflict of Interest Disclosure Policy

The District does not have a conflict of interest disclosure policy. A conflict of interest occurs when a person is in a position to derive personal benefit from actions or decisions made in their official capacity.

³ Utah Code 67-16-2

⁴ See IRS Publication 525(2021), Taxable and Non Taxable Income "Holiday Gifts", page 6.

The Board should establish a culture of transparency by implementing a policy that incorporates best practices over conflict of interest disclosures. The following are best practices for conflict of interest disclosure policies:⁵

- Requiring conflict of interest disclosure (Disclosures) when a public official has a private business interest that does business or intends to do business with the public entity or when the public entity regulates the private interest.
- Requiring Disclosures be written statements, filed with the governing body or designee.
- Requiring routine, annual Disclosures.
- Requiring Disclosures when the public official first takes position with the public entity
- Requiring Disclosures when the public official's private interests that creates a conflict or potential conflict changes.

Undisclosed conflicts of interest significantly increase the risk a public official may act in their own best interests rather than in the best interest of the public and the public entity. This could result in the loss of public trust, waste, misuse, or even fraud.

Recommendation:

We recommend the Board establish a conflict of interest disclosure policy that incorporates statutory requirements and best practices outlined above.

5. Establish a Meal and Food Expenditures Policy

We noted District employees purchase meals and food several times a month. The purchases appear unrelated to overnight travel. The District does not have a policy governing such expenditures.

Written Board policies help set clear expectations for officers and employees. At a minimum, a meal policy should designate:

- When it is appropriate for the District to pay for a meal,
- When such meals are considered a taxable fringe benefit by the IRS,
- The required documentation of the time, place, individuals receiving the food benefit, and work purpose for the meal, when such meals fall outside of allowable IRS per diem regulations.

The lack of a meal and food expenditure policy increases the risk of waste, abuse, and noncompliance with IRS requirements.

Recommendation:

We recommend the Board establish a written policy that governs meal and food expenditures in accordance with best practice. We recommend District management ensure compliance with that policy.

6. Replace Credit Card Use With Purchase Cards

District personnel regularly use District credit cards for expenditures. The use of credit cards can be an efficient method of making purchases, especially small dollar purchases or "micro-purchases." However, credit cards by their nature have a high risk of improper use because an entity must rely heavily on detective controls to reduce the risk of abuse. Alternatively, the use of

⁵ The Office compiled these best practices from *Utah Code 67-16*, *Utah Code 10-3-13*, and *Utah Code 17-16a*. While not all cited sections apply to the District, the Office believes that, collectively, they represent practices that create the greatest opportunity for transparency and accountability. We note that statutes generally only require public officials to disclose the conflict, they do not require abstaining or nonparticipation.

purchase cards (p-cards) can add preventative controls that further help reduce the risk of misuse. For this reason, we consider the use of p-cards a best practice that the District should implement.

Recommendation

We recommend the Board and District management adopt the use of purchase cards, rather than using credit cards.

Our procedures were limited to matters related to the complaint. Had we performed additional procedures, other matters may have come to our attention that would have been reported to you. We appreciate the courtesy and assistance extended to us by District personnel during our review. We look forward to a continuing professional relationship. If you have any questions, please contact Tyson Plastow, Special Projects Audit Supervisor, at 801-234-0544.

Sincerely,



Julie M. Wrigley, CPA, CFE
Special Projects Manager

Auditor Concluding Comments

Finding 1

We note that the annual financial audit does not, and cannot, serve as part of an entity's internal control over financial operations.

Finding 2

We caution the District in following the advice of its attorney in this matter. The claim by the District's attorney that Utah Code 67-16-8 applies only to transactions involving a regulated business is unique in our experience and such an illogical opinion as to render the section of statute essentially useless. This interpretation would allow a board member to participate in a self-serving land deal – being involved in steering, negotiating, pricing, and approving the deal – without any requirement to disclose that board member's personal interest under the rational that the District does not regulate that business.

Utah Code Section 67-16-8 sets forth the requirement for a written, sworn statement when a public officer or employee participates in or receives compensation in a transaction between the governmental entity and a personal business interest. There is no qualifying language in Utah Code 67-16-8 that limits disclosure only to instances when the personal interest is a regulated business of the governmental entity. Therefore, Board and District officials must disclose, in writing, conflicts of interest when the public official participates or receives compensation in their official capacity in a transaction with an entity in which they have a personal interest.

The District's adoption of a disclosure policy should reduce the risk of future noncompliance.



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May 2, 2022

To: Julie Wrigley, Special Projects Manager
Office of the Utah State Auditor

From: Ben Clarkson, Board Chairman
Michael Noel, Executive Director
Kane County Water Conservancy District

Re: Case # KCWC21SP

Dear Ms. Wrigley,

Thank you for the opportunity to respond to the report from the Office of the State Auditor regarding our financial and business practices.

It is our understanding that the State Auditor's Office initially received a complaint from the Taxpayer Association of Kane County regarding a proposed golf course near Jackson Flat Reservoir and the District's ability to provide recreational opportunities with its water facilities. Initially, the Office of the State Auditor (Auditor) "considered matters related to the District's proposed golf course outside of [their] scope of review." The Kane County Water Conservancy District (District) strongly agrees with that consideration and felt that this should be the end of the review.

However, the Auditor still pursued a review of the District's finances and operations. It should be noted that the District performs an annual audit of finances and operations through a State-certified auditing company and always receives a clear report. We appreciate the opportunity to make adjustments and improvements in carrying out the public's business. Below you will find our specific responses to the findings of the Auditor's report. In some instances the District has implemented positive changes to the good work that is being done. However, some of the Auditor's findings require clarification as set forth below.

1. Inadequate Separation of Duties

Many of the purported non-compliance issues are a result of the small size of the District. The District approaches business operations conservatively and therefore does not take on superfluous staff to fill positions not requiring full-time employment. While the District abides by a lean employment model, it maintains several different significant safeguards to ensure no errors, separate misappropriations, or fraud occur.

- District Billing Coordinator opens mail under District Office Manager's supervision (custody of funds)
- District Billing Coordinator posts payments and prepares deposit (custody of funds)
- District Office Manager makes the deposit (custody of funds)

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- All checks must be signed by two authorized signers (authorization)
- The District Board reviews and approves all District transactions (authorization)
- The District hires a State-certified auditing company to annually review all operating and finance procedures (record keeping and reconciliation)

In response to the Auditor's findings, the District has instituted further policy changes to ensure every possibility for adequate separation of duties. For instance, to increase District protections against potential fraud, the original District bank statement is immediately scanned to the District Executive Director, the Board Treasurer and the Board Chairman. The District understands the importance of maintaining internal controls to protect from errors, misappropriations, or fraud and feels confident in its current operating procedures adequately protecting it from any malfeasance and that it abides by State Code.

2. Inadequate Conflict of Interest Disclosure

The Auditor claimed inadequate disclosure regarding a potential conflict of interest for three specific instances between July 2019 and June 2021. Regarding these three incidents, the Auditor interprets Utah Code to require a written sworn disclosure of all potential or actual conflicts of interest from all Board members, District officers, and employees. **The District's legal counsel disagrees with the Auditor's interpretation of State Law.** The District's interpretation of State Law is that a written sworn statement declaring a conflict of interest is only required when the conflict arises due to a relationship with an entity that is regulated by the District. All three instances lie outside of this requirement for a written sworn statement. According to the Auditor, in all three instances, the issue was not that the transactions occurred, but that there was not a sworn statement of the potential conflict of interest. Every transaction was pursued within best business procurement practices, the Board of Directors was fully aware of any potential conflicts and consistently went beyond the legal requirement to ensure all KCWCD activities were above board. Additionally, as discussed in item 4, the District has established a conflict of interest policy which would address the concerns of the Auditor according to the Auditor's interpretation of state law.

3. Gift Cards Not Reported as Taxable Income

The District no longer gives \$100 gift cards to Board members as a Christmas gift and now produces an annual check which appears on their IRS Form-1099, making their taxable income earned from the District \$1,000.

4. Establish a Conflict of Interest Policy

State law does not require a public entity to have a conflict of interest disclosure policy but instead places an obligation on each official or employee of a public entity to make

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appropriate disclosers under specific circumstances. The District however recognizes that there are general unwritten best practices regarding conflicts of interest that when followed can be helpful in promoting public trust and in helping individual officials and employees comply with state law. Previously, the District has not had a formal written policy for disclosing conflicts of interest but instead has relied on general best practices, such as a Board Member declaring a conflict of interest during a public meeting and recusing themselves from the discussion and vote on that item. The District has adopted an official written Conflict of Interest Policy and Disclosure Form according to best business practice that imposes disclosure requirements above what is required of state law.

5. Establish a Meal and Food Expenditure Policy

Currently, the District abides by the Utah State standards regarding the payment or reimbursement of per diem and other similar official business related expenses. However, the District appreciates the recommendation and will research the possibility of implementing a specific Meal and Food Expenditure Policy.

6. Replace Credit Card Use with Purchase Card

Credit Cards and Purchase Cards both have pros and cons to their usage. For example, a Credit Card allows most if not all of the risk of loss to be borne by the merchant and the credit card copy, not the District or the tax payer. The District believes that through its instituted process of immediately scanning the credit card statements and sending copies to the Executive Director, Board Treasurer and Board Chairman, we have adequate oversight of the District credit cards. The District appreciates the recommendation of transitioning to the use of a Purchase Card and will take this recommendation under consideration.

The District desires to thank the Office of State Auditor for the opportunities found in this audit and instituted several of the policy recommendations. The District understands the sanctity of public trust in government institutions and happily abides by State Code and best business practices. We look forward to continuing a strong relationship with the public.

Sincerely,



Ben Clarkson, Board Chairman
Kane County Water Conservancy District



Michael Noel, Executive Director
Kane County Water Conservancy District