

SPECIAL INVESTIGATION REPORT

Investigation Summary

On May 30, 2014, City Management of the City of Republic notified our Office regarding a potential loss of public funds as required by state law.

The City initiated an investigation and provided its file to us. We reviewed the City's investigation, performed an expanded review and determined questionable payroll activity occurred totaling at least \$5,015 related to the former Clerk/Treasurer's wages and benefits. In addition, we identified \$38,556 in questionable and unsupported credit card and general disbursement transactions. Further, the City incurred fines and penalties totaling \$6,415 due to late payments. Our examination focused on January 2011 through October 2013.

Background and Investigation Results

The City, located in Ferry County, operates on an annual budget of approximately \$1.5 million, including \$640,000 in general disbursements including credit card payments, and \$560,000 in payroll expenses. The City operates under a mayor-council form of government. The elected, five-member Council is the City's oversight body that sets and approves all City policies. The City has seven full-time and two part-time employees who handle the day-to-day operations. The Clerk/Treasurer position is responsible for monitoring the day-to-day operations, preparing and processing payroll for all City employees, and processing all accounts payable transactions.

The City's investigation focused on the former Clerk/Treasurer's payroll deductions to determine if they were appropriate. The employee in question was promoted into the Clerk/Treasurer position in April 2011, and her employment was subsequently terminated in October 2013. The City reviewed payroll disbursements from January 2011 to October 2013 and noted a suspected loss of \$1,300 related to her dependent health premiums. In addition, the City requested its software provider examine accounting software transactions where they noted adjustments to the former Clerk/Treasurer's payroll deductions. The software provider found unusual adjustments in her payroll record during the period of November 2012 through May 2013. Multiple adjustments were related to a garnishment that was recorded improperly.

The investigation was turned over to the State Auditor's Office; and we examined the accounting systems to which the former Clerk/Treasurer had access. Our review found the following:

Pay rate

We reviewed payroll disbursements to the former Clerk/Treasurer from January 2011 to October 2013. We attempted to compare the pay rate the former Clerk/Treasurer used when processing her payroll to her authorized pay rate.

In 2011, the City passed Ordinance 2011-01 setting the Clerk/Treasurer’s annual salary at \$30,946.80. In 2012, the City passed Ordinance 2012-01, which changed the Clerk/Treasurer’s pay from an annual salary to an hourly rate, and designated different hourly pay rates based on “year.” Ordinance 2012-01 stated rates per year as follows:

Year	Rate per Ordinance 2012-01
1	\$14.83
2	\$15.88
3	\$17.25

However, the ordinance did not clearly define whether “year” corresponds to the total years of service at the City, or the years worked in the clerk/treasurer position. As such, we were unable to determine the rate of pay applicable to the former Clerk/Treasurer, who began working at the City in July 2009 (2.5 years before the ordinance was enacted) and was promoted to the Clerk/Treasurer position in April 2011 (less than one year before the ordinance was approved).

We interviewed the former Clerk/Treasurer, who stated she was approved at the pay rate for year three; however, she was unable to provide support for the rate approval. We also inquired with the Mayor, who stated that for 2012 forward, he authorized the former Clerk/Treasurer’s pay at \$17.03 per hour under the term of the ordinance stating that pay rates are subject to the Mayor’s discretion. However, the City was unable to provide documentation supporting the Mayor’s approval. As such, we were unable to verify which rate was appropriate.

As noted above, due to lack of sufficient documentation, we are unable to conclude what wage would have been appropriate for the former Clerk/Treasurer, or if a misappropriation occurred regarding her pay rate.

Payroll support

We then attempted to compare the former Clerk/Treasurer’s actual pay to supporting documents such as timesheets and overtime approvals, and to the pay rates described above. City policy states all overtime must be pre-approved; however, a majority of the former Clerk/Treasurer’s timesheets during our testing period were either unapproved or could not be located. From this comparison, we found the following:

- We identified a potential overpayment to the former Clerk/Treasurer of \$4,466, which includes 173.5 hours of unapproved overtime between March 2011 and October 2013. When we interviewed the former Clerk/Treasurer, she stated she would have received overtime related to City Council meetings, time when traveling for training over her regular 40-hour work week, and for budgeting periods during the year.

- We recalculated leave accrual use and payout for the former Clerk/Treasurer. City policy states vacation leave balances are to be paid out to personnel upon termination. We identified 25 hours of leave not properly deducted from the former Clerk/Treasurer's accrued balance, thereby resulting in a \$440 overpayment to the former Clerk/Treasurer upon her termination.
- We tested the former Clerk/Treasurer's payroll deductions for accuracy and proper support and found she deducted \$109 less from her paycheck than she should have, based on inaccurate and inconsistent deductions for a garnishment, dependent health insurance premiums and retirement benefits.
- The former Clerk/Treasurer treated the garnishment, dependent health insurance and retirement benefits as pre-tax benefits, which would have inappropriately increased her retirement benefit calculations. We inquired with the Department of Retirement Systems for assistance in recalculating the appropriate amounts; however, the former Clerk/Treasurer cashed out her retirement subsequent to her termination in October 2013. Further, the City did not retain sufficient retirement records. As such, we were unable to quantify amounts related to her retirement benefits.

Credit card payments

- We examined purchases on the credit card assigned to the former Clerk/Treasurer and identified \$16,352 in questionable transactions. These transactions lacked adequate supporting documentation to determine if there was a legitimate business purpose for the City.

General disbursements

- We examined general disbursements of the City and identified \$3,802 paid directly to the former Clerk/Treasurer. These payments lacked adequate supporting documentation to determine if there was a legitimate business purpose for the City.
- Our general disbursements testing identified more than 200 checks totaling \$369,330 in which the Mayor's signature stamp was used. According to the Mayor, this was done without his knowledge or approval. During our testing of these checks, we identified \$18,403 in unsupported expenses. These payments lacked adequate supporting documentation to determine if there was a legitimate business purpose for the City.

Other concerns

We identified additional payments totaling \$6,415 due to late payroll tax payments and grant reimbursements. Specifically, the City:

- Incurred \$5,000 in IRS penalties and fees
- Incurred \$625 in other expenses due to legal orders and fines

- Missed reimbursement of \$790 that was not submitted to a state agency for reimbursement of public safety overtime wages

The former Clerk/Treasurer did not perform a bank reconciliation for almost two years. As a result, the Mayor and Council stated they were unaware of the City's financial position during 2013.

Control Weaknesses

Internal controls at the City were not adequate to safeguard public resources. We found these questionable payments occurred because the former Clerk/Treasurer was responsible for all payroll processing, benefit tracking and general disbursements processing without effective monitoring by the Mayor and City Council.

Recommendations

We recommend the City strengthen internal controls over payroll disbursements, payroll benefits including leave accruals, and general disbursements to ensure adequate oversight and monitoring to safeguard public resources and compliance with City policies.

We recommend the City ensure that all disbursements are supported with detailed supporting documentation to ensure all expenses are for valid city business purposes.

We further recommend the City ensure records are retained and safeguarded in accordance with Local Government Common Records Retention Schedules and the City's Records Retention Schedules, as prescribed by the Secretary of State.

City's Response

On October 21, 2013 the previous Clerk/Treasurer terminated her employment with the city and the current Clerk/Treasurer took over on October 22, 2013. One of the first tasks the current Clerk/Treasurer had was to prepare the October 2013 payroll. Being her first time processing payroll for the city, she contacted the current accounting vendor for help and training so it was done correctly. As they were processing payroll for the previous Clerk/Treasurer's final check they found some questionable deductions that had been entered into the system for that Clerk/Treasurer. The current Clerk/Treasurer made note of those entries. When the current Clerk/Treasurer checked the financial status of the City's bank account to pay payroll she found there was not enough funds to cover payroll. That was when the city discovered that no bank reconciliations had been done for almost 2 years. The city was forced to transfer monies from the LGIP account to cover payroll and other required disbursements. It was at this time the City asked the current accounting software vendor to do a Forensic Audit of the City's financials.

Over the next month as the current Clerk/Treasurer processed the required monthly financial reports to the Dept. of Retirement, Dept. of Revenue, Northwest Administrators, Inc. and the IRS

she found more accounting issues from the previous Clerk/Treasurer. While processing the City Excise tax to the Department of Revenue it was found that the previous Clerk/Treasurer used the City of Republic Department of Revenue account to prepare and process Excise tax for another local business from 2012 through 2013. With the help of the Department of Revenue we were able to remove the local business from the City's account. We were able to print records of all the dates and times the City's account was used as person authorizing payment. We have checked each payment approved and found that none of the City's bank accounts were used to pay for these transactions. We found that the previous Clerk/Treasurer had used a separate account number to have the local business tax debited from.

While paying the medical premiums for the previous Clerk/Treasurer we found discrepancy in what was paid for her dependent health premiums. We also found that the previous Clerk/Treasurer used the Dept. of Retirement deduction line to deduct her garnishment. This is a pre-tax line and the garnishment should have had its own deduction line post-tax. City also found that the previous clerk failed to report all employee wages to the IRS on the W-3 for 2011 and it resulted in a large penalty to the City and miscalculations for wage earnings for employees to the IRS.

While processing accounts payable to vendors the current Clerk/Treasurer had a tough time deciphering the correct amounts to be paid to vendors due to large credits on some accounts and delinquencies on others. There was no back up attached to previous billings statements to help identify amount previously paid and what was outstanding. Credit card statements had no backup receipts.

As a result of the above issues the current Clerk/Treasurer reported everything she found to the State Auditor's Office as required under (RCW 43.09.185). She gave copies of all of her findings as well as a copy of the Forensic Accounting report that was done by the current accounting software vendor. The City agrees with State Auditor's Office Special Investigation Report for the Period of January 1, 2011, through October 31, 2013. The City acknowledges that there was a lack of internal controls and effective monitoring by the past Mayor and City Council to prevent issues from happening to safeguard public resources. The City has strengthened its internal controls over payroll disbursements, payroll benefits including leave accruals, and general disbursements to ensure adequate oversight now and monitoring to safeguard public resources and to be in compliance with the City policies. The current Clerk/Treasurer presents all disbursements to council for signed approval. All disbursements are presented with backup documentation as well as a Check register report that includes the check number, amount, vendor name and the BARS expense lines used for each payment. All payroll is signed and approved by department head or Mayor and then passed through council.

All bank reconciliations are done in a timely manner and presented to council for signature approval with a treasures report to cross check. All financial reporting to Local, State and Federal agencies are reviewed and approved by Council signature. Yearly budget workshops are

attended by the Mayor and council members as the current Clerk/Treasurer addresses every line item for the governing body to review and approve. The Mayor, Council and City Staff attend annual training for budgeting, grants, accounting and annual reporting. This is to insure both the staff and the governing body has up to date and accurate knowledge of their duties and responsibilities to ensure the efficiency of operations, reliability of financial reporting and to make sure the City is in compliance with applicable laws and regulations moving forward.

All the City files have been reorganized and updated. All records are now kept in a secure unit and retained as per the Secretary of State Retention schedule. All council meeting agenda items are kept as backup with the approved meeting minutes. All payroll, accruals, sick and disbursements made payable to the current Clerk/Treasurer are monitored and approved by the signature of the Mayor on a monthly basis. No checks will be disbursed to the Clerk/Treasurer without back up and the Mayor's signature approval and councils review. The city has always had 4 authorized check signers for the City bank accounts, so there was never a need for any signature stamps to be made or used by the previous Clerk/Treasurer. The city has eliminated all signature stamps. All employees are given a copy of the credit card policy and sign and acknowledgment that they agree to it. All vacation and sick leave for employees are approved by department head or Mayors signature. All pay rates are set by the Mayor and approved by council upon employment. Any changes to that rate will be in writing and a copy will be retained in the employee's personnel file.

Now that the City governing body has been educated as to what they need to see and approve to ensure effective internal controls are being followed the financial state of the city has improved. The City staff has worked very hard since late October 2013 to get back on track and in compliance with local, state and federal agencies. By educating the council on the current accounting system and all the information that it can provide it has empowered them to effectively monitor the current Clerk/Treasurer and staff.

State Auditor's Office Remarks

We thank City officials and personnel for their assistance and cooperation during the investigation.