



Office of the Washington State Auditor
Pat McCarthy

Fraud Investigation Report

Town of Cusick

For the investigation period January 1, 2022 through April 30, 2023

Published April 18, 2024

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

April 18, 2024

Mayor and Town Council
Town of Cusick
Cusick, Washington

Report on Fraud Investigation

Attached is the official report on a misappropriation at the Town of Cusick. On March 8, 2023, the Town notified the Office of the Washington State Auditor 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 Clerk Treasurer's unallowable activities at the Town from September 16, 2022, through March 10, 2023. 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 Director of Communications Kathleen Cooper at (564) 999-0800. Otherwise, please contact Special Investigations Program Manager Stephanie Sullivan at (360) 688-0858.

Pat McCarthy, State Auditor
Olympia, WA

cc: Lisa Davis, Clerk Treasurer

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FRAUD INVESTIGATION REPORT

Investigation Summary

On March 8, 2023, the Town reported a potential loss of public funds, as required by state law (RCW 43.09.185). As our Office began a standard accountability audit, the Mayor and two Town Council members discovered multiple unauthorized bank account transfers and unallowable credit card charges on the Town’s bank and credit card accounts.

We investigated and determined a multi-scheme misappropriation occurred at the Town, totaling at least \$277,570 between September 16, 2022, and March 10, 2023. We summarized questionable amounts of \$30,843 between September 15, 2022, and March 2, 2023. The largest single source of misappropriation was through a scheme involving 421 unauthorized bank account transfers totaling \$242,555 to multiple Town credit cards. Immediately following these transfers, the credit cards were used to make a significant number of unauthorized charges.

The table below shows the misappropriated and questionable amounts by category. “Questionable” means we were unable to determine whether the expenditures were for a legitimate business purpose.

Summary of results		
Investigation area	Misappropriation	Questionable
Credit cards	\$199,348	\$686
Electronic disbursements	\$48,240	\$5,672
Payroll	\$24,406	\$23,846
Check disbursements	\$5,576	\$639
Cash receipting	*Unknown	
TOTAL	\$277,570	\$30,843

**Due to a lack of records, we were unable to quantify a specific amount of cash receipting misappropriation. We were only able to estimate a potential loss of \$76,543 based on an average monthly expected amount of bank deposits compared to actual amounts deposited.*

The Town filed a report with Pend Oreille County Sherriff’s Office, which investigated and referred the case to the FBI. We will share our investigation results with the FBI.

Background and Investigation Results

The Town, located in Pend Oreille County, has a population of about 200 people and operates on an annual budget of about \$838,000. An elected, five-member Council with a separately elected Mayor governs the Town. A Clerk Treasurer, hired by the Council and Mayor, oversees the Town's daily operations. The Clerk Treasurer has key financial system access and handles cash receipting, processing disbursements including payroll, and reconciling Town credit cards and bank accounts.

In August 2022, the Town council had a vacancy. The spouse of a current Council member expressed interest in the position. The Council then voted to appoint him as a new council member.

On September 12, 2022, the Clerk Treasurer resigned, and the newly appointed Council member expressed interest in filling the open Clerk Treasurer position. The Council voted to appoint him as the new Clerk Treasurer, while he also continued in his council member role.

On October 4, 2022, the Council discussed credit card needs for the Clerk Treasurer and maintenance employee positions. The new Clerk Treasurer – a Council member and spouse of another Council member – said during the meeting that the Town needed credit cards to help pay for necessary expenses. He also said a credit card was ordered and on the way for the Mayor to use. The Council then voted to approve issuing credit cards to the Clerk Treasurer and a maintenance employee.

That same month, our Office began a regularly scheduled accountability audit of the Town, which included requesting financial statement records from the Clerk Treasurer. Between October 2022 and February 2023, we made multiple requests for the Clerk Treasurer to provide us the Town's records. He provided none.

Because the Clerk Treasurer did not provide records to our Office or the Council, two Council members went to the Town's bank on March 7, 2023, and obtained a transaction summary report of the Town's bank account covering the period of August 1, 2022, to March 7, 2023. The summary showed an account balance on August 1, 2022, of \$233,822 and by March 7, 2023, it had a balance of only \$249. The Council members informed the rest of the governing body that same day during a meeting, and the Council suspended the Clerk Treasurer from his duties.

On March 8, 2023, the Town formally reported the concerns to our Office. Shortly after this date, a Council member discovered that all accounting software records were no longer on the Town's computer hard drive. The Town contacted its information technology service provider on March 14, 2023, which was able to recover some of the records. On May 3, 2023, the Council voted to terminate the Clerk Treasurer's employment. Although he was terminated from this position, he remained on the Council until the November 2023 election, in which he was not re-elected.

In April 2023, we began investigating the Town's bank account activity, credit cards, disbursements, payroll and cash receipting. The following are the results of our investigation in those areas.

Bank transfers and credit cards

This scheme was the single largest source of misappropriation. To analyze the Town's typical revenues and expenditures, we reviewed its bank statements for the period of January 2022 to April 2023. We then reviewed credit card statements for the period starting September 2022, the month before the new Clerk Treasurer had new credit cards issued to himself and others, to April 2023. We found:

- A total of 421 unauthorized bank account transfers totaling \$242,555, processed between October 11, 2022, to March 6, 2023, that were applied as payments to multiple Town credit cards. Immediately following these transfers, a significant amount of unauthorized charges occurred on the Town's credit cards. For example, on October 6, 2022, three unauthorized credit card charges totaling \$494.82 occurred to an online payment account associated with the Clerk Treasurer's spouse, who is a fellow Council member. Five days later, on October 11, an unauthorized bank transfer payment of \$494.82 processed to the credit card. Overall, this scheme resulted in unauthorized bank transfer payments onto Town credit card accounts so often that cards with credit limits of only \$500 sometimes had available credit balances as high as \$35,588.
- A total of 607 unauthorized credit card transactions, amounting to \$199,348 in misappropriation and questionable amounts of \$686, occurred between October 6, 2022, to March 7, 2023. Of the misappropriated amount, \$182,213 occurred on the credit card issued to the Mayor, and \$17,135 occurred on the credit card issued to the Clerk Treasurer. We issued subpoenas for records identifying who held the accounts that received the funds from the unauthorized credit card transactions. Of the total amount misappropriated, \$131,180 went to a personal account held by the Clerk Treasurer, and \$62,202 went to a personal account of the Clerk Treasurer's spouse, who is a fellow Council member. The last \$5,966 went to a cryptocurrency vendor that had an account in the Clerk Treasurer's name.

Electronic disbursements

We reviewed electronic disbursements on Town bank statements for the period of January 2022 to March 2023. We obtained bank electronic remittance records to confirm amounts paid out were for legitimate business expenses. We found multiple instances of electronic disbursements paid to the Clerk Treasurer's personal bank account when the transaction description on the Town's bank records gave the appearance amounts were paid to legitimate vendors. For example, during the October 4, 2022, Council meeting, the Clerk Treasurer asked the Council to approve a \$15,000 budget for an approved vendor to begin design of the water system replacement project, and to approve expenses associated with hiring a soil scientist as soon as possible to meet a year-end

deadline. The Council approved the requests. We found two electronic disbursements, which appeared to be paid for legitimate expenses, however, they were deposited into the Clerk Treasurer's personal bank account:

- A disbursement on October 11, 2022, for \$5,048 appeared to be paid to the vendor working on the water replacement project.
- A disbursement on October 26, 2022, for \$3,330.24 appeared to be related to a water soil sampling kit.

We summarized a total electronic disbursement misappropriation of \$48,240 between October 7, 2022, to March 3, 2023, and \$5,672 in questionable amounts between September 21, 2022, to March 2, 2023. All amounts misappropriated were deposited into the Clerk Treasurer's personal bank account.

Check disbursements

We reviewed check disbursements on Town bank statements for the period of July 2022 to March 2023. We obtained copies of cleared checks from the bank to confirm amounts paid out were for legitimate business expenses. We found:

- Beginning in October 2022, new electronic check payments were issued and made payable to an online retail vendor. The Town did not have support on file for these disbursements, and the Council did not approve them. We obtained copies of purchase records from the online retail vendor and identified multiple personal purchases by the Clerk Treasurer. Items purchased related to cryptocurrency, a digital voice recorder, and car light parts. We totaled \$2,178 in misappropriation and \$639 questionable amounts.
- A check dated November 25, 2022, for \$3,397 was misappropriated. The check memo indicated it was for an invoice related to a water main break. The Mayor and Council member whose signatures were on the check said they did not sign it. The Clerk Treasurer said the check was a reimbursement to him for a personal purchase he made for the Town. He said he could – but never did – provide a personal receipt to support his contention.

In total, we found a check disbursement misappropriation of \$5,575 between October 12, 2022, to January 6, 2023, and questionable amounts of \$639 between October 13, 2022, to November 15, 2022.

Payroll

We reviewed bank statements, the Town's payroll system, and printed copies of records for the period of August 2022 to March 2023. We analyzed payments made to the Clerk Treasurer that appeared to be related to payroll. We found:

- Most amounts paid to the Clerk Treasurer were unsupported, did not fall within the expected payroll processing periods, were not always recorded in the payroll system, and did not have proper approval by the Mayor or Council.
- Limited timesheet records existed, but we noted instances where hours approved by the Mayor were less than what was recorded in the payroll system and paid to the Clerk Treasurer. This calls into question the Clerk Treasurer's time worked. Further, due to the volume of unauthorized bank transfers, misappropriated credit card amounts, and other areas of loss, we assessed amounts paid to the Clerk Treasurer as either misappropriated or questionable because we could not conclude what amounts paid were for legitimate work.
- The Clerk Treasurer misappropriated a payroll check dated March 10, 2023, for \$4,961 after he was suspended from his position at the Town on March 7, 2023. The Mayor and Council member whose signatures were on the check said they did not prepare this check or sign it. The Town's bank flagged the check as unauthorized and processed a credit to the Town on March 27, 2023.

In total, we found a payroll misappropriation of \$24,406 between September 16, 2022, to March 10, 2023, and questionable amounts of \$23,846 between September 15, 2022, and February 22, 2023.

Cash receipting

We reviewed the Town's bank statement deposit activity for the period of January 2022 to March 2023. We noticed no bank deposits occurred in October 2022, then deposit activity reduced significantly through February 2023. We reviewed bank deposit records during this period and observed that all deposits contained checks but no cash, which is not expected because the Town receipts cash payments for utility bills and other small revenues, such as boat launch fees and dog licenses.

Beginning in October 2022, the Clerk Treasurer did not properly process customer utility billings or record customer payments. Because of this, Town customers had inaccurate account balances or were billed late fees for missing payments. This caused multiple customers to file payment grievances with the Town. As a result, as of March 2024, the Town has waived \$3,996 in customer amounts owed.

Due to a lack of receipt records, we were unable to determine what customer payments were received and the mode of payment. This also prevented us from quantifying a loss or misappropriated amounts. However, based on an average monthly expected amount of bank deposits compared to actual amounts deposited, we estimate a potential revenue loss of \$76,543 between October 2022 and February 2023.

Interviews with the Mayor and Council members

On March 12, 2024, we interviewed the Mayor and three Council members, who all said the Clerk Treasurer's role is to maintain financial system access to the Town's bank accounts and accounting

system. They confirmed the Clerk Treasurer position is responsible for processing and managing the daily activities for payroll, cash receipting and disbursements – including managing the credit cards and reconciling the bank account – and preparing financial statement reports.

The Council member who is the spouse of the former Clerk Treasurer said the following:

- The Town’s bank should not have given information to the two other Council members who went to the bank in March 2023 and discovered the potential loss of public funds, since they were not authorized users on the account.
- She had not viewed any of the bank statements or credit card statements related to the Town’s reported loss. When we showed her the credit card charges going to an online vendor account in her name, she said she had previously created an account with the vendor but was unfamiliar with the email address listed on the account. She then said she was upset with her husband, the former Clerk Treasurer.

On March 15, 2024, we interviewed the former Clerk Treasurer, who said the following:

- He did not have access to the Town’s bank account or statements, and that the Mayor went into Town Hall at night to work on processing disbursements and payroll. This contradicted a November 2023 email that the Clerk Treasurer sent to the Mayor, in which he said he was handling accounts payable, receivables and payroll, and re-entering every transaction to the Town’s accounting system.
- There was an instance when he completed an electronic disbursement to his personal account and that the description did not reflect his name. However, he said this was a reimbursement for a purchase he made for the Town related to water main repairs. He said he could provide – but never did – a receipt to support this contention.
- He did not receive credit card statements for review and did not know there was a Town credit card issued in his name.
- He learned that unauthorized bank transfers and credit card charges were linked to his personal accounts after two Council members had discovered this activity in March 2023. After learning this, he said he immediately reviewed his bank account details and noticed all the transactions, and then promptly contacted his bank to report unauthorized activity and closed all his accounts. We asked him to provide any support he received from the bank that showed he reported concerns about his personal account and the outcome of the bank’s research into the concern. He did not provide any records to support this contention.
- He had an account with the cryptocurrency vendor listed in the Town’s credit card transactions. He said he did not know his cryptocurrency account was also affected, and that he would contact the vendor to discuss the inappropriate account activity.
- He was not the reason the Town’s computer hard drive had no financial data. He said there was a time when he tried to install a software update and it did not work properly.

Control Weaknesses

The Town performed virtually no monitoring of the Clerk Treasurer's activities, which has been an ongoing issue at the Town. This audit is the Town's third consecutive audit where the person in the Clerk Treasurer role misappropriated the Town's funds.

In this investigation, we found the following key weaknesses allowed the misappropriation to occur:

- No one completed a secondary review of the Town's bank account activity or credit card statements, including bank and credit card statements or balances, or documentation supporting transactions listed on the statements.
- No one scrutinized disbursements, including those for payroll, in sufficient detail to detect possible problems.
- Cash receipting controls were inadequate to ensure all funds receipted were recorded and deposited promptly, if at all.

In addition to the information in this Fraud Investigation Report, we describe further internal control weaknesses and issue separate recommendations in our accountability report.

Recommendations

We recommend the Town reevaluate its entire internal control structure and implement effective systems of internal controls over all key operations to safeguard public resources.

At a minimum, this should include:

- A secondary review of all the Town's bank and credit card accounts by someone independent of the cash receipting and payment processes.
- Segregating duties over cash receipting so one person is not responsible for receipting, recording and preparing the bank deposit.
- A secondary review of all payments, including checks, electronic payments, payroll and credit cards, to ensure they are allowable, adequately supported, and for legitimate purposes.

We also recommend the Town seek recovery of the misappropriated \$277,570, questionable transactions and cash receipting amounts, as appropriate, and related investigation costs of \$68,284 from the former Clerk Treasurer and/or its insurance bonding company, as appropriate. Any compromise or settlement of this claim by the Town 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 Matthew.Kernutt@atg.wa.gov. The contact for the Office of the Washington State Auditor is Brandi Pritchard, Assistant Director of Local Audit and Special Investigations, who can be reached at (509) 726-1886 or Brandi.Pritchard@sao.wa.gov.

Town's Response

On March 7th, 2023, Council member #5, and Council member #2 who is also the Mayor Pro Tern, went into the bank office in Newport, Washington and asked for 6 months of bank statements for the Town of Cusick, Council member #5 had been asking for financial reports each month during council meetings and the clerk had never produced the reports for the council. Council member #5 asked the clerk why there had not been accounts payable checks to sign during the council meeting to pay Town vendors. Council member #4/clerk told Council member #5 during a council meeting that he paid accounts payable vendors and creditors through EFT and online banking. They discovered that money in the account was missing. Council member #2 brought this to the attention of the rest of the council at the regular scheduled meeting that night. The Pend Oreille County Sheriff was present at the council meeting and Council member #4/clerk called the sheriff's office during the meeting to report the theft.

On March 9th, 2023, the Mayor, Council member #2, and Council member #5, had a meeting in Newport at the bank, it was then discovered that monies were being transferred to a credit card and then to a personal account. Council member #4 and clerk at Town of Cusick, was told not to come back to work as clerk, indefinitely. Council members #2 and #5 and the Mayor put a hold on the Town bank account, so when a check was written, The Mayor & Mayor Pro Tern/Council member #2, and Council member #5 had to email the bank manager with the check number, name on the check and the amount, in order for the check to clear. The Mayor, Council members #2 and Council member #5 opened a new account for the Town of Cusick with two (2), approved by the bank, account holders; The Mayor and Mayor Pro Tern. The Mayor, the Mayor Pro Tern/Council member #5, current assistant clerk, and current clerk, have access to Town of Cusick's banking statements online thru the bank's website using individual passwords and logins. Checks are put in place by the bank manager where transactions and payrolls are cross-checked by clerks, one initiates a transaction, the other approves and closes the transaction.

Auditor's Remarks

We thank Town officials and personnel for their assistance and cooperation during the investigation. We will follow up on the Town's internal controls during the next audit.

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