



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

## **Accountability Audit Report**

# **City of Republic**

**Ferry County**

**For the period January 1, 2014 through December 31, 2016**

**Published July 30, 2018**

**Report No. 1021812**





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

July 30, 2018

Mayor and City Council  
City of Republic  
Republic, 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 City 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 independent audit report on the City's compliance with applicable requirements and safeguarding of public resources for the areas we examined. We appreciate the opportunity to work with your staff and we value your cooperation during the audit.

Sincerely,

Pat McCarthy  
State Auditor  
Olympia, WA

## TABLE OF CONTENTS

|   |    |
|---|----|
| Audit Results.....                            | 4  |
| Schedule of Audit Findings and Responses..... | 6  |
| Related Reports.....                          | 13 |
| Information about the City.....               | 14 |
| About the State Auditor's Office.....         | 15 |

## AUDIT RESULTS

This report describes the overall results and conclusions for the areas we examined. In most of the areas we examined, except as described below, City operations complied with applicable state laws, regulations, and its own policies, and provided adequate controls over safeguarding of public resources.

As referenced above and described in the attached findings, we identified areas in which the City could make improvements.

We recommend the City:

- Establish a formal, written comprehensive plan to address its financial condition and revise the plan as needed to resolve financial issues
- Closely monitor financial operations to ensure it is able to meet its financial obligations
- Provide training opportunities for the Clerk/Treasurer to increase knowledge of City operations, transactions and reporting to prevent further non-compliance with the requirements for interfund loans and transfers
- Provide training opportunities to staff responsible for processing payroll
- Evaluate and amend City policies to reflect City Council's approved methods for compensation, leave and related benefits
- Establish adequate monitoring controls to ensure the safeguarding of City resources and compliance with policies

These recommendations were included with our report and in a separate communication as findings.

As referenced above, we also noted certain matters that we communicated to City management, Mayor and City Council in a letter dated July 19, 2018, related to Cost Allocations and Safeguarding Public Resources. We appreciate the City's commitment to resolving those matters.

### About the audit

This report contains the results of our independent accountability audit of the City of Republic from January 1, 2014 through December 31, 2016.

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.

This audit was conducted under the authority of RCW 43.09.260, which requires the Office of the State Auditor to examine the financial affairs of all local governments. Our audit involved performing procedures to obtain evidence about the City'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, based on our risk assessment for the years ended December 31, 2016, 2015 and 2014, the areas examined were those representing the highest risk of fraud, loss, abuse, or noncompliance. The following areas were examined during this audit period:

- Financial condition and fiscal sustainability
- Interfund activity – general indirect cost allocation plan, loans and transfers
- Payroll – overtime, paid-time-off conversion, and gross wage recalculation
- General disbursements, credit card activity, travel expenditures and reimbursements
- Utility adjustments – receipting and billing

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

**2016-001 The City's financial condition puts it at risk of not meeting financial obligations or maintain current service levels. Further, the City has not consistently complied with requirements for interfund loans and transfers.**

### *Background*

An elected City Council and Mayor govern the City, and the Clerk/Treasurer records and reports financial transactions. The City serves about 1,000 citizens and operates on an average annual budget of \$1.5 million to provide services including water, sewer, garbage collection and police protection.

### *Description of Condition*

#### *Financial condition*

The City experienced negative or inadequate cash positions in both the Garbage and the Current Expense funds during the audit period and continuing into 2017. The City's expenditures exceeded its revenues every year in the Garbage Fund, leading to a negative operating margin as the table below shows.

#### **Garbage Fund**

|          | <b>Ending cash and investments</b> | <b>Operating revenues less operating expenses</b> |
|----------|------------------------------------|---|
| 2013     | 6,116                              | -13,376   |
| 2014     | -13,054                            | -19,170   |
| 2015     | -66,991                            | -42,421   |
| 2016     | -77,343                            | -8,939  |
| 2017     | -100,832                           | -24,489   |
| May 2018 | -83,432                            | 17,400  |

In addition, the Current Expense Fund experienced a similar circumstance in 2014.

**Current Expense Fund**

|          | <b>Ending Cash &amp;<br/>Investments</b> | <b>Operating Revenues less<br/>Operating Expenses</b> |
|----------|--|---|
| 2013     | 62,489                                   | 36,508  |
| 2014     | -39,684                                  | -80,778   |
| 2015     | 37,006                                   | 60,730  |
| 2016     | 108,812                                  | 131,496   |
| 2017     | 109,811                                  | 379   |
| May 2018 | 93,132                                   | -675  |

Further affecting the City's financial condition in both the Current Expense and Garbage funds, the City failed to comply with requirements for interfund loans and transfers during the audit period.

*Interfund loans*

The *Budgeting, Accounting and Reporting System* (BARS) Manual allows local governments to establish interfund loans between funds, but stipulates minimum acceptable procedures for making and accounting for the loans. Specifically, the legislative body must formally approve all loans, including a planned schedule of repayment and setting a reasonable rate of interest, and must review the loan status annually at an open public meeting. Further, the borrowing fund must anticipate sufficient revenues to make specified principal and interest payments as required. Interfund loans are to be considered "temporary" in nature, which the BARS Manual generally defines as three years.

In 2014, the City Council approved a \$311,122 interfund loan from the Water Fund to the Garbage Fund without adopting an ordinance, setting a repayment schedule or charging interest. The Council also assessed customers \$5 on their garbage bills to repay debt service on the interfund loan; however, the City coded these revenues to the Current Expense Fund, which is neither the lending nor receiving fund.

*Interfund loans made because of negative fund balances*

State law (RCW 43.09.210) and the BARS Manual require the City to separately account for each of its funds, including all resources, expenditures and interfund

activity. During the audit period, the City reported negative year-end balances for the Garbage and Current Expense funds as detailed in the tables above. Negative fund balance indicates that a fund spent more than the resources it had on hand and as such, borrowed resources from other City funds to pay its claims. However, the City did not approve, record or set up a repayment schedule for these interfund loans.

### *Interfund transfers*

The Clerk/Treasurer transferred \$277,000 and \$113,000 between funds in 2014 and 2015, respectively. The City:

- Transferred \$8,575 without Council approval
- Transferred \$19,525 from Streets to Current Expense, leaving a zero balance in the Streets Fund
- Transferred about \$25,000 from three special revenue funds to Current Expense to close the funds. However, the City continued to use the special revenue funds.
- Transferred \$76,417 from Water/Sewer Debt Service Reserve to Water/Sewer Debt Service, leaving a zero balance in the reserve fund without replenishing the fund as required by the bond covenant

### *Cause of Condition*

The City lost arbitration with a garbage collection contractor, costing over \$300,000. City management made decisions to cover the payment without respect to the requirements for interfund loans or the borrowed funds' source.

Management did not adequately monitor the City's financial activities to effectively control costs or make sufficient efforts to reduce expenses and increase revenue. In addition, the City lacked knowledge of negative fund balances, interfund transfers and their effect on other funds, or its bond covenant requirements for a reserve fund.

### *Effect of Condition*

The lack of internal controls and understanding of requirements for financial activities cause the City to be at risk of not meeting financial obligations; maintaining services at their current levels; or obtaining future loans, grants or bonds. Specifically,

- The Water/Sewer Reserve Fund's balance was zero rather than at least \$109,956 as required by bond covenant requirements.



- The Garbage Fund lacks resources to repay \$277,000 of interfund loans in a timely manner or cover operating costs without further cost to the citizens.
- Water/Sewer customers support other government costs and might not be able to cover necessary repairs or other expenditures. In addition, the City did not reimburse the Water Debt Service Reserve Fund for use of its resources by assessing interest.
- Current Expense received \$56,227 that belonged to the Water/Sewer Fund for repayment of the interfund loan.
- The Street Fund did not contain adequate money to cover its costs after funds were transferred from it to cover general government costs.

### ***Recommendations***

We recommend the City's elected officials and management:

- Establish a formal, written comprehensive plan to address its financial condition and revise the plan as needed to resolve financial issues
- Closely monitor financial operations to ensure it is able to meet its financial obligations
- Provide training opportunities for the Clerk/Treasurer to increase knowledge of City operations, transactions and reporting to prevent further non-compliance with the requirements for interfund loans and transfers

### ***City's Response***

*The City has corrected the following errors:*

*Current Expense received \$56,227 that belonged to the Water/Sewer Fund for repayment of the interfund loan – The City made a fund transfer from Current Expense to Water/Sewer on 12/20/2017 for funds incorrectly placed in Current Expense for the repayment of the interfund loan to Water/Sewer. The City has also made the corrections in the accounting software to place all funds for the interfund loan repayment into the Garbage fund and then at year end transfer all earned funds into Water/Sewer.*

*Starting August 1, 2018 the City has passed a resolution to increase garbage rates to start correcting the negative fund balance in the Garbage fund. Payroll and cost allocation has been adjusted to correctly reflect the hours worked for the Garbage fund so it does not receive excess expenditures. The City will also be placing Garbage Utility Tax in the Garbage fund to increase revenues to help correct the negative fund balance.*

*The City has transferred the required funds back into the Water/Sewer Debt Service Reserve fund to be back in compliance with the USDA bond covenant.*

*The new clerk treasurer is proactive in learning how these things should be done and is actively working toward getting the city's finances in order. The City understands the importance of continuing education for its employees and is proactively looking to send the clerks to trainings to keep them updated on compliance and regulations.*

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

We appreciate the steps the District is taking to resolve this issue. We will review the condition during our next audit.

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

RCW 43.09.200 – Local government accounting – Uniform system of accounting. Sets forth the requirements for the state auditor to develop a system of accounting and reporting for all local governments.

BARS Manual 3.1 – Accounting Principles and Internal Controls sets for the requirements for management and the governing board to establish appropriate internal controls, and accounting and financial reporting procedures.

BARS manual 3.9.1 – Interfund Activities - sets forth the requirements for interfund loans and repayment.

RCW 35.33.075 – Budget Final Adoption sets forth the requirements to adopt budget limited to the estimated resources in a fund.

RCW 43.09.210 – Local Government Accounting- Separate Accounts for each fund and activity sets forth the requirements to account for fund resources and activity separately.

United States Department of Agriculture bond document for water, sewer and backhoe defines the bond covenants for reserve funds.

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### **2016-002 The City lacked adequate controls to accurately process and support monthly payroll expenditures.**

#### ***Background***

The City of Republic has seven employees who provide municipal services to the City's citizens. The City reported an average of \$257,000 in annual payroll costs during the audit period.

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

The City lacked adequate internal control procedures to support payroll expenditures. Specifically:

- The City paid hourly employees based on an average of 173.33 hours per month, plus approved overtime, regardless of the number of hours worked in the month.
- Public Works employees accrued and used extra compensatory time during the audit period, which they informally tracked on a calendar. City policy did not allow employees to earn extra compensatory time and the Clerk/Treasurer did not retain the department's informal support.

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

The City experienced turnover in the Clerk/Treasurer position during the audit period and did not provide adequate training to the person who filled that position. Therefore, the former Clerk/Treasurer did not understand that processing hourly payroll based on an average of 173.33 hours per month could result in overpaying or underpaying City employees for work performed.

In addition, the former Mayor allowed employees to accrue and use extra compensatory time not supported by official City policy.

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

The lack of control, oversight, and technical experience of the Clerk/Treasurer and management increases the risk that misappropriation or misuse of City resources could occur and not be prevented or detected in a timely manner.

The City cannot demonstrate that employees received appropriate compensation. We found the City underpaid the former Clerk/Treasurer \$467 during the audit period; however, we could not test the Public Works payroll because of the lack of supporting documentation.

## ***Recommendations***

We recommend the City:

- Provide training opportunities to staff responsible for processing payroll
- Evaluate and amend City policies to reflect City Council's approved methods of compensation, leave and related benefits
- Establish adequate monitoring controls to ensure the safeguarding of City resources and compliance with policies

## ***City's Response***

*The City has restructured its monthly payroll procedures to the following:*

1. *Payroll is processed on the first working day of the following month to ensure all funds are correctly billed for hours worked by employees and there are no estimated hours.*
2. *Employees who work in several different departments are now required to track their daily hours worked by what department their time was spent so each fund is correctly expensed for time worked.*
3. *A payroll review is reviewed by the Mayor or a member of the finance committee if the Mayor is unavailable and compared to timecards then each payroll item has an initial approval to verify all items have been reviewed.*
4. *Employees are paid for the exact amount of hours worked each month; they are no longer paid on an average of 173.33 hours per month.*
5. *The City does not offer compensatory time to employees.*

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

We appreciate the steps the District is taking to resolve this issue. We will review the condition during our next audit.

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

RCW 43.09.200 – Local government accounting - Uniform system of accounting describes the requirements for accounting for public resources.

*Budgeting, Accounting and Reporting system (BARS) Manual* – Section 3.1 issued by the State Auditor's Office pursuant to RCW 43.09.230, describes the management and the governing boards responsibility for developing internal control processes.

## RELATED REPORTS

### **Financial**

Our opinion on the City's financial statements is provided in a separate report, which includes the City's financial statements. That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

## INFORMATION ABOUT THE CITY

The City of Republic serves approximately 1,000 citizens in Ferry County. The City provides an array of services including water, sewer, police, parks and public works. The City contracts with Ferry County Fire Protection District No. 1 to provide fire protection services to the citizens and with Ferry County for Municipal Court services.

An elected, five-member City Council and an independently elected Mayor govern the City. The Council appoints management to oversee the City's daily operations as well as its eight employees. The City also pays a stipend for the Mayor, Public Works Certification, and Building Inspector. The City operated on a budget of \$1.9, \$1.4 and \$1.2 million for fiscal years 2014, 2015 and 2016, respectively.

| Contact information related to this report |   |
|--|---|
| Address:                                   | City of Republic<br>987 S. Clark Avenue<br>P.O. Box 331<br>Republic, WA 99166 |
| Contact:                                   | Jennifer Rabenold, Clerk Treasurer  |
| Telephone:                                 | 509 775-3216  |
| Website:                                   | <a href="http://www.republicwa.org">www.republicwa.org</a>                    |

*Information current as of report publish date.*

### Audit history

You can find current and past audit reports for the City of Republic 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 |  |
|--|--|
| 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>                     |