



# Washington State Auditor's Office

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

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

**Published August 22, 2016**

**Report No. 1017250**





## Washington State Auditor's Office

August 22, 2016

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

### Report on Financial Statements

Please find attached our report on Public Utility District No. 1 of Jefferson County's financial statements.

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

Sincerely,

TROY KELLEY  
STATE AUDITOR  
OLYMPIA, WA

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## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### Public Utility District No. 1 of Jefferson County January 1, 2013 through December 31, 2013

**2013-001 The District's internal controls over accounting and financial statement preparation are inadequate to ensure timely and accurate reporting.**

#### *Background*

It is the responsibility of District management to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting.

Our prior audit reported a significant deficiency in the District's internal controls over financial reporting for fiscal years 2010, 2011 and 2012. The District has since experienced changes which have negatively impacted its internal controls over accounting and financial reporting. Our audit identified deficiencies in internal controls that adversely affect the District's ability to produce reliable financial statements.

#### *Description of Condition*

Our audit identified the following deficiencies in internal controls that, when taken together, represent a material weakness. The District:

- Personnel responsible for recording financial transactions did not have the technical knowledge needed to ensure the accounting records were accurate and complete.
- Lacked procedures to ensure financial statements were completed accurately and in accordance with Generally Accepted Accounting Principles (GAAP).
- Lacked procedures to ensure statements and schedules were submitted timely, in accordance with state law.
- Accounting software was not designed to record transactions in accordance with the District's regulatory accounting requirements and recorded activity in error.
- Lacked procedures to reconcile its cash balances and activity to the bank statements and reports from the County Treasurer.

- Lacked procedures to ensure that journal entries were performed timely, supported, properly reviewed and authorized.
- Lacked procedures to ensure capital assets were properly tracked and depreciation was accurately calculated.

### *Cause of Condition*

The District experienced significant turnover in its key financial position responsible for maintaining accurate accounting records and preparing financial reports during the period from April 2013 through May 2016.

The District expanded operations in 2013 to include provision of electricity in addition to water. District management did not adequately monitor the effectiveness of internal control systems following the expansion.

The District changed accounting software during the audit period. The software was not equipped to properly account for the electric operations and the District did not have adequate compensating controls in place.

The District did not provide adequate training to its staff to ensure accurate and complete reporting.

### *Effect of Condition*

The District did not meet its Single Audit deadline of September 30, 2014 because the 2013 financial statements were not completed until November 18, 2015.

The financial statements were not filed with the State Auditor's Office within 150 days after year-end as required by state law. The fiscal year 2013 statements were filed 535 days late.

Delayed and inaccurate accounting records and financial reports limit access to financial information used by District officials, the public, state and federal agencies and other interested parties. In addition, these conditions delay the audit process and result in increased audit costs.

The District chose not to perform additional work to identify the cause of the discrepancies in the accounting records and correct the misstatements. As a result, the State Auditor's Office was unable to render an opinion as to whether the financial statements were fairly presented. We disclaimed on the financial statements for the year ended December 31, 2013 and no financial statements are included with our audit report.

We identified the following errors in the original financial statements we received for audit:

- Utility plant assets were overstated by \$31,685,488.
- Accumulated depreciation was overstated by \$29,771,410.
- Accounts receivable were understated by \$2,144,582.
- Accounts payable were overstated by \$1,729,606.
- Depreciation expense and accumulated depreciation were misstated by an indeterminable amount due to incomplete capital asset records.
- The net investment in capital assets was understated by \$2,054,809 and unrestricted net position was overstated by the same amount.
- Additional less-significant misstatements ranging from \$124,726 to \$455,241.
- The Statement of Cash flows did not reconcile to other financial statements. Misstatements ranged from \$64,572 to \$4,047,016.
- Management's Discussion and Analysis and Notes to the Financial Statements were missing information and contained inaccurate information.

The District made more than \$550 million of adjusting journal entries for 2013. Our review of selected journal entries identified:

- Multiple out-of-balance entries between funds.
- The ending interfund payables balances exceeded interfund receivables balances by \$3,874,188 in the general ledger. This indicated there were significant unidentified misstatements still outstanding.
- In August 2015, the District made adjusting journal entries to reduce its 2013 ending cash in the general ledger by \$1,692,067 in order to agree to third-party documentation. The variance was not detected timely by the District, and the cause of the variance was not identified or corrected.

### ***Recommendation***

We recommend the District establish and follow procedures to ensure:

- District personnel responsible for recording financial transactions are provided the necessary resources, time, training and oversight to facilitate the preparation of accurate and supported financial statements.

- Financial statements are completed accurately and in accordance with Generally Accepted Accounting Principles (GAAP). This includes preparation and review of the financial statements by persons knowledgeable of District activities and financial reporting requirements.
- Statements and schedules are submitted timely as required by federal and state law.
- The District's accounting system facilitates accurate accounting records and allows the level of detail necessary to comply with all reporting requirements.
- Cash balances and activity are reconciled to the bank statements and reports from the County Treasurer monthly and discrepancies are researched and resolved timely.
- Journal entries are performed timely, adequately supported, properly reviewed and authorized.
- Capital assets are properly tracked and depreciation is accurately calculated.

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

*As the SAO report notes, the acquisition of the electrical facilities in Jefferson County during 2013 presented a tremendous challenge for JPUD. JPUD recognized early on the need to improve its accounting and financial procedures so they would be compliant with the accounting principles required of GAAP, FERC, RUS, and NARUC would meet Washington State and Federal Audit requirements; and adequately handle the increased complexity of the large increases in customers and revenues. Therefore, JPUD purchased and implemented accounting and billing software and procedures designed for an electrical RUS borrower which allows for the level of detail necessary to comply with all reporting requirements. Additionally, the PUD has hired consultants skilled in the areas of RUS Utility accounting and financial controls to correct the problems identified by the SAO in their report; to optimize the new systems; and to establish the controls and procedures to ensure future success. These changes are greatly improving the PUD's financial, accounting, and internal controls. The PUD is reconciling bank statements and reports from the County Treasurer monthly and journal entries are now being performed timely, and are properly reviewed and authorized. The PUD is currently hiring a new CFO and Controller to better meet the needs of the PUD. Also specialized training of existing PUD staff has been conducted and continues to be emphasized. We currently have an Interim Financial Director who is experienced and skilled in RUS borrower*

*accounting. As a result of its efforts, the PUD successfully submitted its 2015 financials to the State on time and is looking forward to the 2015 audit later this year.*

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

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

RCW 43.09.230 Local government accounting – Annual reports – Comparative statistics, states in part:

The state auditor shall require from every local government financial reports covering the full period of each fiscal year, in accordance with the form and methods prescribed by the state auditor, which shall be uniform for all accounts of the same class.

Such reports shall be prepared, certified and filed with the state auditor within one hundred fifty days after the close of each fiscal year.

*Budgeting, Accounting and Reporting System (BARS) Manual – Accounting, Accounting Principles and Internal Control, Internal Control states in part:*

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.

3.1.3.140 This objective refers to fair presentation of financial statements and required schedules in all material respects in accordance with the stated basis of accounting.

3.1.3.150 In meeting this objective, the government should have controls that

- Identification of financial events – Controls should ensure financial events and transactions are properly identified and recorded.
- Properly applying accounting standards – Controls should ensure correct criteria and methodology is applied when accounting for financial events. When the correct method of accounting for or reporting a transaction is unclear, the government should seek clarification by performing research, contracting for accounting assistance, or communicating with the State Auditor's Office or standard setting bodies.
- Correctly accounting for all financial events – Controls should ensure that:
  - Only valid transactions are recorded and reported.
  - All transactions occurred during the period are recorded and reported.
  - Transactions are recorded and reported at properly valued and calculated amounts.
  - Recorded and reported transactions accurately reflect legal rights and obligations.

- Transactions are recorded and reported in the account and fund to which they apply.
- Preparation of the annual report – Controls should ensure that financial statements and required schedules are properly compiled and prepared from source accounting records. Controls should also ensure correct presentation of statements and schedules.

3.1.3.160 Controls and processes should generate adequate documentation to demonstrate achievement of objectives. This is not only important for audit, oversight and public records purposes, but also to enable effective monitoring of controls over financial reporting by management.

*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 on the work performed, (1) significant deficiencies and material weaknesses in internal control; (2) instances of fraud and noncompliance with 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 significant deficiencies and material weaknesses 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:

**Material weakness.** 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.

**Significant deficiency.** 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.

OMB Circular A-133, Audits of States, Local Government, and Non-Profit Organizations, states in part:

Section 200, Audit requirements: (a) Audit required. Non-federal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in determining Federal awards expended is provided in §\_\_\_\_.205.

Section 300, Auditee responsibilities, states in part: The auditee shall: (e) Ensure that the audits required by this part are properly performed and submitted when due.

Section 320, Report Submission, states in part: (a) General. The audit shall be completed and the data collection form described in paragraph (b) of this section and reporting package described in paragraph (c) of this section shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for accordance with the provisions of this part. Guidance on audit . . . .

## SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

### Public Utility District No. 1 of Jefferson County January 1, 2013 through December 31, 2013

This schedule presents the status of findings reported in prior audit periods. The status listed below is the representation of Public Utility District No. 1 of Jefferson County. The State Auditor's Office has reviewed the status as presented by the District.

<b>Audit Period:</b> 01/01/2010 – 12/31/2012	<b>Report Ref. No:</b> 1011579	<b>Finding Ref. No:</b> 2012-001
<b>Finding Caption:</b> The District's internal controls over financial accounting and financial statement preparation are inadequate to ensure accurate and complete reporting.		
<b>Background:</b> District management is responsible to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting. Our audit found that during the audit period, the District hired an outside consultant to prepare the District's basic financial statements and notes. The District did not have a consistent process in place to ensure the financial statements were complete, accurate and prepared in accordance with Generally Accepted Accounting Principles (GAAP) and did not provide adequate oversight to ensure the financial statements were completed timely. In addition, the District lacked procedures to reconcile its year-end balances to the bank statements and reports from the County Treasurer, and did not have adequate controls to ensure its depreciation was calculated correctly.		
<b>Status of Corrective Action:</b> <input type="checkbox"/> Fully Corrected <input checked="" type="checkbox"/> Partially Corrected <input type="checkbox"/> Not Corrected <input type="checkbox"/> Finding is considered no longer valid		
<b>Corrective Action Taken:</b> <i>The PUD has invested in accounting software that is used by a large number of utility companies throughout the country. The PUD has also invested in training and personnel to develop processes and procedures, much of which can be effectively and efficiently recorded in the software, to ensure financial statements are prepared in accordance with GAAP and in a timely manner. The PUD is now reconciling its year-end account balances and is in the process of putting controls in place to ensure that depreciation is calculated correctly. The PUD will continue to work on controls, training and reporting processes.</i>		

# **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**

## **Public Utility District No. 1 of Jefferson County January 1, 2013 through December 31, 2013**

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

We were engaged to audit, 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, the financial statements of Public Utility District No. 1 of Jefferson County, Washington, as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated August 16, 2016. Our report disclaims an opinion on such financial statements because we were not able to obtain financial statements supporting the financial activities of the District for the year ended December 31, 2013, nor were we able to satisfy ourselves as to those financial activities by other auditing procedures.

## **INTERNAL CONTROL OVER FINANCIAL REPORTING**

In connection with our engagement to audit the financial statements of the District, we considered the District'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 District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District'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 District'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 2013-001 to be material weaknesses.

## COMPLIANCE AND OTHER MATTERS

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

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, if the scope of our work had been sufficient to enable us to express an opinion on the financial statements, instances of noncompliance or other matters may have been identified and reported herein.

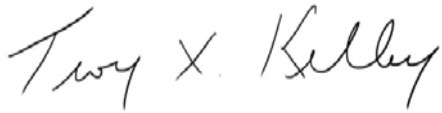
## DISTRICT'S RESPONSE TO FINDINGS

The District's response to the findings identified in our audit is described in the accompanying Schedule of Audit Findings and Responses. The District'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 District'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 District'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

August 16, 2016

# INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

## **Public Utility District No. 1 of Jefferson County January 1, 2013 through December 31, 2013**

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

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

We were engaged to audit the financial statements of Public Utility District No. 1 of Jefferson County, Washington, as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the District'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 audit 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 matter described in the Basis for Disclaimer Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide basis for an audit opinion.

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

The District did not provide accurate financial statements or supporting schedules for the period ended December 31, 2013. Although representations of the District's financial activities were available for audit, our procedures identified material misstatements. Additionally, bank reconciliations were not performed to allow us to evaluate the fair statement of cash balances



presented in the financial statements. Further, our audit identified more than \$64 million of adjusting journal entries made in error, and the District was unable to determine the cause of significant variances between the bank activity and accounting records. Given the lack of internal controls over the general ledger and adjusting journal entries, 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.

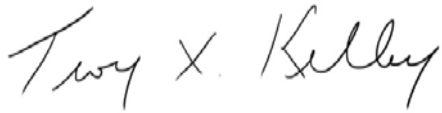
### **Other Matters Regarding Disclaimer of Opinion**

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 August 16, 2016 on our consideration of the District'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 District's internal control over financial reporting and compliance.

A handwritten signature in cursive script that reads "Troy X. Kelley". The signature is written in dark ink and is positioned above the printed name.

TROY KELLEY  
STATE AUDITOR  
OLYMPIA, WA

August 16, 2016

## CORRECTIVE ACTION PLAN FOR FINDINGS REPORTED UNDER OMB CIRCULAR A-133

### Public Utility District No. 1 of Jefferson County January 1, 2013 through December 31, 2013

This schedule presents the corrective action planned by the auditee for findings reported in this report in accordance with OMB Circular A-133. The information in this schedule is the representation of the Public Utility District No. 1 of Jefferson County.

<b>Finding ref number:</b> 2013-001	<b>Finding caption:</b> The District's internal controls over accounting and financial statement preparation are inadequate to ensure timely and accurate reporting.
<b>Name, address, and telephone of auditee contact person:</b> Jim Parker 310 Four Corners Road Port Townsend, WA 98368 (360) 385-8340	
<b>Corrective action the auditee plans to take in response to the finding:</b> <i>The PUD is integrating and implementing new accounting and billing software with improved control measures to provide for better financial accountability and reporting. The PUD is hiring and contracting with needed skilled individuals and is and will continue training appropriate PUD employees to ensure that accurate and supported financial statements are completed in a timely and detailed manner. Improved controls will be developed to ensure secondary review of District activities and financial reporting requirements is being done; the timely submittal of statements and schedules; accurate records are maintained; appropriate cash balance and activity reconciling are performed; and that journal entries are performed timely, are adequately supported and are properly reviewed and authorized. Capital assets are being set up in the new accounting software to allow for proper tracking and so that depreciation can be accurately calculated.</i>	
<b>Anticipated date to complete the corrective action:</b> January 2017	

## 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	
Public Records requests	<a href="mailto:PublicRecords@sao.wa.gov">PublicRecords@sao.wa.gov</a>
Main telephone	(360) 902-0370
Toll-free Citizen Hotline	(866) 902-3900
Website	<a href="http://www.sao.wa.gov">www.sao.wa.gov</a>