

Washington State Auditor's Office
Accountability Audit Report

Freeland Water and Sewer District
Island County

Report Date
January 24, 2013

Report No. 1009507

Issue Date
April 22, 2013



WASHINGTON
TROY KELLEY
STATE AUDITOR



**Washington State Auditor
Troy Kelley**

April 22, 2013

Board of Commissioners
Freeland Water and Sewer District
Freeland, Washington

Report on Accountability

We appreciate the opportunity to work in cooperation with your District to promote accountability, integrity and openness in government. The State Auditor's Office takes seriously our role to advocate for government accountability and transparency and to promote positive change.

Please find attached our report on the Freeland Water and Sewer District's accountability and compliance with state laws and regulations and its own policies and procedures. Thank you for working with us to ensure the efficient and effective use of public resources.

Sincerely,

TROY KELLEY
STATE AUDITOR

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Audit Summary

Freeland Water and Sewer District Island County January 24, 2013

ABOUT THE AUDIT

This report contains the results of our independent accountability audit of the Freeland Water and Sewer District from January 1, 2009 through December 31, 2011.

We evaluated internal controls and performed audit procedures on the activities of the District. We also determined whether the District complied with state laws and regulations and its own policies and procedures.

In keeping with general auditing practices, we do not examine every transaction, activity or area. Instead, the areas examined were those representing the highest risk of noncompliance, misappropriation or misuse. The following areas were examined during this audit period:

- Land purchase
- Inter-local agreements
- Ready-to-serve fees
- Annual financial reporting
- Inter-fund loans
- Auditing Officer/official bond

RESULTS

In most areas, the District complied with state laws and regulations and its own policies and procedures.

However, we identified conditions significant enough to report as findings:

- Freeland Water and Sewer District did not comply with its inter-local agreement with Island County, increasing the risk of unallowable use of restricted funds.
- The Freeland Water and Sewer District received grant funds from both Island County and the state of Washington Department of Ecology for the same purchase of land resulting in additional costs for the District.
- The District did not follow state law when it charged ready to serve fees to owners of unimproved land.

Description of the District

Freeland Water and Sewer District Island County January 24, 2013

ABOUT THE DISTRICT

The Freeland Water and Sewer District is a municipal corporation formed in 1964. The District includes both commercial and residential customers with 453 metered connections and a core capacity of 550 connections. On July 1, 2007, the District purchased Harbor Hills Water System for \$1.2 million. The Harbor Hills Water System has 390 metered connections and a core capacity of 550 connections.

An elected, three-member Board of Commissioners governs the District. The District contracts with a third party to administer the District's operations. The District contracts its water maintenance services to a certified operator. The District's average annual operating revenue was approximately \$500,000. The District also received two significant capital grant awards of \$2,500,000 and \$1,000,000 during the audit period.

ELECTED OFFICIALS

These officials served during the audit period:

Board of Commissioners:	Eric Hansen
	Marilyn Abrahamson (term began December 2011)
	Nolan Knickerbocker
	Chuck Maddox (resigned June 2010)
	Jim Short (appointed September 2010)

APPOINTED OFFICIALS

Administrative Accountant	Edwards Associates
Certified Operator	Whidbey Water Services, Andy Campbell

DISTRICT CONTACT INFORMATION

Address: Freeland Water and Sewer District
P.O. Box 222
Freeland, WA 98249

Phone: (360) 331-5566

Website: www.freelandwsd.com

AUDIT HISTORY

Prior to 2007, we conducted annual assessments of the District. Beginning with the 2007-2008 audit, due to an increase in the District's operating revenue, we started conducting onsite accountability audits. This is the first audit in which findings were issued for the District.

Schedule of Audit Findings and Responses

Freeland Water and Sewer District Island County January 24, 2013

- 1. Freeland Water and Sewer District did not comply with its inter-local agreement with Island County, increasing the risk of unallowable use of restricted funds.**

Description of Condition

Freeland Water and Sewer District and Island County entered into an agreement on January 12, 2009, to assist the District in financing the costs of phase one of a sewer project. The County awarded the District \$2.5 million in Rural County Economic Development grant funds for the project. As of December 2012, the District has been reimbursed \$2,021,463.

During our review, we noted \$34,407 in expenditures that were submitted to the County and partially reimbursed that were not allowable under the agreement:

- Goods and services acquired before the inter-local agreement was signed totaling \$15,550.
- Invoices that did not provide adequate detail to determine whether the services provided were specific to the sewer project totaling \$8,836.
- Invoices that were submitted twice totaling \$897.
- Property taxes totaling \$2,916.
- District Commissioner payroll expenditures totaling \$2,351.
- Website maintenance costs totaling \$905.
- Travel reimbursements for a Freeland Chamber of Commerce employee totaling \$672.
- Airline tickets for a trip to Washington, D.C., totaling \$2,280. We could not determine how the trip was related to the project.

In 2011, Island County conducted an internal review of the expenditures and documentation that was submitted by the District. The County reduced the District's 2011 reimbursement request by \$34,407 to recover the funds.

Cause of Condition

The District did not have an adequate review process to ensure it requested reimbursement for allowable expenditures in accordance with the inter-local agreement, or that invoices submitted included adequate support to show they were only for the sewer project.

Effect of Condition

The District's review process was ineffective and resulted in it being reimbursed for expenditures that are not allowable. This resulted in the District having to repay the County \$34,407.

Recommendation

We recommend the District establish internal controls, such as a review process and/or management oversight, to ensure only allowable expenditures are submitted for reimbursement and that the documentation is adequate to support the charges in accordance with the inter-local agreement.

District's Response

The inter-local agreement has expired. Should the District and Island County extend the agreement or enter into a new one, the District ensures that a review process for allowable expenditures is now in place. The District is aware that when signing reimbursement vouchers, it is responsible to make sure the expenditures are authorized under the terms of the agreement.

Auditor's Remarks

We appreciate the District's commitment to resolve this finding and thank the District for its cooperation and assistance during the audit.

Applicable Laws and Regulations

Interlocal agreement between Island County and the Freeland Water and Sewer District, states in part:

(7) Repayment Guarantee. In the event that it is determined that any portion of the funds provided by the County is used for any purpose not authorized under this Interlocal Agreement, the District hereby guarantees that it will repay to the County all such funds, together with accrued interest at the same rate as if the funds had been invested with the Washington State Local Government Investment Pool.

(8) Documentation. The District shall maintain for a period of six (6) years proper records documenting that the funds provided by County were used solely for the purposes contained herein. The District shall make Project records available for inspection or audit by the County or its duly authorized representatives.

(9) Reporting. The District shall file a report with the County Auditor by January 31, 2010 and each year thereafter when the District has been reimbursed in the prior year.

RCW 82.14.370 Sales and use tax for public facilities in rural counties, states in part:

(3)(a) Moneys collected under this section shall only be used to finance public facilities serving economic development purposes in rural counties and finance personnel in economic development offices. The public facility must be listed as an item in the officially adopted county overall economic development plan, or the economic development section of the county's comprehensive plan, or the comprehensive plan of a city or town located within the county for those counties planning under RCW 36.70A.040. For those counties that do not have an adopted overall economic development plan and do not plan under the growth management act, the public facility must be listed in the county's capital facilities plan or the capital facilities plan of a city or town located within the county.

(b) In implementing this section, the county shall consult with cities, towns, and port districts located within the county and the associate development organization serving the county to ensure that the expenditure meets the goals of chapter 130, Laws of 2004 and the requirements of (a) of this subsection. Each county collecting money under this section shall report, as follows, to the office of the state auditor, within one hundred fifty days after the close of each fiscal year:

(i) A list of new projects begun during the fiscal year, showing that the county has used the funds for those projects consistent with the goals of chapter 130, Laws of 2004 and the requirements of (a) of this subsection; and

(ii) expenditures during the fiscal year on projects begun in a previous year. Any projects financed prior to June 10, 2004, from the proceeds of obligations to which the tax imposed under subsection (1) of this section has been pledged shall not be deemed to be new projects under this subsection. No new projects funded with money collected under this section may be for justice system facilities.

RCW 43.09.200, Local government accounting—Uniform system of accounting, states:

The state auditor shall formulate, prescribe, and install a system of accounting and reporting for all local governments, which shall be uniform for every public institution, and every public office, and every public account of the same class.

The system shall exhibit true accounts and detailed statements of funds collected, received, and expended for account of the public for any purpose whatever, and by all public officers, employees, or other persons.

The accounts shall show the receipt, use, and disposition of all public property, and the income, if any, derived there from; all sources of public income, and the amounts due and received from each source; all receipts, vouchers, and other documents kept, or required to be kept, necessary to isolate and prove the validity of every transaction; all statements and reports made or required to be made, for the internal administration of the office to which they pertain; and all reports published or required to be published, for the information of the people regarding any and all details of the financial administration of public affairs.

Budget Accounting and Reporting System (BARS) Manual (Volume 1, Part 3, Chapter 1, Page 11), states in part:

Management and the governing body are responsible for the government's performance, compliance and financial reporting. Therefore, the adequacy of internal control to provide reasonable assurance of achieving these objectives is also the responsibility of management and the governing body.

Schedule of Audit Findings and Responses

Freeland Water and Sewer District Island County January 24, 2013

2. **The Freeland Water and Sewer District received grant funds from both Island County and the state of Washington Department of Ecology for the same purchase of land resulting in additional costs for the District.**

Description of Condition

In January, 2008, the Freeland Water and Sewer District was awarded a Centennial Clean Water Fund Grant from the Washington State Department of Ecology (DOE) totaling \$1 million. Of this amount, the District was eligible to receive up to \$700,000 for the purchase of land. Additionally, the District entered into an agreement with Island County to receive Rural County Economic Development Funds. The purpose of both the DOE and Island County grants were to assist the District in establishing a sewer treatment plant which was part of the Freeland Comprehensive Sewer Plan.

On December 21, 2009, the District received \$563,822 from Island County to purchase 80 acres of land as a future site for the sewer system. On February 1, 2010, the District submitted a reimbursement request and received \$560,000 from DOE for the same purchase. The District kept the DOE grant money to pay future expenses for the sewer project and received reimbursement on those expenses through Island County.

In 2012 newly elected District Commissioners became aware of the District receiving payment for the same purchase through both grants and notified Island County. Island County determined it was not allowable for the District to receive funding from two grants and requested the District repay it. On June 24, 2012, the District repaid Island County \$533,679. The District currently owes Island County \$32,511 for the remaining balance plus interest.

Cause of Condition

Those involved with monitoring the use of grant funds did not use the resources available to ensure compliance with the grant requirements.

Effect of Condition

Because the District did not immediately repay Island County after it received the DOE grant, the District incurred additional costs for the transaction. The District was required to pay interest on the amount received from the County that would otherwise have not been paid.

Recommendation

We recommend the District ensure all expenses are allowable and reimbursed in accordance with requirements of grantors. Further, we recommend the District repay the remaining balance of \$32,511 plus interest to the County in accordance with terms of the agreement.

District's Response

Under the current Board, the District has paid back most of the funds owing to the county for the land purchase. The District intends to repay the County the remainder as recommended by December 2015.

Auditor's Remarks

We appreciate the District's commitment to resolve this finding and thank the District for its cooperation and assistance during the audit.

Applicable Grant Provisions

Internal Agreement Rural County Economic Development Funds, Section 7, Repayment Guarantee, states:

In the event that it is determined that any portion of the funds provided by the County is used for any purpose not authorized under this interlocal agreement, the District hereby guarantees that it will repay to the County all such funds, together with accrued interest at the same rate as if the funds had been invested with the Washington State Local Government Investment Pool.

If any of the proceeds of this award are used to purchase land for the project and construction of the project has not been substantially completed within five (5) years from the formation of a local improvement district, the District agrees to repay to the County in full any award funds used to purchase said land. If said land is sold by the District for any reason before completion of the project, the District agrees to repay to the County in full any award funds used to purchase said land. Any repayments due to the County shall be paid by the District in three (3) equal annual installments, the first installment due within ninety (90) days of written request made by the County.

Schedule of Audit Findings and Responses

Freeland Water and Sewer District Island County January 24, 2013

3. The District did not follow state law when it charged ready to serve fees to owners of unimproved land.

Description of Condition

On July 1, 2007 the District purchased the Harbor Hills Water System (HHWS) for \$1,475,100. The HHWS has 387 metered connections and a core capacity of 550. The system earned revenues of \$252,638, \$252,874 and \$292,811 in 2009, 2010 and 2011 respectively.

While the HHWS operated as a private system, it was regulated by the Utility and Transportation Committee (UTC) and was able to charge ready to serve fees on unimproved parcels. After the District purchased the water system, it became a public water system and was regulated by state law (RCW 57.08.081) which does not allow districts to charge unimproved lots for water. However, the District continued charging the fees which were \$81 dollars per parcel in 2009 and 2010. The fees increased to \$93 for each parcel in 2011. The District charged these amounts every six months. If a property owner did not pay, the District put a lien on the property and added the lien fee along with interest to the outstanding balance. From January 2009 to April 2012, the District charged a total of \$115,674 in ready to serve fees and lien charges.

Cause of Condition

The District believed, although it owned the HHWS, the water system could still operate as a private system under the UTC and was not regulated by state law. Therefore, it continued to charge ready to serve fees on unimproved properties.

Effect of Condition

The District charged ready to serve fees to owners of unimproved parcels between 2009 and 2012, which was not allowable under state law. Further, the District added liens plus interest charges to property owners who did not pay the fees.

Recommendation

We recommend the District ensure it is following state law for water and sewer districts (RCW Chapter 57.08) and not charge ready to serve fees on unimproved parcels.

District's Response

The District stopped billing ready to serve fees in May 2012. The District does not intend to charge ready to serve fees on unimproved land in the future.

Auditor's Remarks

We appreciate the District's commitment to resolve this finding and thank the District for its cooperation and assistance during the audit.

Applicable Laws and Regulations

RCW 57.08.081 Rates and charges—Delinquencies, states in part:

- (1) Subject to RCW 57.08.005(6), the commissioners of any district shall provide for revenues by fixing rates and charges for furnishing sewer and drainage service and facilities to those to whom service is available or for providing water, such rates and charges to be fixed as deemed necessary by the commissioners, so that uniform charges will be made for the same class of customer or service and facility. Rates and charges may be combined for the furnishing of more than one type of sewer or drainage service or facilities.



ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

Our mission is to work with our audit clients and citizens as an advocate for government accountability. As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

The State Auditor's Office employees are located around the state to deliver services effectively and efficiently.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments and fraud, whistleblower and citizen hotline investigations.

The results of our work are widely distributed through a variety of reports, which are available on our Web site and through our free, electronic subscription service.

We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive quality assurance program.

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