



Office of the Washington State Auditor
Pat McCarthy

Fraud Investigation Report

City of Rock Island

Douglas County

For the Investigation Period January 1, 2015 through December 31, 2016

Published May 8, 2018

Report No. 1021296





**Office of the Washington State Auditor
Pat McCarthy**

May 8, 2018

City of Rock Island
Rock Island, Washington

Report on Fraud Investigation

Attached is the official report on a misappropriation at the City of Rock Island. On November 28, 2016, the City notified the State Auditor's Office of a potential loss of public funds. This notification was submitted to us under the provisions of state law (RCW 43.09.185).

This report contains the results of our investigation over cash receipting at the City from January 1, 2015 through December 31, 2016. The purpose of our investigation was to determine if a misappropriation had occurred.

Our investigation was performed under the authority of state law (RCW 43.09.260) and included procedures we considered necessary under the circumstances.

If you are a member of the media and have questions about this report, please contact Assistant Director for Communications Kathleen Cooper at (360) 902-0470. Otherwise, please contact Fraud Manager Sarah Walker at (509) 454-3621.

Pat McCarthy
State Auditor
Olympia, WA

cc: Mr. Dan Fagan, Clerk/Treasurer

FRAUD INVESTIGATION REPORT

Investigation Summary

On November 28, 2016, the Mayor of the City of Rock Island notified our Office regarding a potential loss of public funds as state law requires.

We investigated and determined a cash receipting misappropriation totaling \$37,056 occurred at the City between November 2015 and October 2016. The misappropriated funds were all cash payments that were received, but not deposited.

In addition to the cash receipting misappropriation, we also identified questionable transactions totaling \$1,071 and a \$225 deleted receipt that was unsupported.

The City did not file a report with the Douglas County Sheriff's Office. Our Office notified the Douglas County Sheriff's Office, and we will send this report to the Douglas County Prosecuting Attorney's Office.

Background and Investigation Results

The City, located in Douglas County, receives annual revenues of about \$1 million. The City's revenue comes from multiple sources but primarily utility sales. Other sources of revenue include lease payments, fees from building permits and licenses. The City has three full-time and two part-time employees. The Clerk/Treasurer is responsible for overseeing the daily financial operations of the City with the support of a Deputy Clerk. The Clerk/Treasurer reconciles the electronic accounting system to the bank records, while the Deputy Clerk handles most of the cash receipting duties and recording those payments in the accounting system.

Our investigation focused on cash receipting. City staff issue receipts for payments made at City Hall. Staff members then record and reconcile receipts in the City's accounting system. Our investigation focused on the following activities:

Cash receipts from January 2015 to November 2016

We compared receipts recorded in the electronic accounting system to amounts deposited at the bank and identified a total of \$37,056 in cash transactions that were entered into the accounting system but not deposited into the bank account. The investigation revealed the following:

- State law requires governments to deposit funds into a bank within 24 hours of receiving them unless the City formalizes a policy or resolution waiving the 24-hour requirement, and allowing deposits no less than weekly. Rock Island had no such waiver. During the period we investigated, the number of days between receipt date and deposit date ranged from one to 119 days, with an average of 34 days.

- In October 2015, the City changed its deposit process, requiring checks and cash to be deposited separately. The reason for this change, according to the former Clerk/Treasurer, was a mutual decision between the Clerk/Treasurer and Deputy Clerk based on information received at their accounting software vendor’s conference in the fall of 2015. The Deputy Clerk said she was directed by the former Clerk/Treasurer to change the process.
- After the deposit process changed, 25 cash deposits noted in the accounting software system were not actually deposited into the bank. The system allows users to select what receipt batches were included in deposits made to the bank. The remaining receipt batches remain in the system as “unattached.” The reconciliation reports sent to the Mayor to review and approve did not include the 25 “unattached” cash deposits. However, these “unattached” deposits appeared on a screen for the Clerk/Treasurer to see before printing the report.
- The Clerk/Treasurer said that when she prepared the reconciliation reports, she was only checking that deposited amounts on the bank statement were listed in the accounting system. However, using that approach and not including any unattached receipt batches defeats the purpose of the Mayor’s review of the reconciliation report.
- On March 8, 2016, 10 deposits totaling about \$8,350 in cash were deposited at the bank, which included cash receipts from November 2015, December 2015, January 2016 and February 2016. This occurred just prior to the Mayor taking over the duty of making deposits in mid to late March 2016.
- After the Mayor took over depositing duties, we did not identify any missing deposits in the period from April 2016 to September 2016. Further, the number of days between receipt date and deposit date averaged 14 days.
- Before March 2016, it is unclear whose responsibility it was to take deposits to the bank. The former Clerk/Treasurer said multiple City employees made deposits. The Deputy Clerk said typically the Clerk/Treasurer made deposits.
- Further, our investigation revealed the City’s safe was not secured during business hours, allowing anyone within the building to access its contents. In addition, it was not clear who knew the safe combination and who had physical access to City Hall because the City’s inventory of keys might not have been accurate.

Manual Receipts from January 2015 to November 2016

Although the City regularly uses its electronic accounting system to record receipts, it also occasionally uses a manual receipt book. City staff later enter manual receipts into the system. We attempted to compare manual receipts to transactions recorded in the system and subsequent deposits. We were unable to trace \$1,071 in receipts because the City did not consistently record

non-sufficient-funds fees in the accounting system and did not deposit within a reasonable amount of time. In addition, 10 receipts were missing from the receipt book, so we were unable to test those receipts.

Deleted receipt transactions from January 2015 to November 2016

The electronic accounting system allows transactions to be deleted to allow for human error and other reasonable circumstances. However, governments should document the reason behind deletions to demonstrate that these inherently risky transactions are valid and appropriate. We compared cash receipts to the deleted transactions report and tested eight transactions for appropriateness. The City could not demonstrate the reason for one deleted \$225 transaction.

To determine if any additional misappropriations occurred, we also examined other significant systems at the City, including payroll and general disbursements. We did not identify any additional misappropriation. We also reviewed additional areas of cash receipting and did not find additional misappropriation; however, we did identify additional internal control weaknesses related to physical access to City Hall and the safe combination.

We determined the City could not assign responsibility for the misappropriation due to control weaknesses over cash receipting procedures and safeguarding of public resources.

Control Weaknesses

Internal controls at the City were not adequate to safeguard public resources. We found the following weaknesses allowed the misappropriation to occur:

- The Clerk/Treasurer and Deputy Clerk, who are responsible for cash receipting, data entry, bank depositing, and reconciliations, have the ability to make adjustments in the accounting system. Further, those adjustments were not reviewed by someone independent of the process.
- An accounting system weakness allows users to apply payments to customer accounts, while the payment remains “unattached” within the system. As a result, the payments do not appear on the monthly reconciliation activity report that lists all funds received for the period, and which the City relies on to reconcile with the bank statement.
- No one independent of the reconciliation process compared these “unattached receipts” in the system to the Clerk/Treasurer’s monthly bank reconciliation to determine if unattached items were reasonable and appropriate.
- The Clerk/Treasurer was responsible for bank reconciliations and also delivered receipted funds to the bank for deposit.
- City staff inconsistently used manual receipts, and the City lacked oversight or reconciliation processes over those manual receipts.

- Access to City Hall's safe was not limited based on need. Rather, all City staff had access to the safe during the day. In addition, the City did not know who had a key to City Hall or the combination to the safe.

Recommendations

We recommend the City strengthen internal controls over cash receipting, including adequate oversight and monitoring to safeguard public resources and comply with City policies. At a minimum, improvements should include:

- Appropriate segregation of duties and monitoring over cash receipting, bank deposit preparation and bank reconciliations
- Adequate documentation of bank reconciliations to verify all amounts received are deposited
- Independent review of cash receipt adjustments in the system and verification that adjustments are reasonable and adequately supported
- Consistent accounting treatment of bank and non-sufficient-funds fees. If manual receipts are used, someone independent of the receipting process should review these and verify they were entered into the system and deposited.
- Limited access to City Hall and the safe to essential personnel only

We also recommend the City seek recovery of the misappropriated \$37,056 and related investigation costs of \$11,165 from its insurance bonding company. Any compromise or settlement of this claim by the City must be approved in writing by the Attorney General and State Auditor as directed by state law (RCW 43.09.260). Assistant Attorney General Matt Kernutt is the contact person for the Attorney General's Office and can be reached at (360) 586-0740 or mattkl@atg.wa.gov. The contact for the State Auditor's Office is Sadie Armijo, Assistant Director of Local Audit, who can be reached at (360) 902-0362 or Sadie.Armijo@sao.wa.gov.

City's Response

Subsequent to the departure of a former City Clerk/Treasurer, the then City Clerk/Treasurer and current Mayor discovered that multiple batched cash receipts had been credited as received by the City and correctly applied to City customer utility accounts, but were never deposited in the City bank account. The current Mayor and the Clerk/Treasurer were unable to account for these missing funds and therefore contacted the State Auditor's office and requested an investigation be conducted. This investigation was followed up by an investigation by the Douglas County Sheriff's office to determine whether criminal charges should be brought against one or more individuals. We understand from your report and from the Douglas County Sheriff's office that

you were able to confirm that the cash was taken and remains missing, but neither your office nor the Sheriff's office were able to identify the person or persons who stole the cash.

You have identified several recommendations most of which we have already implemented and others the City will be implementing soon. One of the challenges for the City is having a limited number of employees which is not ideal when handling the significant amount of cash we receive. We have changed the locks on City Hall and the combination to the City safe and have restricted access to keys to City Hall and have limited knowledge of the safe combination to only two City employees. We appreciate your efforts to identify the thief or thieves and are confident our new team at City Hall will do everything within our power and authority to prevent any such occurrence from happening again.

State Auditor's Office Remarks

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

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	PublicRecords@sao.wa.gov
Main telephone	(360) 902-0370
Toll-free Citizen Hotline	(866) 902-3900
Website	www.sao.wa.gov