



# Washington State Auditor's Office

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## Accountability Audit Report

# Town of Pe Ell

Lewis County

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

Published January 7, 2016

Report No. 1015833





## Washington State Auditor's Office

January 7, 2016

Mayor and Town Council  
Town of Pe Ell  
Pe Ell, 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 Town 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 Town'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

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## AUDIT SUMMARY

### Results in brief

In most areas we audited, Town operations complied with applicable requirements and provided adequate safeguarding of public resources. The Town 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 Town could make improvements.

We recommended the following related to financial condition and cost allocation:

- Establish a formal plan to address cash flow issues.
- Closely monitor and evaluate the financial activities to ensure the plan is being followed and the desired results achieved. It should revise the plan if expected improvements are not achieved.
- Take prompt action to manage operations within available resources.
- Establish a cost allocation plan to support costs allocated to restricted funds.

We also recommended the following related to general disbursements and small and attractive assets:

- Establish additional policies and procedures over aspects of general disbursements, specifically how to ensure invoices are matched with items that have actually been received, and purchase order document maintenance. The policies should also include sufficient monitoring and oversight by an independent party to ensure that adequate support is maintained for all disbursements.
- Strengthen its controls over safeguarding public assets by creating formal policies and procedures and ensuring all items considered theft sensitive and valuable, be monitored and tracked. The policy should include tagging, tracking, moving, adding and removing items from the master list. It should also establish an oversight process and guidelines for performing physical inventories and updating the master list based on the results of these inventories.
- Create a master asset list and investigate and report missing items on the list as required by the *Budget, Accounting and Reporting System* (BARS) Manual and state law (RCW 43.09.185).

These recommendations were included in our report as findings.

We also noted certain matters that we communicated to Town management in a letter dated December 16, 2015, related to open public meetings, payroll and utility adjustments. We appreciate the Town's commitment to resolving those matters.

## **About the audit**

This report contains the results of our independent accountability audit of the Town of Pe Ell from January 1, 2014 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 Town'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:

- Open public meetings
- General revenues and expenditures
- Cash receipting
- Payroll
- General disbursements
- Software conversion
- Cost allocation
- Utility adjustments
- Small and attractive assets
- Financial condition

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### **2014-001    The Town's financial condition puts it at risk of not being able to meet financial obligations and maintain current service levels.**

#### ***Background***

We communicated financial condition concerns to the Town in the prior audit. Although the Town has taken steps to decrease expenditures by cutting back employee hours, its financial condition continues to decline, specifically for its governmental funds.

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

The Town's General Fund and Governmental Funds ending cash balances as of year-end:

Fiscal Year	General Fund	Governmental Funds
2012	\$ 42,210	\$ 56,650
2013	\$ 39,258	\$ 80,305
2014	\$ 42,833	\$ 56,735

As of October 31, 2015, the Town's unaudited General Fund balance was \$6,008 and Governmental Fund's cash balance was \$19,064.

Further, Governmental Fund expenditures have exceeded revenues in recent years:

	2012	2013	2014
Revenues	\$ 1,180,301	\$319,440	\$286,647
Expenditures	\$ 1,126,118	\$336,645	\$278,267
Excess/(Deficit)	54,163	(\$17,205)	\$8,380

As of October 31, 2015, the Town's unaudited revenues were \$294,151 and expenditures were \$306,709, resulting in a deficit of \$12,558.

Additionally, the Town did not have a formal cost allocation plan or documentation for charges such as payroll and insurance costs that were allocated to the restricted

Water and Sewer funds. The payroll costs totaled \$200,765 in 2014 and the insurance costs totaled \$46,225 in 2014.

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

Although the Town has cut expenditures, it still has not effectively addressed its cash flow issues to ensure the Town's financial health remains stable or improves. Specifically, the Town's revenues have not kept up with expenditures.

The Town was unaware that a lack of detailed supporting documentation for cost allocations could result in unauthorized transfers from restricted funds.

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

The Town cannot be sure it can continue to provide services at current levels or meet its operating expenses.

Since the Town does not have adequate supporting documentation for its cost allocations, it could make unauthorized inter-fund transfers.

### ***Recommendation***

We continue to recommend the Town:

- Establish a formal plan to address cash flow issues.
- Closely monitor and evaluate the financial activities to ensure the plan is being followed and the desired results achieved. It should revise the plan if expected improvements are not achieved.
- Take prompt action to manage operations within available resources.
- Establish a cost allocation plan to support costs allocated to restricted funds.

### ***Town's Response***

*The Town does not agree that it is "expending more than it is taking in."*

*As explained in an October 28, 2015 letter to your office, property tax revenue is a large source of funding for the general account. The revenue from the payments of property taxes is generally disbursed from the Lewis County Treasurer's Office to the Town in May and again in November/December. In fact, the Town recently received \$17,753.74 in property tax revenues. In between these two payments, and especially in August, September, and October (the period in which your audit was performed) it is not uncommon for municipal entities comparable in size to our Town to experience an operating decline in governmental funds. However, reserves*

*are maintained to cover these seasonal declines. The Town's position is in accord with that of an independent, external CPA retained by the Town.*

*Nonetheless, the Town will implement the recommendations of your office. The Town is attempting to build up its cash flow in its general fund to avoid any deficits at any time. However, should any deficit arise in the future, the Town will implement inter-fund loans to meet and address the cash flow shortage.*

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

We appreciate the Town's response and recognize that it is committed to ongoing quality improvement and working to improve its financial condition and procedures.

We also wish to thank the Town's staff and management for their cooperation and assistance during our audit. We look forward to working with the Town on these issues and will follow up on them during the next audit.

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

RCW 43.09.210 - Local government accounting – Separate accounts for each fund or activity. Exemption for agency surplus personal property, states, in part:

All service rendered by, or property transferred from, one department, public improvement, undertaking, institution, or public service industry to another, shall be paid for at its true and full value by the department, public improvement, undertaking, institution, or public service industry receiving the same, and no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another.

RCW 35.33.123 Administration, oversight, or supervision of utility – Reimbursement from utility budget authorized.

Whenever any city or town apportions a percentage of the city manager's, administrator's, or supervisor's time, or the time of other management or general government staff, for administration, oversight, or supervision of a utility operated by the city or town, or to provide services to the utility, the utility budget may identify such services and budget for reimbursement of the city's or town's current expense fund for the value of such services.



## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### **2014-002    The Town should establish adequate internal controls over general disbursements and small and attractive assets to avoid the risk of misappropriation.**

#### *Background*

The Town's total disbursements for 2014 were \$1,465,897. We could not determine the value of the Town's small and attractive assets due to incomplete inventory records. Small and attractive assets are items such as electronics, computer equipment, cameras and other items at risk of loss or misappropriation.

#### *Description of Condition*

We communicated general disbursement and small and attractive asset concerns to the Town in the prior audit. Since that report was issued in December 2014, our current audit focused on internal controls and transactions through September 2015. We noted that although the Town adopted new accounting policies and procedures as of September 1, 2015, the policies and procedures lack adequate information and oversight related to general disbursements and do not address controls over small and attractive assets. Specifically, we noted:

#### *General Disbursements*

- Since the Town adopted its general disbursement policy the day before our audit began, we were unable to confirm that the policy and procedures had been implemented. Further the Town does not have a policy or procedure in place to confirm that items or services have been received prior to the payment of invoices.
- There were no invoices or receipts to support expenditures in 18 instances totaling \$560.
- The Town has informal procedures which require purchase orders. A purchase order was missing or did not appear to be approved in 11 instances, totaling \$1,375.
- There was no evidence of approval for 14 employee reimbursements, totaling \$659.

### *Small and Attractive Assets*

- The Town does not have formal policies or procedures for adding, tagging (such as identification or serial numbers), tracking, moving, and reporting, and disposing of items.
- The Town does not maintain a small and attractive assets master list. Instead, the Town generates a new listing at the beginning of each year; however there is no reconciliation from year to year to ensure the list is complete. We also determined that only two departments have prepared listings.
- There is no segregation of duties between purchasing, receiving and disposing of assets. There is also no reconciling or oversight function by an independent party.
- There are no procedures for performing regular physical inventories. No physical inventory has been performed for approximately 18 months.

During our audit, we tested 20 assets and identified the following issues:

- One item on the inventory listing was not able to be located and also lacked a tag/serial number on the listing.
- One item observed was not on inventory listing.
- 13 items that had discrepancies. Of these, five items did not properly document location and 10 items did not properly document tag/serial numbers.

### *Cause of Condition*

The Town has limited staff. Despite prior recommendations relating to the importance of independent monitoring and oversight, the Town has not taken adequate steps to ensure the safeguarding of public resources.

### *Effect of Condition*

The Town needs to strengthen internal controls to safeguard public resources. Without adequate internal controls, public funds and assets are at risk for misappropriation, misuse or loss that would not be detected by management in a timely manner, if at all.

## ***Recommendation***

We continue to recommend the Town:

- Establish additional policies and procedures over aspects of general disbursements, specifically how to ensure invoices are matched with items that have actually been received, and purchase order document maintenance. The policies should also include sufficient monitoring and oversight by an independent party to ensure that adequate support is maintained for all disbursements.
- Strengthen its controls over safeguarding public assets by creating formal policies and procedures and ensuring all items considered theft sensitive and valuable, be monitored and tracked. The policy should include tagging, tracking, moving, adding and removing items from the master list. It should also establish an oversight process and guidelines for performing physical inventories and updating the master list based on the results of these inventories.
- Create a master asset list and investigate and report missing items on the list as required by the *Budget, Accounting and Reporting System* (BARS) Manual and state law (RCW 43.09.185).

## ***Town's Response***

*The Town has worked hard since the prior audit to make improvements to safeguard assets. The Town had staff turnover during the audit period, which caused part of the discrepancies noted during the audit. We have adopted policies and procedures related to general disbursements and will continue to work on strengthening controls surrounding these procedures.*

*The Town will ensure that required approvals are obtained and the documentation to support expenditures supports the payments. It will also evaluate the informal purchase order process. When the Mayor is reviewing the voucher directory, he will ensure that the proper documentation is attached to the voucher.*

*The Town will follow your recommendations in creation of a master list for tracking and inventory purposes. The Town will also implement a policy governing small and attractive assets. In fact, the Town already has drafted a small and attractive assets policy and presented it to the Town Council. This policy contains physical inventory and tagging procedures, as well as oversight of the changes made (disposals, additions) to the master listing.*

*The Town is committed to strengthening its internal controls. It will continue to make improvements to procedures and policies.*

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

We appreciate the Town's response and recognize that the Town is committed to ongoing quality improvement and working to improve its procedures.

We wish to thank the Town's staff and management for their cooperation and assistance during our audit. We look forward to working with the Town on these issues and will follow up on them during the next audit.

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

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. The system shall exhibit true accounts and detailed statements of funds collected, received, and expended for account of the public for any purpose whatever, and by all public officers, employees, or other persons.

The accounts shall show the receipt, use, and disposition of all public property, and the income, if any, derived therefrom; all sources of public income, and the amounts due and received from each source; all receipts, vouchers, and other documents kept, or required to be kept, necessary to isolate and prove the validity of every transaction; all statements and reports made or required to be made, for the internal administration of the office to which they pertain; and all reports published or required to be published, for the information of the people regarding any and all details of the financial administration of public affairs.

Volume 1, Part 3, Chapter 1 of the *2014 Budgeting Accounting and Reporting System* (BARS) manual (3.1.3.10 - 3.1.3.30) issued by the State Auditor's Office pursuant to RCW 43.09.230, states, in part:

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:

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.

## STATUS OF PRIOR AUDIT FINDINGS

This schedule presents the status of findings reported in prior audit periods. The status listed below is the representation of the Town of Pe Ell. The State Auditor's Office has reviewed the status as presented by the Town.

<b>Audit Period:</b> 1/1/2013 – 12/31/2013	<b>Report Ref. No.:</b> 1013349	<b>Finding Ref. No.:</b> 2013 – 001
<b>Finding Caption:</b> The Town should establish adequate internal controls over its financial operations, to avoid the risk of misappropriation.		
<b>Background:</b> Despite prior audit recommendations, the Town continues to have systemic internal control weaknesses over its financial operations. Specifically, the Town lacks adequate internal controls, policies and procedures related to cash receipting, payroll, general disbursements and its key accounting software.  <i>Cash Receipting</i>  We made recommendations in the prior audit relating to the lack of internal controls over the Town's cash receipts. The Town implemented some of the recommendations; however we noted the following issues continue to exist: <ul style="list-style-type: none"><li>• The Town's policy still does not address the cash receipting locations, use of pre-numbered receipts, change fund amounts, replenishment procedures, safeguarding of funds and procedures for voids.</li><li>• Two instances where a receipt was changed from a check payment to a cash payment. The changes were to correct errors made when the funds were receipted.</li><li>• Three of 10 deposits tested totaling \$7,905.18 were not deposited timely in accordance with state law.</li></ul> <i>Payroll</i>  The Town's payroll policy does not specify how payroll disbursements are authorized, approved and reviewed. During our audit work, we identified the following issues: <ul style="list-style-type: none"><li>• A number of overtime, sick leave and vacation forms were either not complete or not maintained.</li><li>• A number of overtime and leave forms that did not match the hours listed on employee timesheets.</li><li>• Overtime hours which were paid in contradiction to Town policy.</li><li>• Mid-month draws that were paid in contradiction to Town policy.</li><li>• One instance when hours paid did not match the hours on the employee's timesheet.</li></ul>		

- The amount of leave shown on employee timesheets did not match the Town's leave balance tracking sheet.
- Sick leave balances were inexplicably increased from the ending balance on one month to the beginning balance on the next month.

Although, these issues did not have a significant dollar impact at this time, the risk of a more significant impact exists if internal controls and oversight are not improved.

#### *General Disbursements*

The Town does not have a formal policy to support its general disbursements. During our audit, we identified the following issues:

- No invoice or receipt to support expenditures in 16 instances, totaling \$4,320.
- The Town has informal procedures which require purchase orders. A purchase order was missing in 13 instances, totaling \$3,420.
- No evidence of approval for 16 travel vouchers, totaling \$860.
- One expenditure, totaling \$150, which was made to an employee's relative for garden work without adequate documentation to support that the services were actually provided.

#### *Software Conversion*

The Town did not maintain documentation for a software conversion that occurred in 2013. As a result, we were unable to confirm the data transfer was complete and accurate. We attempted to reconcile the Town's 2013 cash balances, including its deposits and payments, and determined that the amount in the Town's accounting system was understated by \$8,131 compared to bank statements. Since the Town did not maintain its software conversion information, we could not determine the cause of this difference.

#### **Status of Corrective Action: (check one)**

☐ Fully Corrected      ☒ Partially Corrected      ☐ No Corrective Action Taken      ☐ Finding is considered no longer valid

#### **Corrective Action Taken:**

- Immediately following the audit, the Town Council held a number of workshops to review the findings and formulate a plan to address the findings;
- Meetings were held to discuss the implementation of a financial internal controls policy. After discussing the contents of the policies, the Town hired an independent CPA and consultant to assist drafting and implementing the new policies and procedures in order to ensure that our policies utilized best practices and addressed the concerns raised in the audit.
  - The new policy addresses the payroll concerns set forth in the 2013 audit;
  - The new policy addresses the general disbursement concerns set forth in the 2013 audit;

- Cash receipting has been changed for pre-numbered receipts and the new policy addressed cash receipting;
- We are now using purchase order and receipt detail forms with receipts that come into Town Hall;
- The Town Council has discussed and is considering the implementation of a financial oversight committee to bring additional financial oversight to the town's procedures.



## INFORMATION ABOUT THE TOWN

The Town of Pe Ell, incorporated in 1906, serves approximately 650 citizens in Lewis County. Its four employees provide a range of services, either directly or through contracts, including police, water and sewer, street maintenance, business licenses and general administrative services.

An elected, five-member Council and an independently elected Mayor govern the Town. For fiscal year 2014, the Town operated on a budget of approximately \$1.2 million.

Contact information related to this report	
Address:	Town of Pe Ell P.O. Box 215 Pe Ell, WA 98572-0215
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*Information current as of report publish date.*

### Audit history

You can find current and past audit reports for the Town of Pe Ell 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.

Contact information for the State Auditor's Office	
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