



Washington State Auditor's Office

Troy Kelley

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Examination Report

Public Utility District No. 1 of Kitsap County

For the period July 1, 2012 through June 30, 2013

Published April 13, 2015

Report No. 1014009





Washington State Auditor Troy Kelley

April 13, 2015

Board of Commissioners
Public Utility District No. 1 of Kitsap County
Poulsbo, Washington

Marcie Frost, Director
Department of Retirement Systems
Olympia, Washington

Examination Report

The Washington State Department of Retirement Systems (DRS) administers eight public retirement systems for state and local government employees, with 15 different plans within those systems. These systems serve nearly 700,000 current and former public employees. Both public employers and their employees contribute to the retirement plans and the amounts they contribute are calculated as a percentage of the employee's pay.

Government entities are responsible for reporting accurate and complete pensionable wage and contribution information to DRS in accordance with the applicable retirement plan's requirements set forth in Title 415 of the Washington Administrative Code. The plan's actuarially derived pension liabilities are dependent on demographic data of the plan participants, which is referred to as census data. Significant elements of census data may include: date of birth; date of hire or years of service; marital status; eligible compensation; class of employee; gender; date of termination or retirement; spouse date of birth; and employment status (active, inactive, or retired).

Please find attached our examination report on the Public Utility District No. 1 of Kitsap County.

Sincerely,

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

INDEPENDENT ACCOUNTANT'S REPORT

Public Utility District No. 1 of Kitsap County

July 1, 2012 through June 30, 2013

Board of Commissioners
Public Utility District No. 1 of Kitsap County
Poulsbo, Washington

Marcie Frost, Director
Department of Retirement Systems
Olympia, Washington

We have examined the Public Utility District No. 1 of Kitsap County's management's assertion that pensionable wages and contributions reported to the Washington State Department of Retirement Systems (DRS) for the year ended June 30, 2013 are accurate and complete in accordance with applicable retirement plan requirements set forth in Title 415 of the Washington Administrative Code.

The District's management is responsible for the assertion. Our responsibility is to express an opinion on the assertion based on our examination.

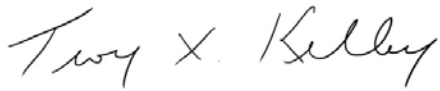
Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Accordingly, it included examining on a test basis, evidence supporting management's assertion and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, management's assertion above is fairly stated, in all material respects, based on the applicable retirement plan requirements set forth in Title 415 of the Washington Administrative Code.

In accordance with *Government Auditing Standards*, we are required to report all deficiencies that are considered to be significant deficiencies or material weaknesses in internal control; fraud and noncompliance with provisions of laws or regulations that have a material effect on the District's pensionable wages and contributions reported to DRS or management's assertion thereon; and any other instances that warrant the attention of those charged with governance, and noncompliance with provisions of contracts or grant agreements, and abuse that have a material effect on the District's pensionable wages and contributions reported to DRS or management's assertion thereon. We are also required to obtain and report the views of management concerning the findings, conclusions, and recommendations, as well as any planned corrective actions. We performed our examination to express an opinion on management's assertion and not for the purpose of expressing an opinion on the internal control over compliance and other matters; accordingly, we express no such opinions.

Our examination disclosed certain findings that are required to be reported under *Government Auditing Standards* and those findings, along with the views of management, are described in the accompanying Schedule of Findings and Responses as Finding 2013-001 and Finding 2013-002.

The District's response to the findings identified in our examination is described in the accompanying Schedule of Findings and Responses. The District's response was not subjected to the procedures applied in the examination and, accordingly, we express no opinion on the response.

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

April 8, 2015

SCHEDULE OF FINDINGS AND RESPONSES

Public Utility District No. 1 of Kitsap County July 1, 2012 through June 30, 2013

2013-001 The District should improve internal controls to ensure accurate determinations of eligibility for retirement plan participation.

Background

The Public Utility District No. 1 provides pension benefits to its employees through participation in the Public Employee Retirement System (PERS) plan administered by the Department of Retirement Systems (the Department). It is the responsibility of the District to design and follow internal controls that provide reasonable assurance that the responsibilities of retirement system employers are met.

Specifically, it is the District's responsibility to ensure plan eligibility is correctly determined and reported for its employees and elected officials.

Description of Condition

The PERS eligibility status for the elected officials was inaccurate. According to State law, elected officials are eligible to participate, however the District used incorrect criteria in determining that the elected officials were ineligible for plan participation.

Three Commissioners were incorrectly informed that they were ineligible for PERS membership. They were unable to contribute to and earn credits towards PERS retirement during their service periods.

We consider this deficiency in internal controls to be a significant deficiency.

Cause of Condition

The District did not provide adequate training to staff determining eligibility requirements.

Effect of Condition

District Commissioners were denied the opportunity to become members of PERS at the time of their election.

Two Commissioners with 25 years and 21 years of service, respectively, as elected District officials chose not to retroactively enroll due to the complicated and costly process. However, they may have chosen to enroll had they been given the option at the time of election.

One Commissioner chose to retroactively enroll, and the District will have to calculate the employee's time, reportable compensation and the employee and employer required contributions for each year of service. The employee and employer contributions, plus interest, must be submitted to the Department for all years for which plan membership is requested.

Recommendation

We recommend the District ensure the eligibility status is correctly determined and reported for its elected officials.

We further recommend that the District work with the Department to complete the enrollment process for the Commissioner that elected to retroactively enroll.

District's Response

The Kitsap Public Utility District has a well-established system of internal controls in place and has had a long history of excellent audit results. In the accountability report for the 2010 and 2011 fiscal years which was posted to the State Auditors website in 2013, the auditor wrote "We audit the District once every two years. This audit marked the eight consecutive audit no findings were reported for the District. We believe this reflects the District's desire and commitment to sound operating procedures and to maintain a strong financial system". The District was also audited for the 2012 and 2013 fiscal years, and received no findings during those audits which marked 18 years of audits with no findings.

The Washington State Auditor's office was recently engaged by the Department of Retirement Systems (DRS) to randomly select and audit the payroll information submitted by various public entities including the Kitsap Public Utility District. This is the first audit of this type that has ever been conducted at the District. The District applauds this effort on the part of DRS and welcomes the review of their internal processes, but was surprised that the auditor choose to escalate the issues to the level of a finding. The District is committed to correcting the issues that the auditor raised and will be conducting a thorough internal review of the personnel files and DRS reporting to ensure that proper documentation is kept and that there are no other corrections needed. The District will also increase training and education for all staff involved with reporting to DRS.

Auditor's Remarks

We thank the District for its cooperation during the audit, and appreciate the steps the District is taking to resolve these issues. We will review this area again during our next attestation audit.

Applicable Laws and Regulations

RCW 41.40.023 – Membership, states in part:

Membership in the retirement system shall consist of all regularly compensated employees and appointive and elective officials of employers, as defined in this chapter, with the following exceptions:

(3)(a) Persons holding elective offices or persons appointed directly by the governor: PROVIDED, That such persons shall have the option of applying for membership during such periods of employment

WAC 415-108-550 Elected Officials – Eligibility and application for retirement service membership, states in part:

(1) . . . "elected" officials means individuals elected to any state, local or political subdivision office or individuals appointed to any vacant elective office.

DRS Handbook - PERS Membership, states in part:

PERS Plan Rules

Employees working in eligible positions for PERS employers must be enrolled as members. This section outlines current rules for membership in PERS. For prior period membership rules, see Membership Rules for Prior Periods. If you have questions about PERS eligibility, please call Employer Support Services (ESS).

PERS Plan 1, 2 or 3

- Plan rules are the same for PERS Plan 1, 2, and 3, unless otherwise noted.
- Refer to PERS Membership Definitions section for Plan 1, Plan 2, or Plan 3 definitions.
- Prior retirement membership impacts current PERS Plan membership. Use Member Reporting Verification (MRV)

to view an employee's prior retirement status before determining in which plan to enroll a new employee.

- If you have questions about PERS eligibility, please contact ESS

How Eligibility Is Determined

The employer is responsible for the determination of the employee's eligibility for membership. The primary determination of eligibility for PERS is based upon the position. An employee who worked for one month in an eligible position before quitting would be entitled to PERS membership. In PERS, there are two ways a position can be eligible. A position is eligible if:

The position normally requires at least five months each year in which regular compensation is earned for at least 70 hours per month. [RCW 41.40.010(11)(a), WAC 415-108-680]

- As used in this definition, "normally" means a position that requires at least five months of at least 70 hours for two consecutive years. Once a position is determined to be eligible, it will continue to be eligible if it requires at least five months of 70 or more hours of compensated service during at least one year in any two-year period. [WAC 415-108-010]
- "Year" means any 12 consecutive month period established and applied consistently by an employer to evaluate the eligibility of a specific position. In the case of ongoing positions, the year used by the employer must be the same for all positions. In the case of a project or temporary position, the year used may be specific to the position. The term may include but is not limited to a school year, calendar year or fiscal year. [WAC 415-108-010]

Or

The position is occupied by an elected official or person appointed directly by the Governor for compensation. [RCW 41.40.010(11)(b)]

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 System (BARS) Manual, states in part:

3.1.3 Internal Control

Purpose and Definition of Internal Controls

3.1.3.10 Internal control is defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), in standards adopted by the American Institute of Certified Public Accountants and by the Federal Office of Management and Budget as follows:

3.1.3.20 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

3.1.3.30 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.

3.1.3.40 COSO and professional auditing standards define five interrelated components of effective internal control, as follows:

1. Control environment – The tone set by management that influences the control consciousness of staff. Control environment includes communication of integrity and

ethical values, commitment to ensure that staff are competent, management's philosophy and operating style, extent of participation by the governing board in scrutinizing activities and holding management accountable, and human resource practices (hiring, organization, development, evaluation, promotion and remedial action).

2. Risk assessment – Management's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be addressed or controlled. Risk assessment includes identification of internal and external risks to the achievement of objectives, such as new contracts or grants, changing regulations and accounting standards, new technology, new personnel, new or discontinued activities and programs, new or discontinued organizational policies and procedures, obsolescence of facilities, and so on. Risk assessment also includes evaluation of risks and determining how to best address them.

3. Information and communication – Systems to support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities. This encompasses the organization's methods of capturing and sharing information as well as its software, including its accounting information systems.

4. Control activities – Specific policies or procedures that directly address risks related to the achievement of objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities such as approvals, reviews, reconciliations, segregation of duties, performance measurement, tracking events or assets, etc.

5. Monitoring – Management's review of the operation of internal controls over time. Monitoring is accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two. Ongoing monitoring occurs during the course of operations when management observes controls and can discern whether they were effective. Separate evaluations occur when

management reviews and assesses a particular control to determine if it has been effective.

3.1.3.50 Internal control should be viewed as an integral or inherent part of the policies, systems and procedures management uses to operate and oversee the organization. This is not to say effective control will never require additional or incremental effort. Rather, controls exist to provide reasonable assurance about the achievement of objectives and so should be integrated into all the organization's fundamental business processes. Controls are normally most effective when built into the government's infrastructure rather than being treated as supplemental or separate processes. In the same way, implementation and monitoring of internal controls should not be viewed as a singular event, but rather a continuous or iterative process.

3.1.3.60 Since internal control is as fundamental as the objectives the controls relate to, the need for effective control is applicable to all organizations, regardless of size. While small entities may implement internal controls differently than larger ones, effective internal control is still both necessary and possible.

SCHEDULE OF FINDINGS AND RESPONSES

Public Utility District No. 1 of Kitsap County July 1, 2012 through June 30, 2013

2013-002 The District should improve internal controls to ensure accurate eligibility reporting to the Department of Retirement Systems.

Background

The District participates in the Public Employee Retirement System (PERS) plan administered by the Washington State Department of Retirement Systems (the Department). It is the responsibility of the District to design and follow internal controls that provide reasonable assurance that member data reported to the Department meets plan requirements.

Specifically, employers are required to obtain written documentation of the retirement status of all new employees, determine the position's eligibility and report all retirees to the Department.

If a retiree in a PERS eligible position works in excess of 867 hours, his pension benefits will be suspended and the employer must make retirement contributions.

Description of Condition

The District's Manager of Communications terminated employment and began receiving retirement payments in February 2013. He entered into a new contract with the District in March 2013, performing the same duties for the same salary. The new contract stated that he would work no more or less than 866 hours per year.

We identified the following deficiencies in internal controls that, when taken together, represent a significant deficiency:

- The Manager was not reported to the Department of Retirement Systems between his rehire in March 2013 and the time of our audit in March 2015. During that period, the Manager made approximately \$100,000 and should have been reported as a Retiree Returning to Work (RRTW). The District began reporting him as a RRTW in a position ineligible to participate in PERS in March 2015.
- The District did not track the Manager's actual hours worked. The Manager worked partially onsite and partially from home, and did not submit timecards or other documentation of time worked. Without proper

records, the District is unable to substantiate the accuracy of this employee's PERS eligibility determination.

Cause of Condition

The District lacked policies and procedures that required the Manager of Communications to complete timecards to track the employee's actual hours worked.

The District did not provide adequate training to staff determining eligibility requirements.

Effect of Condition

Because the Manager's actual hours were never tracked, the District was unable to substantiate his PERS ineligible designation or that he did not work in excess of the 867 maximum annual hours allowed.

The District may be held responsible to pay the applicable employer PERS contributions for the Manager's reportable compensation.

The District may also be held liable for any pension overpayments made to the employee, because it did not report the Manager to the Department following his rehire.

Recommendation

We recommend the District:

- Implement a system for tracking the actual hours worked for all retirees returning to work, and report the actual hours worked to the Department of Retirement Systems.
- Provide adequate training to staff determining PERS eligibility to ensure compliance with documentation and reporting requirements.
- Work with the Department to determine if any repayments or corrections in contributions are necessary.

District's Response

The Kitsap Public Utility District has a well-established system of internal controls in place and has had a long history of excellent audit results. In the accountability report for the 2010 and 2011 fiscal years which was posted to the State Auditors website in 2013, the auditor wrote "We audit the District once every two years. This audit marked the eight consecutive audit no findings were reported for the District. We believe this reflects the District's desire and

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Auditor's Remarks

We thank the District for its cooperation during this audit and appreciate the steps it is taking to resolve these issues. We will review this area again during our next attestation audit.

Applicable Laws and Regulations

RCW 41.50.139, states:

(1) Retirement system employers shall elicit on a written form from all new employees as to their having been retired from a retirement system listed in RCW 41.50.030. Employers must report any retirees in their employ to the department. If a retiree works in excess of applicable postretirement employment restrictions and the employer failed to report the employment of the retiree, that employer is liable for the loss to the trust fund.

(2) If an employer erroneously reports to the department that an employee has separated from service such that a person receives a retirement allowance in contravention of the applicable retirement system statutes, the person's retirement status shall remain unaffected and the employer is liable for the resulting overpayments.

(3) Upon receipt of a billing from the department, the employer shall pay into the appropriate retirement system trust fund the

amount of the overpayment plus interest as determined by the director. The employer's liability under this section shall not exceed the amount of overpayments plus interest received by the retiree within three years of the date of discovery, except in the case of fraud. In the case of fraud, the employer is liable for the entire overpayment plus interest.

Department of Retirement Systems Handbook, Chapter 5, states in part:

When a PERS Plan 1 retiree works more than 867 hours in a calendar year, while employed in an eligible position, the employer will receive an invoice for the applicable employer retirement contributions for the entire duration of the retiree's employment during that calendar year.

Department of Retirement Systems, PERS Plan 1 Retiree Information, states in part:

This publication describes possible impacts to your retirement benefit if you return to work for an employer covered by the Washington State Public Employees' Retirement System (PERS) Plan 1. The Department of Retirement Systems (DRS) has prepared this brochure to help you find answers to many of the questions regarding returning to work after retirement.

When do I become a retiree?

You become a retiree when you:

- Meet the age and service requirements for retirement;
- File an application for retirement with DRS;
- Terminate all employment with DRS-covered employer(s);
and
- Sever all contractual agreements (written or verbal) for future employment with DRS-covered employer(s).

Taking these actions will establish your effective retirement date – the first day of the month following the month in which you meet the conditions for retirement.

When is the earliest I can return to work?

To receive an unreduced retirement benefit, you must wait at least 30 calendar days after your effective retirement date before returning to work. If you return to work for a DRS-covered employer less than 30 days after your effective retirement date, your benefit will be reduced by 5.5 percent for every eight hours worked in a month up to a maximum of 160 hours per month. If the reduction is more than your benefit, the excess is taken from the next month's benefit payment. The reduction continues until you stop working for a full 30 days.

What happens if I return to work before my effective retirement date?

If you terminate employment and file a retirement application, but return to work before your effective retirement date, your application for retirement will be canceled. Because you are not considered retired, you will return to active membership and be required to pay member contributions.

What should I do when I return to work?

When you return to work for a DRS-covered employer, it is important to let your employer know you are a retiree. If you are hired into a position that is eligible for membership in a DRS or higher education retirement plan (HERP) your employer is required to report your hours of employment each month to DRS. HERPs are retirement plans offered by institutions of higher education, such as, University of Washington Retirement Plan (UWRP), and Western Washington University Retirement Plan (WWURP). If you work for a higher education employer, please check with your employer to see if your position is HERP-eligible.

If your employer does not know you are retired, you may be reported as an active member – which may stop your benefit. Contact your employer to determine the eligibility of your position.

How many hours can I work each year and still receive a benefit?

If you return to work in a DRS- or HERP-eligible position, there are limits placed on your employment.

- If you return to work in a DRS-eligible position, you can work up to 867 hours in a calendar year and continue to

receive your monthly benefit. If you work more than the maximum number of hours allowed, your retirement benefit will be suspended for the remainder of the calendar year or until you terminate employment.

- If you're a DRS retiree in a position eligible for a HERP, your hours count toward the annual limit of 867 hours.

If you return to work in a position that is ineligible for DRS or HERP membership, the rules above do not apply. You can work in this position as long as it is classified as ineligible and still receive your full retirement benefit.

Which hours count toward the limit?

Only hours for which you receive compensation in a DRS- or HERP-eligible position count toward the limit. This includes paid holidays or compensatory time, sick leave or annual leave taken in lieu of normal work hours. Sick leave or annual leave that is cashed out at the end of an employment period does not count toward the limit. Cashed out compensatory time does count toward the limit.

There is no cumulative limit placed on your employment. You can continue to work up to 867 hours each calendar year for as long as you like.

RCW 43.09.200 – Local government accounting – uniform system of accounting, state in part:

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achievement of objectives, such as new contracts or grants, changing regulations and accounting standards, new technology, new personnel, new or discontinued activities and programs, new or discontinued organizational policies and procedures, obsolescence of facilities, and so on. Risk assessment also includes evaluation of risks and determining how to best address them.

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internal controls should not be viewed as a singular event, but rather a continuous or iterative process.

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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	
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