



Washington State Auditor's Office

Independence • Respect • Integrity

Financial Statements and Federal Single Audit Report

City of Montesano

Grays Harbor County

For the period January 1, 2012 through December 31, 2013

Published September 11, 2014

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Washington State Auditor's Office

December 21, 2015

Mayor and City Council
City of Montesano
Montesano, Washington

Report on Financial Statements and Federal Single Audit

Please find attached our report on the City of Montesano's financial statements and compliance with federal laws and regulations.

We are issuing this report in order to provide information on the City's financial condition.

Sincerely,

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

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FEDERAL SUMMARY

City of Montesano
Grays Harbor County
January 1, 2013 through December 31, 2013

The results of our audit of the City of Montesano are summarized below in accordance with U.S. Office of Management and Budget Circular A-133.

Financial Statements

An unmodified opinion was issued on the financial statements.

Internal Control Over Financial Reporting:

- *Significant Deficiencies:* We identified deficiencies in the design or operation of internal control over financial reporting that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified no deficiencies that we consider to be material weaknesses.

We noted no instances of noncompliance that were material to the financial statements of the City.

Federal Awards

Internal Control Over Major Programs:

- *Significant Deficiencies:* We reported no deficiencies in the design or operation of internal control over major federal programs that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified deficiencies that we consider to be material weaknesses.

We issued an unmodified opinion on the City's compliance with requirements applicable to each of its major federal programs.

We reported findings that are required to be disclosed under section 510(a) of OMB Circular A-133.

Identification of Major Programs:

The following were major programs during the period under audit:

<u>CFDA No.</u>	<u>Program Title</u>
66.468	Capitalization Grants for Drinking Water State Revolving Funds
20.205	Highway Planning and Construction Cluster - Highway Planning and Construction

The dollar threshold used to distinguish between Type A and Type B programs, as prescribed by OMB Circular A-133, was \$300,000.

The City did not qualify as a low-risk auditee under OMB Circular A-133.

SCHEDULE OF FEDERAL AUDIT FINDINGS AND QUESTIONED COSTS

City of Montesano Grays Harbor County January 1, 2012 through December 31, 2013

2013-001 The City's internal controls were inadequate to ensure compliance with federal Davis-Bacon Act (prevailing wage) requirements.

CFDA Number and Title:	66.468 Capitalization Grants for Drinking Water State Revolving Funds
Federal Grantor Name:	Environmental Protection Agency
Federal Award/Contract Number:	NA
Pass-through Entity Name:	Department of Commerce
Pass-through Award/Contract Number:	DM09-952-024
Questioned Cost Amount:	\$0

Description of Condition

In 2013, the City spent \$716,920 on its reservoir tank demolition and site work project. The Washington State Department of Commerce (Commerce) reimbursed the City for these costs with \$150,786 in state funding and \$566,134 in federal funding. At the time of the audit, the City was unaware that the funding sources included federal.

For federally funded construction projects that exceed \$2,000, the Davis-Bacon Act requires contractors and subcontractors to pay federally prescribed prevailing wages to laborers. Grant recipients must include in construction contracts a provision that the contractor and subcontractors comply with the Act. The Act also requires recipients of federal funds to obtain weekly certified payrolls for all contractors and subcontractors to ensure prevailing wages were paid.

The City hired a project manager to oversee the project and relied on them to obtain the weekly certify payroll reports; however, the project manager thought

the City was obtaining the forms. The City did not adequately monitor to ensure contractors and subcontractors paid prevailing wages and did not obtain all weekly certified payrolls.

We consider this significant internal control deficiency to be a material weakness which led to material noncompliance.

Cause of Condition

The City was unaware this award contained federal funding sources and was unaware of its responsibilities for establishing internal controls over and complying with federal grant requirements when it receives federal awards. In addition, the contract between the City and the project manager did not clearly define the roles and responsibilities nor did the City sufficiently monitor the project manager to ensure compliance with the contract requirements.

Effect of Condition and Questioned Costs

Weekly certified payrolls were not obtained for three out of four contractors and subcontractors. Furthermore, 15 weekly certified payrolls were not obtained for three contractors. Without adequate internal controls, the City cannot ensure the contractors and subcontractors paid workers the prevailing wage. The City could be liable for paying additional wages if prevailing wage was not paid.

Recommendation

We recommend the City improve internal controls by:

- Providing training to employees involved with overseeing projects that are funded in whole or in part with federal funds.
- Clearly outlining roles and responsibilities for federal program requirements in contracts with project managers.
- Monitoring project managers to ensure compliance with federal program requirements,
- Ensuring prevailing wages are paid and all certified weekly payrolls have been received.

City's Response

In 2009 the City of Montesano received a loan from the Department of Health (DOH) through the Drinking Water State Revolving Fund. This loan was for the construction of two new reservoir for the City. The City proceeded in 2010 with the tank construction and reservoirs development which occurred over a five year

period. We received reimbursements through the Office of Financial Management which was audited and administered by the Department of Commerce for the State of Washington.

Each year a draw amount coincided with the construction. At no time were we informed that we were reimbursed specifically with Federal Funds. At the completion of the loan we were given the first indication that federal funds had been used. At no time did the paperwork reflect a source other than the Office of Financial Management. At no time were we informed of the funding change. No federal funds were used in the prior 3 years so this was not something that we would have expected.

While we appreciate the work provided by the auditors, we do not believe that we should be penalized for a state agency that did not properly notify the city of the change in funding source.

Auditor's Remarks

We appreciate the City's response and recognize that the City was unaware that this loan was federally funded at the time the funds were spent. However, material weaknesses in internal controls over federal funds must be reported as audit findings.

We thank the City's staff and management for their cooperation and assistance during our audit. We look forward to working with the City on this issue and will follow up on it during the next audit.

Applicable Laws and Regulations

Office of Management and Budget OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, Section 300 states in part:

The auditee shall;

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

(c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.

U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, Section 500, states in part:

(a) The audit shall be conducted in accordance with GAGAS . . .

Government Auditing Standards, December 2011 Revision, paragraph 4.23 states:

4.23 When performing GAGAS financial audits, auditors should communicate in the report on internal control over financial reporting and compliance, based upon the work performed, (1) significant deficiencies and material weaknesses in internal control; (2) instances of fraud and noncompliance with provisions of laws or regulations that have a material effect on the audit and any other instances that warrant the attention of those charged with governance; (3) noncompliance with provisions of contracts or grant agreements that has a material effect on the audit; and (4) abuse that has a material effect on the audit.

The American Institute of Certified Public Accountants defines significant deficiencies and material weaknesses in its *Codification of Statements on Auditing Standards*, section 935, as follows:

.11 For purposes of adapting GAAS to a compliance audit, the following terms have the meanings attributed as follows:

Deficiency in internal control over compliance. A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis. A deficiency in *design* exists when (a) a control necessary to meet the control objective is missing, or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in *operation* exists when a properly designed control does not operate as designed or the person performing the control does not possess the necessary authority or competence to perform the control effectively . . .

Material weakness in internal control over compliance. A deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that

material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. In this section, a reasonable possibility exists when the likelihood of the event is either reasonably possible or probable as defined as follows:

Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

Remote. The chance of the future event or events occurring is slight.

Probable. The future event or events are likely to occur . . .

Significant deficiency in internal control over compliance. A deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Title 29, Code of Federal Regulations, Section 3.3, Weekly statement with respect to payment of wages, states in part:

(b) Each contractor or subcontractor engaged in the construction, prosecution, completion, or repair of any public building or public work, or building or work financed in whole or in part by loans or grants from the United States, shall furnish each week a statement with respect to the wages paid each of its employees engaged on work covered by this part 3 and part 5 of this chapter during the preceding weekly payroll period. This statement shall be executed by the contractor or subcontractor or by an authorized officer or employee of the contractor or subcontractor who supervises the payment of wages, and shall be on the back of form WH 347; Payroll (For Contractors Optional Use); or on any form with identical wording. Copies of Form WH 347 may be obtained from the Government contracting or sponsoring agency or from the Wage and Hour Division Web site at <http://www.dol.gov/esa/whd/forms/wh347instr.htm> or its successor site.

Title 29, Code of Federal Regulations, Section 5.5 states in part:

(a) The Agency head shall cause or require the contracting officer to insert in full in any contract in excess of \$2,000 which is entered into for the actual construction, alteration and/or repair, including painting and decorating, of a public building or public work, or building or work financed in whole or in part from Federal funds or in accordance with guarantees of a Federal agency or financed from funds obtained by pledge of any contract of a Federal agency to make a loan, grant or annual contribution (except where a different meaning is expressly indicated), and which is subject to the labor standards provisions of any of the acts listed in § 5.1, the following clauses (or any modifications thereof to meet the particular needs of the agency, Provided, That such modifications are first approved by the Department of Labor): . . .

(1) *Minimum wages.* (i) All laborers and mechanics employed or working upon the site of the work (or under the United States Housing Act of 1937 or under the Housing Act of 1949 in the construction or development of the project), will be paid unconditionally and not less often than once a week, and without subsequent deduction or rebate on any account (except such payroll deductions as are permitted by regulations issued by the Secretary of Labor under the Copeland Act (29 CFR part 3)), the full amount of wages and bona fide fringe benefits (or cash equivalents thereof) due at time of payment computed at rates not less than those contained in the wage determination of the Secretary of Labor which is attached hereto and made a part hereof, regardless of any contractual relationship which may be alleged to exist between the contractor and such laborers and mechanics.

(3)(ii)(A) The contractor shall submit weekly for each week in which any contract work is performed a copy of all payrolls to the Environmental Protection Agency if the agency is a party to the contract, but if the agency is not such a party, the contractor will submit the payrolls to the applicant, sponsor, or owner, as the case may be, for transmission to the Environmental Protection Agency . . .

(B) Each payroll submitted shall be accompanied by a "Statement of Compliance," signed by the contractor or subcontractor or his or her agent who pays or supervises the payment of the persons employed under the contract

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

**City of Montesano
Grays Harbor County
January 1, 2012 through December 31, 2013**

2013-002 The City's internal controls over financial statement preparation are inadequate to ensure accurate and complete reporting.

Background

City Council members, state and federal agencies, and the public rely on the information included in the financial statements and reports to make decisions. It is the responsibility of the City to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting. Our audit identified deficiencies in internal controls that adversely affect the City's ability to produce financial statements.

During the prior two audits we have communicated concerns to the Mayor, City Council and management about the City's internal controls over financial reporting.

Description of Condition

During our audit, we identified the following deficiencies in internal controls over financial reporting that, when taken together, represent a significant deficiency (as noted in the Applicable Laws and Regulations section below):

- The City does not have procedures in place, including close supervision and oversight, to ensure information entered into the general ledger is accurate.
- City staff responsible for compiling the financial statements did not always effectively use the *Budget Accounting and Reporting System* (BARS) Manual when preparing the financial statements.
- The City lacks an effective review process to ensure amounts reported on the financial statements agree to supporting records and are prepared in accordance with the *Budgeting, Accounting and Reporting Systems* (BARS) Manual.

- The City did not have a clear understanding of the funding source for its Capitalization Grants for Drinking Water State Revolving Funds loan and did not follow guidance provided in the *Budgeting, Accounting and Reporting Standards* (BARS) manual or OMB Circular A-133 for reporting federal loans.

Cause of Condition

The City has not made it a priority to obtain the necessary resources or processes, such as training and oversight, to prepare accurate accounting records and financial statements.

Effect of Condition

During our review of the financial statements we noted the following errors that were not detected by the City:

- The City miscoded \$300,000 of debt proceeds in its general ledger.
- The beginning and ending balances on the Schedule of Liabilities for both 2012 and 2013 were overstated by \$144,251 and \$153,093, respectively.
- One program on the Schedule of Expenditures of Federal Awards (SEFA) was over reported by \$82,428.
- The City omitted a federal program from the SEFA, which resulted in the schedule being under reported by \$574,505. This resulted in a new major program that was required to be audited. As a result, we have re-issued our 2013 report (originally dated September 11, 2014) to include this additional federal single audit. It also caused the City to fail to meet its single audit reporting deadline for 2013. Non-compliance with this requirement can put future federal funding in jeopardy.

The City corrected these errors in its final financial statements.

Recommendation

We recommend the City dedicate the necessary time and resources to ensure:

- Procedures are in place, such as close supervision and oversight, to ensure general ledger balances are valid, accurate, complete and adequately supported.
- Individuals responsible for preparing the financial statements, notes, and schedules have sufficient technical training and effectively use the BARS Manual when preparing the City's annual financial report.

- The person responsible for reviewing the financial statements has an adequate understanding of reporting requirements and they are given sufficient time and resources to perform this review. The City may wish to consider the use of a checklist or other reviewing tool for this purpose.
- It has an adequate understanding of the type of loan funding it receives and follow guidance in the BARS Manual for reporting federal loans.

City's Response

We appreciate the opportunity to respond to the auditor's report. We respect their hard work and dedication. The City corrected the financial statement, and we appreciate the auditor's office and the help that they provide.

1. The City returned the \$300,000.00 from bond proceeds to the Cumulative Reserve Fund. The transaction was done through a supplemental budget ordinance. It should have been coded as a transfer, and this transaction was corrected. At no time were any funds unaccounted for.

2. The debt service issue has been corrected by using annual tax statements rather than the amortization schedule previously provided. In the future the annual statements will be used as the lender refuses to supply an updated annual schedule.

3. The SEFA was reported correctly and met the federal standards. The division between the Federal and Transportation TIB has been corrected. As stated this error did not affect the single audit scope.

4. See the City's response in the Schedule of Federal Findings above.

The City acknowledges these minor errors in the financial statements. Although we do not believe that any of these rise to the level of a finding, we will continue to improve the oversight, internal controls, and independent review process as noted.

Auditor's Remarks

We appreciate the City's response and recognize that the City is committed to strengthening and improving its internal controls; however, significant deficiencies over internal controls are reported as an audit finding.

We thank the City's staff and management for their cooperation and assistance during our audit. We look forward to working with the City on this issue and will follow up on it during the next audit.

Applicable Laws and Regulations

RCW 43.09.200 states in part:

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.

Budget Accounting and Reporting System (BARS) Manual - Accounting, Accounting Principles and General Procedures, Internal Control, states:

Internal control is a management process for keeping an entity on course in achieving its business objectives, as adopted by the governing body.

This management control system should ensure that resources are guarded against waste, loss and misuse; that reliable data is obtained, maintained, and fairly disclosed in financial statement and other reports; and resource use is consistent with laws, regulations and policies.

Each entity is responsible for establishing and maintaining an effective system of internal control throughout their government.

Government Auditing Standards, July 2007 Revision – Section 5.11 provides that auditors should report material weaknesses and significant deficiencies in internal control.

The American Institute of Certified Public Accountants, Statement on Auditing Standards No. 115 defines significant deficiencies and material weaknesses as follows:

- a. Significant deficiency: A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
- b. Material weakness: A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

**City of Montesano
Grays Harbor County
January 1, 2012 through December 31, 2013**

Mayor and City Council
City of Montesano
Montesano, Washington

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the City of Montesano, Grays Harbor County, Washington, as of and for the years ended December 31, 2012 and 2013, and the related notes to the financial statements, which collectively comprise the City's financial statements, and have issued our report thereon dated November 30, 2015.

We issued an unmodified opinion on the fair presentation of the City's financial statements in accordance with its regulatory basis of accounting. We issued an adverse opinion on the fair presentation with regard to accounting principles generally accepted in the United States of America (GAAP) because the financial statements are prepared by the City using accounting practices prescribed by Washington State statutes and the State Auditor's *Budgeting, Accounting and Reporting System* (BARS) manual described in Note 1, which is a basis of accounting other than GAAP. The effects on the financial statements of the variances between the basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's

internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of City's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Audit Findings and Responses as Finding 2013-002 that we consider to be significant deficiencies.

CITY'S RESPONSE TO FINDINGS

The City's response to the findings identified in our audit is described in the accompanying Schedule of Audit Findings and Responses. The City's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the City's financial statements are free from material misstatement, we performed tests of the City's compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

A handwritten signature in cursive script that reads "Troy X. Kelley".

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

November 30, 2015

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR
EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB
CIRCULAR A-133**

**City of Montesano
Grays Harbor County
January 1, 2013 through December 31, 2013**

Mayor and City Council
City of Montesano
Montesano, Washington

**REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL
PROGRAM**

We have audited the compliance of the City of Montesano, Grays Harbor County, Washington, with the types of compliance requirements described in the U.S. *Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2013. The City's major federal programs are identified in the accompanying Federal Summary.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the City's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program

occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. Our audit does not provide a legal determination on the City's compliance.

Opinion on Each Major Federal Program

In our opinion, the City complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2013.

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying Schedule of Federal Audit Findings and Questioned Costs as Finding 2013-001. Our opinion on each major federal program is not modified with respect to these matters.

City's Response to Findings

The City's response to the noncompliance findings identified in our audit is described in the accompanying Schedule of Federal Audit Findings and Questioned Costs. The City's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

REPORT ON INTERNAL CONTROL OVER COMPLIANCE

Management of the City is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the City's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program in order to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but

not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Federal Audit Findings and Questioned Costs as Finding 2013-001 to be a material weakness.

City's Response to Findings

The City's response to the internal control over compliance findings identified in our audit is described in the accompanying Schedule of Federal Audit Findings and Questioned Costs. The City's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

PURPOSE OF THIS REPORT

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other

purpose. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

A handwritten signature in black ink that reads "Troy X. Kelley". The signature is written in a cursive, flowing style.

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

November 30, 2015

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

City of Montesano Grays Harbor County January 1, 2012 through December 31, 2013

Mayor and City Council
City of Montesano
Montesano, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the City of Montesano, Grays Harbor County, Washington, for the years ended December 31, 2012 and 2013, and the related notes to the financial statements, which collectively comprise the City's financial statements, as listed on page 28.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of Washington State statutes and the *Budgeting, Accounting and Reporting System* (BARS) manual prescribed by the State Auditor described in Note 1. This includes determining that the basis of accounting is acceptable for the presentation of the financial statements in the circumstances. Management is also responsible for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's

judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Unmodified Opinion on Regulatory Basis of Accounting (BARS Manual)

As described in Note 1, the City of Montesano has prepared these financial statements to meet the financial reporting requirements of Washington State statutes using accounting practices prescribed by the State Auditor's *Budgeting, Accounting and Reporting System* (BARS) manual. Those accounting practices differ from accounting principles generally accepted in the United States of America (GAAP). The differences in these accounting practices are also described in Note 1.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position and results of operations of the City of Montesano, for the years ended December 31, 2012 and 2013, on the basis of accounting described in Note 1.

Basis for Adverse Opinion on U.S. GAAP

Auditing standards issued by the American Institute of Certified Public Accountants (AICPA) require auditors to formally acknowledge when governments do not prepare their financial statements, intended for general use, in accordance with GAAP. The effects on the financial statements of the variances between GAAP and the accounting practices the City used, as described in Note 1, although not reasonably determinable, are presumed to be material. As a result, we are required to issue an adverse opinion on whether the financial statements are presented fairly, in all material respects, in accordance with GAAP.

Adverse Opinion on U.S. GAAP

The financial statements referred to above were not intended to, and in our opinion they do not, present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the City of Montesano, as of December 31, 2013 and 2012,

or the changes in financial position or cash flows for the years then ended, due to the significance of the matter discussed in the above “Basis for Adverse Opinion on U.S. GAAP” paragraph.

Other Matters

Supplementary and Other Information

Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The accompanying Schedules of Liabilities are also presented for purposes of additional analysis, as required by the prescribed BARS manual. These schedules are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2015 on our consideration of the City’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That

report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over financial reporting and compliance.

A handwritten signature in cursive script that reads "Troy X. Kelley".

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

November 30, 2015

FINANCIAL SECTION

**City of Montesano
Grays Harbor County
January 1, 2012 through December 31, 2013**

FINANCIAL STATEMENTS

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FUND RESOURCES AND USES ARISING FROM CASH TRANSACTIONS

For the Year Ended December 31, 2013

BARS Code		Total for All funds*	001 General Fund	101 Ambulance Fund	103 Hotel/motel Tax (ord. #1278)
Beginning Cash and Investments					
30810	Beg Fund Bal-Reserved	0	0	0	0
30880	Beg Fund Bal-Unreserved	3,480,625	224,904	215	5,320
38800/58800	Prior Period Adjustments, net	0	0	0	0
Operating Revenues					
310	Taxes	2,193,602	1,753,124	419,011	2,184
320	Licenses & Permits	50,675	50,555	0	0
330	Intergovernmental Revenues	1,548,038	159,087	5,133	0
340	Charges for Goods and Services	2,080,593	42,761	468,082	0
350	Fines & Penalties	64,771	64,771	0	0
360	Miscellaneous Revenues	95,771	53,326	7,883	0
Total Operating Revenues:		6,033,451	2,123,625	900,109	2,184
Operating Expenditures					
510	General Government	462,133	459,133	0	3,000
520	Public Safety	2,333,988	1,135,893	1,148,157	0
530	Utilities	2,134,464	0	0	0
540	Transportation	140,522	72,874	0	0
550	Natural and Economic Environment	94,285	94,285	0	0
560	Social Services	685	685	0	0
570	Culture And Recreation	67,447	67,447	0	0
598	Intergovernmental Payments	0	0	0	0
Total Operating Expenditures:		5,233,524	1,830,317	1,148,157	3,000
Net Operating Increase (Decrease):		799,927	293,308	-248,048	-816
Nonoperating Revenues					
370, 380, 395, 398	Other Financing Sources	2,644,344	24,242	0	0
391-393	Debt Proceeds	716,920	0	0	0
397	Transfers-In	878,313	0	518,579	0
Total Nonoperating Revenues:		4,239,577	24,242	518,579	
Nonoperating Expenditures					
580, 596, 599	Other Financing Uses	242,069	43,104	49,748	0
591-593	Debt Service	274,673	0	1,762	0
594-595	Capital Expenditures	2,842,192	14,520	0	0
597	Transfers-Out	878,313	356,750	219,235	0
Total Nonoperating Expenditures:		4,237,247	414,374	270,746	
Increase (Decrease) in Cash and Investments		802,257	-96,825	-214	-816
Ending Cash and Investments					
50810	End Fund Bal-Reserved	739,000	0	0	0
50880	End Fund Balance-Unreserved	3,543,883	128,081	1	4,504

The accompanying notes are an integral part of this Statement.

BARS Code		105 Municipal Court Drug Fund	106 Re Excise Restricted Revenue	304 City Shop Project	310 CIP Water Tank
Beginning Cash and Investments					
30810	Beg Fund Bal-Reserved	0	0	0	0
30880	Beg Fund Bal-Unreserved	268	49,608	365,557	28,639
38800/58800	Prior Period Adjustments, net	0	0	0	0
Operating Revenues					
310	Taxes	0	19,283	0	0
320	Licenses & Permits	0	0	0	0
330	Intergovernmental Revenues	0	0	0	0
340	Charges for Goods and Services	0	0	0	0
350	Fines & Penalties	0	0	0	0
360	Miscellaneous Revenues	885	0	0	0
Total Operating Revenues:		885	19,283		
Operating Expenditures					
510	General Government	0	0	0	0
520	Public Safety	0	0	0	0
530	Utilities	0	0	0	0
540	Transportation	0	0	0	0
550	Natural and Economic Environment	0	0	0	0
560	Social Services	0	0	0	0
570	Culture And Recreation	0	0	0	0
598	Intergovernmental Payments	0	0	0	0
Total Operating Expenditures:					
Net Operating Increase (Decrease):		885	19,283	0	0
Nonoperating Revenues					
370, 380, 395, 398	Other Financing Sources	0	0	0	0
391-393	Debt Proceeds	0	0	0	716,920
397	Transfers-In	0	0	0	0
Total Nonoperating Revenues:					716,920
Nonoperating Expenditures					
580, 596, 599	Other Financing Uses	0	0	0	0
591-593	Debt Service	0	0	0	0
594-595	Capital Expenditures	0	0	364,225	740,906
597	Transfers-Out	0	0	0	0
Total Nonoperating Expenditures:				364,225	740,906
Increase (Decrease) in Cash and Investments		885	19,283	-364,225	-23,986
Ending Cash and Investments					
50810	End Fund Bal-Reserved	0	0	0	0
50880	End Fund Balance-Unreserved	1,154	68,891	1,332	4,653

The accompanying notes are an integral part of this Statement.

BARS Code		311 Capital-Main Street Phase II	312 Mary's River Revetment Project	401 Current Water	402 Storm Water Fund
Beginning Cash and Investments					
30810	Beg Fund Bal-Reserved	0	0	0	0
30880	Beg Fund Bal-Unreserved	0	0	2,550,424	13,954
38800/58800	Prior Period Adjustments, net	0	0	0	0
Operating Revenues					
310	Taxes	0	0	0	0
320	Licenses & Permits	0	0	120	0
330	Intergovernmental Revenues	1,255,144	117,697	10,978	0
340	Charges for Goods and Services	0	0	1,469,645	55,853
350	Fines & Penalties	0	0	0	0
360	Miscellaneous Revenues	0	0	17,783	0
Total Operating Revenues:		1,255,144	117,697	1,498,526	55,853
Operating Expenditures					
510	General Government	0	0	0	0
520	Public Safety	0	0	0	0
530	Utilities	0	96,611	1,987,985	0
540	Transportation	0	0	0	1,075
550	Natural and Economic Environment	0	0	0	0
560	Social Services	0	0	0	0
570	Culture And Recreation	0	0	0	0
598	Intergovernmental Payments	0	0	0	0
Total Operating Expenditures:			96,611	1,987,985	1,075
Net Operating Increase (Decrease):		1,255,144	21,086	-489,459	54,778
Nonoperating Revenues					
370, 380, 395, 398	Other Financing Sources	0	0	2,620,102	0
391-393	Debt Proceeds	0	0	0	0
397	Transfers-In	57,000	0	0	0
Total Nonoperating Revenues:		57,000		2,620,102	
Nonoperating Expenditures					
580, 596, 599	Other Financing Uses	0	0	101,436	42,782
591-593	Debt Service	0	0	267,237	5,370
594-595	Capital Expenditures	1,257,956	69,935	212,047	0
597	Transfers-Out	0	0	276,533	0
Total Nonoperating Expenditures:		1,257,956	69,935	857,252	48,152
Increase (Decrease) in Cash and Investments		54,188	-48,849	1,273,390	6,626
Ending Cash and Investments					
50810	End Fund Bal-Reserved	0	0	739,000	0
50880	End Fund Balance-Unreserved	54,188	-48,848	3,084,815	20,580

The accompanying notes are an integral part of this Statement.

BARS Code		408 Cemetery Fund	502 Unemployment Compensation	503 Long Term Care	504 Motor Pool Fund
Beginning Cash and Investments					
30810	Beg Fund Bal-Reserved	0	0	0	0
30880	Beg Fund Bal-Unreserved	61,261	81,374	69,365	29,736
38800/58800	Prior Period Adjustments, net	0	0	0	0
Operating Revenues					
310	Taxes	0	0	0	0
320	Licenses & Permits	0	0	0	0
330	Intergovernmental Revenues	0	0	0	0
340	Charges for Goods and Services	44,251	0	0	0
350	Fines & Penalties	0	0	0	0
360	Miscellaneous Revenues	0	8,310	0	7,584
Total Operating Revenues:		44,251	8,310		7,584
Operating Expenditures					
510	General Government	0	0	0	0
520	Public Safety	0	0	10,141	39,798
530	Utilities	28,123	0	0	21,745
540	Transportation	0	0	0	66,573
550	Natural and Economic Environment	0	0	0	0
560	Social Services	0	0	0	0
570	Culture And Recreation	0	0	0	0
598	Intergovernmental Payments	0	0	0	0
Total Operating Expenditures:		28,123		10,141	128,116
Net Operating Increase (Decrease):		16,128	8,310	-10,141	-120,532
Nonoperating Revenues					
370, 380, 395, 398	Other Financing Sources	0	0	0	0
391-393	Debt Proceeds	0	0	0	0
397	Transfers-In	0	0	11,666	291,068
Total Nonoperating Revenues:				11,666	291,068
Nonoperating Expenditures					
580, 596, 599	Other Financing Uses	4,999	0	0	0
591-593	Debt Service	304	0	0	0
594-595	Capital Expenditures	0	0	0	182,603
597	Transfers-Out	0	0	25,795	0
Total Nonoperating Expenditures:		5,303		25,795	182,603
Increase (Decrease) in Cash and Investments		10,825	8,310	-24,270	-12,067
Ending Cash and Investments					
50810	End Fund Bal-Reserved	0	0	0	0
50880	End Fund Balance-Unreserved	72,086	89,684	45,095	17,668

The accompanying notes are an integral part of this Statement.

FUND RESOURCES AND USES ARISING FROM CASH TRANSACTIONS

For the Year Ended December 31, 2012

BARS Code		Total for All funds*	001 General Fund	101 Ambulance Fund	103 Hotel/motel Tax (ord. #1278)
Beginning Cash and Investments					
30810	Beg Fund Bal-Reserved	112,959	0	9,173	4,630
30880	Beg Fund Bal-Unreserved	2,969,086	169,270	0	0
38800/58800	Prior Period Adjustments, net	0	0	0	0
Operating Revenues					
310	Taxes	2,217,744	1,677,827	410,521	7,713
320	Licenses & Permits	67,450	67,350	0	0
330	Intergovernmental Revenues	498,418	107,385	267,809	0
340	Charges for Goods and Services	2,037,334	42,162	448,894	0
350	Fines & Penalties	112,343	79,274	0	0
360	Miscellaneous Revenues	117,529	72,835	4,803	0
Total Operating Revenues:		5,050,818	2,046,832	1,132,028	7,713
Operating Expenditures					
510	General Government	440,025	440,025	0	0
520	Public Safety	2,480,967	1,118,586	1,309,623	0
530	Utilities And Environment	1,822,789	1,622	0	0
540	Transportation	283,904	0	0	0
550	Economic Environment	99,843	92,819	0	7,024
560	Mental & Physical Health	1,142	1,142	0	0
570	Culture And Recreation	67,153	66,566	0	0
598	Intergovernmental Payments	0	0	0	0
Total Operating Expenditures:		5,195,824	1,720,761	1,309,623	7,024
Net Operating Increase (Decrease):		-145,005	326,072	-177,596	689
Nonoperating Revenues					
370, 380, 395, 398	Other Financing Sources	1,779,880	41,898	0	0
391-393	Debt Proceeds	1,135,833	0	0	0
397	Transfers-In	1,826,026	0	300,000	0
Total Nonoperating Revenues:		4,741,739	41,898	300,000	
Nonoperating Expenditures					
580, 596, 599	Other Financing Uses	44,067	-31,076	62,439	0
591-593	Debt Service	359,503	0	27,043	0
594-595	Capital Expenditures	1,968,556	6,131	722	0
597	Transfers-Out	1,826,026	372,192	41,158	0
Total Nonoperating Expenditures:		4,198,151	347,247	131,362	
Increase (Decrease) in Cash and Investments		398,582	20,724	-8,958	689
Ending Cash and Investments					
50810	End Fund Bal-Reserved	2,319,775	0	215	5,320
50880	End Fund Balance-Unreserved	1,160,850	189,991	0	0

The accompanying notes are an integral part of this Statement.

BARS Code		105 Municipal Court Drug Fund	106 Re Excise Restricted Revenue	110 Street Fund	302 Bryan Park Development
Beginning Cash and Investments					
30810	Beg Fund Bal-Reserved	268	32,611	66,276	0
30880	Beg Fund Bal-Unreserved	0	0	0	154
38800/58800	Prior Period Adjustments, net	0	0	0	0
Operating Revenues					
310	Taxes	0	16,997	104,686	0
320	Licenses & Permits	0	0	100	0
330	Intergovernmental Revenues	0	0	89,700	0
340	Charges for Goods and Services	0	0	0	0
350	Fines & Penalties	0	0	0	0
360	Miscellaneous Revenues	0	0	4,086	0
Total Operating Revenues:			16,997	198,572	
Operating Expenditures					
510	General Government	0	0	0	0
520	Public Safety	0	0	0	0
530	Utilities And Environment	0	0	0	0
540	Transportation	0	0	160,732	0
550	Economic Environment	0	0	0	0
560	Mental & Physical Health	0	0	0	0
570	Culture And Recreation	0	0	0	0
598	Intergovernmental Payments	0	0	0	0
Total Operating Expenditures:				160,732	
Net Operating Increase (Decrease):		0	16,997	37,840	0
Nonoperating Revenues					
370, 380, 395, 398	Other Financing Sources	0	0	0	0
391-393	Debt Proceeds	0	0	0	0
397	Transfers-In	0	0	0	0
Total Nonoperating Revenues:					
Nonoperating Expenditures					
580, 596, 599	Other Financing Uses	0	0	0	0
591-593	Debt Service	0	0	0	0
594-595	Capital Expenditures	0	0	47,466	0
597	Transfers-Out	0	0	21,992	0
Total Nonoperating Expenditures:				69,458	
Increase (Decrease) in Cash and Investments		0	16,997	-31,618	0
Ending Cash and Investments					
50810	End Fund Bal-Reserved	268	49,608	34,657	0
50880	End Fund Balance-Unreserved	0	0	0	154

The accompanying notes are an integral part of this Statement.

BARS Code		304 City Shop Project	310 Capital Projects Fund	401 Current Water	402 Storm Water Fund
Beginning Cash and Investments					
30810	Beg Fund Bal-Reserved	0	0	0	0
30880	Beg Fund Bal-Unreserved	40,400	30,012	2,447,410	24,420
38800/58800	Prior Period Adjustments, net	0	0	0	0
Operating Revenues					
310	Taxes	0	0	0	0
320	Licenses & Permits	0	0	0	0
330	Intergovernmental Revenues	0	0	33,524	0
340	Charges for Goods and Services	0	0	1,431,387	54,054
350	Fines & Penalties	0	0	33,020	0
360	Miscellaneous Revenues	0	0	15,205	0
Total Operating Revenues:				1,513,136	54,054
Operating Expenditures					
510	General Government	0	0	0	0
520	Public Safety	0	0	0	0
530	Utilities And Environment	0	0	1,775,913	0
540	Transportation	0	0	0	15,974
550	Economic Environment	0	0	0	0
560	Mental & Physical Health	0	0	0	0
570	Culture And Recreation	0	0	0	0
598	Intergovernmental Payments	0	0	0	0
Total Operating Expenditures:				1,775,913	15,974
Net Operating Increase (Decrease):		0	0	-262,777	38,080
Nonoperating Revenues					
370, 380, 395, 398	Other Financing Sources	0	0	1,731,981	0
391-393	Debt Proceeds	1,000,000	135,833	0	0
397	Transfers-In	1,000,000	0	300,000	0
Total Nonoperating Revenues:		2,000,000	135,833	2,031,981	
Nonoperating Expenditures					
580, 596, 599	Other Financing Uses	0	0	1,000	0
591-593	Debt Service	0	0	283,858	48,152
594-595	Capital Expenditures	1,374,843	137,206	290,648	394
597	Transfers-Out	300,000	0	1,090,684	0
Total Nonoperating Expenditures:		1,674,843	137,206	1,666,191	48,546
Increase (Decrease) in Cash and Investments		325,157	-1,373	103,014	-10,466
Ending Cash and Investments					
50810	End Fund Bal-Reserved	0	0	2,229,706	0
50880	End Fund Balance-Unreserved	365,557	28,639	320,718	13,954

The accompanying notes are an integral part of this Statement.

BARS Code		408 Cemetery Fund	410 Solid Waste Management	502 Unemployment Compensation	503 Long Term Care
Beginning Cash and Investments					
30810	Beg Fund Bal-Reserved	0	0	0	0
30880	Beg Fund Bal-Unreserved	30,487	39	76,601	71,815
38800/58800	Prior Period Adjustments, net	0	0	0	0
Operating Revenues					
310	Taxes	0	0	0	0
320	Licenses & Permits	0	0	0	0
330	Intergovernmental Revenues	0	0	0	0
340	Charges for Goods and Services	60,825	12	0	0
350	Fines & Penalties	0	50	0	0
360	Miscellaneous Revenues	0	0	10,352	0
Total Operating Revenues:		60,825	62	10,352	
Operating Expenditures					
510	General Government	0	0	0	0
520	Public Safety	0	0	0	10,116
530	Utilities And Environment	24,748	0	0	0
540	Transportation	0	0	0	0
550	Economic Environment	0	0	0	0
560	Mental & Physical Health	0	0	0	0
570	Culture And Recreation	0	0	0	0
598	Intergovernmental Payments	0	0	0	0
Total Operating Expenditures:		24,748			10,116
Net Operating Increase (Decrease):		36,077	62	10,352	-10,116
Nonoperating Revenues					
370, 380, 395, 398	Other Financing Sources	0	1	0	0
391-393	Debt Proceeds	0	0	0	0
397	Transfers-In	0	0	0	7,666
Total Nonoperating Revenues:			1		7,666
Nonoperating Expenditures					
580, 596, 599	Other Financing Uses	4,853	0	5,578	0
591-593	Debt Service	450	0	0	0
594-595	Capital Expenditures	0	0	0	0
597	Transfers-Out	0	0	0	0
Total Nonoperating Expenditures:		5,303		5,578	
Increase (Decrease) in Cash and Investments		30,774	63	4,774	-2,450
Ending Cash and Investments					
50810	End Fund Bal-Reserved	0	0	0	0
50880	End Fund Balance-Unreserved	61,261	102	81,374	69,365

The accompanying notes are an integral part of this Statement.

BARS Code		504 Motor Pool Fund
Beginning Cash and Investments		
30810	Beg Fund Bal-Reserved	0
30880	Beg Fund Bal-Unreserved	78,478
38800/58800	Prior Period Adjustments, net	0
Operating Revenues		
310	Taxes	0
320	Licenses & Permits	0
330	Intergovernmental Revenues	0
340	Charges for Goods and Services	0
350	Fines & Penalties	0
360	Miscellaneous Revenues	10,249
Total Operating Revenues:		10,249
Operating Expenditures		
510	General Government	0
520	Public Safety	42,643
530	Utilities And Environment	20,506
540	Transportation	107,197
550	Economic Environment	0
560	Mental & Physical Health	0
570	Culture And Recreation	587
598	Intergovernmental Payments	0
Total Operating Expenditures:		170,933
Net Operating Increase (Decrease):		-160,684
Nonoperating Revenues		
370, 380, 395, 398	Other Financing Sources	6,000
391-393	Debt Proceeds	0
397	Transfers-In	218,360
Total Nonoperating Revenues:		224,360
Nonoperating Expenditures		
580, 596, 599	Other Financing Uses	1,273
591-593	Debt Service	0
594-595	Capital Expenditures	111,144
597	Transfers-Out	0
Total Nonoperating Expenditures:		112,417
Increase (Decrease) in Cash and Investments		-48,740
Ending Cash and Investments		
50810	End Fund Bal-Reserved	0
50880	End Fund Balance-Unreserved	29,736

The accompanying notes are an integral part of this Statement.

FIDUCIARY FUND RESOURCES AND USES ARISING FROM CASH TRANSACTIONS

For the Year Ended December 31, 2013

BARS Code		Total for All funds	630 Agency Funds/non Revenue	633 Agency Fund/Donations
308	Beginning Cash and Investments	12,134	10,811	1,323
388 and 588	Prior Period Adjustments, net	0	0	0
310-360	Revenues	0	0	0
380-390	Other Increases and Financing Sources	67,599	67,599	0
510-570	Expenditures	0	0	0
580-590	Other Decreases and Financing Uses	68,032	68,032	0
Increase (Decrease) in Cash and Investments		-433	-433	0
508	Ending Cash and Investments	11,701	10,378	1,323

The accompanying notes are an integral part of this Statement.

FIDUCIARY FUND RESOURCES AND USES ARISING FROM CASH TRANSACTIONS

For the Year Ended December 31, 2012

BARS Code		Total for All funds	630 Agency Funds/non Revenue	633 Agency Fund/Donations
308	Beginning Cash and Investments	11,987	10,664	1,323
388 and 588	Prior Period Adjustments, net	0	0	0
310-360	Revenues	0	0	0
370-390	Other Increases and Financing Sources	72,277	72,277	0
510-570	Expenditures	0	0	0
580-590	Other Decreases and Financing Uses	72,131	72,131	0
Increase (Decrease) in Cash and Investments		146	146	0
508	Ending Cash and Investments	12,134	10,811	1,323

The accompanying notes are an integral part of this Statement.

REPORTING

Note 1 - Summary of Significant Accounting Policies

The City of Montesano reports financial activity using the revenue and expenditure classifications, statements, and schedules contained in the *Cash Basis Budgeting, Accounting and Reporting System* (BARS) manual. This basis of accounting and reporting is another comprehensive basis of accounting (OCBOA) that is prescribed by the State Auditor's Office under the authority of Washington State law, Chapter 43.09 RCW.

The City of Montesano was incorporated on November 26, 1883 and operates under the laws of the state of Washington applicable to a Category Two, Third Class, and Non-Charter code with a Mayor Council form of government. The City of Montesano is a general purpose government and provides public safety, fire prevention, emergency medical service, street improvement, parks, and general administrative services. The City of Montesano uses single-entry, cash basis accounting which is a departure from generally accepted accounting principles (GAAP).

A. Fund Accounting

The accounts of the City of Montesano are organized on the basis of funds, each of which is considered a separate accounting entity. Each fund is accounted for with a separate set of single-entry accounts that comprises its cash, investments, revenues and expenditures, as appropriate. The City of Montesano resources are allocated to and accounted for in individual funds depending on their intended purpose. The following are the fund types used by the City of Montesano:

GOVERNMENTAL FUND TYPES:

General (Current Expense) Fund

This fund is the primary operating fund of the City of Montesano. It accounts for all financial resources except those required or elected to be accounted for in another fund.

Special Revenue Funds

These funds account for specific revenue sources that are restricted or committed to expenditures for specified purposes of the City of Montesano.

Debt Service Funds

These funds account for the financial resources that are restricted, committed, or assigned to expenditures for principal, interest and related costs on general long-term debt.

Capital Projects Funds

These funds account for financial resources which are restricted, committed, or assigned for the acquisition or construction of capital facilities or other capital assets.

Permanent Funds

These funds account for financial resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support programs for the benefit of the government or its citizenry.

PROPRIETARY FUND TYPES:

Enterprise Funds

These funds account for operations that provide goods or services to the general public and are supported primarily through user charges.

Internal Service Funds

These funds account for operations that provide goods or services to other departments or funds of the City of Montesano on a cost reimbursement basis.

FIDUCIARY FUND TYPES:

Fiduciary funds account for assets held by the City of Montesano in a trustee capacity or as an agent on behalf of others.

Private-Purpose Trust Funds

These funds report all trust arrangements under which principal and income benefit individuals, private organizations or other governments.

Agency Funds

These funds are used to account assets that City of Montesano holds for others in an agency capacity.

B. Basis of Accounting

Basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Revenues are recognized only when cash is received and expenditures are recognized when paid, including those properly chargeable against the report year(s) budget appropriations as required by state law.

In accordance with state law the City of Montesano also recognizes expenditures paid during twenty days after the close of the fiscal year for claims incurred during the previous period.

Purchases of capital assets are expensed during the year of acquisition. There is no capitalization of capital assets, nor allocation of depreciation expense. Inventory is expensed when purchased.

The basis of accounting described above represents a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

C. Budgets

The City of Montesano adopts annual appropriated budgets for all funds. These budgets are appropriated at the fund level. The budget constitutes the legal authority for expenditures at that level. Annual appropriations for these funds lapse at the fiscal year end.

The appropriated and actual expenditures for the legally adopted budgets were as follows:

Fund/Department	Appropriated	Expenses	Variance
General Fund	\$2,376,867.63	\$2,244,690.33	\$132,177.30
Ambulance Fund	\$1,426,938.34	\$1,418,902.66	\$8,035.68
Hotel/Motel	\$10,319.90	\$3,000.00	\$7,319.90
Municipal Court Drug Fund	\$268.49		\$268.49
REET	\$67,608.00		\$67,608.00
Debt Service PUD			\$0.00
City Shop	\$364,225.47	\$364,225.47	\$0.00
Water Tank	\$946,440.60	\$740,905.68	\$205,534.92
Main Street Phase II	\$1,261,000.00	\$1,257,956.44	\$3,043.56
Revetment Project	\$102,000.00	\$166,545.03	(\$64,545.03)
Water Fund	\$2,335,718.60	\$2,364,415.40	(\$28,696.80)
Storm Water Fund	\$71,690.00	\$49,226.53	\$22,463.47
Forest	\$1,199,862.22	\$1,258,574.99	(\$58,712.77)
Debt Reserve Fund	\$388,900.00		\$0.00
Cemetery Fund	\$32,712.23	\$33,425.90	(\$713.67)
Unemployment	\$90,400.00	\$0.00	\$90,400.00
Long Term Care	\$145,754.00	\$35,936.08	\$109,817.92
Motor Pool	\$320,918.32	\$310,719.34	\$10,198.98
Agency Funds	\$0.00	\$68,029.70	(\$68,029.70)
	\$11,141,623.8	\$10,316,553.55	\$436,170.25

Budgeted amounts are authorized to be transferred between (departments within any fund/object classes within departments); however, any revisions that alter the total expenditures of a fund, or that affect the number of authorized employee positions, salary ranges, hours, or other conditions of employment must be approved by the City of Montesano legislative body.

D. Cash

It is the City of Montesano's policy to invest all temporary cash surpluses. The amount is included in the cash and investments shown on the statements of fund resources and uses arising from cash transactions. The interest on these investments is prorated to the various funds.

E. Deposits

The City of Montesano deposits and certificates of deposit are covered by the Federal Deposit Insurance Corporation and/or the Washington Public Deposit Protection Commission.

F. Investments See Note 2, *Investments*.

G. Capital Assets

Capital assets are assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of 5 years. The capital assets of the City of Montesano are recorded as expenditures when purchased.

H. Compensated Absences

Vacation leave may be accumulated up to 240 hours and is payable upon separation or retirement.

Sick leave may be accumulated 1,040 hours. Upon separation or retirement employees receive payment for unused sick leave up to 200 hours.

I. Long-Term Debt See Note 3, *Debt Service Requirements*.

J. Other Financing Sources or Uses

The City of Montesano's *Other Financing Sources or Uses* consist of inter-fund transfers, insurance proceeds.

K. Risk Management

The City of Montesano contracts for insurance and risk management with Nicholson and Associates insurance, LLC, through broker, Karen Nicholson Miltenberger who is a Certified Insurance Consultant. She is an "all lines" agent/broker licensed, having worked in the insurance and risk management for more than 27 years.

The coverage is provided by two carriers, Travelers (NYSE:TRV) a leading provider of insurance and surety products, along with risk management services for public entities along for the private sector. The other carrier, Continental Western Insurance (CWG) also a leader in their niche market of Emergency Services. Both Travelers and CWG have many loss control field services, claims and litigation administration, coordinated with our own legal counsel. We are provided training for Employment Practices Liability, Emergency Vehicle Apparatus Program/EVIP provided free of charge. This was provided once last year to recertify the trainers in our departments. A scholarship for two attendees, who went to Northwest Leadership Conference in March, 2014 was also provided to enhance our risk management training.

Travelers Is "A+" Best Financial strength ratings which reflect the Travelers claims-paying ability. (A= is the 2nd highest of 16).

Continental Western Insurance Group part of the Berkeley Group has the same ratings provided by "Best" on their specialty product for Fire Departments, called Fire EMS Pak. Having two insurance programs, it keeps the liability limits becoming diluted and it improves the coverage by another 10,000,000 in Liability Limits (per location) from any of the prior insurance programs in their pools.

Traveler's property and casualty insurance coverage is written on an occurrence basis with some endorsements written on Claims Made Form. (Each with variety of limits and applicable deductibles) per schedule on file. Deluxe Property Coverage includes Real and Business Personal Property, Inland Marine (Contractors, Mobile Equipment and Scheduled items such as Traffic control signals and Street Lights), Computers, and Mechanical Breakdown (Boiler & Machinery)

and Crime with additional coverage and extensions for a premier public sector service insurance program. Business Income and Extra Expense is also included.

General Liability is with limits of 1 Million Each Occ/2 Million Aggregate plus an Umbrella with Liability Limits of 10 Million Each Occ/ 10 Million Policy Aggregate. Coverage is provided for Products and Completed Operations; Aggregate at 2 Million (Plus 10 Million Umbrella Liability), Personal and Advertising Injury Liability at 1 Million Each Occ. Liability coverage is Included for Professional (E&O), Employment Practices, and Cemetery Professional Liability. Employee Benefits and Employer Liability (Stop Gap) is also included.

The Auto Liability policy's with limits of 1,000,000 has no aggregate. Automobile Physical Damage is on a scheduled basis with the value chosen by the City. (Schedule on file).

Crime coverage is included along with a Fidelity Blanket Coverage including coverage for Dishonest Acts with Faithful Performance included for Police, and Public Officials Errors and Omissions. This year we purchased an endorsement for Cyber Liability \$1,000,000 (3rd party Ea Occ Limit) and \$500,000 (1't Party) Ea Occ Limit.

Scheduled Locations/buildings for Flood and Earthquake are included. (Schedule on file). Nicholson provides In-house and contracted services with a variety of vendors for risk management consultation, employment practices training, and website provided human resources assistance.

The Fire Department is provided coverage on separate policy through Fire EMS Pak (CWG) further increasing liability limits by 10,000,000. Property Coverage includes Guaranteed Replacement Cost on buildings, Replacement Cost on Business Personal Property, Guaranteed Replacement Cost on Blanket Portable Equipment, (Inland Marine), Auto Liability 1,000,000 (No Aggregate) and Designated Value Coverage for emergency apparatus. (Schedule on file). The General Liability Coverage for Products and Completed Operations of 1 Million Each/10 Million Aggregate plus an Umbrella of 9,000,000 with a total Liability of \$10,000,000 Ea Occ/13,000,000 Aggregate. The Fire EMS Pak provides PRIMARY Auto Liability for members of the district but in their own personal autos while traveling to an emergency. All forms with Fire EMS Pak are all on an Occurrence Form. Liability for Employment Practices, Management, Medical Malpractice, Employers Liability (Stop Gap), Employee Benefits along with Crime provided on a Blanket Fidelity Bond including Faithful Performance.

Liability for Failure to Provide Fire Suppression, Coverage for Elected Officials and Volunteers. An important note is that both carriers supply "first dollar" defense with limits outside the limits of the carrier policies.

The City has taken advantage of the monthly payment plans of both carriers which is a nice touch during the tight economy.

L. Reserved Fund Balance

Fund	Reserved Amount	Description
Water 406 WWTP	\$388,999.92	Debt Repayment
Water 405	\$350,000.00	Public Works Warrant

Note 2 – Investments

The City of Montesano's investments are either insured, registered or held by the City of Montesano or its agent in the City of Montesano's name. Investments are presented at fair market value and face value. Interest will be booked as received.

Investments by type at December 31, 2013 are as follows: Table below

Type of Investment	Montesano Investments	Agent Held Investment	Total
LGIP	322,383.62		322,383.62
Federal Home Loan	165.28		165.28
LPL Financial CD	250,000.34		250,000.34

Note 3 - Property Tax

The county treasurer acts as an agent to collect property tax levied in the county for all taxing authorities. Collections are distributed after the end of each month.

Property tax revenues are recognized when cash is received by City of Montesano. Delinquent taxes are considered fully collectible because a lien affixes to the property after tax is levied.

The City of Montesano's regular levy for the year 2013 was \$2.71 per \$1,000 on an assessed valuation of \$ 272,374,499 for a total collected regular levy of \$701,136.50.

Note 4- Interfund Loans

The following table displays inter-fund loan activity during 2013: Table below

Borrower	Lender	Balance	New Loans	Repayment	Balance 2013
402	405	178,985.36		42,782.35	136,203.01
101	405	100,496.68		49,748.37	50,748.31
408	405	10,147.04		4,998.55	5,148.49
101	405		182,784.00		182,784.00
		\$289,629.08	\$182,784.00	\$97,529.27	\$374,883.81

Note 5– Debt Service Requirements

The accompanying Schedule of Liabilities (09) provides more details of the outstanding debt and liabilities of the City of Montesano and summarizes the City of Montesano's debt transactions for year ended December 31, 2013. The debt service requirements for revenue bonds and other, including both principle and interest, are as follows: (The table includes the close out through 2014 and updated tank project loan)

2013 - Notes to the Financials			
	Revenue Debt	Other Debt	TOTAL
2013	267,236.73	-	267,236.73
2014	320,873.40	-	320,873.40
2015	1,343,317.60	-	1,343,317.60
2016	330,801.72	-	330,801.72
2017	328,285.83	-	328,285.83
2018-2022	1,535,217.74	-	1,535,217.74
2023-2027	1,540,793.13	-	1,540,793.13
2028-2029	497,763.34	-	497,763.34

Note 6 - Pension Plans

Substantially all City of Montesano's full-time and qualifying part-time employees participate in LEOFF II; PERS I, or PERS II plans administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. Actuarial information is on a system-wide basis and is not considered pertinent to the City of Montesano's financial statements. Contributions to the systems by both employee and employer are based upon gross wages covered by plan benefits.

Historical trend or other information regarding each plan is presented in the Washington State Department of Retirement Systems annual financial report. A copy of this report may be obtained by writing to:

Department of Retirement Systems
Communications Unit
PO Box 48380
Olympia, WA 98504-8380

Note 7 - Other Disclosures

Section I. Claims: (City Attorney Opinion)

A. Patricia Ambrose: This case was noted in the two prior annual reports. It was a claim for damages based upon allegations of negligence in a land use matter. The case has been settled and the litigation dismissed.

B. Hyde/White Land Use Litigation: As noted previously, this is an outgrowth of the Ambrose situation and the vacation of right of way. The Plaintiffs, abutting property owners, challenged the grant under a writ process and also included a claim for damages. The claim which remains after a partial summary judgment being granted is a claim for damages against the Director of Community Development and the City as named defendants.

As currently postured, the claim is being covered primarily by WCIA. As with the Ambrose matter, the one potential uncovered exposure relates to a taking claim. The Settlement negotiations are close to finalization.

C. Burke Claim: Mr. Burke, a former city employee who was terminated from employment, has filed a multi-faceted claim for damages alleging, among other claims, wrongful termination and defamation. The litigation is currently pending with most elements subject to coverage by the City's insurer. The matter was originally filed in the Grays Harbor Superior Court but by agreement may be transferred to Thurston County. Dispositive motions are likely to be filed within the next several months. Even if denied and the Plaintiff is successful, there is unlikely to be any significant impact upon the City's financial status.

D. South Bay Construction: Unlike the other matters, this is a dispute arising out of a construction project. South Bay was awarded the bid to carry out a program of improvements to a portion of Main Street. In the opinion of the City's Public Works Director and Consulting Engineer, it has failed to do so adequately and completely. Thus, after the giving of contractually required notices, it has been terminated and the bonding company put on notice as to the need to resolve the deficiencies. The bond is greater than the likely cost of corrective steps. However, South Bay claims that it has not been fully paid for its service. There is no insurance coverage on this matter. However, the claim for damages is of such a level and the factual situation is such that even if the dispute were to come out contrary to the City's position, the result would not significantly impair the City's fiscal condition.

Section II. Sowers Matter

As reflected in prior reports, Ray Sowers, who served as a member of the Police Department for many years and as chief for over a decade, was charged with misappropriation of funds of the City. He pled guilty and was ordered to make restitution. While he filed for Chapter 7 bankruptcy, he did not name the City as a creditor since this type of debt would not be subject to discharge. As of this date, I am unaware of any restitution payment having been made by him to the City. As to recovering the misappropriated funds, the City received moneys from the provision of the fiduciary bond in the amount of \$10,000.00, as well \$6,000.00 from the carrier which provides theft insurance. Given Mr. Sowers' pattern of behavior since release from the initial sentence, unless there carpe' diem is a major change it is unlikely that the City will receive much restitution from Mr. Sowers. Fortunately, the monetary amount determined to have been misappropriated does not create a significant fiscal risk to the City's financial condition and has been absorbed.

Fund Reclassification and Fund Balance Comparison

The BARS manual references that all Debt Service accounts should be in the 200 range. The 405 Fund has been renumbered for 2013 reporting to the 205 Fund in order to meet this requirement.

The Street Fund was rolled into the General Fund and the Reserve Fund amounted to the change in the ending balance for 2012, and the beginning balance for 2013. In addition the 410 fund which is a proprietary fund was moved to the General Fund as we no longer provide solid waste billing. The General Fund provides customer service for the solid waste billing, and so it was appropriate to move that amount from the enterprise or proprietary fund into the General.

Violation of Finance related legal or contractual provisions

Grant driven funds in the budget were not amended as the project moved forward in 2014:

Mary's River Revetment was over the budgeted amount by \$64,545.03. The cemetery fund was not amended as part of the year end resolution and the budget was exceeded by \$713.67. The Current Water Fund which in review related to administrative costs in the 401 fund in the amount of \$28,696.80. This is due to the fact that a bid bond for \$100,000 was not budgeted. A bid bond is normally not budgeted for because it is a pass-through.

REPORTING

Note 1 - Summary of Significant Accounting Policies

The City of Montesano reports financial activity using the revenue and expenditure classifications, statements, and schedules contained in the *Cash Basis Budgeting, Accounting and Reporting System* (BARS) manual. This basis of accounting and reporting is another comprehensive basis of accounting (OCBOA) that is prescribed by the State Auditor's Office under the authority of Washington State law, Chapter 43.09 RCW.

The City of Montesano was incorporated on November 26, 1883 and operates under the laws of the state of Washington applicable to a Category Two, Third Class, and Non-Charter code City with a Mayor-Council form of government. The City of Montesano is a general purpose government and provides public safety, fire prevention, emergency medical service, street improvement, parks, and general administrative services. The City of Montesano uses single-entry, cash basis accounting which is a departure from generally accepted accounting principles (GAAP).

A. Fund Accounting

The accounts of the City of Montesano are organized on the basis of funds, each of which is considered a separate accounting entity. Each fund is accounted for with a separate set of single-entry accounts that comprises its cash, investments, revenues and expenditures, as appropriate. The City of Montesano resources are allocated to and accounted for in individual funds depending on their intended purpose. The following are the fund types used by the City of Montesano:

GOVERNMENTAL FUND TYPES:

General (Current Expense) Fund

This fund is the primary operating fund of the City of Montesano. It accounts for all financial resources except those required or elected to be accounted for in another fund.

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These funds account for specific revenue sources that are restricted or committed to expenditures for specified purposes of the City of Montesano.

Capital Projects Funds

These funds account for financial resources which are restricted, committed, or assigned for the acquisition or construction of capital facilities or other capital assets.

PROPRIETARY FUND TYPES:

Enterprise Funds

These funds account for operations that provide goods or services to the general public and are supported primarily through user charges.

Internal Service Funds

These funds account for operations that provide goods or services to other departments or funds of the City of Montesano on a cost reimbursement basis.

FIDUCIARY FUND TYPES:

Fiduciary funds account for assets held by the City of Montesano in a trustee capacity or as an agent on behalf of others.

Agency Funds

These funds are used to account assets that City of Montesano holds for others in an agency capacity.

B. Basis of Accounting

Basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Revenues are recognized only when cash is received and expenditures are recognized when paid, including those properly chargeable against the report year(s) budget appropriations as required by state law.

In accordance with state law the City of Montesano_also recognizes expenditures paid during twenty days after the close of the fiscal year for claims incurred during the previous period.

Purchases of capital assets are expensed during the year of acquisition. There is no capitalization of capital assets, nor allocation of depreciation expense. Inventory is expensed when purchased.

The basis of accounting described above represents a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

C. Budgets

The City of Montesano_adopts annual appropriated budgets for all funds. These budgets are appropriated at the fund level. The budget constitutes the legal authority for expenditures at that level. Annual appropriations for these funds lapse at the fiscal year end.

Annual appropriated budgets are adopted on the same basis of accounting as used for financial reporting.

The appropriated and actual expenditures for the legally adopted budgets were as follow:

Fund/Department	Final Appropriated Amounts	Actual Expenses	Variance
001 - General Fund	2,186,685	2,068,008	118,677
101 - Ambulance Fund	1,517,340	1,440,985	76,355
103 - Hotel/motel Tax (ord. #1278)	9,000	7,024	1,976
110 - Street Fund	261,147	230,190	30,956
304 - City Shop Project	1,740,400	1,374,843	365,557
310 - Capital Projects Fund	131,862	137,206	(5,345)
401 - Current Water			
Current Water	2,240,089	2,203,067	37,022
Cumulative Reserve Fund	<u>2,068,421</u>	<u>2,060,805</u>	<u>7,616</u>
Total 401 - Current Water	4,308,510	4,263,872	44,638
402 - Storm Water Fund	57,900	64,521	(6,621)
408 - Cemetery Fund	48,000	30,051	17,949
502 - Unemployment Compensation	10,000	5,578	4,422
503 - Long Term Care	8,200	10,116	(1,916)
504 - Motor Pool Fund	275,577	283,350	(7,773)

Budgeted amounts are authorized to be transferred between (departments within any fund/object classes within departments); however, any revisions that alter the total expenditures of a fund, or that affect the number of authorized employee positions, salary ranges, hours, or other conditions of employment must be approved by the City of Montesano legislative body.

D. Cash

It is the City of Montesano policy to invest all temporary cash surpluses. The amount is included in the cash and investments shown on the statements of fund resources and uses arising from cash transactions. The interest on these investments is prorated to the various funds.

E. Deposits

The City of Montesano deposits and certificates of deposit are covered by (the Federal Deposit Insurance Corporation and/or the Washington Public Deposit Protection Commission).

F. Investments. See Note #2

G. Compensated Absences

Vacation leave may be accumulated up to 220 hours for all employees except fire department/ems responders which can accrue up to 268, and is payable upon separation or retirement..

Sick leave may be accumulated up to 1,000 hours for all employees except the fire/ems department. Currently, they have an unlimited sick leave accrual. This will be a negotiation point in the 2014 contract meetings. Upon separation or retirement employees receive 25 % payment for unused sick leave.

The total cost of compensated (schedule 9) absences is equal to \$310,147.00.
Proprietary =\$96,480 Governmental=\$213,667

G. Long-Term Debt See Note 5, Debt Service Requirements.

H. Other Financing Sources or Uses

The City *Other Financing Sources or Uses* consist of sale of surplus property; IT proceeds, inter-fund loans, debt transfers from other funds, and sales of timber.

I. Risk Management

The City of Montesano contracts for insurance and risk management with Nicholson and Associates Insurance, LLC, through broker, Karen Nicholson Miltenberger who is a Certified Insurance Consultant. She has been in insurance with an "all lines" license more than 26 years.

The coverage is provided by two carriers, Travelers (NYSE: TRV) a leading provider of insurance and surety products, along with risk management services to a variety of businesses including municipalities, other organizations and to individuals. We provide Employment Liability Training, EVIP Training free of charge once last year for your members for recertification for train the trainer, a scholarship for an attendee to Northwest Leadership Conference in March, 2013 and we provide other services, too many to list here.

Travelers A.M. Best financial strength ratings, which reflect the Travelers claims-paying ability is A+ (A+ is the 2nd highest of 16)

The Fire Department is insured by Continental Western Insurance Group (Berkeley Group) through a specialty product "Fire EMS Pak" on their separate policy helping to keep the liability limits from becoming diluted. Continental Western's Insurance Group's A.M. Best rating is A+. Having two different programs provides higher liability limits than previous Pools.

Traveler's property and casualty insurance coverage is written on an occurrence basis, with some of the endorsements written on Claims Made Form. (Each with separate variety and applicable deductibles) per schedule on file. Deluxe Property Coverage includes Real and Business Personal Property, Inland Marine (Contractors Equipment and scheduled Items such as Traffic control signals and street lights), Computers, and Mechanical Breakdown (Boiler & Machinery) and Crime with additional coverage and extensions for a premier public sector service insurance program. Business Income and Extra Expense is also included.

In the General Liability Section, coverage is provided for Products and Completed Operations; Aggregate at 2 Million (Plus 10 Million Umbrella Liability), Personal and Advertising Injury Liability at 1 Million, Ea. Occurrence Limit 1 Million. Included is Professional/(E&O), Employment Related Practices, Cemetery Professional Services Liability with General Liability at 1 Million Ea. Occ/2 Million Aggregate with the Umbrella Liability Limits of 10 Million Ea. Occurrence/10 Million Aggregate. The Auto Liability policy's has no aggregate.

Automobile physical damage is on a scheduled basis with the limit chosen by the City per schedule on file. Fidelity Blanket Coverage is included for Dishonest Acts with faithful performance included for Police, and Public Officials Errors and Omissions, Stop Gap (Employers Liability), and Employee Benefits Liability is also included. Flood and Earthquake are included coverage on scheduled buildings on file.

In-house and contracted services with a variety of vendors for risk management consultation, employment practices training, human resources assistance on line web access. Travelers have many loss control field services, claims and litigation administration, coordinated with our own legal counsel.

The Fire Department is provided coverage with a separate policy further increasing liability limits and protection through Fire EMS Pak (CWG Berkeley Group) Providing a Package of specialty coverage for Guaranteed Replacement Cost on buildings, replacement cost on business personal property, Guaranteed Replacement Cost on Blanket Portable Equipment (Inland Marine) Auto Liability (No Aggregate) and Designated Values Coverage for emergency apparatus by schedule on file. The General Liability Coverage for Products and Completed Operations with limits of 1 Million Ea/10 Million Aggregate with an Umbrella that increases this limit. It provides PRIMARY Auto Liability for members of the district but in their own personal autos while traveling to an emergency. Employment Practices Liability, Management Liability, Medical Malpractice, Employers Liability (Stop Gap), Employee Benefits along with Crime, Blanket Fidelity Bond including Faithful Performance, protection for Failure to Provide Fire Suppression, Coverage for Elected Officials and Volunteers.

An important note is that both carriers supply "first dollar" defense with limits outside the limits of the carrier policies.

The City has taken advantage of the free payment plans of both carriers which is a nice touch during the tight economy

M. Reserved Fund Balance Table Below

Fund	Reserve Description	Amount
Ambulance (101)	Reserved for EMS	215
Hotel Motel (103)	Reserved for Tourism	5,320
Drug Fund (105)	Reserved for Drug Money	268
REET (106)	Reserved for REET	49,608
Water (405)	USDA Loan (Cumulative Loan)	1,918,506
Water (406)	Debt Service WWTP	311,200

Note 2 - Investments

The investments are insured, registered or held by the City or its agent in the City's name.

Investments are presented at fair market value; by type at December 31, 2012 they are as follows:

<u>Type of Investment</u>	<u>Amount</u>
L.G.I.P.	\$321,877.94
TOTAL	\$321,877.94

Note 3 - Property Tax

The county treasurer acts as an agent to collect property tax levied in the county for all taxing authorities. Collections are distributed after the end of each month.

Property tax revenues are recognized when cash is received by City of Montesano. Delinquent taxes are considered fully collectible because a lien affixes to the property after tax is levied.

The City's regular levy for the year 2012 was \$2.17 per \$1,000 on an assessed valuation of 320,270,574 for a total regular levy of \$697,109.

Note 4 - Interfund Loans

The following table displays inter-fund loan activity during 2012: Table Below

Borrowing Fund	Lending Fund	Balance 1/1/2012	New Loans	Principal Repay	Balance 12/31/2012
402	405	\$220,521.00		\$41,536.26	\$178,985.36
101	405	\$150,000.00		\$33,002.21	\$116,997.79
408	405	\$15,000.00		\$4,852.96	\$10,147.04
Total		\$385,521.00		\$79,391.43	\$306,130.19

Note 5 – Debt Service Requirements

The accompanying Schedule of Long-Term Liabilities (09) provides a listing of the outstanding debt of the City and Summarizes the City's debt transaction for 2012 and future years. The liability associated with compensated absences is included in schedule (9). The debt service payment for the fiscal year being reported and future payment requirements, including interest are as follows:

Currently the loan on the tank project is at \$1,390,189. During 2014 we expect that the full loan of \$3,030,000 will be implemented. The increase in revenue is due to a warrant that was sold to the PUD. This warrant will be due and payable on July 1, 2015 at 1% interest. The debt service requirements for general obligation bonds, revenue bonds including both principle and interest, are as follows: (This includes the updated final loan information on tank construction.)

2012 - Notes to the Financials			
	Revenue Debt	Other Debt	Total
2012	283,858.55	25,542.72	309,401.27
2013	267,236.90	0.00	267,236.90
2014	320,873.40	0.00	320,873.40
2015	1,343,317.60	0.00	1,343,317.60
2016	330,801.72	0.00	330,801.72
2017-2021	853,199.10	0.00	853,199.10
2022-2026	1,596,233.51	0.00	1,596,233.51
2027-2028	1,080,771.19	0.00	1,080,771.19

Note 6 - Pension Plans

Substantially all full-time and qualifying part-time employees participate in the LEOFF II; PERS I, or PERS II plans administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. Actuarial information is on a system-wide basis and is not considered pertinent to the City's financial statements. Contributions to the system by both employee and employer are based upon gross wages covered by plan benefits.

Historical trend or other information regarding each plan is presented in the Washington State Department of Retirement Systems annual financial report. A copy of this report may be obtained by writing to:

Department of Retirement System
Communications Unit PO Box 48380
Olympia, WA 98504-8380

Note 7- Other Disclosures

City Attorney's Opinion

The City Attorney outlined the legal issues of the City. His letter as written is below:

A. *Patricia Ambrose: This case has been noted in the at least three prior annual reports.*

The claim and resulting litigation arises from the issuance of a building permit to Ms. Ambrose and certain associated land use decisions. A neighbor filed an administrative appeal to the Hearing Examiner who found the issuance of the permit to be invalid due to some issues related to a boundary line adjustment granted several years before. A land use petition act (LUPA) proceeding filed by Ms. Ambrose, on one hand, and Mr. Hyde, the adjoining property owner, on the other hand, upheld the hearing examiner's decision finding the building permit invalid. The trial court's decision was appealed.

The Court of Appeals reversed the decision finding that the issues upon which the hearing examiner had based his ruling had not been timely raised, directed that the City reissue/reinstate the building permit, and remanded the matter for further consideration by the Hearing Examiner on certain timely raised issues. The Supreme Court denied review. The City reissued the building permit.

The matter went back before the Hearing.

Examiner for hearing on Mr. Hyde's contentions that the issuance of the building permit upon a lot "created" by a boundary line adjustment, but which is smaller than either of the two lots existing prior to the BLA, was invalid. The result of the hearing was that the City's issuance of the building permit was found to be valid. No appeal was taken from that decision

As noted in the prior reports, her claim has various elements and bases. Since the Court reversed and remanded for further action on the matter, as indicated in the prior report, the story is continuing. She has filed her suit in State Court. The City, in cooperation

with its insurer, has filed an answer denying any basis for liability or damages resulting from the City's actions.

Most of the bases of her claim for damages are subject to coverage. Specifically, to the extent Ms. Ambrose contends the City's Department was negligent in terms of its administration of her requests, there is some possibility of a portion of her claim, if the claim is found valid, not being covered by the insurance. That element is the "taking without due process" element.

Among other defenses the City will rely upon are the following:

1. That she assumed the risks of continuing to build during the appeal process which she did from the beginning. Both the Director of Community Development and a prior counsel of Mr. Hyde warned her that, if she took action until matters were final, she did so at her own risk.

2. That the City's issuance of the building permit was found to be valid at the end of the process which was the position the City took at all time. That a citizen challenged that action, was found initially to be correct, but was then reversed by the Court of Appeals is not a basis for a claim.

3. That the decisions of a Hearing Examiner are quasi-judicial in nature under Washington law and thus there is an exemption from liability for damages.

4. Further, that at the 2012 hearing before the Examiner, her counsel agreed the City had done everything correctly.

Interrogatories have been exchanged between the parties. It is likely that at one stage or another, the City will move for summary judgment seeking dismissal of the case. Given the nature of the taking claim, it is likely the City will move to transfer the matter to federal court. The potential exposure continues to not create a fiscal risk for the City that would have a significant impact upon the City's fiscal condition.

B. Hyde/White Land Use Litigation: This is an outgrowth of the Ambrose situation. The City granted a petition filed by Ms. Ambrose to vacate a portion of an abutting right of way. Two abutting property owners challenged the grant under a writ process and also included a claim for damages. While the City's position that seeking and obtaining the writ of prohibition against the vacation legally prohibited a claim for damages, the Court denied a summary judgment motion to dismiss that claim against all of the named defendants, but did dismiss the damage claim against the City Council Members, leaving the Director of Community Development and the City as named defendants. Further, the case is weakened by the status of the final land use decision on the Ambrose matter referenced above.

As currently postured, the claim is being covered primarily by WCIA. As with the Ambrose matter, the one potential uncovered exposure relates to a taking claim. The claims, even if found to be with merit, would have no significant impact upon the City's fiscal status.

C. Burke Claim: A claim has been filed by Russell Burke, an employee of the City who has been on leave for several months due to an ongoing investigation as to his actions during the course of employment. The claim makes a number of allegations. It has been tendered to the City's current insurer, Traveler's which has assigned counsel to assist in pre-filing preparation. As is usually true, certain of the claims, if found valid, would not be covered by the insurer. However, the major claims are.

Regardless, if found legitimate the claim would not significantly affect the City's fiscal condition.

Section II. Sowers Matter

As reflected in the prior report, Ray Sowers, who served as a member of the Police Department for many years and as chief for over a decade, was charged with misappropriation of funds of the City. He has pled guilty and been ordered to make restitution. While he filed for Chapter 7 bankruptcy, he did not name the City as a creditor. If he had, an objection to discharge based upon the nature of the basis of the debt (theft) would likely have prevented its discharge. As of this date, I am unaware of any restitution payment having been made by him to the City.

In terms of recovering its lost funds, the City has recovered \$10,000.00 from the carrier which provided the fiduciary bond in the amount of \$10,000.00, as well \$6,000.00 from the carrier which provides theft insurance. Any additional recovery will have to come from Mr. Sower's paying restitution. At this stage, that possibility does not seem to present a major fiscal benefit to the City.

It should be noted, as to the misappropriations identified to this point, they did not create a significant fiscal risk to the City's financial condition.

Fund Reclassification

Two Managerial Funds - Cumulative Reserve (Fund 405), and Debt Service (Fund 406) were erroneously presented in 2011 as standalone funds. They have been properly rolled into the Water Fund (Fund 401) for 2012.

Compliance and Accountability

The capital projects fund expenditures exceeded appropriation by \$5,345 due to lag time in draw on existing tank project loan.

The storm water fund expenditure exceed appropriation in the amount of \$6,621, however it did not exceed the general ledger.

The Long Term Care expenditures increased \$1,916 due to LEOFF 1 insurance premium from previous year and was not included in a budget supplement.

Motor Pool Fund-Budget adjustment in the amount of \$7,773 did not reflect increase in expenditures.

City of Montesano

Schedule of Liabilities

For the year ended December 31, 2013

Debt Type	ID. No.	Description	Maturity/Payment Due Date	Beginning Balance January 1, 2013	Additions	Reductions	Ending Balance December 31, 2013
General Obligations							
	259.11	Compensated Absences-Gov		213,667	61,485	0	275,152
Total General Obligations:				213,667	61,485	0	275,152
Revenue Obligations							
	252.11	Revenue Debt	3/4/2028	884,759		60,154	824,605
	252.11	Revenue Debt	7/1/2027	394,737		26,316	368,421
	252.11	Revenue Debt	10/1/2029	1,574,688	716,920	105,884	2,185,724
	252.11	PUD Warrant Debt	7/1/2015	1,000,000	0		1,000,000
	259.12	Compensated Absences-Proprietary		96,480	0	23,202	73,278
Total Revenue Obligations:				3,950,664	716,920	215,556	4,452,028
Total Liabilities:				4,164,331	778,405	215,556	4,727,180

The accompanying notes to the financial statements are an integral part of this schedule

City of Montesano

Schedule of Liabilities

For the year ended December 31, 2012

Debt Type	ID. No.	Description	Maturity/Payment Due Date	Beginning Balance January 1, 2012	Additions	Reductions	Ending Balance December 31, 2012
General Obligations							
	251.12	GO DEBT	12/1/2012	24,786		24,786	0
	259.11	Compensated Absences-Gov		202,192	11,475	0	213,667
Total General Obligations:				226,978	11,475	24,786	213,667
Revenue Obligations							
	252.11	Revenue Debt	3/4/2028	942,365		57,606	884,759
	252.11	Revenue Debt	7/1/2027	421,052		26,316	394,736
	252.11	Revenue Debt	10/1/2029	1,520,631	135,834	81,776	1,574,688
	252.11	Revenue Debt	7/1/2012	50,363		50,363	0
	252.11	Revenue Debt	1/1/2012	0	1,000,000	0	1,000,000
	259.12	Compensated Absences-Proprietary		87,580	8,900	0	96,480
Total Revenue Obligations:				3,021,990	1,144,734	216,060	3,950,664
Total Liabilities:				3,248,968	1,156,209	240,846	4,164,331

The accompanying notes to the financial statements are an integral part of this schedule

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For the Year Ended December 31, 2013

Federal Agency Name/Pass-Through Agency Name	Federal Program Name	CFDA Number	Other Award Number	Expenditures		Footnote Ref
				From Pass-Through Awards	From Direct Awards	
Office of Water, Environmental Protection Agency (via WA Dept of Commerce)	Capitalization Grants for Drinking Water State Revolving Funds	66.468	DM09-952-024	574,505	-	574,505
Federal Highway Administration (fhwa), Department Of Transportation/DEPARTMENT OF TRANSPORTATION	Highway Planning and Construction	20.205	STPRT143(001)	528,149		528,149 1,2
Total Federal Awards Expended:				1,102,654	0	1,102,654

CITY OF MONTESANO, WA

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended December 31, 2013**

Note 1 is required for all entities. Disclose other notes only if applicable to your circumstances.

NOTE 1 - BASIS OF ACCOUNTING

This schedule is prepared on the same basis of accounting as the City Of Montesano financial statements. The City of Montesano uses the cash basis of accounting as part of OCBOA.

NOTE 2 - PROGRAM COSTS

The amounts shown as current year expenditures represent only the federal grant portion of the program costs. Entire program costs, including the city's portion, are more than shown.

CORRECTIVE ACTION PLAN FOR FINDINGS REPORTED UNDER OMB CIRCULAR A-133

City of Montesano Grays Harbor County January 1, 2012 through December 31, 2013

This schedule presents the corrective action planned by the auditee for findings reported in this report in accordance with OMB Circular A-133. The information in this schedule is the representation of the City of Montesano.

Finding ref number: 2013-001	Finding caption: The City's internal controls were inadequate to ensure compliance with federal Davis-Bacon Act (prevailing wage) requirements.
Name, address, and telephone of auditee contact person: Kristy Powell, City Administrator/ Finance Director 112 Main Street Montesano, WA 98563 (360) 249-3021	
Corrective action the auditee plans to take in response to the finding: <i>The employees responsible for monitoring the requirements have asked for additional training from the auditors and are currently looking for additional resource information. The City does not agree with the concept that a state agency can change funding sources without notifying the recipient and cannot speak to the finding.</i>	
Anticipated date to complete the corrective action: 12/31/15	
Finding ref number: 2013-002	Finding caption: The City's internal controls over financial statement preparation are inadequate to ensure accurate and complete reporting.
Name, address, and telephone of auditee contact person: Kristy Powell, City Administrator/ Finance Director 112 Main Street Montesano, WA 98563 (360) 249-3021	
Corrective action the auditee plans to take in response to the finding: <i>We appreciate the opportunity to respond to the auditor's report. We respect their hard work and dedication. The City corrected the financial statement, and we appreciate the auditor's office and the help that they provide.</i> <i>1. The City returned the \$300,000.00 from bond proceeds to the Cumulative Reserve Fund. The transaction was done through a supplemental budget ordinance. It should have been coded as a</i>	

transfer, and this transaction was corrected. At no time were any funds unaccounted for.

2. The debt service issue has been corrected by using annual tax statements rather than the amortization schedule previously provided. In the future the annual statements will be used as the lender refuses to supply an updated annual schedule.

3. The SEFA was reported correctly and met the federal standards. The division between the Federal and Transportation TIB has been corrected. As stated this error did not affect the single audit scope.

4. See the City's response in the Schedule of Federal Findings above. The City acknowledges these minor errors in the financial statements. Although we do not believe that any of these rise to the level of a finding, we will continue to improve the oversight, internal controls, and independent review process as noted.

Anticipated date to complete the corrective action: 12/31/15

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.

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

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.

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 as well as [fraud](#), state [whistleblower](#) and [citizen hotline](#) investigations.

The results of our work are widely distributed through a variety of reports, which are available on our [website](#) and through our free, electronic [subscription](#) service.

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

Contact information for the State Auditor's Office	
Deputy Director for Communications	Adam Wilson Adam.Wilson@sao.wa.gov (360) 902-0367
Public Records requests	(360) 725-5617
Main telephone	(360) 902-0370
Toll-free Citizen Hotline	(866) 902-3900
Website	www.sao.wa.gov