

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### **2015-001    The Belfair Sewer and Rustlewood Sewer funds' financial condition puts the utilities at risk of not being able to meet their financial obligations.**

#### ***Background***

The Belfair Sewer Utility began operations in 2012, charging customers \$96 per month for each Equivalent Residential Unit (ERU). The project was financed through loans issued by Department of Ecology and a general obligation bond. At the end of 2015, the Belfair Sewer Fund had \$11.5 million in outstanding debt.

The Rustlewood Sewer Utility began operations in the early 1970s, charging customers \$96 per month for each ERU. The project was financed through loans issued by Department of Ecology and a general obligation bond. At the end of 2015, the Rustlewood Sewer Fund had \$1.3 million in outstanding debt.

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

##### **Belfair Sewer**

Belfair Sewer has not generated enough revenues to pay back the debt. Mason County (County) used real estate excise tax (REET) proceeds to help make debt payments. Without the support of REET money, the Belfair Sewer Fund would have had an estimated shortfall of about \$475,000 at the end of 2015.

The County created a financial plan in 2015 to improve Belfair Sewer's financial condition. This plan includes expanding the number of customers in 2018 to make the system self-sustaining, but the County has not been able to begin this phased expansion due to lack of funds for construction. The County also brought in less rate revenue, loan repayments and hook-up fees in fiscal year 2015 than originally forecast. Therefore, the financial plan that was created is not accurate, and the plan has not been adjusted to forecast actual activity.

We reviewed financial ratios for the Belfair Sewer fund for fiscal year 2015 and found the following:

- Cash on hand was sufficient to cover only 15 days of operating costs, a decrease of two days from fiscal year 2014.
- The current ratio was 0.36, meaning there were more current liabilities than current assets at the end of the year; the ratio was a decrease of 54 percent from 2014.

- Unrestricted net assets were negative \$841,887.
- Income before transfers has been negative for the past five years, with a loss of \$1.1 million in 2015.
- Operating revenues have not been sufficient to make annual debt payments on the sewer system project.

### **Rustlewood Sewer**

The County was not aware of Rustlewood Sewer's declining financial condition until after fiscal year 2015 had ended. There was no monitoring or financial plan for the sewer system's financial position to ensure the aging system would be able to continue.

We reviewed financial ratios for the Rustlewood Sewer Fund for fiscal year 2015 and found the following:

- Cash on hand was sufficient to cover operating costs for only 15 days in 2015, a significant decrease from 107 days in 2014.
- The current ratio decreased from 3.09 in 2014 to 1.32 in 2015. If the ratio continues to decrease at the same rate, the fund will have more current liabilities than assets in 2016.
- Unrestricted net assets were negative \$3,562.
- Income before transfers has been negative for the past five years, with a loss of \$103,194 in 2015.

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

#### **Belfair Sewer**

In 2012 the Belfair Sewer project planned for more ERUs in Phase 1 than actually materialized. At the time the project was approved, annual ERU growth was 9 percent. The project's feasibility study used a projection of 5 percent annual ERU growth, which appeared conservative at that time. However, growth stalled and has been only about 1 percent since 2013.

In addition to the lack of growth, planners overestimated the number of ERUs that business would generate, and some property owners were exempted from connecting to the system.

Only the first of the four planned phases has been implemented. Phase 2 was initially planned to be operational in 2013 but has not yet been started.

The project exceeded initial cost estimates as the scope of the project changed to meet the construction needs of the system.

In addition, the County was found to be liable for \$1.2 million in additional construction costs, which were paid to the contractor of the plant at the end of 2015.

The County did not take into account the difference between projected and actual activity and alter its plan to ensure the system would become self-sustaining.

### **Rustlewood Sewer**

There was no monitoring or financial plan for the sewer system's financial position to ensure the aging system would continue to be self-sufficient.

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

#### **Belfair Sewer**

If Belfair Sewer's financial position continues to decline, the utility may not be able to:

- Repay the \$11.5 million of debt.
- Support its operations without continuing operating transfers of Real Estate Excise Tax.
- Pay for any significant maintenance or repairs as needed.

#### **Rustlewood Sewer**

If Rustlewood Sewer's financial position continues to decline, it will not be able to support its operations without additional funding. Also, Rustlewood Sewer does not have the funds to pay for any maintenance or repairs as needed.

### ***Recommendations***

We recommend the Board of County Commissioners:

- Establish a formal financial plan to address how it plans to improve Rustlewood Sewer's financial condition.
- Closely monitor and evaluate the Belfair Sewer and Rustlewood Sewer Funds' financial activities to ensure the plans are being followed and the desired results achieved. The Board should revise the plans as needed to resolve any cash flow issues.

### ***County's Response***

*The Mason County Board of County Commissioners will continue the process of reviewing and modifying the financial plan for the Belfair Sewer and develop one for the Rustlewood Sewer that adequately funds the operations and maintenance of the systems as well as provides adequate funding for their debt service. Alternative means of increasing revenue, other than simply expanding the system, is being reviewed for The Belfair Sewer and for The Rustlewood Sewer we will begin reviewing options to address its financial stability and review the Funds revenue generating capability. The Board of County Commissioners also continue to look at reducing outstanding debt with grants afforded by the Washington State's Department of Commerce and the State's Capital Funds as well as debt restructuring options.*

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

We appreciate the County's commitment to resolving this finding and thank it for its cooperation and assistance during the audit. We will review the corrective action taken during our next regular audit.

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### **2015-002    The County lacked adequate controls over the collection of past due utility accounts and Belfair Sewer loan agreements.**

#### ***Background***

Mason County Utilities and Waste Management is a Division of the Mason County Public Works Department. It is responsible for managing water, waste water and solid waste facilities in the unincorporated areas of Mason County.

This includes operations of the Rustlewood and Beards Cove water systems, and the Rustlewood, North Bay/Case Inlet and Belfair water reclamation/sewer collection and treatment facilities.

The County received a management letter during the fiscal year 2014 audit, which identified several concerns regarding collection policy, past-due accounts and loan agreements.

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

During our follow up testing, we found the following issues had not been resolved:

- The County did not adopt a formal policy for collection of past-due accounts. Utility accounts with balances 90 plus days past due continued to increase from \$327,589 on December 31, 2014, to \$330,690 on December 31, 2015.
- Of the 29 Belfair Sewer accounts tested that had overdue charges in excess of 90 days, seven still did not have liens filed (24 percent).
- Of the 70 Belfair Sewer accounts we identified that had obtained a loan from the County for connection fees, 49 had not been paid in full and did not have a loan agreement on file.

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

The Public Works Department did not have a collections policy that outlined the collection procedure on past-due accounts.

The Public Works Department experienced significant turnover in upper-management positions during fiscal year 2015. Due to this turnover, staff were uncertain who was responsible for following up on prior audit issues.

## ***Effect of Condition***

As of December 31, 2015, the County had \$330,690 in utility account receivables that were 90 or more days overdue. The County's inability to collect on past-due accounts has diminished the utilities' financial condition and places their ongoing financial sustainability at increased risk.

## ***Recommendation***

We recommend the County:

- Adopt a formal policy for the collection of past-due accounts.
- File liens for past-due sewer accounts in a timely and consistent manner.
- Obtain signed loan agreements for remaining Belfair Sewer loans.

## ***County's Response***

*Mason County is taking steps to increase controls over the collection of past due utility accounts and Belfair Sewer loan agreements. Past due lien letters are being sent out, payment arrangements are being made, and water shut-offs have been performed. Utility accounts with balances 90 plus days past due decreased from \$330,690 on December 31, 2015 to \$309,225 on November 30, 2016.*

*The Utilities Department has met with the Mason County Prosecuting Attorney's Office and Treasurer's Office to discuss options for the formal policy to be complete in 2017. The Utilities Department has also briefed the Board of Mason County Commissioners on the changes to the lien and foreclosure procedures discussed with the Deputy Prosecutor and Treasurer.*

*Accounts are looked at monthly to identify the need to file liens. The timing of the lien filing will be addressed in the formal policy.*

*The Utilities Department has contacted the Prosecuting Attorney's Office to discuss options for the forty-nine accounts that do not have signed loan agreements for the Belfair Sewer loans.*

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

We appreciate the County's commitment to resolving this finding and thank it for its cooperation and assistance during the audit. We will review the corrective action taken during our next regular audit.

## *Applicable Laws and Regulations*

*Budgeting Accounting and Reporting System (BARS) manual- Part 3, Accounting, Chapter 1. Accounting Principles and General Procedures, Section C. Internal Controls, 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.

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### **2015-003    The County lacked adequate controls over cash receipting at its solid waste transfer stations.**

#### ***Background***

Mason County Utilities and Waste Management is a Division of the Mason County Public Works Department. It is responsible for managing water, waste water and solid waste facilities in the unincorporated areas of Mason County.

The Division manages solid waste, recycling and household hazardous waste collection at the Union, Hoodsport and Belfair Drop Box stations and at the Eells Hill Transfer Station near Shelton.

In our previous audit, we noted a concern over the cash receipting internal controls at the transfer stations. Our current audit found the County did not implement controls to mitigate the risk of fraud, loss or misappropriation of public funds.

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

We found the following control deficiencies during our cash receipt testing at the County solid waste transfer stations:

- All transfer station attendants had access to the safe containing all change funds and daily deposits.
- One username and password was shared by all attendants to log in to the cash receipting system.
- One change fund was shared by all attendants at each transfer station.
- The attendant who performed close-out procedures at the end of the day did not count or reconcile the cash.
- Department staff relied on the Treasurer's Department to tell them if a deposit did not match the amount receipted.
- Overages and shortages were not tracked or followed up on.
- Voided transactions were not reviewed for reasonableness.

These control deficiencies, when viewed together, contribute to a significant control weakness over cash receipting at the solid waste transfer stations.



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

The Public Works Department experienced turnover in upper-management positions during fiscal year 2015. Due to this turnover, staff were uncertain who was responsible for following up on prior audit issues.

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

A lack of controls over cash receipting increases the risk of fraud, loss, or misappropriation of public funds.

### ***Recommendations***

We recommend the County strengthen controls over cash receipting at the solid waste transfer stations to ensure public funds are adequately safeguarded from loss or misappropriation. Specifically, we recommend the County:

- Limit access to the solid waste transfer station safe.
- Assign an individual username and password for the cash receipting system to each solid waste attendant, and ensure they are used.
- Assign an individual change fund to each solid waste attendant for the duration of their shift, and ensure it is used.
- Ensure the attendant who performs close-out procedures at the end of the day counts and reconciles the cash deposit.
- Segregate duties of reconciling the cash deposit, preparing the deposit form and making the deposit, or have compensating controls.
- Ensure the bank deposit is reconciled to the daily cash count in a timely manner to confirm all funds collected are deposited.
- Track and follow up on overages and shortages in a timely manner.
- Review voids for reasonableness in a timely manner.

### ***County's Response***

*Mason County is in agreement that there were inadequate controls over cash receipting at its solid waste transfer stations and has taken action to correct the deficiencies. The controls now in place include:*

- *Limiting employee access to the solid waste transfer station safe*
- *A cash handling procedure reviewed by the State Auditor's Office has been instituted with a statement signed by all solid waste attendants and their*

*manager certifying their understanding and agreement to follow the procedures*

- *Separate change funds for each solid waste attendant are assigned, utilized, and closed-out at the end of the day by counting and reconciling the cash deposit*
- *Duties are segregated between staff who prepare deposits and staff who take the deposits to the bank*
- *The bank deposit is reconciled in a timely manner, overages and shortages are tracked and followed up on monthly, and voids are reviewed for reasonableness in a timely manner*
- *Surprise cash counts are performed periodically.*

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

We appreciate the County's commitment to resolving this finding and thank it for its cooperation and assistance during the audit. We will review the corrective action taken during our next regular audit.

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

Applicable Laws and Regulations *Budgeting, Accounting and Reporting System (BARS) Manual - Accounting, Accounting Principles and Internal Control*, Internal Control states in part:

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.

*Budgeting, Accounting and Reporting System (BARS) Manual – Accounting, Special Topics, Expenditure, Imprest, Petty Cash and Change Funds* states in part:

#### **Controls**

The following are minimum requirements for establishment and operation of such funds:

1. The governing body must authorize each petty cash account in the manner that local legislation is officially enacted, i.e., resolution or ordinance. This applies also to all subsequent increases or decreases in the imprest amount. The original authorized balance and any subsequent increase may be established by treasurer's check.
2. The governing body or its delegate must appoint one custodian of each petty cash account who should be independent of invoice processing, check signing, general accounting and cash receipts functions. As part of the appointment, the custodian should render a receipt for the imprest amount to the treasurer, clerk-treasurer or auditor from whom he/she receives it. When it is not practical to hire additional personnel or to reallocate these duties among existing personnel, the governing body must establish some mechanism of review that accomplishes the objectives of the segregation of duties. For example, periodic monitoring of cash receipts and/or independent performance of the reconciliation may be adequate compensating controls for when complete segregation of duties is not possible.
3. The authorized balance should not exceed one month's salary or the surety bond covering the custodian.
4. On a monthly basis, the fund should be reconciled to the authorized balance and to the actual balance per bank statements or a count of cash on hand. If this reconciliation is done by the custodian, it should be checked or re-performed periodically by someone other than the custodian.
5. For funds on hand (i.e., petty cash or change funds), the custodian must ensure cash is kept in a secured place, such as a locked drawer or box.

RCW 43.09.240 Local government accounting – Public officers and employees – Duty to account and report – Removal from office – Deposit of collections states in part:

Every public officer and employee, whose duty it is to collect or receive payments due or for the use of the public shall deposit such moneys collected or received by him or her with the treasurer of the local government once every twenty-four consecutive hours. The treasurer may in his or her discretion grant an exception where such daily transfers would not be administratively practical or feasible as long as the treasurer has received a written request from the department, district, or agency, and where the department, district, or agency certifies that the money is held with proper safekeeping and that the entity carries out proper theft protection to reduce risk of loss of funds. Exceptions granted by the treasurer shall state the frequency with which deposits are required as long as no exception exceeds a time period greater than one deposit per week.

RCW 43.09.200 Local government accounting – Uniform system of accounting states:

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 there from; 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.