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NEWS RELEASE

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FOR RELEASE April 14, 2015

Auditor of State Mary Mosiman today released a report on a special investigation of the City of Pacific Junction for the period July 1, 2008 through June 30, 2013. The special investigation was conducted as a result of citizen concerns regarding the frequency and number of payroll checks issued to City employees.

Mosiman reported the special investigation identified \$31,842.26 of improper disbursements, including:

- \$15,857.01 of improper vacation, sick leave, and holiday pay received by the City Clerk, Kari Williams,
- \$5,370.50 of improper vacation payouts,
- \$2,616.88 of improper sick leave payouts,
- \$1,202.26 of improper bonuses,
- \$701.50 of improper payroll issued to Ms. Williams for double-counted hours,
- \$460.00 for a payout issued to Ms. Williams which could not be identified as being for vacation or sick leave,
- \$3,904.34 of FICA and IPERS contributions on the improper payroll, and
- \$1,729.77 of late fees and interest on the City's IPERS contributions.

In addition, Mosiman reported, the City had an outstanding liability to the Internal Revenue Service (IRS) for unpaid payroll taxes, penalties, and interest as of December 29, 2014. The total amount of the obligation is \$73,825.98, including \$25,753.31 of penalties and interest. City officials are currently working with representatives of the IRS to resolve the issue.

The report includes recommendations to strengthen the City's internal controls and overall operations, such as improving segregation of duties, performing bank reconciliations, and performing an independent review of bank statements and payroll.

Copies of the report have been filed with the Mills County Attorney's Office, the Attorney General's Office, and the Division of Criminal Investigation. A copy of the report is available for review in the Office of Auditor of State and on the Auditor of State's website at <http://auditor.iowa.gov/specials/1322-0621-BE00.pdf>.

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**REPORT ON SPECIAL INVESTIGATION
OF THE
CITY OF PACIFIC JUNCTION

FOR THE PERIOD
JULY 1, 2008 THROUGH JUNE 30, 2013**

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Auditor of State's Report

To the Honorable Mayor and Members
of the City Council:

As a result of alleged improprieties regarding the frequency and number of payroll checks issued to City employees, we conducted a special investigation of the City of Pacific Junction. We have applied certain tests and procedures to selected financial transactions of the City for the period July 1, 2008 through June 30, 2013. Based on a review of relevant information and discussions with City officials and personnel, we performed the following procedures:

- (1) Evaluated internal controls to determine whether adequate policies and procedures were in place and operating effectively.
- (2) Scanned images of redeemed checks issued from the City's checking account for reasonableness and examined certain disbursements to determine if they were appropriate, properly approved, and supported by adequate documentation.
- (3) Reviewed payroll disbursements and other payments to Kari Williams, City Clerk, and Donald Kates, Maintenance Supervisor, to determine the propriety of the payments, if the appropriate number of payroll disbursements were made, and if the amounts were appropriate.
- (4) Reviewed documentation from the Internal Revenue Service to determine the amount of payroll taxes owed and the resulting accrued penalties and interest.
- (5) Confirmed payments to the City by the State of Iowa, Mills County, and the City of Glenwood to determine if they were properly deposited to the City's checking account in a timely manner.
- (6) Reviewed the Annual Financial Report, the Street Financial Report, and the "Profit & Loss Detail" for fiscal year 2013 to determine if the City was properly reporting receipts and disbursements by fund and to analyze the financial position of the City's funds.

These procedures identified \$31,842.26 of improper disbursements. Several internal control weaknesses were also identified. Our detailed findings and recommendations are presented in the Investigative Summary and **Exhibits A** through **C** of this report.

The procedures described above do not constitute an audit of financial statements conducted in accordance with U. S. generally accepted auditing standards. Had we performed additional procedures, or had we performed an audit of financial statements of the City of Pacific Junction, other matters might have come to our attention that would have been reported to you.

Copies of this report have been filed with the Mills County Attorney's Office, the Attorney General's Office, and the Division of Criminal Investigation.

We would like to acknowledge the assistance and many courtesies extended to us by the officials and personnel of the City of Pacific Junction during the course of our investigation.


MARY MOSIMAN, CPA
Auditor of State


WARREN G. JENKINS, CPA
Chief Deputy Auditor of State

February 17, 2015

Report on Special Investigation of the
City of Pacific Junction
Investigative Summary

Background Information

The City of Pacific Junction is located in Mills County and has a population of approximately 471 according to the 2010 census. The City operates City Hall, the Fire and Rescue Department, and the Community Center. Kari Williams became the City Clerk on May 17, 2004. As the City Clerk, Ms. Williams is responsible for the following functions:

- 1) Receipts – collecting, posting to the accounting records, and preparing and making bank deposits,
- 2) Disbursements – making purchases, receiving certain goods and services, presenting disbursements to the City Council for approval, maintaining supporting documentation, preparing, signing, and distributing checks, and posting payments to the accounting records,
- 3) Payroll – calculating, preparing, signing, and distributing checks, and posting payments to the accounting records,
- 4) Bank accounts – receiving and reconciling monthly bank statements to accounting records, and
- 5) Reporting – preparing City Council meeting minutes and financial reports, including monthly City Clerk reports.

In addition to the City Clerk, the City employs a full-time Maintenance Supervisor, Donald Kates, and multiple Fire and Rescue workers.

The City's primary revenue sources include local option sales tax and road use tax from the State of Iowa, property tax collected by Mills County and remitted to the City, and sewer billings collected by the City of Glenwood and remitted to the City. Revenue is also received from the Fire and Rescue Department for ambulance billings. All payments are collected through the mail or in person. PCC Ambulance Billing Services, the billing service hired by the City, prepares the billing for the Fire and Rescue Department, and payments are received at the Fire and Rescue Department. The Fire and Rescue Department previously deposited payments received to a separate checking account and periodically issued a check to the City. However, the Fire and Rescue Department now remits all checks to the City Clerk for deposit. Neither Ms. Williams nor the Fire and Rescue Department prepared receipts for collections or recorded the collections on an initial receipts listing.

All City disbursements, including payroll, are made by check. All disbursements are supported by invoices or other documentation obtained by or submitted to the City Clerk. The City Clerk presents the bills to the City Council for approval during each City Council meeting. After the City Council approves the bills, the City Clerk prepares and signs the checks. The checks are counter-signed by the Mayor or Mayor Pro Tem.

City employees report their hours worked on paper timecards, which are to be time stamped using the time clock. However, this is not always done, and hours worked are often handwritten. Employees are paid each week, except for City Council members and the Mayor, who are paid once per month at \$25.00 and \$35.00, respectively, for each meeting attended. Employees are to be paid 3 days after the end of a pay period; however, we identified many instances where the City Clerk issued her paycheck prior to processing payroll for the other City employees. In addition, the City Clerk signs her own paycheck.

The City maintains a checking account and 2 savings accounts (one for local option sales tax and the other for sewer operation and maintenance) at a bank in Glenwood, Iowa. Monthly statements for the City's accounts are mailed to City Hall, and the City Clerk is responsible for reconciling the

accounts to the City's accounting records. However, there is no evidence the monthly reconciliations are being performed.

On May 2, 2013, we received documentation regarding concerns with the City's payroll from a concerned citizen. As a result of the concerns identified and review of the documentation submitted, the Office of Auditor of State reviewed the City's financial transactions. We performed the procedures detailed in the Auditor of State's report for the period July 1, 2008 through June 30, 2013.

Detailed Findings

These procedures identified \$31,842.26 of improper payroll disbursements for the period July 1, 2008 through June 30, 2013, including:

- \$15,857.01 of improper vacation, sick leave, and holiday pay received by Ms. Williams,
- \$5,370.50 of improper vacation payouts,
- \$2,616.88 of improper sick leave payouts,
- \$1,202.26 of improper bonuses,
- \$701.50 of improper payroll issued to Ms. Williams for double-counted hours,
- \$460.00 for a payout issued to Ms. Williams which could not be identified as being for vacation or sick leave,
- \$3,904.34 of FICA and IPERS contributions on the improper payroll, and
- \$1,729.77 of late fees and interest on the City's IPERS contributions.

All findings are summarized in **Exhibit A** and a detailed explanation of each finding follows.

PAYROLL

We reviewed all payroll disbursements and employee timecards for the period July 1, 2008 through June 30, 2013. We did not identify concerns relating to payroll disbursements to members of the Fire and Rescue Department. However, we identified concerns regarding payroll disbursements to Ms. Williams and Mr. Kates. As a result, except as noted, we reviewed all payroll disbursements issued to Ms. Williams and Mr. Kates for the period July 1, 2008 through June 30, 2013. We were unable to review the payroll disbursements issued to Ms. Williams for the period May 30, 2011 through December 25, 2011 because the payroll records could not be located. Additionally, the payroll records could not be located for the payroll disbursements issued to Mr. Kates for the periods May 30, 2011 through December 11, 2011, December 17, 2012 through February 24, 2013, and March 4, 2013 through June 30, 2013.

According to the City's personnel policy, all employees working 32 hours per week or more are eligible for benefits, including 9 paid holidays plus a floating holiday per calendar year, paid vacation, and paid sick leave. In addition, the policy specifically states these benefits do not apply to seasonal, temporary, or part-time employees unless otherwise designated. Based on a review of the personnel policy, there were no designations for part-time employees made. **Table 1** summarizes the vacation and sick leave accrual rates for eligible employees, which are based on years of service.

Table 1

Years of Service	Vacation Accrual	Sick Leave Accrual
After 1 year	5 days per year	40 hours per year
After 3 years	10 days per year	80 hours per year
After 5 years	15 days per year	120 hours per year

Additional provisions regarding vacation and sick leave per the personnel policy are as follows:

- Upon separation from the City, an employee shall be paid the vacation earned and not taken prior to dismissal. However, an employee who resigns or is separated from City service shall not be entitled to reimbursement of accumulated, unused sick leave.
- Vacation shall be taken in 1 hour increments, but sick leave may be taken in 15-minute increments. In addition, a day of vacation shall be equal to the number of hours in an employee's normal workday.
- Neither vacation nor sick leave may be taken in advance, and sick leave shall not be used as vacation.
- An eligible employee may carry over vacation; however, they may not exceed a maximum accumulation of 15 days per calendar year. Employees wishing to carry over vacation must submit a request to the department head 30 days prior to the end of the calendar year. Vacation accumulated over the maximum amount allowed per year will be paid in a lump sum in the last pay period of the calendar year.

Employee Timecards – As previously stated, City employees report their hours worked on paper timecards, which are to be time stamped using the time clock. However, this is not always done, and hours worked are often handwritten. Of the 420 payroll checks issued, we identified 259 for which the supporting timecards contained handwritten times rather than time stamps. Of those, 153 timecards were for Ms. Williams and 106 timecards were for Mr. Kates.

In addition, supporting documentation, such as timecards, check stubs, or payroll registers, could not be located for 97 of the 420 payroll checks issued. Of those, 73 were issued to Ms. Williams and 24 were issued to Mr. Kates.

There is no evidence employee timecards for Ms. Williams or Mr. Kates are reviewed and approved by the Mayor or the City Council.

Payroll Issued to Kari Williams – When Ms. Williams began employment with the City in May 2004, she was added to the payroll as a full-time employee and received benefits, including paid holidays, paid vacation, paid sick leave, and health insurance. Based on conversations with the former and current Mayor and City Council members, the City Clerk is expected to work during City Hall office hours. Any remaining unfinished work is expected to be completed from City Hall after the office is closed. In addition, the City Clerk is expected to attend City Council meetings twice each month. The average length of City Council meetings is 1 to 2 hours each. City Hall hours of operation are 9:00 a.m. to 12:30 p.m. Monday through Friday, or approximately 17 hours per week.

As previously stated, sewer billings are collected by the City of Glenwood and remitted to the City. In addition, on average, the City issues 72 checks a month, including weekly payroll for City employees and Fire and Rescue workers. We spoke with the former and current Mayor, 2 former City Council members, and 2 current City Council members regarding Ms. Williams' hours. The responses from the Mayors and the City Council members were inconsistent. Both the former and the current Mayor stated Ms. Williams was expected to work more than 32 hours each week. However, 3 of the 4 City Council members stated the expectation was between 20 and 25 hours each week. In addition, while the remaining City Council member stated the expectation was more than 32 hours each week, she further stated Ms. Williams' actual hours were only 15 hours each week, or the City Hall hours of operations. We also calculated Ms. Williams' average hours worked each week based on the 240 payroll checks reviewed. **Table 2** summarizes the calculation performed.

Description	Number
Total hours worked per paychecks	5,458.95
Divided by:	
Number of payroll checks with hours worked	211
Average hours worked	25.87

Based on the duties Ms. Williams is responsible for and discussions with the former and current Mayor and City Council members, it is not reasonable to expect her normal work hours each week to be 32 hours or greater. In addition, as illustrated by the **Table**, Ms. Williams reported working an average of approximately 26 hours each week. As a result, Ms. Williams is not eligible for and should not have received the benefits awarded to a full-time employee, including paid holidays, paid vacation, paid sick leave, and health insurance.

Based on a review of the available 240 payroll checks issued to Ms. Williams during the period July 1, 2008 through June 30, 2013, she received paid leave totaling \$20,414.51, including:

- 753 hours of vacation totaling \$8,659.52,
- 698.5 hours of sick leave totaling \$7,987.29, and
- 306.5 holiday hours totaling \$3,767.70.

Of the \$20,414.51 of paid leave identified, \$4,557.50 was determined to be payouts of either vacation or sick leave which are discussed in the following paragraphs. The remaining \$15,857.01 of paid leave received by Ms. Williams is included in **Exhibit A** as improper disbursements.

During our review of Ms. Williams' paid leave, we also identified 9 instances where Ms. Williams included vacation, sick leave, holiday, and/or overtime hours within the regular hours worked for the pay period. For example, **Table 3** compares the hours recorded on Ms. Williams' timecard to the hours recorded on Ms. Williams' check stub for the pay period June 30, 2008 through July 6, 2008.

Description	Hours per Timecard	Hours per Check Stub	Variance
Regular Hours	19.25	28.25	9.00
Holiday Hours	8.00	8.00	-
Overtime Hours	1.00	1.00	-
Total	28.25	37.25	9.00

Because certain hours were being double-counted, Ms. Williams received \$701.50 of improper payroll for 61 hours. The improper payroll identified is included in **Exhibit A** as improper disbursements.

As previously stated, an eligible employee may receive a payout for unused vacation accumulated in excess of 15 days in the last pay period of the calendar year. However, there are no other provisions allowing current employees to periodically receive payouts for earned but unused vacation and/or sick leave. Based on a review of the payroll checks issued, we determined Ms. Williams periodically paid out accrued vacation and/or sick leave hours at her own discretion. Of the 240 payroll checks issued to Ms. Williams, 18 included payouts totaling \$3,220.00 for 280

hours of accumulated vacation and \$1,337.50 for 117 hours of sick leave. An additional payroll check issued June 7, 2012 was identified as a vacation and/or sick leave payout; however, no supporting documentation could be located to determine the allocation of vacation and/or sick leave hours. The gross pay of \$460.00 for the check is included in **Exhibit A** as an improper disbursement.

Each payroll check issued had a corresponding check stub retained by the City, which detailed the composition of the hours being paid. Specifically, the check stub listed the pay period, the hours worked, vacation hours accumulated and used, sick leave hours accumulated and used, gross pay, net pay, and any applicable payroll deductions. Based on a review of the information on the check stub, the following criteria were used to identify which payroll checks were issued as vacation and/or sick leave payouts:

- The payroll check only included vacation and/or sick leave hours.
- The pay period recorded on the payroll check overlapped with pay periods recorded on other payroll checks which included hours worked.
- The payouts were issued either on the same day as, or within a couple of days of, Ms. Williams’ regular paycheck.
- No timecard or other supporting documentation could be located.

Because sufficient supporting documentation was not available for all paychecks issued, we were unable to determine if additional vacation and/or sick leave hours were paid out. The 18 payroll checks identified are detailed in **Exhibit B**, and the total vacation and sick leave payouts of \$3,220.00 and \$1,337.50, respectively, are included in **Exhibit A** as improper disbursements.

During our review of the 240 payroll checks issued to Ms. Williams, we also identified 4 paychecks which were identified as an employee bonus. **Table 4** summarizes the 4 paychecks identified, including the check date, check number, and amount.

Check Date	Check Number	Amount
12/01/08	16488	\$ 319.55
11/25/09	17584	307.10
11/22/10	18699	250.00
11/28/12	20718	309.15
Total		<u>\$ 1,185.80</u>

The bonuses issued in 2008 and 2010 were approved by the City Council in the meeting minutes. However, we were unable to locate City Council approval for the bonuses issued in 2009 and 2012. As a result, \$616.25 of the \$1,185.80 of bonuses identified is included in **Exhibit A** as improper disbursements.

Payroll Issued to Donald Kates – Based on conversations with the former and current Mayor and City Council members, Mr. Kates is expected to work a minimum of 32 hours per week. His duties include, but are not limited to, snow removal, lawn maintenance, equipment repairs, and cleaning. In addition, Mr. Kates serves as the City’s Fire Chief. He is requested to attend City Council meetings but generally does not record hours for time spent at these meetings on his timesheet. It is reasonable to expect Mr. Kates to record more than 32 hours in the course of a normal week. As a result, it is reasonable for Mr. Kates to receive the benefits awarded to a full-time employee, including paid holidays, paid vacation, paid sick leave, and health insurance.

As previously stated, an eligible employee may receive a payout for unused vacation accumulated in excess of 15 days in the last pay period of the calendar year. However, there are no other provisions allowing employees to periodically receive payouts for earned but unused vacation and/or sick leave. Based on a review of the payroll checks issued, we determined Mr. Kates periodically received payouts of accrued vacation and/or sick leave hours upon his request. Of the 180 payroll checks issued to Mr. Kates, 16 included payouts totaling \$2,150.50 for 187 hours of accumulated vacation and \$1,279.38 for 111.25 hours of sick leave. Mr. Kates' payroll checks were evaluated using the same criteria as applied to Ms. Williams' payroll checks.

Because sufficient supporting documentation was not available for all paychecks issued, we were unable to determine if additional vacation and/or sick leave hours were paid out. The 16 payroll checks identified are detailed in **Exhibit C**, and the total vacation and sick leave payouts of \$2,150.50 and \$1,279.38, respectively, are included in **Exhibit A** as improper disbursements.

During our review of the 180 payroll checks issued to Mr. Kates, we also identified 4 paychecks which were identified as an employee bonus. **Table 5** summarizes the 4 paychecks identified, including the check date, check number, and amount.

Check Date	Check Number	Amount
12/01/08	16496	\$ 311.62
11/25/09	17583	293.50
11/17/10	18675	250.00
11/28/12	20720	292.51
Total		<u>\$ 1,147.63</u>

The bonuses issued in 2008 and 2010 were approved by the City Council in the meeting minutes. However, we were unable to locate City Council approval for the bonuses issued in 2009 and 2012. As a result, \$586.01 of the \$1,147.63 of bonuses identified is included in **Exhibit A** as improper disbursements.

City's FICA and IPERS Contributions – The paid leave, improper payroll, vacation and sick leave payouts, and bonuses identified were processed through payroll. As a result, the City incurred FICA and IPERS on those paychecks. **Table 6** calculates the FICA and IPERS incurred by the City by fiscal year. Because the identified payments are considered to be improper disbursements, the total FICA and IPERS identified of \$3,904.34 is also included in **Exhibit A** as improper disbursements.

Description	Fiscal Year					Total
	2009	2010	2011	2012	2013	
Improper payroll identified	\$5,676.72	6,908.86	5,143.39	2,185.00	6,294.18	26,208.15
FICA percentage	7.65%	7.65	7.65	7.65	7.65	
Subtotal	434.27	528.53	393.47	167.15	481.50	2,004.92
IPERS percentage	6.35%	6.65	6.95	8.07	8.67	
Subtotal	360.47	459.44	357.47	176.33	545.71	1,899.42
Total	<u>\$ 794.74</u>	<u>987.97</u>	<u>750.94</u>	<u>343.48</u>	<u>1,027.21</u>	<u>3,904.34</u>

In addition, during a review of activity statements obtained from IPERS, we determined the City incurred late fees and interest totaling \$1,729.77, which is included in **Exhibit A** as improper disbursements.

Payroll Taxes – At the September 2, 2014 City Council meeting, City Council members were informed the City had received a final notice from the Internal Revenue Service (IRS) regarding unpaid payroll taxes dated August 23, 2014. According to discussions with City officials, details regarding the unpaid payroll taxes had been previously communicated to the City Council in closed session at the City Council meeting held on November 18, 2013. However, because new City Council members took office January 1, 2014, not all members of the current City Council had been made aware of the situation.

The City obtained copies of its account transcripts dated December 18, 2014 from the IRS. Based on our review of these transcripts, we determined federal withholding taxes for the City were not properly reported to the IRS for the quarters ended March 31, 2011 through June 30, 2013. In addition, “Form 941 – Employer’s Quarterly Federal Tax Returns” for the quarters identified were all signed and dated by Ms. Williams on August 6 and 7, 2013. As City Clerk, it is Ms. Williams’ responsibility to ensure federal withholding taxes are properly calculated, withheld from employees’ payroll checks, and properly reported and remitted to the IRS in a timely manner. According to the transcripts obtained from the IRS, the City’s unpaid payroll taxes, including penalties and interest accrued through December 29, 2014, total \$73,825.98. **Table 7** summarizes the composition of the outstanding IRS obligation.

Description	Amount
Unpaid payroll taxes	\$ 54,405.90
Assessed penalties, late fees, and collection fees	19,117.18
Accrued penalties and interest	6,636.13
Less: Applied payments and credits	(6,333.23)
Total outstanding obligation	<u>\$ 73,825.98</u>

The City is currently working with IRS representatives to resolve this issue. Because the outstanding obligation included in the **Table** has not been disbursed by the City, no amount is included in **Exhibit A**.

COLLECTIONS

As previously stated, the City’s primary revenue sources included taxes from the State of Iowa and Mills County and sewer billings collected by the City of Glenwood. We reviewed documentation related to these revenue sources to determine if collections were properly deposited.

Taxes from the State of Iowa – The majority of revenues received from the State of Iowa are road use tax and local option sales tax. We confirmed all payments to the City by the State of Iowa and determined they were properly deposited to the City’s checking account.

Taxes from Mills County – We confirmed all payments to the City by Mills County were properly deposited to the City’s checking account.

Sewer Fees – We confirmed all payments to the City by the City of Glenwood were properly deposited to the City’s checking account.

OTHER ADMINISTRATIVE ISSUES

During our investigation, we determined Ms. Williams and the City Council did not properly carry out their fiduciary responsibilities as an employee and officials of the City. The concerns identified include:

- Prior to July 1, 2014, the City maintained its general ledger in QuickBooks. However, the City did not utilize the fund accounting function within QuickBooks. As a result, the road use tax received from the State was recorded in an account within the General Fund, which overstated General Fund receipts by \$46,564 in fiscal year 2013. Effective July 1, 2014, the City began using different accounting software and properly recording road use tax in a separate special revenue fund.
- Monthly City Clerk's reports are not prepared, and monthly fund balances are not reported to the City Council. Based on a review of the City's financial records, there are discrepancies in the receipts and disbursements recorded in the general ledger, reported in the financial reports presented to the City Council, and reported in the City's Annual Financial Report (AFR). According to City officials, the implementation of the new accounting software will allow the City to maintain proper fund accounting, and the City Clerk should be able to prepare the monthly City Clerk's report and report accurate fund balances to the City Council monthly.
- Based on a review of the "Profit & Loss Detail" generated from QuickBooks for fiscal year 2013, revenue sources available to support the Fire and Rescue Department totaled approximately \$143,000.00; however, disbursements of the Fire and Rescue Department totaled approximately \$208,000.00. Based on these amounts, disbursements exceeded receipts by approximately \$65,000.00 for fiscal year 2013. As a result, the City had to use local option sales tax and/or other general operating receipts to sustain the Fire and Rescue Department at its current level. In addition, according to the fiscal year 2013 AFR, the General Fund had a deficit fund balance of \$98,216, and the total fund balance for all governmental funds was a deficit of \$57,157.
- The City Council is responsible for all City operations, including financial operations. We determined the City Council did not segregate duties, which allowed Ms. Williams to perform all functions related to the cash receipt and disbursement processes, except for sewer fee billings and collections. The City Council also failed to conduct appropriate oversight to mitigate the lack of segregation of duties. In addition, we determined the Mayor and/or City Council did not:
 - properly review payroll prior to issuance. There was no evidence either Ms. Williams' or Mr. Kates' timecards were reviewed, and detailed payroll information was not provided to the City Council.
 - regularly review the City's financial reports and/or bank statements.
 - review Ms. Williams' hours and define expectations to determine whether she should be eligible to receive the benefits awarded to a full-time employee.

Recommended Control Procedures

As part of our investigation, we reviewed the procedures used by the City of Pacific Junction to perform bank reconciliations and process receipts, disbursements, and payroll. An important aspect of internal control is to establish procedures which provide accountability for assets susceptible to loss from error and irregularities. These procedures provide the actions of one individual will act as a check on those of another and provide a level of assurance errors or irregularities will be noted within a reasonable time during the course of normal operations. Based on our findings and observations detailed below, the following recommendations are made to strengthen the City's internal controls.

- A. Segregation of Duties – An important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. The City Clerk has control over each of the following areas:
- (1) Receipts – collecting, depositing, and posting.
 - (2) Disbursements – making purchases, receiving certain goods and services, presenting disbursements to the City Council for approval, maintaining supporting documentation, preparing, signing, and distributing checks, and posting payments.
 - (3) Payroll – calculating, preparing, signing and distributing checks, and posting payments.
 - (4) Bank accounts – receiving and reconciling monthly bank statements to accounting records.
 - (5) Reporting – preparing City Council meeting minutes and financial reports, including monthly City Clerk reports.

Recommendation – We realize segregation of duties is difficult with a limited number of office employees. However, the duties within each function listed above should be segregated between the City Clerk, the Mayor, and City Council members. In addition, the Mayor or City Council members should review financial records, perform reconciliations, and examine supporting documentation for accounting records on a periodic basis.

In addition, bank statements should be delivered to an official who does not collect or disburse City funds. The bank statements should be reviewed in a timely manner for unusual activity.

- B. Bank Reconciliations – There is no evidence monthly reconciliations of bank to book balances for all City funds were prepared.

Recommendation – Monthly bank to book reconciliations should be prepared for all City funds and maintained. The reconciliations should be reviewed by someone independent of other financial responsibilities (i.e., a City Council member) and the review should be documented by the signature or initials of the reviewer and the date of review.

- C. Monthly Financial Reports – Monthly City Clerk's reports were not prepared and fund balances were not reported to the City Council monthly. Although receipts and disbursements were presented to the City Council, they did not include comparisons to budgeted amounts. In addition, discrepancies between receipt and disbursement amounts recorded in the general ledger, reported on the financial reports submitted to the City Council, and reported on the City's Annual Financial Report were identified.

Recommendation – Monthly City Clerk's reports, which include receipts, disbursements, and beginning and ending fund balances, should be prepared and submitted to the City Council for its review and approval. Comparisons to budgeted amounts should be

included in the financial reports to provide better control over budgeted disbursements and provide the opportunity for timely amendment to the budget. The monthly City Clerk's reports should agree to the City's general ledger which has been reconciled to the bank balance.

- D. Fire and Rescue Collections – Ambulance billings were collected by the Fire and Rescue Department and deposited in a separate bank account. The Department then periodically issued a check to the City. Currently, the Department remits all checks to the City Clerk for deposit. However, neither Ms. Williams nor the Department prepare receipts or record the collections on an initial receipts listing.

Recommendation – The City Clerk should continue to process all City receipts and deposit them to the City's checking account. In addition, receipts and/or an initial receipts listing should be prepared by the Department, which should be reconciled to the deposit by an independent person. The City Council should determine the necessity of the Department maintaining a separate bank account.

- E. Payroll – We identified several discrepancies with payroll, including:

- (1) Timecards were to be time stamped using the time clock. However, hours worked are often handwritten. Of the 420 payroll checks issued, we identified 259 for which the supporting documentation contained handwritten times rather than time stamps. Of those, 153 timecards were for Ms. Williams and 106 timecards were for Mr. Kates.
- (2) There is no evidence employee timecards for Ms. Williams or Mr. Kates are reviewed and approved by the Mayor or the City Council.
- (3) Employees are to be paid 3 days after the end of a pay period; however, there were several instances where the City Clerk issued her paycheck prior to processing payroll for other City employees.
- (4) No supporting documentation could be located for the payroll disbursements issued to Ms. Williams for the period May 30, 2011 through December 25, 2011 and the payroll disbursements issued to Mr. Kates for the period May 30, 2011 through December 11, 2011, December 17, 2012 through February 24, 2013, and March 4, 2013 through June 30, 2013.
- (5) Based on the duties Ms. Williams is responsible for, it is not reasonable to expect her normal work hours each week to be 32 hours or greater. As a result, Ms. Williams is not eligible for and should not receive the benefits awarded to a full-time employee.
- (6) Both Ms. Williams and Mr. Kates received payouts for unused vacation and sick leave hours which were not in compliance with the City's personnel policy.
- (7) Federal withholding taxes for the City were not properly reported to the IRS for the quarters ended March 31, 2011 through June 30, 2013.

Recommendation – The City Council should ensure all policies and procedures specified in the City's personnel policies are implemented and complied with, including stamping employee timecards using the time clock, compliance with the established pay date, provision of paid leave, issuance of vacation and/or sick leave payouts, and submission of federal withholding tax. In addition, the City Council should ensure payroll is properly reviewed and approved prior to issuance and payroll checks issued are supported by sufficient documentation.

- F. Chart of Accounts and Fund Accounting – The City had not fully implemented the Uniform Chart of Accounts. As a result, road use tax receipts were not accounted for in

a separate Special Revenue Fund. However, the City implemented new accounting software which allows proper fund accounting to be used.

Recommendation – To provide better financial information and control, the City Council should ensure a chart of accounts, such as the Uniform Chart of Accounts approved by the City Finance Committee, is followed. In addition, the City Council should ensure all funds are properly recorded in the new accounting software.

- G. Financial Condition – Based on our review of receipts and disbursements for the Fire and Rescue Department, disbursements exceeded receipts by approximately \$65,000.00 for fiscal year 2013. As a result, the City had to use local option sales tax and/or other general operating receipts to sustain the Fire and Rescue Department at its current level. In addition, the City reported a deficit fund balance in the General Fund of \$98,216 on the fiscal year 2013 Annual Financial Report.

Recommendation – The City Council should ensure only allowable funds are used to support the Fire and Rescue Department. Specifically, the City Council should ensure local option sales tax is spent in accordance with the purpose(s) stated on the ballot. In addition, the City Council should evaluate the City’s need for fire and rescue services. The City cannot continue to operate the Fire and Rescue Department at a deficit and sustain current levels of service. In addition, the City should investigate alternatives to eliminate this deficit in order to return this fund to a sound financial position.

- H. City Council Oversight – The City Council has a fiduciary responsibility to provide oversight of the City’s operations and financial transactions. Oversight is typically defined as the “watchful and responsible care” a governing body exercises in its fiduciary capacity.

Based on our observations and procedures performed, we identified the City Council failed to exercise proper fiduciary oversight. The lack of appropriate oversight and failure to ensure implementation of adequate internal controls permitted an employee to exercise too much power over the operations of the City.

Recommendation – Oversight by the City Council is essential and should be an ongoing effort by all members. In the future, the City Council should exercise due care and require and review pertinent information and documentation prior to making decisions affecting the City.

In addition, appropriate policies and procedures should be adopted, implemented, and monitored to ensure compliance with established policies and procedures.

Exhibits

Report on Special Investigation of the
City of Pacific Junction

Summary of Findings
For the Period July 1, 2008 through June 30, 2013

Description	Exhibit/Table/ Page Number	Amount	
Improper Disbursements:			
Paid leave received by Kari Williams	Page 8	\$15,857.01	
Improper payroll issued to Kari Williams	Page 8	701.50	
Payout issued to Kari Williams**	Page 9	460.00	
Vacation payouts issued to:			
Kari Williams	Exhibit B	\$3,220.00	
Donald Kates	Exhibit C	2,150.50	5,370.50
Sick leave payouts issued to:			
Kari Williams	Exhibit B	1,337.50	
Donald Kates	Exhibit C	1,279.38	2,616.88
Bonuses issued to:			
Kari Williams	Page 9	616.25	
Donald Kates	Page 10	586.01	1,202.26
FICA and IPERS on payouts	Table 6		3,904.34
Late fees and interest on IPERS	Page 11		1,729.77
Total improper disbursements			<u>\$ 31,842.26</u>

** - Unable to determine the allocation between vacation and sick leave.

**Report on Special Investigation
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Improper Vacation and Sick Leave Payouts Issued to Kari Williams
For the Period July 1, 2008 through June 30, 2013

Check Date	Check Number	Total Hours	Sick Leave Hours Paid	Sick Leave Payout	Vacation Hours Paid	Vacation Payout
10/02/08	16310	10.00	4.00	\$ 46.00	6.00	\$ 69.00
05/07/09	16962	30.00	-	-	30.00	345.00 ^
05/13/09	16974	21.00	-	-	21.00	241.50 ^
05/22/09	17012	10.00	-	-	10.00	115.00
07/08/09	17135	22.00	-	-	22.00	253.00
09/02/09	17301	40.00	-	-	40.00	460.00
09/25/09	17373	9.00	5.00	57.50	4.00	46.00
10/15/09	17443	20.00	20.00	230.00	-	-
11/05/09	17532	16.00	16.00	176.00	-	-
09/17/10	18492	10.00	-	-	10.00	115.00
11/22/10	18699	15.00	-	-	15.00	172.50
04/28/11	19151	40.00	-	-	40.00	460.00
04/10/12	20193	40.00	40.00	460.00	-	-
05/10/12	20262	50.00	-	-	50.00	575.00
05/11/12	20268	20.00	-	-	20.00	230.00
05/25/12	20299	10.00	10.00	115.00	-	-
06/07/12	20333	40.00	##	##	##	##
08/17/12	20506	34.00	22.00	253.00	12.00	138.00
Total			117.00	\$ 1,337.50	280.00	\$3,220.00

^ - No supporting documentation could be located. However, because a payroll check was identified for the pay period, this check is considered to be a vacation payout.

- Based on a review of surrounding paychecks, we determined this check was a payout of paid leave. However, because we could not obtain sufficient supporting documentation, we are unable to determine the allocation between sick leave and vacation. Gross pay issued with this paycheck was \$460.00.

Report on Special Investigation of the
City of Pacific Junction

Improper Vacation and Sick Leave Payouts Issued to Donald Kates
For the Period July 1, 2008 through June 30, 2013

Check Date	Check Number	Total Hours**	Sick Leave Hours Paid	Sick Leave Payout	Vacation Hours Paid	Vacation Payout
07/25/08	16131	0.00	-	\$ -	30.00	\$ 345.00
08/06/08	16156	68.25	16.00	184.00	16.00	184.00
08/29/08	16215	11.00	11.00	126.50	-	-
02/11/09	16702	49.25	-	-	8.50	97.75
08/06/09	17232	64.00	18.00	207.00	-	-
08/21/09	17288	19.00	10.00	115.00	9.00	103.50
08/28/09	17299	21.00	-	-	21.00	241.50
10/07/09	17429	49.50	12.00	138.00	12.00	138.00
02/05/10	17765	50.50	-	-	9.00	103.50
03/04/10	17854	62.00	-	-	24.00	276.00
04/16/10	17967	59.25	3.00	34.50	20.00	230.00
04/30/10	17998	58.00	26.25	301.88	-	-
07/26/10	18332	12.00	-	-	12.00	138.00
09/01/10	18427	20.00	10.00	115.00	10.00	115.00
09/17/10	18491	10.00	-	-	10.00	115.00
11/03/10	18628	39.00	-	-	5.50	63.25
02/01/11	18902	35.25	5.00	57.50	-	-
Total			111.25	\$ 1,279.38	187.00	\$2,150.50

** - Total hours recorded in the payroll register for this check. There were often regular hours worked in addition to the vacation and/or sick leave hours cashed in.

Written Remarks per Timesheet

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"Request to cash 16 hrs vacation/16 hrs sick to pay bills"

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"Cashout"

"Please cashout 18 hrs of sick to help cover my van tires"

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"Cash out enough for about 100.00"

"I need to cashout about 9 hrs vacation. DJ's ins is due and she has no money to cover"

"DJ's Insurance and some of her car. Just cash out whatever vacation I have. And I would like to go tax exempt just this time to help out."

"Cash another 20 hrs. For DJ's car payment"

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"Cash 5.3 hrs of vacation please"

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Report on Special Investigation of the
City of Pacific Junction

Staff

This special investigation was performed by:

Annette K. Campbell, CPA, Director
Jennifer Campbell, CPA, Manager
Jenny M. Podrebarac, Senior Auditor II
Anthony M. Heibult, Staff Auditor
Ryan Pithan, Staff Auditor



Tamera S. Kusian, CPA
Deputy Auditor of State