

City of Tenino

January 1, 2023 through December 31, 2023

2023-001 The City did not have adequate internal controls over preparing financial statements and monitoring financial activity, resulting in noncompliance with state law and a significant decline in financial position.

Background

City management, state and federal agencies, and the public rely on the information included in financial statements and reports to make decisions. City management is responsible for designing and following internal controls that provide reasonable assurance financial reporting is reliable and complete.

The City prepares its financial statements in accordance with the cash-basis accounting method prescribed in the State Auditor’s Office’s *Budgeting, Accounting, and Reporting System* (BARS) Manual.

The City Council annually approves a budget determining the City’s legal spending limits. Under state law, spending should not exceed this amount without a Council-approved budget amendment. Moreover, the Council cannot authorize spendings that exceed available funds. When expenditures in a fund exceed the available resources, the City is effectively borrowing from other funds without formally establishing an interfund loan. The Council must approve interfund loans by resolution or ordinance that includes a payment plan and set a reasonable interest rate to pay to the lending fund.

Our audit found deficiencies in internal controls over accounting and financial reporting that affected the City’s ability to produce reliable financial statements. *Government Auditing Standards* require our Office to communicate material weaknesses as a finding.

Description of Condition

We found the following deficiencies in internal controls that represent a material weakness. The City did not:

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- Monitor the budget when spending funds to ensure the City was spending within its authorized appropriations
- Adequately monitor its financial activity nor approve and account for interfund loans as required
- Establish an appropriate plan to ensure it can sustain operations and meet obligations

The City's financial condition has continued to decline since 2021. The City reported a decrease in cash position within its governmental funds, as shown in the following table:

| | For year ended December 31 | | | |
|--|----------------------------|---------|---------|-----------|
| | 2020 | 2021 | 2022 | 2023 |
| Govt fund beginning cash and investments | 535,478 | 309,006 | 691,144 | 100,248 |
| Govt fund ending cash and investments | 309,006 | 691,144 | 100,248 | (358,422) |
| Percent change in cash position | (42%) | 124% | (85%) | (454%) |
| Days of operating expenditures | 21 | 187 | 99.4 | (73.7) |

Cause of Condition

The City recently experienced turnover in key positions and employees responsible for financial oversight lacked the necessary experience and training in financial reporting. As such, employees did not make City management and the Council aware of the City's poor financial health.

Effect of Condition

The City's noncompliance with state laws has a direct and material effect on its 2023 financial statements. Specifically, the City did not implement or account for interfund loans for the general fund and spent \$68,657 more than the final budgeted amounts. This resulted in negative cash and investment balances totaling \$464,722 in the general fund, making the fund reliant on other restricted funds to sustain general operations.

As a result, the City is at an increased risk of being unable to meet its financial obligations and maintain its operations at the present level.

Recommendation

We recommend the City establish adequate internal controls over financial operations and closely monitor financial operations. Specifically, City management and the Council should:

- Establish and follow effective internal controls to monitor expenditures to ensure they do not exceed the appropriate budget and approve amendments, when necessary, to comply with state law
- Approve and report interfund loans, as applicable, that include a payment plan and set a reasonable interest rate to pay to the lending fund
- Implement a comprehensive financial plan to improve its financial condition

City's Response

Auditor's Remarks

Applicable Laws and Regulations

Government Auditing Standards, July 2018 Revision, paragraphs 6.40 and 6.41 establish reporting requirements related to significant deficiencies or material weaknesses in internal control, instances of fraud, and noncompliance with provisions of laws, regulations, contracts, or grant agreements.

The American Institute of Certified Public Accountants defines significant deficiencies and material weaknesses in its *Codification of Statements on Auditing Standards*, section 265, Communicating Internal Control Related Matters Identified in an Audit, paragraph 7.

The Budgeting Accounting and Reporting System (BARS) Manual 3.1.3, Internal Control, requires each local government to establish and maintain an effective system of internal controls that provides reasonable assurance that the government will achieve its objective.

The Budgeting, Accounting and Reporting System (BARS) Manual, 3.9.1, Interfund Loans, sets the requirements for interfund loans and repayments.

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RCW 35A.33.120 – Funds – Limitations on expenditures, restricts the Council from authorizing any claim on expenditures in excess of total budgeted amounts for any individual fund