



Office of the Washington State Auditor
Pat McCarthy

Fraud Investigation Report

Port of Centralia

Lewis County

For the Investigation Period March 20, 2013 through December 31, 2016

Published July 12, 2018

Report No. 1021737





**Office of the Washington State Auditor
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July 12, 2018

Board of Commissioners
Port of Centralia
Centralia, Washington

Report on Fraud Investigation

Attached is the official report on a misappropriation at the Port of Centralia. On December 27, 2016, the Port 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 of the former Property Management Company's Property Manager's unallowable activities at the Port from May, 2013 through December 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: Amy Davidson, Director of Finance and Administration

FRAUD INVESTIGATION REPORT

Investigation Summary

On December 27, 2016, Port of Centralia's Director of Finance & Administration notified our Office regarding a potential loss of public funds as required by state law.

The Port investigated and provided its files to us. We reviewed the Port's investigation and determined a contracted service provider's former employee had misappropriated Port rental revenues totaling \$53,138. Another \$2,020 in potential losses that occurred between May 2013 and December 2016 is questionable – the funds could have been either misappropriated or legitimate expenses.

The Port filed a report with Centralia Police Department, which is investigating. We will refer this report to the Lewis County Prosecuting Attorney's Office.

Background and Investigation Results

The Port of Centralia was created in 1986 by a public vote of the residents within the Port boundaries in Lewis County. The Port's main purpose is to generate jobs and economic development diversification by acquiring and improving lands for industrial or commercial purposes. An elected, three-member Board of Commissioners governs the Port. The Board is the primary policy-making body, exercising budgetary and financial control. Two employees manage the Port's daily operations.

The Port entered into a rental management agreement on March 20, 2013, for a Property Management Company (Company) to manage the Port's apartment complex in Centralia. This apartment complex included 12 units.

The Company dealt directly with the tenants by performing tenant screenings, executing lease agreements, collecting rents, and facilitating maintenance and repairs. Rents collected were transmitted to the Port electronically once a month, with a corresponding Owner's Statement emailed monthly to the Port.

In accordance with the rental management agreement, the Company received 6.5 percent of collected rents (excluding the first month's rent on new leases); 100 percent of all late and screening fees; and a service fee of 15 percent on all purchased materials, subcontracted work, and dumping and cleanout fees, unless those services were administered by the Port. The Port relied on the Company to report the occupancy level and any related vacancies.

On December 22, 2016, an attorney representing the Company called the Port and said the Company's owner had discovered that one of the Company's employees had been misappropriating funds from multiple properties he managed, including the Port's apartment complex. On December 23, 2016, the Company's owner called the Port to say he had fired the

employee. The Company's owner said the employee acknowledged falsely reporting vacancies and taking the money collected for rent. The former employee and the Company's owner signed a contract that called for the former employee to pay back the Company for the misappropriated funds.

On December 27, 2016, the Port's Director of Finance met with the Company's owner. The Port received copies of some of the leases and a copy of an investigation performed by the Company's owner that showed the misappropriation amount related to the Port was \$39,355.

The Port began its own audit of the apartment complex by comparing the lease agreements by unit to the Owner's Statements. Expenses including maintenance repairs and utilities were compared to Port-paid invoices and emailed correspondence between the Port and the Company. The Port also analyzed management fees the property management company charged. The Port determined the misappropriated amount was \$56,041.

We reviewed the Port's investigation and determined additional work needed to be done. The Port's calculation did not distinguish between the funds owed only to the management company and the funds owed only to the Port. For example, with the exception of the first month, the Port receives 93.5 percent of each tenant's monthly rental amount and the Company receives 6.5 percent. The Port's calculations did not deduct the Company's portion from the total it determined was misappropriated.

We also determined the Port's investigation relied on lease agreements that proved problematic when trying to accurately determine whether a unit was occupied. The following additional work was needed:

- First, we determined which tenants were occupying the units each month using reports on utility usage and responsible parties from the City of Centralia.
- Second, we calculated the amount of rent that was misappropriated through claimed vacancies by cross-referencing the Owner's Statements, which showed how much tenants paid each month when they actually lived there.
- Third, we needed to determine if there was any misappropriation aside from rent funds. We reviewed various records between the Port and the Company to ensure costs listed on the Owner's Statements were accounted for. We found the amounts shown in the table below were misappropriated, and identified other costs as questionable because we cannot determine if they were misappropriated or legitimate expenses.

Unit	Total	Misappropriation owed to Port	Questioned Costs
1	\$19,512	\$18,963	\$ 549
2	\$ 9	\$ 9	\$ -
3	\$ -	\$ -	\$ -
4	\$ -	\$ -	\$ -
5	\$ 1,204	\$ 911	\$ 294
6	\$ 3,645	\$ 3,645	\$ -
7	\$ 155	\$ 155	\$ -
8	\$ 5,214	\$ 5,214	\$ -
9	\$ 1,232	\$ 1,170	\$ 62
10	\$ 1,105	\$ 655	\$ 450
11	\$13,262	\$12,623	\$ 639
12	\$ 9,819	\$ 9,793	\$ 26
Total	\$55,158	\$53,138	\$2,020

Control Weaknesses

We recognize the Port contracted with a Property Management Company to oversee rental revenues. It received the funds owed to it according to the Owner's Statement received from the Property Management Company. However, the Port requires no additional information to ensure the Owner's Statements are complete and accurate.

Recommendations

The controls were not sufficient to safeguard public resources. We recommend the Port strengthen internal controls over third party apartment rental billing to ensure adequate oversight and monitoring to safeguard public resources.

We also recommend the Port seek recovery of the misappropriated \$53,138, questionable losses as appropriate, and related investigation costs of \$3,945 from the Property Management Company and/or its insurance bonding company, as appropriate.

Port's Response

All embezzled funds have been recovered by the Port prior to this final audit report being issued. The Port is appreciative of the SAO's staff and assistance in resolving this issue and insuring the public's funds were properly recovered.

State Auditor's Office Remarks

We thank the Port for its cooperation throughout the investigation and the steps it has taken to address these concerns. We will review the status of the Port's corrective action during our next audit.

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