



**Washington State Auditor's Office**

**Troy Kelley**

**Integrity • Respect • Independence**

## **Financial Statements Audit Report**

# **Housing Authority of the City of Kalama**

**Cowlitz County**

**For the period July 1, 2012 through June 30, 2014**

**Published March 30, 2015**

**Report No. 1013884**





**Washington State Auditor**  
**Troy Kelley**

March 30, 2015

Board of Commissioners  
Housing Authority of the City of Kalama  
Kalama, Washington

**Report on Financial Statements**

Please find attached our report on the Housing Authority of the City of Kalama's financial statements.

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

Sincerely,

TROY KELLEY  
STATE AUDITOR  
OLYMPIA, WA

## TABLE OF CONTENTS

Schedule Of Audit Findings And Responses.....	4
Status Of Prior Audit Findings.....	6
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 .....	12
Independent Auditor’s Report On Financial Statements .....	15
About The State Auditor’s Office.....	18

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### Housing Authority of the City of Kalama Cowlitz County July 1, 2012 through June 30, 2014

**2014-001 The Authority's financial condition, lack of adequate internal controls over financial reporting and non-compliance with federal requirements places it at risk of not being able to continue operations.**

#### *Background*

The Housing Authority of the City of Kalama was organized in 1953 to provide housing for low-income individuals. The Authority owns and manages a 16-unit public housing project and manages several grant programs funded by the U.S. Department of Housing and Urban Development (HUD), which up until January 1, 2015, included 27 housing vouchers. Approximately 90% of the Authority's operating revenues are provided by HUD. During the past two audits we communicated concerns with the Authority's financial condition.

It is the responsibility of Authority Management and the Board to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting. Controls must ensure that financial data is reliably authorized, processed and reported.

Report users rely on the Authority to establish effective internal controls to ensure compliance with laws and policies and the safeguarding of public resources. During our audit, we found the Authority does not have effective internal controls over financial reporting. The lack of internal controls hinders the Authority's ability to produce reliable financial statements, ensure compliance with laws and policies, and prevent or detect misappropriation.

#### *Description of Condition*

##### Internal Controls over Financial Reporting

We identified the following control deficiencies, that when taken together, represent a material weakness in internal controls:

- Staff responsible for financial reporting lack adequate knowledge and training to ensure financial statements are accurate, complete, and prepared in accordance with Generally Accepted Accounting Principles (GAAP).

- The Authority did not perform complete bank reconciliations to ensure amounts recorded in the general ledger reconciled with transactions clearing the Authority's bank account and therefore the Authority is unable to support its current bank balance.
- The authority records its financial activity on a cash basis, not GAAP as required. As a result, no accruals are recorded and the respective liabilities and receivables are not presented in the financial statements.

### Financial Condition

The Authority has experienced a significant decrease in its ending cash balance as illustrated as follows:

<b><u>Ending Cash Per Bank Statements</u></b>		
<b>FYE</b>	<b>Total</b>	<b>Change</b>
2012	\$53,138.35	
2013	\$29,531.41	\$ (23,606.94)
2014	\$14,886.71	\$ (14,644.70)

The Authority's total ending bank balance as of January 2015 was \$15,142.95.

In addition, the Authority's operating expenditures have exceeded operating revenues for over five years, which appears to have contributed to the overall decline in cash. The operating revenues and expenditures for some of the last five years are presented below.

<b>Operating</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Revenues	\$306,049	\$299,216	\$295,814		
Expenses	\$335,413	\$348,723	\$313,585		
(Deficit)	\$(29,364)	\$(49,507)	\$(17,771)		

\*Given the concerns over the internal controls for financial reporting, we could not place reliance upon the financial records maintained by the Authority to determine the operating revenues and expenses for 2013 and 2014.

### Material Non-Compliance

Additionally, HUD performed an audit of the Authority's operations in August 2014 where it was determined the Authority owed \$50,424 to HUD for misuse of Section 8 Housing Choice Voucher funds. We consider this to be material noncompliance as the Authority does not have sufficient cash reserves to repay this obligation.

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

The Authority experienced frequent turnover in all positions, including the executive director, as well as implemented a new accounting system in 2012.

Staff and the Authority Board did not effectively monitor its cash position and compliance with HUD guidelines. In addition, the Authority has not developed a plan to adequately address their continued declining financial position to ensure their ongoing operations.

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

Because of these control deficiencies and errors identified, we were unable to give an opinion on the accuracy and completeness of the financial statements for 2013 or 2014. Specifically:

- The Authority did not include a liability owed to HUD for identified misuse of Section 8 program funds of \$50,424 for 2014.
- The Authority's reported cash and investments, revenues and expenses could not be reconciled to independent bank records.
- The Authority's bank account was debited \$2,200 by an internet vendor; these transactions could not be supported.

Additionally, the Authority does not have cash reserves available to meet obligations. Without a plan in place to address the negative financial position and obligation to HUD the Authority is at risk of loss of federal funding or dissolution.

### ***Recommendation***

We recommend the Authority:

- Ensure staff responsible for financial reporting have the appropriate training and knowledge to ensure information provided to the Board is accurate and complete.
- Implement procedures to ensure cash and investments, revenues and expenditures are reconciled on a timely basis with supporting independent bank statements and third party records.
- Develop a formal financial plan to address its cash flow issues and improve its monitoring of actual results as compared to the plan to ensure its financial condition improves
- Work directly with HUD to resolve the Authority's outstanding liability.

## ***Housing Authority's Response***

*The Board of Commissioners and the Executive Director of the Kalama Housing Authority thank the State Auditor's Office, Tina Watkins and Paula McCoy in particular for their assistance and professionalism in bringing this audit requirement to completion.*

*As has been the case for approximately the last ten to fifteen years, the Kalama Housing Authority has been facing significant challenges when it comes to financial sustainability.*

*During that time the Authority has experienced frequent turnover in all positions including the Executive Director. Spanning the period of 2003 through present there have been a total of 6 different Executive Directors including the current ED.*

*In the last ten years in particular, The KHA's financial resources have gradually been eroded due to reduced HUD and Federal Funding levels, increasing costs, and the expense of staff turnover which resulted in costly errors due to inexperience and lack of relevant training.*

*Although a significant number of steps have been taken in the last three years to re-instate cost efficiencies and increased accountability through Board oversight, the hurdles which have presented themselves from the last several years are proving to be very difficult to overcome and still persist.*

*The results of this audit speak loud and clear to the need to "re-align" the current staffing model and bring in more skilled and professional accounting talent. It also clear that the existing staff does not possess the knowledge and experience required to properly address the complexity and intricacies of the matters at hand.*

*It has been with that intent in late 2014 that the Boards of Commissioners of the Kalama Housing Authority and the Kelso Housing Authority entered into an agreement to transfer the Kalama Housing Authority Housing Choice Voucher/Section 8 Program completely to the Kelso Housing Authority.*

*With the approval of the US Department of Housing and Urban Development (HUD), the Kalama Housing Authority completed divesting itself of the Section 8 Housing Voucher Program which was then taken over by Kelso effective January 1, 2015.*

*Due to the increasing costs of managing and administering this program combined with the ever decreasing Administrative Cost subsidies provide by the Federal Government, this one move should result in completely stopping the loss of thousands of dollars that Kalama Housing has been absorbing for several years in offering this program locally.*

*Further, it is the stated intent of the Kalama Housing Authority Board of Commissioners and the Staff Management to investigate and, when appropriate, initiate measures and procedures that are intended to address and resolve, once and for all, the weaknesses and lack of appropriate skillsets required to make the KHA a financially sound and fiscally viable entity.*

*The Board and Management are preparing to approach other outside organizations and possibly local government to discuss the takeover of the administration of the KHA financial, accounting, and reporting responsibilities as an agent/contractor of the Kalama Housing Authority.*

*In addition, as a direct result of the reduced workload that was intended as part of the transfer of the Section 8 Program to Kelso Housing, and the potential contracting of the financial management duties, staffing hours are being reduced. The intended result will be to lower overhead and bring organizational operations expenses to a more realistic and balanced state in meeting KHA needs.*

*The Board of Commissioners and the Kalama Housing Authority Management are steadfastly and resolutely intent on taking and expediting all measures required assuring that quality low income housing is preserved for the residents of the City of Kalama in a financially viable and fiscally responsible way for years to come.*

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

We appreciate the Authority's desire to make improvements in their financial condition and will review the corrective action taken during our next audit.

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

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 material weaknesses and significant deficiencies in its *Codification of Statements on Auditing Standards*, Section 265, as follows:

**.07** For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

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.

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.

RCW 43.09.200 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.

Budgeting, Accounting and Reporting Systems (BARS) manual, chapter 3.3.1.3, Accounting Principles and Internal Control, 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.

## STATUS OF PRIOR AUDIT FINDINGS

### **Housing Authority of the City of Kalama Cowlitz County July 1, 2012 through June 30, 2014**

The status of findings contained in the prior years' audit reports of the Housing Authority of the City of Kalama is provided below:

#### **1. The Authority's financial condition and non-compliance with federal requirements places it at risk of not being able to continue operations.**

Report No. 1009423, dated March 25, 2013

##### ***Background***

The Housing Authority's financial condition has declined significantly over the past several years. We reported concerns over the Authority's ability to continue operations and meet financial obligations. Additionally, the Housing and Urban Development agency reported that the Authority did not comply with federal requirements relating to the Housing Choice Voucher Program. This resulted in a significant liability that is owed to HUD.

##### ***Status***

We are reporting similar concerns in our current audit report. See Finding 2014-001.

**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**

**Housing Authority of the City of Kalama  
Cowlitz County  
July 1, 2012 through June 30, 2014**

Board of Commissioners  
Housing Authority of the City of Kalama  
Kalama, Washington

We were engaged to audit, in accordance with auditing standards general 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 Housing Authority of the City of Kalama, Cowlitz County, Washington, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the Housing Authority's basic financial statements, and have issued our report thereon dated March 13, 2015. Our report disclaims an opinion on such financial statements because we were not able to obtain financial statements supporting the financial activities of the Housing Authority for the years ended June 30, 2014 and 2013, nor were we able to satisfy ourselves as to those financial activities by other auditing procedures.

Our report also includes information about the status of the Housing Authority's financial condition. This information is more fully described in Finding 2014-001 in the Schedule of Audit Findings and Responses.

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

In connection with our engagement to audit the financial statements of the Housing Authority, we considered the Housing Authority'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 Housing Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Housing Authority's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying Schedule of Audit Findings and Responses, we identified certain deficiencies in internal control that we consider to be material weaknesses.

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 the Housing Authority'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. We consider the deficiencies described in the accompanying Schedule of Audit Findings and Responses as Finding 2014-001 to be material weaknesses.

## COMPLIANCE AND OTHER MATTERS

In connection with our engagement to audit the financial statements of the Housing Authority, we performed tests of the Housing Authority'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 engagement, and accordingly, we do not express such an opinion.

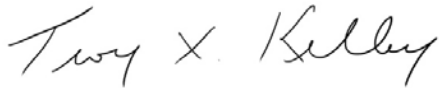
The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and are described in the accompanying Schedule of Audit Findings and Responses as Finding 2014-001. Additionally, if the scope of our work had been sufficient to enable us to express an opinion on the basic financial statements, instances of noncompliance or other matters may have been identified and reported herein.

## HOUSING AUTHORITY'S RESPONSE TO FINDINGS

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

## 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 Housing Authority'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 Housing Authority'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 black ink that reads "Troy X. Kelley". The signature is written in a cursive, flowing style.

TROY KELLEY  
STATE AUDITOR  
OLYMPIA, WA

March 13, 2015

# INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

## **Housing Authority of the City of Kalama Cowlitz County July 1, 2012 through June 30, 2014**

Board of Commissioners  
Housing Authority of the City of Kalama  
Kalama, Washington

### **REPORT ON THE FINANCIAL STATEMENTS**

We were engaged to audit the financial statements of the Housing Authority of the City of Kalama, Cowlitz County, Washington, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the Housing Authority's basic financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes 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 conducting the 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. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were unable to obtain sufficient appropriate audit evidence to provide a basis for our opinions.

### **Basis for Disclaimer of Opinion**

The Housing Authority did not provide accurate financial statements for the periods ended June 30, 2013 and 2014. Although representations of the Housing Authority's financial activities were available for audit our procedures identified, in some cases, material misstatements. Given the lack of internal controls over the general ledger, we were unable to determine whether transactions were accurately reflected in the financial system, or the financial statements themselves.

### **Disclaimer of Opinion**

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements. The statements are not included in our report.

### **Matters of Emphasis Regarding Fiscal Sustainability**

As described in Finding 2014-001 in the Schedule of Audit Findings and Responses, the Housing Authority's declining cash and investment balances and significant current liability owed to its oversight agency, reflects the significant cash flow challenges that affect the Housing Authority's operations. The Housing Authority's cash flow constraints are expected to continue in the near future. As a result, there exists substantial uncertainty about the Housing Authority's ability to maintain services at present levels under these conditions.

### **Housing Authority's Response to Finding**

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

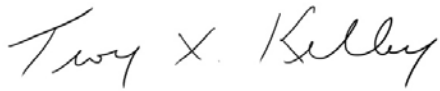
### **Other Matters Regarding Disclaimer of Opinion**

As the statutory auditor of all public accounts in the state of Washington we are precluded from withdrawing from the audit engagement, regardless of the matters described in the Basis for Disclaimer of Opinion paragraph.



## OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated March 13, 2015 on our consideration of the Housing Authority'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 Housing Authority's internal control over financial reporting and compliance.



TROY KELLEY  
STATE AUDITOR  
OLYMPIA, WA

March 13, 2015

## 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	
<b>Deputy Director for Communications</b>	Thomas Shapley <a href="mailto:Thomas.Shapley@sao.wa.gov">Thomas.Shapley@sao.wa.gov</a> (360) 902-0367
<b>Public Records requests</b>	(360) 725-5617
<b>Main telephone</b>	(360) 902-0370
<b>Toll-free Citizen Hotline</b>	(866) 902-3900
<b>Website</b>	<a href="http://www.sao.wa.gov">www.sao.wa.gov</a>