



Office of the Washington State Auditor
Pat McCarthy

Accountability Audit Report
City of Sedro-Woolley

For the period January 1, 2018 through December 31, 2019

Published January 21, 2021

Report No. 1027683





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

January 21, 2021

Mayor and City Council
City of Sedro-Woolley
Sedro Woolley, Washington

Report on Accountability

Thank you for the opportunity to work with you to promote accountability, integrity and openness in government. The Office of the Washington State Auditor 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.

Attached is 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

Americans with Disabilities

In accordance with the Americans with Disabilities Act, we will make this document available in alternative formats. For more information, please contact our Office at (564) 999-0950, TDD Relay at (800) 833-6388, or email our webmaster at webmaster@sao.wa.gov.

TABLE OF CONTENTS

Audit Results.....	4
Schedule of Audit Findings and Responses.....	5
Related Reports.....	9
Information about the City.....	10
About the State Auditor's Office.....	11

AUDIT RESULTS

Results in brief

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

As referenced above, we identified areas where the City could make improvements. These recommendations are included with our report as a finding.

We also noted certain matters related to municipal court processes that we communicated to City management and Mayor and City Council in a letter dated January 13, 2021. We appreciate the City's commitment to resolving those matters.

In keeping with general auditing practices, we do not examine every transaction, activity, policy, internal control, or area. As a result, no information is provided on the areas that were not examined.

About the audit

This report contains the results of our independent accountability audit of the City of Sedro-Woolley from January 1, 2018 through December 31, 2019.

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 obtaining evidence about the City's use of public resources, compliance with state laws and regulations and its own policies and procedures, and internal controls over such matters. The procedures performed were based on our assessment of risks in the areas we examined.

Based on our risk assessment for the years ended December 31, 2019 and 2018, the areas examined were those representing the highest risk of fraud, loss, abuse, or noncompliance. We examined the following areas during this audit period:

- Municipal Court – cash receipting, disbursements, adjustments, account activity, and report compliance
- Cost allocation plan– equitable distribution of indirect costs
- Utility accounts receivable – billing rates, adjustments and collections
- Electronic funds transfers – payroll and accounts payable
- Compliance with YMCA contract terms

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

2019-001 The City did not have adequate controls over the allocation of shared costs to restricted funds.

Background

Cities may charge costs incurred for central service functions, such as general administration, human resources, payroll and purchasing to funds that benefit from the services. The charged costs must be in proportion to the benefit received.

The City has a responsibility to adopt a fair and equitable method of distributing shared costs among funds and to document the benefit received for these charges. Additionally, state law prohibits resources restricted for specific uses, such as utilities that collect usage-based fees from citizens, from benefitting or subsidizing other functions of government.

The City of Sedro-Woolley has developed a cost allocation plan which allocates shared costs to several funds. In 2019, the City allocated about \$1.9 million in indirect costs in accordance with this plan.

Description of Condition

We reviewed the City's plan and identified the following:

- The City allocated 33.33 percent of total fire department costs to the Sewer and Storm Water utility funds. Although the City evaluated the charges included in the allocation, the City could not demonstrate the utility funds received equitable benefits for the costs charged.
- The City also allocated costs from several departments, such as Finance and Legal. Although the City had support for portions of the allocation, it could not provide adequate documentation to support all of the allocation factors in use.

Cause of Condition

Although the City has developed a cost allocation plan, portions of the plan have not been reviewed or updated to ensure costs are fully supported and allowable.

Effect of Condition

The City's allocation plan does not ensure that charges reflect the benefit each fund receives, especially restricted funds like the utilities. Specifically, 33.33 percent of all fire department costs were charged to the utility funds, resulting in total unallowable charges of \$489,758, including \$313,257 to the Sewer fund and

\$176,501 to the Storm Water fund. When costs allocated to restricted utility funds are not reasonable, City utility customers might be paying higher rates unnecessarily.

Further, the unsupported factors used to allocate costs from departments, such as Finance and Legal, make it difficult to determine if all of these charges are equitable.

Recommendations

We recommend the City evaluate and update its allocation plan to ensure costs are adequately supported and allocated in an equitable manner. We further recommend the City re-evaluate previous allocations and make a plan for repayment of any unsupported charges to restricted funds.

City's Response

The City appreciates the recommendations and suggestions of the State Auditor's Office.

The City has recently revised its Indirect Cost Allocation Plan policy in an effort to bring the process into current applicable standards. From a historical perspective, the City has used calculations that involved certain degrees of professional judgement regarding the allocation of overhead costs between the various functions of City operations. For example, overhead costs pertaining to a specific function could be allocated to other functions 75% by based on appropriated budget, with the remaining 25% allocated by the number of fulltime equivalents (FTEs) – the percentage allocation split being based on professional judgement. While the subsequent appropriated budget dollar amounts and FTE count data are documented, specific and supportable, the process of using the estimated 75%/25% split between the two metrics is a subjective estimate that is not based on a documented data metric. After discussions with the State Auditor's Office, the City agrees that for the allocation process to be less subjective, the City will change its policy to incorporate the elimination of steps that are based on estimates.

The City also agrees with the State Auditor's Office that the process of allocating costs of the Fire Department to the Sewer and Storm Water Funds should be changed. From a historical perspective, the City has allocated estimates for its confined space rescue program to the two utilities using a methodology that is too general – the full estimated costs of the program have been allocated rather than basing the allocation on the actual usage of the program by the two funds. While there exists a level of appropriateness to allocate some level of confined rescue costs to the utilities, the amount should only be for actual costs for time and

materials should either or both of the two utilities require the service. Based on the recommendations of the State Auditor's Office, the City will be revising its policy and allocation plan to eliminate this allocation methodology.

Again, the City appreciates the recommendations from the State Auditor's Office and looks forward to making the noted revisions.

Auditor's Remarks

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

Applicable Laws and Regulations

RCW 35.33.122 Administration, oversight, or supervision of utility – Reimbursement from utility budget authorized, states:

Whenever any city or town apportions a percentage of the city manager's, administrator's, or supervisor's time, or the time of other management or general government staff, for administration, oversight, or supervision of a utility operated by the city or town, or to provide services to the utility, the utility budget may identify such services and budget for reimbursement of the city's or town's current expense fund for the value of such services.

RCW 43.09.210 – Local government accounting – Separate accounts for each fund or activity – Exemption for agency surplus personal property, states:

(1) Separate accounts shall be kept for every appropriation or fund of a taxing or legislative body showing date and manner of each payment made therefrom, the name, address, and vocation of each person, organization, corporation, or association to whom paid, and for what purpose paid.

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

(3) 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.

(4) All unexpended balances of appropriations shall be transferred to the fund from which appropriated, whenever the account with an appropriation is closed.

(5) This section does not apply to:

(a) Agency surplus personal property handled under RCW [43.19.1919\(1\)\(e\)](#); or

(b) The transfer, lease, or other disposal of surplus property for public benefit purposes, as provided under RCW [39.33.015](#).

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 Sedro-Woolley, incorporated in 1898, serves approximately 12,000 citizens in Skagit County. The City provides services including police, fire, municipal court, building inspection, general administration, stormwater, wastewater treatment, solid waste disposal, legal administration, street construction and maintenance, parks and a cemetery.

An elected, seven-member Council and an independently elected Mayor govern the City. The Council appoints management to oversee the City's daily operations as well as its 73 employees. The City had operating revenues of \$22.5 million for fiscal year 2019.

Contact information related to this report	
Address:	City of Sedro-Woolley 325 Metcalf Street Sedro Woolley, WA 98284
Contact:	Douglas Merriman, City Supervisor/Finance Director
Telephone:	(360) 855-9925
Website:	www.ci.sedro-woolley.wa.us

Information current as of report publish date.

Audit history

You can find current and past audit reports for the City of Sedro-Woolley 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	PublicRecords@sao.wa.gov
Main telephone	(564) 999-0950
Toll-free Citizen Hotline	(866) 902-3900
Website	www.sao.wa.gov