-

City
Audit Planning Guide

April 14, 2022

Table of Contents

Planning Guide Information

Supersedes previous planning guide dated April 1, 2021. Please direct questions or suggestions to the City Subject Matter Experts.

Guidance is based on the extensive research, brainstorming and reviews conducted as part of the planning guide update process. For this update, guidance was also informed by discussion with:

- Municipal Research and Services Center (MRSC)

Guidance is intended only for internal use to help auditors gain an understanding of cities. The guide is intended to enhance planning and risk assessment procedures, not replace them. Information in the guide should therefore be considered along with other planning and risk assessment procedures. While guidance is designed to be as comprehensive as feasible, auditors must be alert for audit issues and situations not specifically addressed.

This guide is used by the State Auditor's Office staff as they plan audit engagements. Information presented in this document does not represent policy or legal guidance. State agencies and local governments should contact their legal counsels with specific questions.

WHAT'S NEW

Auditors should be aware of the following:

- Golf Course – Guidance added on risks associated with golf courses managed by city employees or contracted out to a third-party service provider. The golf course testing strategies in TeamMate have also been updated.

REQUIRED RISKS TO ASSESS

The following risks must be documented as red flags and discussed during brainstorming to ensure sufficient consideration. They should be prioritized for all audit types to the extent they are applicable and significant to the city and type of audit.

EFT Controls

Payroll and vendor electronic file transfer (EFT) related cyber frauds continue to occur. Accordingly, controls over EFTs is a required risk to assess for all entities we audit. When assessing this area of risk, auditors should talk with the entity about its controls related to changing existing EFT contact information and associated bank account numbers. The approach perpetrators of these frauds use has evolved to include changing contact information for existing EFT transactions before requesting a change to the associated bank account numbers. Previously, entities were encouraged to follow up with the contact information known at the time of the request for changes to bank account information; however, a stronger control is to independently confirm any change to payroll or vendor profile contact information or banking account information. Individuals with the ability to change or add EFT accounts need to have clear guidance on the process to authorize these changes through a proper validation method.A testing strategy is available in TeamMate at Accountability | Expenses | EFT Disbursements | Controls over EFTs. Contact Team IT Audit at SAOITAudit@sao.wa.gov for additional clarification or guidance.

Financial Condition

Financial condition risk will be assessed as a baseline test for accountability audits and as part of our going concern analysis for financial audits. Governments have experienced a wide range of effects as a result of COVID-19, so auditors should be alert for impacts to financial condition and review FYI 2020-01 for expected disclosures. Utilities, including water providers, may have been impacted by the governor's proclamations on deferrals of late payments and prohibitions against shut-off of service, see Appendix 3 – COVID 19 Impacts in the Water-Sewer Districts planning guide. The proclamation expired September 30, 2021. See also the Measurement of Financial Health section below for more details.

Vision Software Cash Receipting(only applicable for cities that use Vision)

Like any cash receipting system that is segregated from the financial system, there is a risk that not all cash received is captured and communicated to the financial system. This vulnerability has been extremely abused by some of the towns and cities that use Vision Software.

Historically, Vision did not have a report available to monitor unattached receipts from the receipting system and many cities and towns lacked proper monitoring of the system to timely capture frauds using this vulnerability. Vision now has a report that captures any receipts in the cash management module that was not attached to a deposit. Suggested steps to consider and other risks that have been identified are summarized in the Vision Common System Review.

BACKGROUND

Since governance structure and legal requirements for cities and towns vary somewhat by the city's classification, auditors should determine classification by checking MRSC City Profiles. Cities are classified by population at the time of incorporation as either a first class city (population of 10,000 and over), second class city (population of 1,500 to 10,000) or town (population 1,500 and under). Throughout the guide, all classes are referred to as "cities." Cities may also operate under the optional municipal code as either a non-charter code city or as a charter code city. All code cities are governed by Title 35A RCW, while all other cities are governed by Title 35 RCW. Within Titles 35 and 35A RCW, different laws apply based on classification. However, the auditor should be aware that code cities also have the authority to utilize the provisions of Title 35 RCW. First class and code cities have fairly broad statutory authority and can generally perform activities unless otherwise prohibited. Other cities' powers are generally limited to what is specifically authorized by statute.

Cities operate with three separate divisions of government: executive (Mayor or City Manager), legislative (Council) and judicial (municipal or district court). The Council establishes local law and broad policy through enactment of ordinances, which are codified into the municipal code, and through resolutions. Resolutions establish Council's intent and set policy, but generally do not carry the weight or sanctions of law. The Council also controls the city or town's finances through adoption and, as necessary, amendment of the budget. These entities are governed either by a Mayor-Council (Mayor independently elected by the citizens) or Council-Manager (Mayor elected by the Council, Council appoints a City Manager) form of government.

Common Activities
Typical city services include public safety (police and fire), public utilities, comprehensive planning, building permits and land use regulation, municipal court (or violations bureau), parks and recreation and cemetery operations. Some of these services may be contracted out with private and/or other municipal organizations (e.g., police protection or jail services from the county). A city may also assist in the development or preservation of publicly or privately owned housing for persons of low income by providing loans or grants of general municipal funds to the owners or developers of the housing (RCW 35.21.685).

Reviewing the city's budget is a good way to quickly identify services provided by the city.

Industry, Regulatory and Other External Factors
Most city services are mandatory and established by state law. We would not expect city operations to be exposed to direct competition, except for recreational facilities (ex: golf courses) and event centers.

Cities may be subject to significant financial pressures due to limits on their ability to increase revenues. The cost of maintaining existing levels of services may be increasing faster than revenues sources. This financial pressure increases the risk that management may divert restricted resources to pay for general governmental services.

City activities are generally not reliant on key suppliers, service providers, or key customers. However, they are impacted by significant changes in the economy. A city may see substantial decreases in sales tax or other revenues if economic conditions decline. Also, cities can experience legal exposures or financial pressures if demand for basic public services escalates or if system-wide improvements are needed to capital facilities such as roads, utility systems or records/data management without a corresponding increase in revenues.

Measurement of Financial Health
Almost all of cities' activities are supported by property taxes, relatively stable grant funding, mandatory fees, or charges for services (i.e. water/sewer). However, many of these sources are subject to restrictions on increases. Financial distress may occur when increases in expenditures for mandated public services outstrip the maximum allowable increases in funding - either for the city as a whole or for general fund activities supported only by limited taxes and grants. For this reason, the amount and trend of unrestricted general fund cash and fund balance and the ability of the general fund to continue to make debt service are primary measurements of the financial health of a city.

Even if a city does not have going concern issues for financial audit purposes, we still want to ensure that if there is a problem with significant financial deterioration, we communicate the issue to users, the governing body, and management.
SAO has reported unsustainable financial condition findings in several cities. We identified conditions including:

- Significant decreases in ending unreserved fund balance or cash and investments in the General fund.
- Expenditures consistently exceeding budgets.
- Increases in interfund loans from utilities to the General Fund.
- Utility revenues not covering expenses leading to decreases in ending cash within those funds
- Past due payment of bills due to insufficient cash balances.
- Exhausted "rainy day" funds.
- Potential inability to make debt payments.
- Budgeted revenue significantly higher than actual.

The risk of the above conditions appears to be higher in cities with high turnover in the chief financial officer position.

See also Required Risks to Assess.

PLANNING & ADMINISTRATION

Guidance for the following potential city functions are contained in other planning guides: law enforcement (Police & Sheriff guide and Jail guide), municipal court (Courts guide), self-insurance or risk management fund (Self Insurance / Risk Pools guide), industrial development corporations (IDC guide), fire protection and EMS (Fire Emergency Services guide), library (Library Districts guide), electric utilities (Public Utility Ds guide), transportation benefit districts (Transportation Benefit Districts guide), interlocal agreement entities (Interlocal Agreement Entities guide), and water, sewer and storm water utilities (Water-Sewer Districts guide).

In addition, see area guidance covering information technology, bidding and procurement, financial statement audits, investments, pension and OPEB, and Single Audit.

Training and Additional Resources

The following recorded webinars are available in the training system and may be helpful when auditing cities including:

- Know Before You Go: Cities and Towns
- Schedule 06 Bank Reconciliations for Cash Basis Governments

Additional resources related to cities can be found on the SAO HUB under Audit | Reference Guide | City Resources.

Key Operational Information

Key information about city operations the auditor should document in permanent file includes:

- The City's class (first class, second class, non-charter code, charter code or town). The classification of all cities can be found under "MRSC City Profiles" under City Resources in the SAO Reference Guide.
- The City's form of government (mayor-council, council-manager or commission).
- Scope of city activities and programs. Examples of activities that cities may or may not be involved in: fire protection and/or EMS services; water, sewer and/or storm water utilities; public health services (instead of a separate health district); jail and juvenile detention facilities; tourism promotion; recreational facilities; self-insurance; and provision of a landfill or garbage service.
- The nature and extent of any self-insurance, pension (other than PERS) or OPEB programs.

ACCOUNTABILITY

Cities act as their own treasurer. They may also act as treasurer for joint ventures or other entities they create.

Revenues

- **Cash receipting** - Recent city audits continue to identifiy issues related to cash receipting. The most common issues include the following:
  - Lack of segregation of duties and/or lack of or inadequate independent monitoring (see the Center's Segregation of Duties: Essential Internal Controls guide)
  - Lack of or inadequate independent reconciliation of daily receipts to deposits to ensure all funds collected were deposited
  - Not depositing funds timely
  - Lack of or improper documentation of composition of receipts
  - Lack of or inadequate independent review of adjustments, refunds, voids, shorts, etc.

  Cities that use cashier systems that electronically exchange information to the general ledger have the potential for the same unattached receipt risk identified in the Vision software system.

  Fraud investigations are also discovering risks with unexpected revenues. Auditors may be able to identify potential indicators by focusing on drops in revenues when reviewing revenue trends.

Smaller cities with limited staff or resources, cities who receipt manually or cities that use less sophisticated systems are at higher risk.

- **Construction Related and Land Use Permits** – Cities collect fees for construction related permits such as building permits and for permits regulation land use. Such fees are normally set to recover no more than the cost of the related services. Additional information on building and land use permits is provided below in Compliance Requirements.

- **Third Party Receipting (includes payments made online, in person, by mail or phone using E-check/ACH or credit card) -** Cities might be using third party service organizations for payment processing or bill payer functions. It is also possible that different departments may use different vendors to process their payments. To determine if a particular city uses third parties for cash receipting, check their website for payment options and inquire with city personnel (typically IT staff need to be involved with the interface so the IT department is a good place to start). Auditors can use the "Third Party Cash Receipting" step available in TeamMate in the Accountability | Revenues folder to evaluate this risk.

- **Miscellaneous Receipts and Concession Revenues -** Cities have miscellaneous revenues that may, or may not, be controlled by a billing/receipting system. For example, there may be parking garages, boat ramps, fire and police department supplemental services and many other areas. Manual and automated billing processes have different risks associated with the control activities. As these collections may just go to the General Fund, management may not have a clear incentive to ensure optimal collections. Risk may be higher that management does not develop expectations or other controls to help ensure complete collections. Further, these minor receipting revenue streams may not be timely deposited, not deposited in the main bank account or not fully collected and reported. Testing strategies related to manual and electronic receipting processes are available in TeamMate in the Accountability | Revenues | Cash Receipting folder.

- **Taxes**—Cities receive significant tax revenue collected by the state and county. They may also have significant locally collected taxes (e.g., about 40 cities assess business and occupation taxes). Audit risk associated with locally collected taxes will be higher than taxes collected by other governments.

- **Special Property Tax Levies**—Cities' authority for tax incremental financing (TIF) to pay for public improvement costs (MRSC article). There may be more special levies for parks and other objectives as cities look for new revenue sources. There may be an increased risk that any new revenue source such as new levies may be partly diverted for unauthorized purposes.

- **Federal and State Grants and Entitlements**—Cities typically receive federal and state grants and entitlements. Most of these revenues are restricted for certain objectives.

- **Utilities**—Cities often provide electricity, water, drainage and wastewater, and solid waste services. These utilities are a higher risk area for misappropriated revenues and inappropriate use or shifting of restricted resources. See the Water & Sewer Districts audit planning guide for additional guidance for this area.

- **Courts**— Court operations include billing, adjustments, collections, receipting, disbursements and trust account management. Due to the nature of court transactions, court revenues are at high risk for misappropriation, especially via adjusting / deleting cases or substitution schemes. Refer to the Courts area guide for details.

- **Parks**—Parks departments can have significant revenues from the rental of athletic fields and various recreation programs.

- **Police Department**—Revenue sources include gun permits and alarm permits and fines. See the Police & Sheriff guide for details.

Expenditures

Cities often have systems or controls over the following types of expenditures that are separate from the normal accounts payable and payroll systems:

- ACH or Electronic payments
- Credit Card payments
- Imprest and Petty cash funds, including police department confidential funds
- Jury & Witness payments paid by the Court
- Developer credits, which are non-cash credits assigned to developers in exchange for construction of necessary infrastructure. See discussion in the financial section below.

Some expenditure risks to be aware of are:

- **ACH or Electronic Payments** - Recent SAO audits have identified concerns with electronic payments being used to commit fraud within cities. For example, a City Clerk/Treasurer setup an automatic withdrawl for her personal mortgage payment to be disbursed out of the city bank account monthly. This type of fraud can be identified through a review of bank statements. A recently published SAO article provides guidance to local governments regarding how to review bank statements and could be a useful tool for auditors to use in scanning bank statements. See also Required Risks to Assess.

- **Leave Cashouts** – Recent frauds have identified misappropriation and fraudulent activity at cities involving leave cashouts. This is seen most often at smaller cities and decentralizaed locations. It is easiest to perpetuate when there is a lack of segregation of duties and/or inadequate independent monitoring (see the Center's Segregation of Duties: Essential Internal Controls guide for guidance on these topics)

Many cities donate funds to nonprofits that support the poor and infirm. The donation to the nonprofit violates article 8 § 7 of the Washington State Constitution because the nonprofit is neither poor or infirm. This advice is found in 1973 AGO No. 18.

Assets

- **Small & Attractive Assets** - In addition to normal office equipment, small and attractive assets may include the following, depending on city operations:
  - Maintenance equipment, inventories and supplies used by utility, public works, and parks departments
  - Equipment, weapons and supplies used by the police department
  - Evidence and confiscated assets held by the police department (see Police/Sheriff planning guide for additional information)
  - Vehicles used by the public works department or equipment internal service fund. Note that vehicles should be clearly marked as belonging to the city (RCW 46.08.065) and be used only for business purposes
  - Fuel pump or fuel cards
  - Technology equipment, such as laptops, digital cameras, media storage devices
  - Inventories of metal parts or products, such as copper wire and piping from utility or public works departments. Both the inventories and any scrap or wastage from projects can be readily converted to cash at metal-recycling businesses and are at high risk for theft.

- **Sale of Surplus Assets** - Cities have few statutory restrictions on the sale of surplus city assets but many cities have adopted policies on the surplusing of real and personal property. One common point of confusion is chapter 39.33 RCW Intergovernmental Disposition of Property. This chapter is deemed an alternative process to other methods of disposing of property when property is transferred between governmental entities.

- **Military Surplus -** Acquired assets from the Department of Defense (DOD) 1033 program are often small and attractive. Auditors should inquire about any assets acquired through the program and request a list of "closed" assets, since these are no longer actively monitored through the program and will not show up in the listing link. If the entity's controls over tracking and monitoring assets are weak, then there is an increased risk of inadequate tracking of these assets. Auditors can find a listing of the 1033 program assets each entity has received at www.dla.mil/DispositionServices/Offers/Reutilization/LawEnforcement.aspx.

Compliance Requirements

General compliance requirements apply to cities, including the Open Public Meetings Act, expenditure audit and certification, conflict of interest, limitation on compensation of public officials, insurance / bonding requirements, limitation of indebtedness, authorized investments and budgeting.

Other compliance requirements and risks to be aware of are as follows:

- ***Golf Course -*** Golf courses can be managed by city employees or contracted out to a third-party service provider. There are various types of contracts cities can have with service providers to manage operations and assets. It's important to understand the management structure at the golf course prior to auditing.

  Private golf courses have a culture that lends itself to expectations of playing privileges such as, playing discounts and free rounds of play. However, for municipal golf courses, these practices may be an unallowable gifting of public funds under the State Constitution Article 8, Section 7.

  If the city completely contracts with a third-party service provider to manage the golf course, the auditor should focus on contract compliance and monitoring by the city. Auditors should be particularly alert to controls over contracts with variable revenues.

  If city employees manage the golf course, consider the following risks:
  - Potential revenue loss (possible gifting of public resources) such as, playing fee discounts or waivers, reloadable accounts and punch cards, driving range ball fees, and facility rentals.
  - Lack of controls over inventory, specifically Pro Shop merchandise, equipment, and theft sensitive items.

  Updated golf course testing strategies are available in the TeamStore at Accountability | Entity Specific Areas | City/County | Golf Course.

- **Restricted Funds** – See Appendix 1 for a comprehensive list of restricted resources. Additional criteria and citations are provided in the Revenue/Expenditure/Expense Accounts Chart of Accounts in the BARS manual. Statewide analysis has identified the following as the highest-risk areas:

  - **Affordable and Supportive Sales Tax** – The 2019 Legislature passed the Encouraging Investments in Affordable and Supportive Housing Act (RCW 82.14.540), authorizing a new state-shared local sales and use tax to be used for affordable and supportive housing. Eligible counties and cities can pass resolutions of intent to implement the tax credit and can enter into an interlocal agreement with housing authorities to pool and allocate this revenue. As of October 1, 2020, seventy-seven of these jurisdictions have passed resolutions and adopted this legislation. Twenty-seven jurisdictions started receiving distributions from the State Treasurer from October through December 2019, totaling approximately $959,000; however, we expect this amount to increase significantly in 2020. Sales and use tax revenue may be used to provide housing and services only to persons whose income is at or below 60% of the median income of the city or county imposing the tax. Counties with populations over 400K and cities over 100K must use the revenue only for acquiring, rehabilitating or constructing affordable housing or funding the operations and maintenance costs of new units of affordable or supportive housing. Smaller couties and cities may also use the revenue to provide rental assistance to tenants.

  - **Hotel/Motel Tax** – Under Chapter 67.28 RCW and RCW 67.28.1815 cities may pay for all or any part of the cost of tourism promotion and acquisition or operation of tourism-related facilities. See testing strategy available in TeamMate under Accountability | Compliance Requirements | Restricted Funds | City/County Restricted Funds | Hotel-Motel Tax Expenditures for details.

- **Cost Allocations** – RCW 43.09.210 prohibits using restricted funds to benefit a different fund or objective. This can occur through cost allocations, which include internal service fund charges, overhead, indirect cost rates or cost allocation plans. A common example of inadequate support includes payroll charges based on management's estimates of time spent supporting utility activities with no actual supporting time records or other studies. Additional information and guidance regarding cost allocations can be found in the GAAP and Cash Basis BARS manuals under Accounting | Interfund Activities | Overhead Cost Allocation (section 3.9.5) and the testing strategy available in TeamMate under Accountability | Compliance Requirements | Interfund Transactions | Cost Allocation Plans. In addition, cities struggle to properly record cost allocations, also see the Financial Statement section on Cost Allocations.

- **Stormwater Utilities –** If cities have a stormwater utility, RCW 35.92.021 and RCW 43.09.210 require charges be uniform to both private customers and other funds and governments. As these utilities are relatively new to cities, there may be more risk the cities are not uniformly applying rates to their own property.

- **Building and Land Use Permits**—Cities collect fees for building permits and land development. RCW 82.02.020 prohibits these fees except to cover the cost of "processing applications, inspecting and reviewing plans, or preparing detailed [environmental] statements." Cities should have some support that demonstrates the revenue from building and land use permits is only used for allowable activities. Building and land use permit revenue should **not** be used to fund:
  - Planning (city/county planning for zoning, etc.)
  - Nuisance abatement
  - Fire marshal services
  - Code enforcement activities unrelated to or prior to filing permit applications
  - Fire inspections
  - Environmental health activities
  - Public works activities
  - Cost allocations from the Mayor and Council

- **Bid Compliance** – Cities are required to bid public works and purchases – see the Bidding and Procurement Guide for details. Cities also have limits on public works performed by city employees (referred to as "day labor"), which is also described in the Bidding and Procurement Guide. Larger cities generally have additional policies regulating purchases and personal service contracts.

- **Prevailing Wages** – Prevailing wage requirements apply to city public works and certain maintenance activity. There is no dollar threshold for prevailing wage requirements.

- **Support for Personal/Purchased Service Contracts –**
  - "Personal service" means professional or technical expertise provided by a consultant to accomplish a specific study, project, task, or other work statement.
  - "Purchased services" means services provided by a vendor to accomplish routine, continuing and necessary functions.

  In general, cities are not required to competitively procure personal or purchased services. There is a higher risk of inadequate support or no clear public purpose if contracts have been issued without competitive procurement. With competitive procurement, there generally will be at least some defined work product that can be monitored. In reviewing support for personal or purchased service contract costs, there should be sufficient support so that an entity can tell the difference in how much service they receive based on how much they pay. With good monitoring, there should be some confidence management would know that they would receive a different level of service if they increased or decreased the contract by 10%.

- **Professional Services (A&E) -** Competitive negotiation requirements of Chapter 39.80 RCW apply to all **local governments** when contracting for professional services defined by Chapter 18.08 RCW (Architects), Chapter 18.43 RCW (Engineers and Land Surveyors), or Chapter 18.96 RCW (Landscape

Architects). RCW 39.80.030-050 outlines the requirements for procuring such architectural and engineering (A&E) services. These requirements **do not** have a specified dollar threshold. Additionally, A&E services **are not** subject to prevailing wage or day labor requirements. Architectural and engineering (A&E) services should be selected based on a determination of the "most qualified firm", not "lowest responsible bidder". Once a firm is selected, a price is negotiated.

- **Support for Non-Profit-Subrecipient Service Contracts** – There is a higher risk of inadequate support for these contracts than for services provided directly to the cities as program managers may not have as direct knowledge of service delivery. There can be increased political pressure to support non-profit service providers as they may have more active participation at City Council meetings than the general population. This pressure can increase the risk payments may be approved without clear support. Auditors should consider the "Personal Service Contracts" step available in TeamMate in the Compliance Requirements | Procurement folder for testing this area.

- **Creation of New Entities –** Cities are authorized to create numerous different types of special purpose districts, as well as to create separate legal entities as part of an interlocal agreement (including non-profit corporations, LLCs and partnerships), (see Auditor Reference Guide | New Entity Creation or Dissolution Form and Instructions for details). Auditors should be alert for other entities requiring an audit when reviewing activity, contracts or agency funds of a city. We should ensure that these entities are submitting financial statements in accordance with BARS requirements and receiving audits. Follow the SAO Hub | Auditor Reference Guide | New Entity Creation or Dissolution Form and Instructions in evaluating new or previously unidentified entities.

- **Transportation Benefit Districts** – In 2015, the legislature added RCW 36.74 (Transportation Benefit Districts – Assumptions by Cities and Counties). See Transportation Benefit Districts planning guide for more information. Under this legislation a city or county created TBD can be assumed by the creating entity. RCW 36.74.010 states that any city or county in which a transportation benefit district has been established pursuant to chapter 36.73 with boundaries coterminous with the boundaries of the city or county may by ordinance or resolution of the city or county legislative authority assume the rights, powers, functions, and obligations of the transportation benefit district in accordance with this chapter. Auditors should refer to the TeamMate steps in the Accountability | Compliance Requirements | Formation, Merger or Dissolution folder for instructions and testing strategies when TBDs are created or dissolved.

- **CPA Firm Financial Statement Services** - There are a couple cities where a portion of the primary government is audited by an external firm (City of Seattle, City of Tacoma). To ensure this work is properly addressed please follow Policy 3510 and Policy 6240. See the Review Work of Others planning guide for additional information.

- **Self-Insurance Programs** – Reminder that RCW 43.09.260(1) and Audit Policy 1210 require an examination of all individual health and welfare programs and local government self-insurance programs at least once every two years. (Note: Self-Insurance will need to be included in every audit for those on a 2- or 3-year cycle.) Self-insurance programs or assumptions of any insurable risk type include: liability, property, health and welfare, worker's compensation, and unemployment compensation. Auditors should review the Schedule 21, which requires all local governments to report self-insurance or the assumption of any insurable risk type to help identify self-insurance programs. Self-insurance is a complicated topic and it can be challenging to complete an accurate Schedule 21. The auditor should consider the risk that self-insurance programs are not identified. The "Self-Insurance Assessment" workpaper located in the Accountability Planning folder can assist auditors in better understanding if the entity self-insures and what type of information can be gathered to help better assess risks. Please note: This step and workpaper is a planning procedure to help assess audit risk, and is not intended to be a substantive procedure. Self-insurance steps are available in TeamMate in the Accountability | Compliance Requirements | Self-Insurance folder to examine these programs.

- **Medical Self-Insurance Programs -** Auditors should inquire if the city allows other entities (such as special purpose districts or component units) to participate in their medical self-insurance program. If they allow other participants, please inform the self-insurance/risk pool subject matter experts.

Fraud Risks - Risk Management Department's Claim Payments

A small number of cities with their own risk management departments choose to process their own warrants to pay claims versus using a risk pool to perform this function. A recent fraud investigation has identified weaknesses in monitoring the validity of these payments and a lack of segregation of duties. If you want more information on this fraud case, please contact Team Fraud.

Typically, the city Finance Department, would review support for payments, such as invoices, prior to processing the payments. However, for claim payments some first party documentation may contain confidential information and therefore, may not be provided to support the payments. As a result, there is a risk these payments are processed without adequate review to ensure they are valid. It is important within the risk management department to have an independent review process in place for these claims prior to them being sent for processing.

When auditing a city with a risk management department, auditors should gain an understanding of the control process in place and consider testing claims for adequate support. The control process should include an independent thorough review of claim payments processed by the city Finance Department.

IT Risks

The Information Technology guide describes various general information system-related topics and identifies key primary risks related to computer systems that auditors should consider. Some relevant to cities include:

- **User Access** – Appropriate user access can strengthen segregation of duties. Cities of all sizes have historically faced challenges with maintaining adequate controls over User Access and Authentication. Particularly common issues are around segregation of duties, weak user authentication controls, and not removing former employee accounts. Auditors should refer to the TeamMate steps in Accountability | IT Controls | User Access.

- **Data Backup and Recovery** - With ransomware and other attacks focused on denial of access to confidential and critical data becoming increasingly common in addition to the regular risks to data such as equipment failure, it is vital that cities have backups of all critical data. Typical weaknesses tend to be not retaining at least some of the backups "offline" so the backups do not fall victim to the attack. Additionally, it is not uncommon for offline backups to fail due to a configuration or storage issue. As such, it is important that backups be tested on a regular basis. Auditors should refer to the TeamMate steps in Accountability | IT Controls | Data Backup and Recovery.

- **Patch Management & Updates –** One key defense to ransomware and other attacks is to minimize vulnerabilities within the network and various systems through patch management and udpates. Depending on how the system was developed and is supported by the vendor impacts how patches are communicated, analyzed and utilized by the cities. Auditors should refer to the TeamMate steps in Accountability | IT Controls | Patch Management.

Financial management policies and resources

Governments and their policy needs vary considerably due to differences in size, scope of activities, organizational and staffing structures, contractual and program structures, technology, and the governing body's values and priorities. Financial policies should be designed by each government according to its needs. MRSC, in partnership with SAO, has developed a series of online resources to help local governments develop and adopt effective financial policies and procedures.

FINANCIAL STATEMENTS

Cities are considered a general government with both governmental and business-type funds. Cities may report on either a cash or GAAP basis.

Reporting changes in the BARS Manuals

The 2021 BARS manual revisions include changes to the chart of accounts as well as updates for new GASBs in the Accounting and Reporting sections.

The 2020 BARS manual revisions include changes to the chart of accounts as well as updates for new GASBs in the Accounting and Reporting sections. Fiduciary fund reporting guidance was updated with new information regarding activity that should be reporting in Custodial Funds. Furthermore, the classifications for beginning and ending fund balances have been changed for cash basis entities to resemble GAAP fund balance categories. The classification categories are no longer reserved and unreserved; instead, the categories are nonspendable, restricted, committed, assigned and unassigned. Cash basis cities will be expected to reclassify their fund balances in accordance with these new classifications.

The 2019 BARS manual revisions include changes to the chart of accounts as well as updates for new GASBs in the Accounting and Reporting sections. A new section called Bank Reconciliation has been added to both GAAP and Cash Basis versions. In addition, revisions include clarification to the pension note on non-governmental plans and defined contribution pension plans for GAAP entities, and new schedule 9 codes for environmental liabilities (pollution remediation, asset retirement obligations, etc.). For Cash Basis cities, new sections were added on Other Postemployment Benefits (OPEB), Environmental Liabilities, Certain Assets Retirement Obligitions and Fiduciary Activities. An additional note template is also available for reporting of Component Units, Joint Ventures and Related Parties. *Note: Schedules 07 & 11 have been eliminated for all Cities. Schedule 6 is a required schedule for BARS cash basis governments. Cities with total revenues usually less than $300,000 are also required to submit an Assessment Questionnaire.*

GAAP reporting changes

All new GASBs are identified and evaluated by the Financial Audit Committee (FAC), as summarized on the GASB Tracker available on the FAC Sharepoint page. When evaluating implementation of new GASBs for Cities, auditors should specifically consider:

- **GASB 83** (Asset Retirement Obligations, original implementation effective for FYE 2019, new implementation effective for FYE 2020) is expected to impact most Cities. For example, we expect that it would apply to fuel tanks. See the Center's Identifying Asset Retirement Obligations helpful information. (Note: This is not authoritative guidance but instead is a resource to help entities evaluate for potential obligations). A TeamMate testing strategy workpaper is available in Financial Statement | GAAP | Workpapers.
- **GASB 84** (Fiduciary Activities, original implementation effective for FYE 2019, new implementation effective for FYE 2020) is expected to have an impact on many Cities and require re-evaluation and changes to reporting for fiduciary activities. A TeamMate testing strategy workpaper is available in Financial Statement | GAAP | Workpapers.
- **GASB 87** (Leases, original implementation effective FYE 2020, new implementation effective FYE 2022) is also expected to have a major impact on Cities and require re-evaluating and changes to reporting for leases. Due to a City's naturally decentralized operations and extent of activities, we would expect this to require significant effort and analysis. We would not expect any early adoption of this GASB. A TeamMate testing strategy workpaper is available in Financial Statement | GAAP | Workpapers.

GASB 95, issued May 8, 2020, delayed the implementation date of certain new standards. Entities have the option to decide whether or not to delay implementation. During planning, as part of Understanding the Entity & Environment, auditors should inquire with the entity and confirm the entity's implementation decisions.

GAAP Reporting - Capital Contributions of infrastructure built by private developers

Cities require (as part of policy or code) that private developments construct various infrastructure, such as roads, water, sewer, lights, etc. as part of the building and permitting process. The infrastructure required to be built by the developer is subsequently turned over to the city for upkeep and operation at the conclusion of the development. This infrastructure is considered a capital contribution (donated infrastructure). The city may offer developers the option of paying a system development fee in lieu of actually constructing the infrastructure themselves. In this case, the city would construct the necessary infrastructure paid for by the fees. These transactions should be reported as follows:

- *Capital Contributions (Donated Infrastructure)* - This amount would be reported in the Capital Grants and Contributions column of the Government-wide Statement of Activities. It would not be reported on Governmental fund operating statements, but would be reported on the Proprietary Fund operating statements as a line item ("Capital Contributions") underneath Non-Operating Income (Loss). See the BARS manual for reporting examples.
- *System Development Charges* – Should be reported as revenue to the city similar to any other plan or permit fees.
- *Developer Credits (issued under RCW 82.02.060)* – Should be reported as capital assets and a developer credit liability when the credit is issued. When the credit is redeemed, the liability is reduced and contributed capital revenue (or impact fee revenue) is recorded. For proprietary funds and on the government-wide statements, developer credits should be reported as contributed capital.

GAAP reporting – Revenue recognition of Impact Fees
In prior audits, we have found that entities are reporting impact fee revenues differently. We determined that revenues (capital contributions) should be recognized when the local government has an enforceable legal claim to the fee. Normally, the enforceable claim comes when the local government receives the fee payment. However, recognition will be delayed if the government has a refund policy requiring return of the fee to the developer. This is further discussed in section 3.6.7 of the GAAP BARS Manual under Accounting, Revenues, and Impact Fees.

GAAP reporting – Revenue recognition of Taxes
Recent audits have found that some entities are not properly accruing property, sales and other taxes. They are instead reporting them when the cash is received, causing errors on the financial statements. Guidance on proper reporting for modified accrual (governmental funds) and full accrual (government-wide statements) is available in the BARS Manual at 3.6.9, Revenue Accruals in Governmental Funds, and 3.5.2, Accounting and Reporting of Property Tax. A Digital Audit Connections article is also available, Tax Receivable: Are you reporting it correctly?

Enterprise Fund reporting
Recent issues have been identified for inappropriate reporting of enterprise activities. Issues include reporting activities almost exclusively financed by user fees reported in the general fund or special revenue funds; separate enterprise funds for reporting construction capital improvements or debt servicing; separate enterprise funds for reporting customer deposits or equipment reserves; and enterprise funds incorrectly used to report activities when the only revenue sources are taxes, grants or transfers. A Digital Audit Connections article is also available, When Should I Use Enterprise Funds?

Cost Allocations
Cities struggle to properly record cost allocations. These reimbursements should reduce expenditures/expenses in the fund that initially paid for them and move the expenditure/expense to the fund that is responsible, BARS 3.9.4. If a city incorrectly records these reimbursements as revenues, the error could be material for financial statement purposes, particularly if all amounts are initially paid out of the general fund and the city does not utilize an internal service fund for allocating costs. (*The exception to this is if an internal service fund is used, then cost allocations are treated as revenues rather than reimbursements.)* Also see the Accountability section on Cost Allocations.

License Fee Reporting (TBDs)
As summarized in an MRSC article, the Washington Supreme Court's October 2020 decision found I-976 to be unconstitutional. As such, cities that had considered it a loss contingency pending the outcome of the case should no longer be reporting this way.

While the constitutionality of the initiative was being challenged in court, the vehicle licensing fees subject to the litigation continued to be collected pending the outcome of the case. There were strong diversity of views on the likelihood of future events during the pending litigation which affected how governments reported the matter.

- If a city's legal counsel or governing body had determined that the funds couldn't or shouldn't be spent due to the pending litigation, the amounts would have been considered restricted. The outcome of the case would have no effect on this reporting.
- If a city had determined that amounts spent or held met criteria for reporting as a contingent liability, then 263.99 (miscellaneous liabilities) would have been used. Cities should no longer be reporting this way due to the Supreme Court's decision.

Potential higher risk financial statement areas based on other SAO audits
We noted the following issues in city financial audit findings.

- Inadequate review of financial statements, note disclosures, journal entries, reconciliations and reporting entity determinations. Issues included missing statements, incorrect fund balance classifications, short term debt note omitted, discretely presented component unit should have been blended, expenditure cut-off misstatements, failure to eliminate intrafund activity, unsupported cost allocations and unsupported landfill closure liabilities. The Center for Government Innovation has developed a Checklist for Preparing Cash Basis Financial Statements.

- Inadequate evaluation or support for newly implemented standards. The Center for Government Innovation has developed a fully-customizable word document to ensure financial statement preparation includes sufficient research to correctly and timely implement changes in GASB standards, Checklist for Accounting Standards Changes. This form can be adjusted to reflect the assigned responsibilities and processes for financial statement preparation at each government. The Center also provides some Best Practices for Implementing New GASB Standards.

- Inadequate manual and/or automated controls and misstatements related to capital assets, including omission of developer contributions or other donated property, incorrect valuation of donated property, duplicate recording of property, failure to remove land disposition and reporting assets that are depreciated beyond their useful lives. The Center for Government Innovation has developed a Checklist for Capital Assets. A Digital Audit Connections article is also available, Resources for Capital Asset Accounting.

- Improper support for classification of funds. In particular, street funds have been coded as proprietary funds at some cities. If auditing a city where this is the case, consider inquiring with the client about their rationale and reaching out to LGS for assistance on this as this generally does not meet SAO's expectations for reporting this type of activity.

- Incorrect accounting for courts activity – if the City has a municipal court that they they run themselves, all transactions to the AOC must be recorded as fiduciary using activity codes 386 and 586. Some cities are reporting this as non-fiduciary, which is incorrect.

- Poor financial condition.

SINGLE AUDIT

Many cities expend $750,000 or more in federal financial assistance and require a single audit in accordance with the Uniform Guidance at 2 CFR 200 – Subpart F Audit Requirements. Refer to the Single Audit planning guide for details on the Single Audit.

EPA Clean Water State Revolving Fund (CFDA 66.458)
The EPA has stated in the Compliance Supplement (see IV. Other Information) that subrecipients receiving loans under this program (66.458) should only report project expenditures incurred (***see update on timing of SEFA reporting below***) because it considers it a subaward, not direct federal loan. For this program, the loan

reporting requirements of 2 CFR sections 200.502(b) or (d) do not apply when calculating the amount of federal funds expended. In other words, loan balances are not reported.

CAUTION: EPA further stated in the Compliance Supplement that to achieve consistency in meeting program requirements and eliminate the possibility of over-reporting information under the Federal Funding Accountability and Transparency Act ("FFATA" or "Transparency Act"), the State CWSRF program must use the same group of loans for purposes of meeting federal cross-cutting, single audit, procurement, and Transparency Act reporting requirements. EPA refers to this as "Equivalency", which is an option states can use to streamline program implementation. The State awarding agency for CWSRF, WA Department of Ecology (DOE), makes the determination as to which awards it will use for equivalency purposes. See below for more detailed information about DOE awards. **Only those awards deemed equivalent (by DOE) are reported on the SEFA, *<u>regardless of the funding source</u>*.** Entities should refer to their awarding documents and/or consult with their awarding agency if they are unclear whether or not their award is an equivalency project or being reported as FFATA. A HelpDesk request may be submitted with our Office for assistance.

TIMING OF SEFA REPORTING 4/10/20: In consultation with the EPA, the subrecipient should not report the expenditures on its SEFA <u>until it requests reimbursement</u> from its awarding agency. This may result in prior period expenditures being reported on the SEFA. *Note, for FY19 SEFA reporting only, entities will not report expenditures that were already reported on a previous SEFA to avoid double reporting. This may result in reconciling items to tie the SEFA to the entity's supporting documentation.*

DOE Awards: Within the DOE agreement, there are two "funding distributions", each with their own unique identifying numbers starting with "EL" and will state if the funding is federal or state. Funding distributions are how ECY is keeping track of the equivalency awards. This is the piece of our understanding that was missing from our guidance in the past. Previously, it was understood the award/project in its entirety was either deemed equivalency or not. Now, it is understood the award/project may include only a part of it for equivalency.

EPA Drinking Water State Revolving Fund (CFDA 66.468)
The EPA has stated in the Compliance Supplement (see IV. Other Information) that subrecipients receiving loans under program (66.468) should only report project expenditures incurred (*see update on timing of SEFA reporting below*) because it considers it a subaward, not a direct federal loan. For this program, the loan reporting requirements of 2 CFR sections 200.502(b) or (d) do not apply when calculating the amount of federal funds expended. In other words, loan balances are not reported.

CAUTION: EPA further stated in the Compliance Supplement that to achieve consistency in meeting program requirements and eliminate the possibility of over-reporting information under the Federal Funding Accountability and Transparency Act ("FFATA" or "Transparency Act"), the State DWSRF program must use the same group of loans for purposes of meeting federal cross-cutting, single audit, procurement, and Transparency Act reporting requirements. EPA refers to this as "Equivalency", which is an option states can use to streamline program implementation. The State awarding agency for DWSRF, WA Department of Health (DOH), **has chosen to not implement equivalency**. This means that the subset of FFATA projects, as well as other DWSRF projects are all subject to Federal cross-cutting requirements. All DWSRF projects expending federal funds will be reported to the SEFA. **DOH will notify subrecipients of actual federal dollars expended.** Entities should refer to their awarding documents and/or consult with their awarding agency if they are unclear whether or not their award is being reported as Federal funds. A HelpDesk request may be submitted with our Office for assistance.

TIMING OF SEFA REPORTING 4/10/20: In consultation with the EPA, the subrecipient should not report the expenditures on its SEFA <u>until it requests reimbursement</u> from its awarding agency. This may result in prior period expenditures being reported on the SEFA. *Note for FY19 SEFA reporting only, entities will not report expenditures that were already reported on a previous SEFA to avoid double reporting. This may result in reconciling items to tie the SEFA to the entity's supporting documentation.*

PERFORMANCE AUDIT

Information on ongoing performance audits can be found on SAO website at: https://www.sao.wa.gov/performance-audits/performance-audits-in-progress. For all other inquiries please contact the Assistant Director for Performance Audit.

APPENDIX 1: List of Restricted Funds for Cities

The following table lists potential sources of restricted funds, along with details and citations. A quick way to check what restricted funds a city is reporting is by BARS coding.

Restrictions on the use of Resources
General Restrictions
Special Revenue Funds (RCW 43.09.210) – These funds are used to account for revenues restricted to a certain purpose. If funds are not already restricted by statute or contract, we would expect the resolution authorizing a special revenue fund would specify a restriction.
Internal Service Funds (RCW 43.09.210) – The function of an internal service fund is to accumulate and allocate joint or shared costs among funds. Internal Service Fund resources are considered restricted to their stated activity or function. In addition, excessive accumulation of undesignated reserves or improper cost allocation methods or structures may be considered improper use of restricted funds when such resources are being paid into the internal service fund.
Proprietary Funds (RCW 43.09.210) – Proprietary funds are typically considered restricted as a separate undertaking of the city. Additional clarification of restrictions is often found in statute, contracts and resolutions authorizing the fund.
Cost Allocations **Overhead costs** consist of the costs of central services or support functions shared across departments. They may include accounting, human resources, payroll, information technology, janitorial services and others. Overhead costs may include not only the salaries, wages and benefits of the employees who work in these departments, but the utilities, supplies, information technology, building maintenance and other costs that support these employees. Typically, such services are initially paid through the general fund or an internal service fund and charged back to the departments and programs that directly benefited from them. The cost allocation process must be guided by an **overhead cost allocation plan** that describes how the organization will allocate costs reasonably and equitably across funds and departments and identifies the documentation required to support the charges.
Transfers of Interest Income to the General Fund Based on the language of the statute, interest earnings from some restricted revenue sources are considered unrestricted and can be transferred to the general fund. Cities may transfer interest income to their general fund if the transfer is in compliance with RCW 35.39.034 (non-code cities) or RCW 35A.40.050 (code cities).
Specific Restrictions
Marijuana Enforcement - Chapter 4, Laws of 2015, 2nd special session, section 1603 (2E2SHB 2136). State distribution for marijuana enforcement. The bill does not define "marijuana enforcement" but city should be able to demonstrate how the expenditures tie to "marijuana enforcement."
Equipment Rental and Revolving Fund (RCW 35.21.088) - The ER&R fund is established by RCW 35.21.088. It is "a revolving fund for to be expended for salaries, wages, and operations required for the repair, replacement, purchase, and operation of equipment, and for the purchase of equipment, materials, and supplies to be used in the administration and operation of the fund. See testing strategy available in TeamMate under Accountability | Compliance Requirements | Restricted Funds | City/County Restricted Funds | Equipment Rental & Revolving Fund for details.
Earmarked Property Tax Levies (RCWs, 84.52.069, 73.08.080, 71.20.110, 84.52.135, 84.34.210-230) - Could have additional earmarked levies. For example: EMS, Veterans, Conservation Futures, etc. See testing strategy available in TeamMate under Accountability | Compliance Requirements | Restricted Funds | City/County Restricted Funds | Veteran's Relief Funds for details on veteran's assistance program.
Annexation Area Sales Tax (RCW 82.14.415) – to provide, maintain, and operate municipal services for the annexation area

Restrictions on the use of Resources
Chemical Dependency / Mental Health Service Tax (RCW 82.14.460) - providing new or expanded chemical dependency or mental health treatment services and for the operation of new or expanded therapeutic court programs
Special Purpose Sales Tax (RCW 82.14.450) - sales and use tax imposed for a special purpose - ballot measure will indicate restrictions, but at least one third must be used for criminal justice purposes, fire protection purposes, or both
Emergency Communication Tax (RCW 82.14.420) - financing, design, acquisition, construction, equipping, operating, maintaining, remodeling, repairing, reequipping, and improvement of emergency communication systems and facilities
Zoo, Aquarium and Wildlife facilities Sales Tax (RCW 82.14.400) - financing, design, acquisition, construction, equipping, operating, maintaining, remodeling, repairing, reequipping, and improvement of zoo, aquarium and wildlife preservation and a display facilities that are currently accredited by the American Zoo and Aquarium Association. Also can be used for parks as defined in RCW 82.14.400
Hotel-Motel Tax (Chapter 67.28 RCW and RCW 67.28.1815) - paying all or any part of the cost of tourism promotion and acquisition or operation of tourism-related facilities. See testing strategy available in TeamMate under Accountability | Compliance Requirements | Restricted Funds | City/County Restricted Funds | Hotel-Motel Tax Expenditures for details.
Criminal Justice Sales Tax (RCW 82.14.340) - criminal justice purposes
Juvenile Detention Facilities and Jails Sales and Use Tax (RCW 82.14.350) – financing, design, acquisition, construction, equipping, operating, maintaining, remodeling, repairing, reequipping, and improvement of juvenile detention facilities and jails
High Capacity Transportation Employer Tax and Rental Car Sales Tax (RCWs 81.104.160(1) and 81.104.150) – to be used solely for providing high capacity transportation service.
Border Area Jurisdiction Sales and Use Tax (RCW 82.47.020, .030) – to be used for border area street maintenance and construction.
REET 1 (RCWs 82.46.010, 82.46.030(2) and 82.45.180(2)) – real estate excise tax (REET) 1 funds are to be used solely for local capital projects identified in RCW 82.46.010(2)(6) which are identified in the capital facilities plan element of the city's Growth Management Act Comprehensive Plan. Proceeds should be placed in the capital improvement fund. Small cities with a population of 5,000 or less may also use funds for local capital improvements listed in RCW 35.43.040.
REET 2 (RCW 82.46.035) – to be used solely for local capital projects specified in the capital facilities plan.
Conservation Areas Tax (RCW 82.46.070) – to be used solely for acquisition and maintenance of conservation areas.
Gambling Excise Tax (RCW 9.46.110, .113,) - Cities are authorized to collect taxes on gambling activities that occur in their jurisdiction. Chapter 9.46 RCW sets tax rates and requires that revenue be used "primarily" for public safety.
Tourism Promotion Charges (RCW 35.101.010-.130) – upon formation of a tourism promotion area, a city may impose a lodging charge to be used solely for tourism promotion.
Grants – review the grant agreement for any restrictions related to federal, state and private grants.
Federal entitlements, impact payments, and in-lieu taxes - see specific requirements in BARS or in authorizing legislation.
Vessel Registration Fees (RCW 88.02.650) – to be used for boating safety education/programs and law enforcement programs - counties can further allocate this money to other jurisdictions with approved boating safety programs, but these funds cannot supplant existing local funds used for boating safety.
Local Option MVFT (RCW 82.80.070) – for transportation purposes only, consistent with the adopted transportation plan.
Judge's Salaries (RCW 43.08.250) – State contribution for district and municipal court judges' salaries.

Restrictions on the use of Resources
Water Improvements (RCW 79.115.150) - must be deposited in a special fund and must be used only for water-related improvements
State Criminal Justice 320 Funding (RCW 82.14.320, BARS section 3.6.4.10) - must be expended for criminal justice purposes and should not be used to replace or supplant existing funding.
State Criminal Justice 330 (1)(a)/330(2)(a) Funding (RCWs 82.14.330 (1)(a) & 82.14.330(2)(a), BARS section 3.6.4.10) - must be used for criminal justice purposes.
State Criminal Justice 330(1)(b) Funding (RCW 82.14.330(1)(b)) - funds should be used only for (1) innovative law enforcement strategies, (2) programs to help at-risk children or child abuse victim resource programs or (3) programs designed to reduce the level of domestic violence or to provide counseling for domestic violence victims.
State Juvenile Justice Funding - funds should be used solely for county adult court cost associated with implementation of revised Juvenile Justice Act. See chapter 13.40 RCW.
State Juvenile Impact Funding - funds should be used to provide funding for county impacts associated with the implementation of the Chapter 338, Laws 1997 (juvenile code revision) . See chapter 13.40 RCW.
State DUI Implementation Funding - used for the cost of implementation of the DUI and other criminal justice statutes
State Extraordinary Criminal Justice Funding - for the extraordinary criminal justice cost related to the aggravated murder cases
Liquor Taxes and Profits for Substance Abuse (RCWs 66.08.170-210, 66.24.290, 71.24.550-.555, 82.08.150-200, BARS section 3.6.8) – 2% of the County's share must be spent on substance abuse treatment program(s) approved by DSHS and the applicable alcoholism and drug abuse board.
Firefighters Pension fund (RCW 41.16.050) – The tax must be deposited in the firemen's pension fund.
Zoning and Subdivision fees (RCW 82.02.020) – Permit related fees can only be used to cover the cost of processing applications, inspecting and reviewing plans, or preparing detailed [environmental] statements. Voluntary agreement revenues and SEPA mitigation may only be expended to fund a capital improvement agreed upon by the parties to mitigate the identified, direct impact.
Plan Check Fees (RCW 82.02.020) – Fees can only be used to cover the cost of processing applications, inspecting and reviewing plans, or preparing detailed [environmental] statements.
Transportation Impact Fees (RCW 39.92.040) – impact fees from new development shall be used in substantial part to pay for improvements mitigating the impacts of the development or be refunded to the property owners of record. See testing strategy available in TeamMate under Accountability | Compliance Requirements | Restricted Funds | City/County Restricted Funds | Impact Fees for details.
GMA Impact Fees (RCWs 82.02.050-090, 36.70A.070) - funds collected as a result of new developments shall be used in substantial part to pay for improvements mitigating the impacts of the development, in compliance with the Growth Management Act, or be refunded to the property owners of record. Includes Park Impact Fees, Fire Impact Fees, School Impact Fees, etc. See testing strategy available in TeamMate under Accountability | Compliance Requirements | Restricted Funds | City/County Restricted Funds | Impact Fees and Impact Fee Credits for details.
Domestic Violence fines (RCW 10.99.080) - assessments on convicted domestic violence offenders must be used for establishing and operating domestic violence advocacy, prevention and prosecution programs. Revenues may not be used for indigent criminal defense.
Criminal profiteering fines - funds should be used by the county prosecuting attorney for the investigation and civil enforcement of criminal profiteering.
Donations – donations or bequests may have purpose or use restrictions. The city is responsible for tracking and complying with these restrictions. See testing strategy available in TeamMate under Accountability | Revenues | Fundraising & Donations for details.

Restrictions on the use of Resources
Proceeds of Voted General Obligation Bonds (Constitution Article 7, Section 2b) - voted GO bond levy funds may only be used for capital purposes. This restriction is repeated in the authority to levy excess property taxes at RCW 84.52.056. This restricts the use of GO debt from replacement equipment or allocating a portion of such funds to an arts program to the extent such allocation is not restricted to capital objectives.
Affordable and Supportive Sales Tax (RCW 82.14.540) - funds may be used to provide housing and services only to persons whose income is at or below 60% of the median income of the city imposing the tax. Cities with populations over 100K must use the revenue only for acquiring, rehabilitating or constructing affordable housing or funding the operations and maintenance costs of new units of affordable or supportive housing. Smaller cities may also use the revenue to provide rental assistance to tenants.

APPENDIX 2: Assessment Audits

Below is a summary of information specific to small cities where an assessment audit is performed. Additional risk factors and activity less common for small cities can be found in the guide. See also the Small Government Assessment Audits planning guide.

Small cities usually have minimal staff and may have limitations tos effectively segregate key duties. Oversight becomes the responsibility of the Mayor and/or City Council, which are part-time roles. As such, they may not have the time or knowledge to effectively perform monitoring duties.

Revenues

For cities, common revenue streams are property taxes (receipted by the County treasurer), utility revenues (receipted locally), and miscellaneous charges for services, such as program fees, fines, donations, etc. (receipted locally). Risk of misappropriation is higher when revenues are locally receipted due to the limited staffing levels and potential lack of segregation of duties. For local receipting, audit effort in this area is typically focused on substantive procedures (rather than analytical review). Auditors should consider reviewing their cash receipting policy, performing revenue reasonableness tests, trending revenue streams looking for unusual activity, reviewing bank statements to look for daily deposits (or less frequent deposits in line with any exception per RCW 43.09.240), reviewing voids and adjustments, and performing block testing on cash receipts.

Expenditures

- **Payroll** - Small cities usually have minimal staff including the clerk/treasurer. Due to the limited staff, cities typically have limitations to effectively segregate key duties. Recent frauds have identified misappropriation and fraudulent activity at cities involving leave cashouts, particularly in smaller cities when there is lack of segregation of duties and/or inadequate independent monitoring (see the Center's Segregation of Duties: Essential Internal Controls guide for guidance on these topics).

- **Credit cards** - It is common for cities to establish open accounts, have fuel cards or other credit cards active for the city. Fuel cards are typically used by various individuals for fuel purchases for the police or public works vehicles. Open accounts, fuel cards and credit cards have a higher risk of misappropriation or misuse due to limited oversight or monitoring of the accounts/cards especially if the city has limited administrative staff. Auditors should consider evaluating the activity for significance to the total operations and performing testing if risks are noted.

- **ACH or Electronic Payments** - Recent SAO audits have identified concerns with electronic payments being used to commit fraud within cities. For example, a City Clerk/Treasurer setup an automatic withdrawal for her personal mortgage payment to be disbursed out of the city bank account monthly. This type of fraud can be identified through a review of bank statements. A recently published SAO article provides guidance to local governments regarding how to review bank statements and could be a useful tool for auditors to use in scanning these bank statements.

Assets

Assets for cities can include trucks, vehicles, lawn care or grounds keeping equipment (for parks), and other small and attractive assets such as general office equipment, tools, parts, equipment or supplies.

Compliance Requirements

General compliance risks considered in assessment audits are:

- **Open Public Meetings Act** – Cities are required to hold regular meetings in compliance with RCW 42.30.

- **Procurement** – Cities are required to bid public works and purchases – see the Bidding and Procurement Guide for details. Cities also have limits on public works performed by city employees (referred to as "day labor"), which is also described in the Bidding and Procurement Guide.