



# Washington State Auditor's Office

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## Accountability Audit Report **Public Utility District No. 1 of Jefferson County**

**For the period January 1, 2013 through December 31, 2014**

**Published August 22, 2016**

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## Washington State Auditor's Office

August 22, 2016

Board of Commissioners  
Public Utility District No. 1 of Jefferson County  
Port Townsend, Washington

### Report on Accountability

Thank you for the opportunity to work with you to promote accountability, integrity and openness in government. The State Auditor's Office takes seriously our role of providing state and local governments with assurance and accountability as the independent auditor of public accounts. In this way, we strive to help government work better, cost less, deliver higher value and earn greater public trust.

Independent audits provide essential accountability and transparency for District operations. This information is valuable to management, the governing body and public stakeholders when assessing the government's stewardship of public resources.

The attached comprises our report on the District's compliance and safeguarding of public resources. Our independent audit report describes the overall results and conclusions for areas we examined. We appreciate the opportunity to work with your staff and we value your cooperation during the audit.

Sincerely,

TROY KELLEY  
STATE AUDITOR  
OLYMPIA, WA

## TABLE OF CONTENTS

Audit Summary .....	4
Schedule Of Audit Findings And Responses .....	6
Related Reports .....	15
Information About The District .....	16
About The State Auditor’s Office.....	17

## AUDIT SUMMARY

### Results in brief

In most areas we audited, District operations complied with applicable requirements and provided adequate safeguarding of public resources. The District also complied with state laws and regulations and its own policies and procedures in the areas we examined.

However, we identified areas in which the District could make improvements.

We recommended the District establish a process to proactively identify, assess and respond to risks.

We further recommended the District establish and follow internal controls to ensure:

- Employees responsible for key controls receive adequate training to effectively perform their duties.
- General, credit card and payroll disbursements are properly authorized, adequately supported and for an allowable District purpose.
- Small and attractive assets are adequately tracked and safeguarded from loss, misappropriation, or misuse. This includes establishing and maintaining a small and attractive asset listing, performing periodic inventories and following up on identified discrepancies.
- Materials inventories are appropriately tracked and safeguarded from loss, misappropriation or misuse. This includes processing work orders timely, tracking materials used, performing periodic inventories and following up on identified discrepancies.
- The District receives all contracted services and contractors are in compliance with applicable state or federal requirements.

These recommendations were included in our report as a finding.

## About the audit

This report contains the results of our independent accountability audit of Public Utility District No. 1 of Jefferson County from January 1, 2013 through December 31, 2014.

Management is responsible for ensuring compliance and adequate safeguarding of public resources from fraud, loss or abuse. This includes the design, implementation and maintenance of internal controls relevant to these objectives.

Our audit involved performing procedures to obtain evidence about the District's uses of public resources, compliance with state laws and regulations and its own policies and procedures, and internal controls over such matters.

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

- Payments/expenditures
- Utilities billing and adjustments
- Third party receipting
- Open public records laws compliance
- Authority to acquire electric facility
- Contracts/agreements
- Payroll disbursements
- Information technology/data security
- Safeguarding of small and attractive assets such as computers
- Safeguarding of materials inventories

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### **2014-001 The District did not have adequate internal controls to safeguard public funds.**

#### ***Background***

It is the responsibility of the District to establish effective internal controls to ensure public funds and assets purchased with those funds are adequately safeguarded.

The District's expenses totaled approximately \$19 million and \$25 million and materials inventories totaled approximately \$1.1 million and \$0.7 million in 2013 and 2014, respectively.

#### ***Description of Condition***

The District's internal controls over disbursements, payroll, small and attractive assets, inventory, and contracts were inadequate to safeguard public resources. Our audit identified the following control deficiencies:

#### **General Disbursements**

We tested 80 general disbursement transactions totaling \$628,398 from 2013, 2014 and 2015 and identified the following:

- 34 transactions totaling \$440,361 did not have approval signatures, as required by the District's procurement policy.
- One transaction totaling \$1,497 did not have adequate supporting documentation.
- Two transactions totaling \$2,441 were not allowable under the District's procurement policy.

#### **Credit Card Disbursements**

We tested 20 credit card transactions totaling \$9,299 from 2013, 2014 and 2015 and identified the following:

- 12 transactions totaling \$6,885 did not have approval signatures, as required by the District's procurement policy.

- Two transactions totaling \$871 did not have adequate supporting documentation.
- Approximately \$2,174 of assets purchased were not added to the asset listing.

### **Payroll**

Payroll disbursements were not subject to secondary review or monitored to ensure errors were detected and corrected timely. During our review of payroll we identified the following:

- A 2013 payroll processing error resulted in three-day overpayment totaling \$12,750 for 25 District employees. The District did not identify the error until 2014. As of May 2016, \$1,586 was still outstanding.
- The District did not seek recovery of a \$4,000 moving expense allowance from an employee terminated in 2013 who was not eligible to keep the allowance.
- The District did not seek recovery of \$716 for vacation and sick leave wrongfully paid to an employee terminated in 2013.

### **Small and Attractive Assets**

The District did not have a policy that established procedures to track and safeguard small and attractive assets such as laptops, cameras and maintenance equipment. The District did not maintain an inventory listing or perform periodic inventory checks to ensure small and attractive assets remained in the possession of the District.

### **Material Inventory**

The District did not have adequate controls to safeguard material inventory. We identified the following:

- Of 24 materials inventories tested, 14 had discrepancies between the quantities on hand per the asset listing and the quantities on hand per our physical verification.
- At the time of our audit, the District had more than 100 work orders that had not yet been processed causing significant discrepancies in the materials inventories.

## **Contracts**

In 2012, the District entered into a management agreement with Northwest Open Access Network (NoaNet) for administration of the District's portion of a federal grant.

Under the agreement, NoaNet was to establish a bank account in the District's name to deposit the federal funds and disburse project funds after the expenses were approved by the District.

Our audit found the bank account was never established. NoaNet receipted and disbursed funds on behalf of the District, including payment to itself of more than \$100,000 in management fees, without prior District approval. The District did not detect the non-compliance.

### ***Cause of Condition***

The District did not have a process to proactively identify, assess and respond to risks.

The District did not dedicate sufficient resources to ensure effective internal controls were established and consistently applied.

Staff members responsible for key internal controls did not receive adequate training to effectively perform their duties.

### ***Effect of Condition***

Without adequate internal controls over disbursements and payroll, the District cannot ensure its resources are safe from loss, misappropriation or misuse and purchases are for an allowable District purpose.

Without adequate internal controls over small and attractive assets and materials inventories, the District cannot ensure its assets are safe from loss, misappropriation or misuse. In addition, work order processing delays result in misstated capital asset and materials inventory financial statement balances.

Without adequate internal controls over contract monitoring, the District cannot ensure that all contracted services are received. The District also cannot ensure contractors are in compliance with applicable State or federal requirements, when required.

## ***Recommendation***

We recommend the District establish a process to proactively identify, assess and respond to risks.

We further recommend the District establish and follow internal controls to ensure:

- Employees responsible for key controls receive adequate training to effectively perform their duties.
- General, credit card and payroll disbursements are properly authorized, adequately supported and for an allowable District purpose.
- Small and attractive assets are adequately tracked and safeguarded from loss, misappropriation, or misuse. This includes establishing and maintaining a small and attractive asset listing, performing periodic inventories and following up on identified discrepancies.
- Materials inventories are appropriately tracked and safeguarded from loss, misappropriation or misuse. This includes processing work orders timely, tracking materials used, performing periodic inventories and following up on identified discrepancies.
- The District receives all contracted services and contractors are in compliance with applicable state or federal requirements.

## ***District's Response***

*The PUD has and continues to review all of its policies and procedures related to controls and safeguards. The PUD's new accounting and billing system is better designed to ensure procedures are in place and followed. Also PUD staff continues to be trained to effectively perform their duties and to follow the improved control measures. The PUD is hiring both a new Chief Financial Officer and Controller to provide better internal controls and procedures. The PUD has hired a consultant who has RUS borrower accounting and Chief Financial Officer experience to review and establish internal controls and to identify, assess, and respond to risks.*

*General, Credit Cards, and Payroll Disbursements: In conjunction with the new accounting system the PUD has instituted better controls on the authorization and approval of disbursements. Management has reviewed the occurrences cited in the SAO report and taken measures to correct and prevent reoccurrence in the*

*future (e.g. a policy has been established and implemented for small and attractive items).*

*Material Inventory: An issue with the old accounting system was that it did not have a work order module that complied with RUS accounting. As a result Work Orders were not being closed properly and material inventories were not being properly counted. With the new accounting software processes and controls have been established to provide proper accounting and controls for work orders and materials inventory.*

*Contracts: The PUD is hiring a Chief Financial Officer and a Controller whose responsibilities will be better management of grants and contracts; to develop and implement improved control measures; and to implement secondary review processes.*

### ***Auditor's Remarks***

We thank the District for its assistance throughout the audit, and the steps it is taking to address these issues. We will review the status of the District's corrective action during our next scheduled audit.

### ***Applicable Laws and Regulations***

RCW 42.09.200 – Local government accounting – Uniform system of accounting 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.

Section 3.1.3 of the *Budgeting, Accounting and Reporting System (BARS)* manual states in part:

*Internal control is a process – affected by those charged with governance, management and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories:*

- *Effectiveness and efficiency of operations*
- *Compliance with applicable laws and regulations*
- *Reliability of financial reporting*

*Management and the governing body are responsible for the government's performance, compliance and financial reporting. Therefore, the adequacy of internal control to provide reasonable assurance of achieving these objectives is also the responsibility of management and the governing body. The governing body has ultimate responsibility for ensuring adequate controls to achieve objectives, even though primary responsibility has been delegated to management. Since management and the governing body are assumed to work in harmony, both parties are collectively referred to as "management" throughout the rest of this section.*

*The Washington State Auditor's Office does not require specific controls to be implemented by entities. The State Auditor only requires that whatever controls entities choose to implement be adequate to provide reasonable assurance regarding compliance and financial reporting risks. The burden of demonstrating the adequacy of internal controls rests on management, since management is responsible both for the achievement of objectives and the determination of the design and operation of controls.*

Safeguarding of public resources – Controls should prevent misappropriation or misuse of public resources or detect misappropriation or misuse in a timely manner and assign responsibility to individuals charged with custody of assets. Such controls should cover all receipts and receivables, expenditures and commitments, provisions of goods or services and the safekeeping of all public assets at risk of misappropriation, misuse or loss.

RCW 42.24.115 – Municipal corporations and political subdivisions – Charge cards for officers' and employees' travel expenses, states:

- (1) Any municipal corporation or political subdivision may provide for the issuance of charge cards to officers and employees for the purpose of covering expenses incident to authorized travel.
- (2) If a charge card is issued for the purpose of covering expenses relating to authorized travel, upon billing or no later than thirty days of the billing date, the officer or employee

using a charge card issued under this section shall submit a fully itemized travel expense voucher. Any charges against the charge card not properly identified on the travel expense voucher or not allowed following the audit required under RCW [42.24.080](#) shall be paid by the official or employee by check, United States currency, or salary deduction.

(3) If, for any reason, disallowed charges are not repaid before the charge card billing is due and payable, the municipal corporation or political subdivision shall have a prior lien against and a right to withhold any and all funds payable or to become payable to the official or employee up to an amount of the disallowed charges and interest at the same rate as charged by the company which issued the charge card. Any official or employee who has been issued a charge card by a municipal corporation or political subdivision shall not use the card if any disallowed charges are outstanding and shall surrender the card upon demand of the auditing officer. The municipal corporation or political subdivision shall have unlimited authority to revoke use of any charge card issued under this section, and, upon such revocation order being delivered to the charge card company, shall not be liable for any costs.

RCW 43.09.2855 – Local governments—Use of credit cards, states:

(1) Local governments, including counties, cities, towns, special purpose districts, municipal and quasi-municipal corporations, and political subdivisions, are authorized to use credit cards for official government purchases and acquisitions.

(2) A local government may contract for issuance of the credit cards.

(3) The legislative body shall adopt a system for:

(a) The distribution of the credit cards;

(b) The authorization and control of the use of credit card funds;

(c) The credit limits available on the credit cards;

(d) Payment of the bills; and

(e) Any other rule necessary to implement or administer the system under this section.

(4) As used in this section, "credit card" means a card or device issued under an arrangement pursuant to which the issuer gives to a card holder the privilege of obtaining credit from the issuer.

(5) Any credit card system adopted under this section is subject to examination by the state auditor's office pursuant to chapter [43.09](#) RCW.

(6) Cash advances on credit cards are prohibited.

The Jefferson County Public Utility District Procurement Manual, section 3.1 General states in part:

No document may be processed; item purchased; task order, change order, or contract executed; or payment made without the appropriate approvals and signatures. The General Manager, District Auditor, or Treasurer/Controller may, at their discretion, authorize the payment of an invoice or voucher if, due to extenuating circumstances, all approvals and signatures cannot be obtained.

Under no circumstances shall pre-authorization of voucher payments be made without the approval of the General Manager, or District Auditor.

All vouchers must be reviewed by the District Auditor and approved by the Commission.

The Jefferson County Public Utility District Procurement Manual, section 6.3 Travel states in part:

When employees use a District credit card, detailed receipts shall be retained, attached to an expense claim voucher and turned in to Accounts Payable within five working days of returning from the travel. Each receipt must clearly identify the type of expense.

An expense claim voucher for reimbursable expenses not charged on a District credit card must be submitted to Accounts Payable within thirty days of the earliest expense item shown

on the voucher. Reimbursements less than \$25 may be requested from petty cash. The General Manager may approve other exceptions for employees when the requirement of this provision is not met and circumstances warrant special consideration.

## RELATED REPORTS

### Financial

We have reissued a separate report containing our opinion on the District's financial statements for fiscal years ending December 31, 2012, 2011, and 2010. This report was reissued to address the Schedule of Expenditures of Federal Awards and to report on the District's compliance with federal program requirements. That report includes a finding for a significant deficiency in internal controls and noncompliance with state laws that require the preparation of an annual financial report, and a finding for a material weakness in internal controls over financial reporting regarding preparation of the Schedule of Expenditures of Federal Awards. That report is available on our website at <http://portal.sa.wa.gov/ReportSearch>.

We have also issued separate reports related to our engagements to audit the District's 2014 and 2013 financial statements; however, we did not express an opinion on the District's financial statements. We were not able to obtain statements supporting the financial activities of the District for the years ended December 31, 2014 and 2013, nor were we able to satisfy ourselves as to those financial activities by other auditing procedures. Those reports includes findings related to deficiencies in the District's internal controls and noncompliance with state laws that require the preparation of an annual financial report. Those reports are available on our website, <http://portal.sao.wa.gov/ReportSearch>.

### Federal grant programs

We evaluated internal controls and tested compliance with the federal program requirements, as applicable, for the District's major federal programs, which are listed in the Schedule of Findings and Questioned Costs section of the separate financial statement and single audit reports for the years ended December 31, 2014, 2013, and 2012. The report for the year ended December 31, 2014 includes a federal finding regarding internal controls and compliance with reporting requirements for grants funded under the American Reinvestment and Recovery Act. The report for the year ended December 31, 2012 includes a federal finding regarding internal controls over suspension and debarment requirements. Those reports are available on our website, <http://portal.sao.wa.gov/ReportSearch>.

Our opinions on the District's Schedule of Expenditures of Federal Awards for the years ended December 31, 2014 and 2013 are provided in the separate reports referred to in the above paragraph. The report for the year ended December 31, 2014 includes a finding for a material weakness in internal controls over financial reporting regarding preparation of the Schedule of Expenditures of Federal Awards.

## INFORMATION ABOUT THE DISTRICT

Public Utility District No. 1 of Jefferson County supplies water to approximately 3,500 customers on water systems throughout Jefferson County. The District also operates community septic systems and monitors alternative drain fields. In April 2013, the District expanded operations and now supplies electricity to approximately 18,000 customers throughout Jefferson County.

An elected, three-member Board of Commissioners governs the District. The Board appoints a Manager to oversee the District's daily business operations as well as its approximately 40 employees. For 2013 and 2014, the District operated on annual budgets of approximately \$24 million and \$35 million, respectively.

<b>Contact information related to this report</b>	
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*Information current as of report publish date.*

### **Audit history**

You can find current and past audit reports for Public Utility District No. 1 of Jefferson County at <http://portal.sao.wa.gov/ReportSearch>.

## 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.

<b>Contact information for the State Auditor's Office</b>	
<b>Public Records requests</b>	<a href="mailto:PublicRecords@sao.wa.gov">PublicRecords@sao.wa.gov</a>
<b>Main telephone</b>	(360) 902-0370
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