

Washington State Auditor's Office
Accountability Audit Report

Pacific County

Report Date
December 27, 2013

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WASHINGTON
TROY KELLEY
STATE AUDITOR



**Washington State Auditor
Troy Kelley**

January 21, 2014

Board of Commissioners
Pacific County
South Bend, Washington

Report on Accountability

We appreciate the opportunity to work in cooperation with your County to promote accountability, integrity and openness in government. The State Auditor's Office takes seriously our role to advocate for government accountability and transparency and to promote positive change.

Please find attached our report on Pacific County's accountability and compliance with state laws and regulations and its own policies and procedures. Thank you for working with us to ensure the efficient and effective use of public resources.

Sincerely,

A handwritten signature in black ink that reads "Troy X. Kelley". The signature is written in a cursive style with a large "X" for the middle initial.

**TROY KELLEY
STATE AUDITOR**

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December 27, 2013

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Audit Summary

Pacific County
December 27, 2013

ABOUT THE AUDIT

This report contains the results of our independent accountability audit of Pacific County from January 1, 2011 through December 31, 2012.

We evaluated internal controls and performed audit procedures on the activities of the County. We also determined whether the County complied with state laws and regulations and its own policies and procedures.

In keeping with general auditing practices, we do not examine every transaction, activity or area. Instead, the areas examined were those representing the highest risk of noncompliance, misappropriation or misuse. The following areas were examined during this audit period:

- Open Public Meetings Act
- Superior Court Clerk's Office
- County Treasurer's Office
- Procurement
- Cost allocation
- Restricted funds
- Insurance and bonding
- Auditor's Office
- Citizen concern
- Fair

RESULTS

In most areas, the County complied with state laws and regulations and its own policies and procedures.

However, we identified a condition significant enough to report as a finding:

- Pacific County allocated shared services costs in excess of \$8.3 million without adequate documentation supporting the costs were fair and equitable.

Related Reports

**Pacific County
December 27, 2013**

FINANCIAL

Our opinion on the County's financial statements and compliance with federal grant program requirements is provided in a separate report, which includes the County's financial statements.

FEDERAL GRANT PROGRAMS

We evaluated internal controls and tested compliance with the federal program requirements, as applicable, for the County's major federal programs, which are listed in the Federal Summary section of the financial statement and single audit report.

Description of the County

Pacific County
December 27, 2013

ABOUT THE COUNTY

Pacific County is located in the southwest region of the state and has approximately 21,000 residents. The County is governed by an elected, three-member Board of Commissioners. Additional County elected positions include Superior Court Judge, two District Court Judges, Assessor, Auditor, Clerk, Prosecuting Attorney, Sheriff and Treasurer. The County operates on a \$30 million annual budget. Its 198 employees provide public safety, construction and maintenance of roads and bridges, sanitation facilities, health and social services, cultural and recreational facilities and activities, planning and zoning services, and general administration services. In addition, the County owns and operates an emergency communication system.

ELECTED OFFICIALS

These officials served during the audit period:

Board of Commissioners:

District 1	Jon Kaino (ending May 30, 2012) Beverly Olson (July 30, 2012 through November 30, 2012) Steve Rogers (effective December 1, 2012)
District 2	Bud Cuffel
District 3	Lisa Ayers
Superior Court Judge	Mike Sullivan
District Court Judges:	Elizabeth Penoyar
Assessor	Douglas Goelz
Auditor	Bruce Walker
Pacific County Clerk	Pat Gardner
Prosecuting Attorney	Virginia Leach
Sheriff	David Burke
Treasurer	Scott Johnson Renee Goodin

APPOINTED OFFICIALS

County Administrative Officer	Bryan Harrison (ending August 31, 2011) Kathy Spoor (effective September 1, 2011)
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COUNTY CONTACT INFORMATION

Address: Pacific County
300 Memorial Avenue
South Bend, WA 98586

Phone: (360) 875-9311

Website: www.co.pacific.wa.us

AUDIT HISTORY

The County receives an accountability audit every other year. Prior to 2011, it received an audit annually. The past six audits were free of accountability findings, but for the current audit, we reported a finding regarding the County's cost allocation practices.

Schedule of Audit Findings and Responses

Pacific County
December 27, 2013

1. Pacific County allocated shared services costs in excess of \$8.3 million without adequate documentation that the costs were fair and equitable.

Background

The County has programs for payroll as well as property and casualty insurance that are operated as internal service funds. These funds, the Cumulative/Reserve Insurance Fund and Payroll Internal Service Fund, provide insurance coverage and payroll benefits to other County departments in exchange for contributions to finance the programs.

The County operates an Equipment Rental and Reserve Fund (ER&R) to centralize the management of costs associated with equipment and vehicles. This includes setting aside money for future replacement and routine maintenance. The County is required to establish rates sufficient to recover costs of the fund. The established rate is charged to all funds that use this equipment monthly.

The *Budgeting Accounting and Reporting System* (BARS) manual and accounting principles give the County flexibility on how to allocate costs to its departments, but state that the allocation should be based on relevant, sufficient and reliable data. Also, the BARS manual requires the County to retain documents to support all charges.

Some of the County departments making contributions are doing so with restricted monies that can only be spent for specific purposes. Therefore it is important that departments contribute in a fair and equitable manner.

Description of Condition

Although the County has practices in place for its allocations of shared service costs, it did not have adequate documentation to support these practices. For example:

- The County's Cumulative/Reserve Insurance Fund charged other funds \$582,522 in insurance premiums during the 2011-2012 biennium based on full-time equivalents (FTE's). This is not an adequate methodology to ensure all funds were equitably charged in proportion to the benefit received.
- The County's Payroll Internal Service Fund charged other funds \$3,295,498 during the 2011-2012 biennium based on a percentage of salaries. These salaries were based on budgeted amounts. The budgeted amounts were not compared to actual expenditures to determine whether the initial allocations were reasonable.

- The County used spreadsheets to calculate and support the allocation of operating costs for the ER&R Fund, but does not have a documented plan to support the allocations. Total costs allocated were \$3,968,886.

In addition, the County was unable to provide support for \$493,466 in traffic enforcement costs charged to the County Roads Fund. As the County Road Fund contains restricted resources, any use of these monies needs to have support and demonstrate the benefits received by the fund. As a result, the County is unable to show documentation that it complied with state laws that prohibit shifting restricted resources to other funds.

Cause of Condition

The County has not dedicated the necessary resources to ensure charges for shared services costs were appropriately allocated and supported.

The County charged funds based on budgeted amounts and available resources instead of using a cost allocation plan.

In addition, the County has been cautious in its use of General Fund resources as there are many demands for these funds across the County.

Effect of Condition

As a result of the conditions identified above, the County is unable to demonstrate the allocations below complied with state laws that prohibit shifting restricted resources to other funds:

- \$582,522 in insurance premiums.
- \$3,295,498 in payroll benefit costs.
- \$3,968,886 in ER&R costs.
- \$493,466 in traffic enforcement costs.

Recommendation

We recommend the County:

- Develop and follow policies that govern how the County calculates and charges shared services costs and Equipment Rental and Reserve Fund charges to all funds. Costs charged to each fund should be proportional to the level of service or benefit provided to each fund. To accomplish this, the policy should specifically require the County to:
 - Develop and use a cost allocation plan for charging shared services across funds. The plan should include a reconciliation of actual expenditures to budgeted amounts if budgeted amounts are used for cost allocations.
 - Document the charges and support for the charges, ensuring that all allocated charges are applicable to the funds charged for the shared services.

- Periodically review and update the policy and the cost allocation plan.

County's Response

Pacific County is committed to transparent, accurate, and efficient accounting practices and policies. We are also committed to ongoing quality improvement and will work to improve our procedures to better comply with state requirements.

We are very disappointed with your decision to issue Pacific County a finding rather than a management letter. Our existing cost allocation practices have been in place for many years and endured many audits without question. Discussing our processes with other counties' officials, we found that our cost allocation practices are not unusual or unique to Pacific County. The issues raised in your audit did not identify any unsound accounting practices, misconduct, or loss of county assets. It did identify areas of improvement which typically are addressed with a management letter. A letter would have provided sufficient notice to encourage process improvements.

Response to Description of Condition

Cumulative Reserve Insurance Fund

The County bases its employee liability insurance charge distribution on the number of full-time equivalents (FTE) in each department. The auditor's recommendation is to evaluate each department as an insurance actuarial would, based on history and future projections. In large counties there may be clear evidence that one department has a much higher liability history than others, however, due to Pacific County's small sample base (number of FTE's), and limited history of employee liability claims, projecting risk accurately will be difficult at best. For the same reason, any new claim would disproportionately increase costs for the claiming department. Because of our limited claims activity, the cost of risk analysis would clearly exceed any allocation adjustments. We feel strongly that the current cost allocation is fair and equitable. If we see dramatic changes in future claims, this will be re-evaluated. We are willing to consider any cost effective alternatives that you may have available.

Payroll Internal Service Fund

The process for allocating payroll benefit costs is not purely budget based. A detailed evaluation of benefit costs is completed each year prior to budget adoption. The overall cost is estimated and distributed equally based on salaries by department. This practice will be evaluated and a more equitable allocation process will be developed.

ER&R

Over the past several years, very detailed tracking has been developed and implemented. The department utilizes spreadsheets for allocating operating costs supplemented by filed backup documentation. Although spreadsheets are a commonly used tracking tool, the auditor finds our current tracking spreadsheets difficult to work with. We will work on developing a written plan to assure the State audit staff can clearly identify how costs are assigned and tracked.

Road Fund – Traffic Enforcement

Historically, traffic enforcement expenses have been paid by road funds. While these are legitimate road fund expenses, prior to 2013, tracking of these costs was minimal. In 2013, a contract was executed between the Sheriff's fund and the Road fund requiring

traffic enforcement expense tracking. This tracking is currently occurring. We will be reviewing and improving the current tracking requirements.

We agree that documented cost allocation planning and policy development will provide clear guidelines to follow in the future. The finding describes our existing processes as “not adequate” and recommends developing new policies. However, the auditor does not provide specific recommendations or examples of proper procedures to assist in this development. We ask that along with the recommendations, the State Auditor provide examples of tools that are appropriate and easily adaptable for a county government similar in size to Pacific County.

Auditor’s Remarks

We appreciate the County’s response and recognize that the County is committed to ongoing quality improvement and working to improve its procedures; however we continue to emphasize that the County maintain documentation to support its shared service costs. Without the necessary documentation to demonstrate the proper spending of restricted money there exists a higher risk that errors and irregularities may occur and go undetected. These kinds of significant risks are typically reported by us at a higher level.

The County should ensure that shared services costs charged to restricted funds correlate to the service or benefit each fund receives. Specifically, the County should create a written plan that governs how it calculates and charges shared services costs to all funds and departments. Costs should be charged in proportion to the level of service or benefit provided to each fund or department. The cost allocation plan should be reviewed and updated annually.

As described in the Budgeting Accounting and Reporting Systems manual, the cost allocation plan should include the following:

- The specific costs to be allocated
- Which funds or accounts the costs will be allocated among
- The allocation basis used
- When the allocation will be made
- Specific calculations used to determine the allocation
- Annual review and update of the cost allocation plan

Additional cost allocation tools and resources can be found in our Local Government Performance Center, which provides assistance and direction to local governments, on our website at www.sao.wa.gov.

We wish to thank the County’s staff and management for their cooperation and assistance during our audit. We look forward to working with the County on this issue and will follow up on it during the next audit.

Applicable Laws and Regulations

RCW 43.09.210 states in part:

Separate accounts shall be kept for each department, public improvement, undertaking, institution, and public service industry under the jurisdiction of every taxing body.

All service rendered by, or property transferred from, one department, public improvement, undertaking, institution, or public service industry to another, shall be paid for at its true and full value by the department, public improvement, undertaking, institution, or public service industry receiving the same, and no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another

Budgeting, Accounting, and Reporting System (BARS) 2012 Manual, Part 3, Chapter 12, states in part:

The internal service fund may use any basis it considers appropriate to charge other funds of the entity, as long as the following conditions are met:

- (1) The total charge by the internal service fund to the other funds for the period is calculated in accordance with GASB Statement 10, paragraphs 53 through 57; or,
- (2) The total charge by the internal service fund to the other funds is based on an actuarial method or historical cost information and adjusted over a reasonable period of time so that internal service fund revenues and expenses are approximately equal.

RCW 36.82.020, County road fund – limitation upon expenditures, states:

Any funds accruing to and to be deposited in the county road fund arising from any levy in any road district shall be expended for proper county road purposes.

RCW 36.82.070, Purposes for which road fund can be used, states in part:

Any money paid to any county road fund may be used for the construction, alteration, repair, improvement, or maintenance of county roads and bridges thereon and for wharves necessary for ferriage of motor vehicle traffic, and for ferries, and for the acquiring, operating, and maintaining of machinery, equipment, quarries, or pits for the extraction of materials, and for the cost of establishing county roads, acquiring rights-of-way therefor, and expenses for the operation of the county engineering office, and for any of the following programs when directly related to county road purposes: (1) Insurance; (2) self-insurance programs; and (3) risk management programs; and for any other proper county road purpose



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 as an advocate for government accountability. 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.

The State Auditor's Office employees are located around the state to deliver services effectively and efficiently.

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 and fraud, whistleblower and citizen hotline investigations.

The results of our work are widely distributed through a variety of reports, which are available on our Web site and through our free, electronic subscription service.

We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive quality assurance program.

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