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Office of the Washington State Auditor
Pat McCarthy

Accountability Audit Report

City of Mercer Island

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

Published (Inserted by OS)

Report No. 1026125





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

Issue Date – (Inserted by OS)

Council
City of Mercer Island
Mercer Island, 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

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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 in which the City could make improvements. These recommendations are included with our report as a finding.

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 Mercer Island from January 1, 2018 through December 31, 2018.

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 uses 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 year ended December 31, 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:

- EFT controls – review of vendor and payroll electronic funds transfer (EFT) payments
- Fire department – review of overtime payments
- Payroll disbursements – review of timesheets, leave balance accruals, and leave cash-outs

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

2018-001 The City's internal controls over payroll disbursements were not adequate to safeguard public resources, resulting in errors and overpayments.

Background

The City of Mercer Island employs about 180 employees and provides a full range of services to the public, including general government, public safety, municipal court, street and trails maintenance, parks and recreation activities, public improvements, planning and zoning, and youth and family services. In fiscal year 2018, the City reported \$29.5 million in payroll and benefit payments.

It is the City's responsibility to establish internal control processes that ensure payroll disbursements are allowable under State law and City policies.

Description of Condition

The City's payroll internal controls and policies were not adequate to ensure public resources were safeguarded. Our audit identified the following internal control deficiencies:

- The City had multiple policies related to leave balance accruals and cash-outs. Different policies outlined different guidelines, resulting in guidance not being uniform across policies. In addition, there were instances where practices were not supported by a policy or when the guidance documented in policy was not being followed.
- The City did not have adequate policies or procedures for the Director's Compensation Program, including stipends. The City provides a stipend to director-level employees that is paid as a lump sum at the beginning of the year. The City had several Directors leave the City in 2019 and did not require the employees to pay back a pro-rated amount for the stipend received.
- The City did not perform adequate reviews over timesheets, leave balance reconciliations, vacation leave cash-outs, and payroll and benefit calculations for reporting and payments to the state Department of Labor and Industries.
- The City did not require employees to submit a leave slip or other documentation for approval to support leave taken.

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The City issued a large number of manual checks for payroll that is outside of the normal payroll run (off-cycle payroll checks). This practice should be minimized because it does not follow the same monitoring or controls established through the normal check run process.

Cause of Condition

The City did not have adequate oversight and monitoring over payroll functions, including adequate reviews of employee timesheets, leave cash-outs, and leave balance tracking. Further, the City did not have consistent policies and procedures related to vacation leave cash-outs and leave accruals.

Effect of Condition

The lack of control and oversight of the City’s payroll functions increases the risk that misappropriation or misuse of City resources could occur and not be detected in a timely manner, if at all. Our audit specifically identified the following:

Timesheets, leave accruals, and leave-balance tracking

We examined timesheets, leave summary reports, and payroll summary reports for 15 of the City’s director-level employees during 2018 and 2019. We identified the following:

- Timesheets were not adequately reviewed and approved. Also, timesheets were not consistently completed and turned in.
- Vacation and sick leave reported on employee timesheets did not consistently match payroll summary reports or leave summary reports, and leave used was not consistently deducted from employee leave balance accounts. We noted instances when employees either used leave or received a cash-out but the hours were not deducted from the employee’s leave balances. In some instances, we noted employee’s leave balances were overstated by one-and-a-half to two weeks. In total, we noted 240 hours of sick and vacation leave that was not deducted from employee leave balances, and the City overpaid \$24,746 for leave cash-outs.
- Eight employees were allowed to accrue vacation hours over the maximum 240-hour vacation accrual limit outlined in City policies.
- Two employees were allowed to accrue sick leave hours over the maximum 720-hour sick leave accrual limit outlined in City policies.

Disbursements for vacation leave cash-outs

We also examined documentation for vacation leave cash-outs for 15 of the City’s director-level employees during 2018 and 2019. We noted the following:

- Eleven instances when leave cash-out request forms did not contain proper approvals
- Two instances when employees cashed out more leave than allowed by City policy, totaling \$10,262
- Two instances when employees were cashed out for incorrect leave amounts, resulting in a total overpayment of \$14,484

Manual checks and reporting to the Department of Labor and Industries

- For fiscal years 2018 and 2019, we noted 921 manual checks totaling \$1,313,542 for payroll that were issued outside of the City’s normal payroll cycle.
Overpayments totaling \$221,402 were made to the Department of Labor and Industries between 2015 and 2018 due to manual errors and adjustments for non-working hours for the Police and Fire Departments. The City was able to recover the full amount of overpayment from the Department of Labor and Industries.

Recommendations

We recommend the City:

- Establish and review policies to ensure payroll practices documented across various policies covering are uniform
- Ensure all staff receive proper training over the payroll process
- Establish and follow policies and guidelines for the Director’s Compensation Program
- Implement practices and procedures to ensure payroll and benefit calculations are performed and reviewed adequately. This includes review of employee timesheets, leave balances, and changes to rates in the payroll system.
- As a best practice, ensure employee leave reported on timesheets are adequately supported by a leave slip or other adequate documentation
- Follow established policies and procedures related to leave cash-outs and leave accruals to ensure adequate safeguarding of resources
- Consistently reconcile leave balances for all employees to ensure leave balances are accurate and complete

- Minimize the number of off-cycle payroll runs that occur during the month, and establish controls to ensure these payments are properly reviewed and approved.

City's Response

The City would like to thank the State Auditor's Office for their response to City Management's request to expand the 2018 Accountability Audit to include internal controls over payroll disbursements. The City will follow the Auditor's recommendations to strengthen its internal controls over payroll disbursements to avoid errors and overpayments. The City's payroll function is heavily dependent on manual processes and the use of spreadsheets for time keeping, leave accruals, and benefits administration. Use of predominately manual processes across departmental time keeping functions has led to errors and inconsistencies in leave accruals. Furthermore, the lack of clear and consistent policies has added to the potential for errors.

The City is committed to improving internal controls over timekeeping, leave accruals, and payroll disbursements. The following steps are being taken in response to the audit recommendations:

- *The Human Resources Department is moving forward with implementation of a new software solution that will modernize and automate many of the processes within the Human Resources and Payroll functions including leave accruals, benefits administration, and timekeeping. This project will increase accuracy and efficiency of the payroll function by automating many of the manual processes currently in use.*
- *The Human Resources Department is reviewing, updating, and creating policies related to payroll and paid time off administration and will prioritize uniformity of related policies. This ongoing work includes policies related to leave accrual limits, leave cash-outs and director-specific benefits. Up-to-date policies will be kept and saved in a single document*
- *The Human Resources and Payroll functions have implemented additional review steps to ensure leave accruals are reconciled against timesheets on a regular basis.*
- *Timesheets and leave cash-out requests are being properly authorized by supervisors. Director timesheets and cash-out requests are being authorized by the City Manager. The City Manager's timesheet is being authorized by the Mayor.*
- *Manual off-cycle payroll checks will be restricted to emergent situations only.*

Auditor's Remarks

We appreciate the City's commitment to resolve this issue 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

BARS manual 3.1.3 – Internal Control

RCW 43.09.200 – Local government accounting – Uniform system of accounting

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>.

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INFORMATION ABOUT THE CITY

The City of Mercer Island was incorporated in 1960. The City operates under the council-manager form of government, and has seven council members. The Council elects one of its members to serve a two-year term as Mayor. The Council appoints a City Manager to oversee the City's daily operations as well as its 178 employees.

The City serves approximately 24,000 residents. The City provides a full range of services to the public including general government, public safety, municipal court, street and trails maintenance, utilities maintenance, parks and recreation activities, public improvements, planning and zoning, and youth and family services.

The City is funded by a variety of revenue sources, including property taxes, sales taxes, utility taxes, business taxes, charges for services, and grants. In fiscal year 2018, the City's general fund operating budget was approximately \$28 million.

Contact information related to this report	
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Information current as of report publish date.

Audit history

You can find current and past audit reports for the City of Mercer Island 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	
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