

## Transcription of Auditor Presentation to Council, 2001-2002 Audit Report

### Auditors: Sadie Armijo and Jack Broyles

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**Tolson**

We are going to proceed immediately now to the audit report. And I would like to turn that over to the state auditor representatives at this time.

**S. Armijo**

Hi. We are glad to be here today. This isn't our normal exit conference, but at the City's request we are going to do our exit at an open public meeting today. Um, what we have to present today, we have handed out to the board, are packets. And so we're just going to kind of go through that. We're going to go over our audit reports today, a management letter and our exit documents. If there's any questions along the way, feel free to ask questions and we'll ask at various points in time. I should introduce myself. My name is Sadie Armijo. I'm the Audit Manager for Team Lynnwood. I oversaw this audit in total. Jack Broyles is with me today as well, and he was the auditor in charge and he performed the majority of the audit work while we were on site.

The first report that I'd like to talk about is our Accountability Report. That's the first document that you have. Within this document, we -- This is where we report on the City's accountability for public resources, basically ensuring that, how the City is using their funds, [that] it's properly entered--within state laws and regulations. So we also ensure that legal compliance, state laws in regards to cities are being followed. The first page talks just a little bit about the audit. Our audit period, again, we had a two-year audit period, and it was January 1<sup>st</sup> of 2001 through December 31<sup>st</sup> of 2002. We did issue three findings in our audit report, but it's not actually in this report, it's in our second report which we will talk about in a second. It has to do with your federal programs and your compliance for financial statements, as well.

A few pages back, we have a description of the City. We've already run this by the City. We talked a little bit about the City, the history of your previous audits, and we list the elected officials during the time period of our audit. [The] Page after that is the audit areas examined. And, again, this splits out our audit into the four main areas of our audit, accountability for public resources. Those are areas we really feel that we want to take a close look at the City's internal controls to make sure it's strong in those areas. The legal compliance, that section, these are areas we say the management within the City, the public or others would be concerned if there was any noncompliance. Under the federal programs, again, during the 2001 year, the city did receive over \$300,000 in federal funds and required a single audit. So the one problem was is that our office wasn't informed of that in time. So we still perform that audit, but we need to be informed right after you knew that you received it. And at the bottom area is the financial areas examined. And those were the areas that we had to take a close look at in order for us to give you an opinion on your financial [*someone coughs*].

That covers that report. The second report in your packet has to do with the financial statements and Federal Single Audit, which is basically your federal compliance. The next page after that is just, is kind of a lead-in cover sheet. And then a few pages back after the table of contents is a federal summary. And on this page, it's kind of a, not only a federal summary, but also a quick summary of this audit report. The first issue I wanted to point out is we did give the City a qualified opinion on the financial statements that we took a look at. And the reason there was a qualified opinion was because the city exceeded its budget for...it was the 2002 year?

**J. Broyles**

2002 is the good year. It actually involves [*unintelligible*].

**S. Armijo**

In both years. And so that's why we didn't give you a clean opinion. The one qualification that we had had to do directly with budget compliance for this city. So, any questions on that? [*silence*]

The next issue is, again, that one finding which we'll get into a minute that has to do with the budgets, was material. So that's why we qualified [it]. As far as, let's see, as far as the compliance with federal programs, we did issue an unqualified opinion, and that relates directly to just the 2001 audit because that was the only year that you received in excess of \$300,000 in federal funds. But we did report one finding in that area, and that was because the city didn't know or also didn't

tell us that they received in excess of \$300,000. And, again, so that's just -- the rest of that is just a summary. And as far as the City not being...the City did not qualify as a low risk auditee, though. And the one program that we did take a close look at was the public safety partnership, the community policing grants (sic), and again, we didn't have any issues with the City's compliance with that.

The next page is the first finding and it's a federal finding that we wanted to talk about. Were there any questions at this time? [silence] Okay. I'm going to turn this over to Jack and he's going to talk a little bit about this.

**J. Broyles** Okay. This one's pretty clear. The Office of Management and Budget requires a federal audit, anytime an entity receives more than \$300,000 in federal funds. After recomputing the schedule of federal awards for 2001, we came up with \$305,000. The thing that pushed you over here was that Drinking Water Program loan on the bottom right column. That was funded through a department-State Department of Ecology, but it was partially federally funded. And I looked at the grant and it wasn't very clear. Basically you're required to tell us when you're subject to single audit, and if you don't, a finding comes with it. And that's what this is. It summarizes the programs and expenditures made in 2001 only.

**S. Armijo** So for the 2002 year, the City did not receive over \$300,000 so there was not a federal audit required.

**J. Broyles** And basically, the City's response was that it wasn't clear, and ... it wasn't clear. Are there any questions on this one?

**Tolson** This, this particular audit is, it's been treated in other communities as well --

**J. Broyles** Yes.

**Tolson** -- and it's not uncommon?

**J. Broyles** Now I know, I think this Town of Coupeville had a finding or a management letter for the same exact loan. The same exact loan.

**S. Armijo** It does happen. Oftentimes the documentation that the City or the entity's received doesn't, it's not real clear what's state and what's federal. So if you actually go to our website and take a look, there are other cities who've gotten a similar finding.

**J. Broyles** So were there other questions on this one? [silence]

**S. Armijo** The next two findings that we're going to present are not federal. They really have more to do with the financial statement side of this report.

**J. Broyles** Okay. We sort of touched on the first one already, but the City exceeded its budget, approved budget in both 2001 and 2002. In 2001, it's exceeded by about \$300,000 and in 2002 by over \$1.5 million. Basically the issue here is that expenditures were going out without the council approving amended budgets which needs to happen before the money's spent. The actual final financial statement figures for 2002 show it exceeding the budget of \$889,000, but that was *after* a budget amendment occurred in January, 2003 for the 2002 year.

**S. Armijo** So, then, I guess what we really recommend is that the city council make sure that budget amendments get put in place *prior to the money being spent*, 'cause after the fact doesn't really cover the City, because it needs to be approved ahead of time.

**J. Broyles** And the City's response here is pretty explanatory. Does anybody have any questions on this one? [silence] And at the bottom of the finding, there's the applicable laws regarding the budget for optional code city, which you are. And then the last one in here relates to the financial condition of the city. At the close of business 2002, the current expense fund had a fund balance of only \$3,850, and three funds -- the street construction fund, the LID fund and the payroll clearing fund had negative fund balances. The problem is exasperated [*sic - exacerbated*] by the city council authorizing a loan from the utility to cover general fund expenditures. Without that loan, the general fund would have ended the year about \$200,000 in the hole. In addition, another \$100,00

was loaned in January of this year to close the year out, I believe, in the black. Is that right, Laura?

**Koenig** Um-hm.

**J. Broyles** Haven't seen it yet, so... The deal on -- the basic thing on -- when you make an interfund loan, the concern we had was that the BARS manual requires that the fund making the loan -- the fund *receiving* the loan has to have a reasonable opportunity repay the loan. There was no -- the original promissory note called for two equal annual installments from the general fund of the utility. Neither one of them happened. And at the point of -- at the end of fill-work, it wasn't likely that it was going to happen in 2002. So if you're going to make an interfund loan, the fund that is giving the loan has to have some sort of capacity to repay it. In addition, there's some issues regarding allocation of overhead, particularly Finance Department overhead to the utility fund. That's certainly something you can do, but there's no...there was no time and effort or any other [*sounds like, "study"*] to indicate that the city actually examined how much it was costing for Laura to process warrants for the street fund or the utility fund. The numbers seemed arbitrary to us, and we wanted to see some sort of study that shows, you know, Laura spends 40% of her time on the water fund and 10% on sewer, or whatever, so that it supports the amount of money that's being charged to the utilities as overhead.

**S. Armijo** Are there any questions on that?

**J. Broyles** This one's [*unintelligible -- "fairly"?*] complex, so you can feel free to ask a quest--ask questions, you know?

**Tolson** Was that through a note in here that says, uh...at the bottom of Item two it says that, "however, the amount does not appear to have been repaid." Was that just through this time period? Is that to date, or did you go that far as far as your...?

**J. Broyles** We left fill work on December 23<sup>rd</sup>, and at that point it had not been. And I know that in the adopted budget for 2004, there was a payment plan, or \$3,800 a month or something for the utility loan...? Laura? Am I right on that?

**Koenig** Yes.

**J. Broyles** Okay. And to be fair, we haven't checked to see if that happened in January. It was set up, the new resolution called for monthly payments, and I don't know if that's happened yet. Any other questions on this?

**Criswell** You say there [are] monthly payments? I thought they were, like, quarterly.

**Koenig** They were set at --

**Criswell** Twice a year, or maybe --

[*simultaneous comments*]

**J. Broyles** The original terms called for two, two annual payments, but neither one of them happened.

**Tolson** Two annual lump sum payments to wipe it out in total?

**J. Broyles** Right. That's what the resolution called for.

**Criswell** [*unintelligible*]. That was my question.

**Koenig** I did...I am just working on the January close-out.

**Criswell** Oh, okay.

**Koenig** [*unintelligible*].

**J. Broyles** Okay. The next thing here is the status of the prior federal findings. That's after Finding #2. And what this is is the City's response to our previous finding [and] how the City addressed the issues. There was a finding on the COPS program in 2000. There's a little basic blurb here about how the

City addressed it. It was our experience that the situation was resolved as well, so that the COPS program was given a clean opinion.

**S. Armijo** 'Cause we looked at the same -- we did audit that same grant during our audit period and we did not find any problems with it. And behind that, there's two actual -- well, I guess there's actually three statements. The first is our report on compliance with the internal controls over financial reporting in accordance with government auditing standards. And we take a look at compliance and internal controls in those areas. And behind that is also, it's our report on the federal compliance. And again, that was a clean opinion. And the final document back there, which I talked a little bit about earlier, had to do with -- basically it's our independent opinion on your financial statements. And, again, that's where you actually qualified for your opinion for the budget issue, which was the first--the second finding that we talked about.

**J. Broyles** And that's actually the fourth paragraph down if you want to look at it.

**S. Armijo** So it would be the last page...

**J. Broyles** It's before the last page.

**S. Armijo** Independent Audit Report on Financial Statements. Are there any questions on that? *[silence]* The next item in your packet that we wanted to discuss was a Management Letter. As far as our levels of reporting are concerned, obviously a finding which were the issues that we just discussed, are part of your audit report. And those are significant non-compliance issues that rise to a level where we need to put them in your audit report. The next step down is a Management Letter item. A Management Letter item is still significant; we definitely want to bring it to management's attention. We put it in a written format because we feel that these are areas that the City really needs to be concerned about and also ensure that there is compliance in the future, because obviously, if a Management Letter item isn't addressed and those issues aren't dealt with, it could escalate in the next audit period to be a finding. So there--there's--they're issues that are not as severe and not as big of a deal as a finding, but they're issues that we really want to make sure the City focuses on in the near future. So we do have three items that are in our Management Letter.

**J. Broyles** The first one relates to the general-- oh, no. I'm going to *[unintelligible]* -- the revenue debt of the City. There's been some issues with the bank calling the principal payments. We noted that it didn't happen for about three years, and then it happened once and then it didn't happen for two more years. In summary, though, the City's responsible for making sure that it gets paid. So if it's not paid on the due date, someone needs to call the bank and find out why. Next one down is utility adjustments. Basically we, there's no adequate support in the Utility Adjustment file for the adjustments that were made. Part of it was related to a software issue, and we were able to do other testing that satisfied our curiosity there. But there's an issue with the software that's showing utility adjustments that don't really exist. And the final thing is we recommended that internal controls be improved over the custody and issuance of building permits. There's a little bullet list of issues there you can take a look at if you want. We've already talked with Craig about it and he's already on top of it.

**S. Armijo** Are there any questions on the Management Letter items?

**Tolson** Could the utility adjustments, um...have you been able to substantiate them, the final numbers?

**J. Broyles** The month that we looked at, the July of 2002, one of them was an \$11,000 adjustment from an account that doesn't exist. And I actually drove by the service address and there's not even a house there. So I wasn't really too worried about it. It looks like it was a misread meter, and then it was adjusted off for some reason. The software's bringing it back up as an active account. But there hasn't been a house there for a long time. It's pretty well grown over.

**Boyd(?)** *[Not certain who asks this question, it sounded like Councilman Boyd]* Can you explain the problem with the software?

**J. Broyles** I don't know. I think Laura might be someone who -- I don't know much about it. We get -- The system that you guys use is almost unique in the state. There's only two or three other cities that are using it that I know of, and so I really don't know much about it.

**S. Armijo** We didn't see all that -- with the situation that there was any type of fraud or misuse of funds or accounts being written off or anything like that. It was just, it definitely looks like it's an issue within your system as to -- you know, and it's just determining -- either working with the company to really figure out what that problem is.

**J. Broyles** Any other questions on the Management Letter?

**Champeaux** Rick? It is the first, uh, what's the first issue of *[unintelligible]* not be able to make payment?

**J. Broyles** No, the money was in the fund. The bank never withdrew it. But the bank is acting as the fiscal agent. Ultimately it's the City's responsibility to make sure it gets paid. For some reason -- and Laura had documentation from the bank saying, hey, you know, we dropped the ball on this. So the bank did -- the bank's supposed to take the money out. But if they don't, someone needs to make sure that they do, because the money's still due.

**Champeaux** Laura, you accounted for the money going *out*, but it was never taken out?

**Koenig** Well, I actually, the Bank of New York is the fiscal agent for bonds in the state of Washington, and they're supposed to notify us on the Call, and this is not the only bond that we've been having a problem with the Bank of New York and we *[unintelligible]*. At this point I've been calling them to verify our bond amounts. And I said I did provide the auditor with the total documentation on the file, because they were not only not calling the principal, but the interest that they were calling was incorrect, too. So I had to go back and re-document with the bank. And we thought we had the issue all resolved, and then they failed to Call them again, so we made contact with them shortly after the bonds were due. We called them again and said, "We had a bond call here and you guys missed it." So I'm working with a representative at the Bank of New York to make sure this issue on this particular bond is resolved. And part of it *[unintelligible]*, we do have a letter from the bank admitting it was their error. And this was a combined re-bonded issue, as well as the new issue at the same time.

**Tolson** Well, has this cost the City any extra money?

**Koenig** No.

**J. Broyles** *[unintelligible]* to have it as an item.

**Koenig** We had the money in our accounts, so we were actually making interest on the money that was sitting there.

**Champeaux** *[unintelligible]*.

*[An inaudible comment, then a bit of chuckling.]*

**S. Armijo** Okay, the last -- I'm sorry. Was here any other questions? *[silence]* The last items that we wanted to present, are, um, exit items. And again, those were in the last document that you have, and that's actually our Exit Agenda. We kind of put these in a little bit of reverse order, just to make this presentation. On this page we have the mission of our office. We talk a little bit about our scope, and again, we use a high-risk approach to auditing, really focusing on areas that we really feel that, you know, the public or others are going to be really concerned about. And just focusing on the internal controls. Again, on the first page of this document, we....we have already gone over the financial *[unintelligible]* report, single audit and the accountability report. On the second page, again, we've gone over those three management letter items. The last two items are exit items and those are on the third page of this document. And an exit item, again, we -- those are just things that, again, are not significant enough that we would report them at a Management Letter finding level, they're just, kind of, you know, what we would call "housekeeping"-type items, things that we just want to bring to management's attention and just, just to let the council be, the council and the mayor be aware. So.

**J. Broyles** Okay. The first one relates to public records requests. It was our experience that the City has its fair share of those. And sometimes they're not always -- because of the scope of the request or the time of the request, they're not always able to be filled in five days. The City is required to respond to them in five days. They're documentation that the City currently uses [that] I felt could

be improved so that there's a log of when the initial contact was made by the constituent. Then when the request was fulfilled, if it was fulfilled timely. If not, why, and an expected time. It's just a, it's sort of a track record that shows you're doing your best to comply on your -- comply with -- *[unintelligible]* and also when this stuff actually goes out the door. The next one down relates to utility billings. We found one account that had apparently a serious water leak. They owe the City \$10,000. The City hasn't made any effort to collect that money at this time. And that's about it. Does anybody have any questions on that?

**Criswell** This \$10,000, that was...in an account that was outside the city, then, if I'm not mistaken, and they decided that *[unintelligible]* well?

**J. Broyles** Well, you certainly have the opportunity to *[sounds like, "close"]* a legal lien on the property. You might not get it now, but when they -- when and if they ever move, you might see that money. And I understand that the City attempted to work with these people and they were belligerent and unhelpful.

**S. Armijo** We also wanted to make sure that we took this opportunity to thank the City as well. We were able to come in here and do our audit, and everyone was willing to help us out and get us the information that we needed. We really appreciate having, being able to work in an environment that we can, we can get things done. So we do really want to thank the city for that.

**Criswell** Well, thank you for the compliment.

**S. Armijo** And another thing I wanted to point out, too, as far as the reports that we did hand out today, again, we're handing this out in a public meeting, so, you know, it's part of your record at this point in time, and it's, you know, the City is, if people want to do a records request they can get that report at the time. Our actual official audit report which is issued from Olympia will probably be about in a week or two. And that will -- none of the things that we've presented today is your final set of financial statements. It's not part of this report at this time, but it will be when it's issued through Olympia. And it will include the findings. Management Letters can also be requested through our office, as well. But, again, those, at this time, since we presented those at this meeting, those are public records.

**Tolson** No further question *[unintelligible]* council? I want to thank the audit team. They've been very, very helpful, thorough through all of this. And I just want to recognize them for their work.

**S. Armijo** Thank you.

**Tolson** All right. At this time we would like to receive comments from the public.

*[end of Audit presentation]*