



June 19, 2023

Clyde Duke
Eastsound Water Users Association
286 Enchanted Forest Way
Eastsound, WA 98245

Dear Mr. Duke:

Re: Eastsound Water Users Association Internal Investigation

Acuity Forensics (Acuity) has conducted an internal investigation related to the financial activities at Eastsound Water Users Association (EWUA). This investigation was initiated when your former treasurer discovered that your General Manager, Dan Burke, had issued himself payouts of paid time off (PTO) without the knowledge of the Board.

The purpose of this report is to communicate my findings to you. I reserve the right to amend my findings if new or additional information becomes available.

Executive Summary

During my engagement, I confirmed that Mr. Burke's cash out of PTO appeared to be noncompliant with the employee handbook and also appeared to be noncompliant with check writing procedures for EWUA.

In addition, I found that during the entirety of his employment, Mr. Burke never allocated any of his time to paid time off. This included sick time, holiday time, and other personal time taken. It is my professional opinion that at least a portion of Mr. Burke's payout of PTO was effectively an overpayment of payroll (because there were more hours to "cash out" than should have been available had he properly deducted his personal time during the previous two years of employment).

What's more, I found evidence of excessive spending on items for the EWUA office, vehicles, and employee housing that did not appear to be approved by or reviewed by any member of the EWUA Board.

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During the course of my engagement, I became aware of information that had not been provided to me at the outset of my work. Specifically, this included the concerns of current and former Board members and their findings related to the General Manager's potential overpayment of payroll. During an Executive Session meeting on May 16, 2023, I expressed my concern about the limited information that had been provided to me and indicated that I wanted to better understand these issues and examine additional documents before providing a written professional opinion. That subsequent information and detailed examination of documents materially changed the preliminary opinion I provided to EWUA in May 2023.

In addition to my findings, this report contains recommendations for improved internal controls at EWUA. It is my professional opinion that the General Manager position at EWUA has too much control over the finances without proper oversight by the Board.

Background and Scope of Work

Eastsound Water Users Association is a private, non-profit association owned by its more than 1,300 members. EWUA delivers water to its members living in the Eastsound service area in San Juan County, Washington (on Orcas Island).

In late 2020, Dan Burke replaced the former long-time general manager.

In early 2023, a new EWUA Board Treasurer began asking for specific financial information and access to financial programs at EWUA. It is understood that the treasurer faced difficulties gaining access to those systems. A subsequent review of the EWUA bank statements and cancelled check images revealed that two checks had been issued to Mr. Burke (and signed by Mr. Burke) for the cash out of accrued paid time off (PTO).

Acuity Forensics was engaged in April 2023 to investigate "the finances of EWUA". In order to conduct my work, I relied on the following documents:

- January 2021 – December 2022 Bank Statements and Cancelled Checks, Banner Bank
- October 2021 – March 2023 Bank Statements and Cancelled Checks, WaFd Bank
- January – December 2022 Divvy Credit Card Statements
- Access to Gusto (Payroll system)
- Access to Bill.com (Bill Pay system)
- Access to Caselle (Accounting System)
- Access to Amazon order history
- Various emails and other communications

Detailed Findings

It is my professional opinion that EWUA should change its procedures related to the oversight of financial activities. This professional opinion arises due to the findings of potential questionable spending and the lack of procedures that allowed the questionable spending to occur without notice.

My findings and recommendations are as follows:

Bank Statement Analysis

I analyzed the bank statements for Banner Bank and WaFD bank, including all cancelled check images. I noted that Dan Burke issued several checks to himself, for PTO payouts and reimbursements. It did not appear that any board member reviewed or approved them.

I provided the Board with a summary of the sources and uses of funds into and out of the EWUA bank accounts and asked for feedback on any potential questionable expenditures. I did not receive any specific requests for additional review.

Based on my review of the checks, I identified an additional ten checks that warranted extra scrutiny, primarily due to the fact that they had been handwritten or the nature of the expense was potentially questionable. Not all of these checks had a proper receipt, though it appeared that there was an explanation or knowledge by the board about these payments.

Divvy Credit Card Statements

I analyzed the Divvy credit card statements between January 2021 and December 2022, itemizing all charges on the card. I provided the Board with a summary of those charges and asked for feedback on any potential questionable expenditures. I did not receive any specific requests for additional review.

In total, I noted \$283,059 in charges on the card in a 2-year period (an average of \$141,500 per year or \$11,800 per month).

Based on my review of the charges, I identified several expenditures that warranted extra scrutiny. Members of the EWUA board attempted to obtain those receipts and found extreme difficulty in this exercise. I learned that the receipts supporting the credit card charges are not retained with a copy of the statement, making it difficult for any review of the underlying documentation. This exercise also revealed that EWUA had no receipts for several charges (and thus staff or Board Members had to request those receipts from the vendors directly).

I noted that \$42,000 of these credit card charges were in the "Suspense" account ledger of your accounting system, denoting that they were never posted to a budgeted expense line item. I noted thousands of dollars of charges to home goods stores like Costco, Pottery Barn, Etsy, Target, Home Depot, Amazon, and Bed Bath & Beyond.

What's more, when receipts were obtained, they revealed a pattern of potentially excessive spending, as follows:

- \$2,384 for 2 pendant lights for office
- \$480 for a single black out curtain for employee housing
- Purchase of a \$2,923 Apple MAC Computer for General Manager, followed by the purchase of a \$974 Apple iPad for General Manager (sent to his personal home).
- Significant purchases for 4-wheel drive vehicle accessories

I learned that charges less than \$5,000 do not have to be reviewed by a Board Member. What's more, I learned that there is no regular review of the Divvy credit card statements or supporting receipts.

Dan Burke Payroll Analysis

Based on my review of Mr. Burke's employment contract, I learned that he was a salaried employee. As such, the following section of the EWUA Employee Handbook appeared to apply to Mr. Burke:

Overtime is not paid to salaried employees. Salaried employees may be compensated for working more than 40 hrs in a given week with additions to their Equivalent Days Off (EDO) pool. Compensation will be awarded as time off, with no additional moneys being paid to the employee. Salaried employees should provide written overtime EDO requests to the General Manager within the same month the overtime occurred.

In terms of Earned Leave, the EWUA Employee Handbook states the following:

Earned leave is described in terms of Equivalent Days Off (EDO). Because of the nature of the service Eastsound Water provides, it is likely necessary to schedule work or work shifts during holidays or weekends. For that reason, Eastsound Water does not recognize individual holidays, but awards a block of EDO to each employee who is hired to work 20 or more hours per week.

In terms of Sick Leave, the EWUA Employee Handbook states the following:

In addition to the EDO Policy Eastsound Water also has a paid sick leave policy in compliance with WA State laws. See details of policy under separate cover.

In terms of payout of PTO time, the EWUA Employee Handbook states the following:

EDO not used in a particular year may be banked for later use up to a maximum of 30 days. No additional EDO can be accumulated in excess of 30 days, and no other compensation alternative is available. Employees leaving Eastsound Water in good standing and providing the recommended advance written notice will be paid for accumulated time off at their most recent compensation rate.

I obtained all of Mr. Burke's payroll-related records from both Gusto and Caselle. Specifically, I looked at his payroll history (gross pay, number of hours, net pay, etc.) and I also looked at his personal time off and sick leave bank. I noted that between January 2021 and March 2023, Mr. Burke regularly accrued PTO and sick leave, but never deducted these "banks" for any usage of such time.

Specifically, Mr. Burke earns 18 days of personal leave time per year (144 hours). In addition, he earns approximately 40 additional hours of annual sick leave.

I learned that Mr. Burke took two weeks off in March 2023 for a significant medical leave. He did not deduct his leave banks for this time. What's more, given that it is EWUA's policy that PTO must be taken for holidays, Mr. Burke's payroll reporting history would indicate that for two years he worked every Christmas, Thanksgiving, New Year, and Fourth of July holiday (not to mention other holidays).

Lastly, I learned that there are no requests from Mr. Burke to the Board for any overtime-related EDO provisions.

In late 2022, Mr. Burke paid himself 200 hours of PTO time (25 days of pay). He did not seek board approval on either of the checks he issued to himself.

It is my professional opinion that Mr. Burke's payout of PTO not only violated the check-writing procedures in place at the time of the payments, but that his PTO bank was likely significantly overstated at the time of his payout. As such, the PTO payouts likely represent an overpayment of payroll.

Budget Analysis

I reviewed the 2022 budget and compared it to both your 2021 activities and budget and the actual 2022 activities. It did not appear that the person or persons preparing the 2022 budget understood the process. Typically, a budget is created by looking at the prior year's history and projecting the subsequent year results. Examples of EWUA's budget to actual problems in 2022 included:

- Chemicals
 - 2021 Actual - \$13,088
 - 2022 Budget - \$5,000
 - 2022 Actual - \$13,194

- CPA/Finance
 - 2021 Actual - \$14,350
 - 2022 Budget - \$1,000
 - 2022 Actual - \$17,611

- Bookkeeping/Accounting
 - 2021 Actual - \$46,020
 - 2022 Budget - \$15,000
 - 2022 Actual - \$46,889

It is my professional opinion that the lack of a proper budget, along with a lack of proper financial accounting (e.g., monthly budget to actual reports) led to the overspending of EWUA funds.

Employee Housing

I understand that EWUA provides employee housing to employees. I understand that employees are required to make regular lease payments, as per executed lease agreements. I recommended that you have those lease agreements reviewed by a lawyer.

I was informed that Mr. Burke has paid all of his lease payments in full but was not given documents to verify these payments.

Recommendations

It is my professional opinion that the General Manager position at EWUA has too much financial control without proper oversight. Internal controls should be designed to effectively transact the business of EWUA and to also ensure all funds are deposited to EWUA's bank accounts and subsequently used for EWUA's business purposes. Internal controls should also be designed to keep employees safe in their jobs. Internal controls should not be construed as a "punishment" or as a signal of mistrust between an organization and its employees.

Based on my work in this matter, it is my professional opinion that EWUA should consider changing some of its financial oversight protocols, as follows:

Finding #1: EWUA uses an online "Bill.com" service to pay some vendors.

Bill.com is an online service that will handle the bill-paying function of an individual or organization. On the bank statement, the only information reported is that "Bill.com" was used to pay an invoice; it provides no information on the face of the bank statement to alert the reviewer about the true nature of the expense. In addition, the entire system is outside of EWUA's accounting and banking systems and requires a separate log in to review transactions.

Recommendation: EWUA should consider abandoning the "Bill.com" system and process all vendor invoices and checks through its normal accounts payable cycle.

Finding #2: WaFD Bank does not return cancelled check images with monthly bank statements.

The most effective way to ensure all payments are for the benefit of EWUA is to ensure cancelled check images are reviewed.

Recommendation: Ask WaFD to return cancelled check images with the monthly bank statements (this may require an additional bank fee).

Finding #3: EWUA Board Member(s) do not regularly review bank statements and cancelled check images.

The primary method of misuse of company funds is the unauthorized use of bank and credit card accounts. The primary method to uncover such a scheme is the consistent review of bank statements and cancelled check images each month.

Recommendation: Bank statements should be issued in paper form to EWUA and provided to the Board Treasurer or a Board designee, unopened. The Board should review all bank statements to ensure total deposits align with budgeted income for the month and to ensure all electronic and check payments are for the benefit of EWUA.

Finding #4: No Limitations on Credit Card accounts.

The Divvy account has a \$24,000 limit and pays twice monthly. Ostensibly, EWUA could run up charges of \$50,000 per month (or more) prior to the Board's review of the charges (as an example, total payments made in January 2023 equated to \$33,422). Other than the overall limit on the cards, there does not appear to be any limits placed on individual cardholders or on where charges can be made.

Recommendation: It is highly recommended that EWUA consider significantly limiting the activity allowed on the Divvy credit card accounts. This would include ensuring that all individual cardholders have daily and monthly charge limitations and limitations on where charges can be made (e.g., no charges at certain types of establishments).

Finding #5: Credit Card receipts are not regularly retained.

EWUA was unable to easily find receipts supporting credit card charges. Financial best practices include ensuring that all expenditures are supported by an itemized receipt that contains information about the date, location, and vendor name where the charge was made, along with detail indicating the nature of goods or services purchased.

Recommendation: All credit card charges should be supported by an itemized receipt and retained in a format which can ensure the easy review of those receipts by the EWUA Board (e.g., an electronic filing system, a paper filing system, etc.)

Finding #6: Credit Card Charges are not preapproved.

Financial best practices include ensuring that all expenditures are budgeted for and that all expenditures are properly approved prior to payment, this includes credit card charges.

Recommendation: Proposed credit card charges should be preapproved by an appropriate Board Member prior to the charge being made.

Finding #7: EWUA Board Member(s) do not regularly review credit card statements.

The most effective way to ensure all payments are for the benefit of EWUA is to ensure credit card statements are reviewed each month.

Recommendation: Credit card statements should be issued in paper format to EWUA and provided to the Board Treasurer or a Board designee, unopened. The Board should review all credit card statements to ensure that charges were pre-approved and were for the benefit of EWUA.

Finding #8: Consider revamping expense approval process.

Currently, the Board only approves expenditures in excess of \$5,000. This process, along with an insufficient budgeting process, led to unnecessary overspending by EWUA staff.

Recommendation: All regularly recurring expenditures (e.g., utilities, dues, equipment lease payments, etc.) should be budgeted for properly, but such payments would not necessitate a review by the EWUA board members prior to the issuance of payment. All non-recurring expenditures should also be budgeted for. However, non-recurring expenses (e.g., repair bills, accountant fees, attorney fees, etc.), no matter the amount, should be pre-approved prior to payment. Ideally, the process would be as follows:

- Annual Budget is approved.
- Vendor invoices received.
 - Non-recurring invoices should be coded with a proper budget line item and routed to Board Designee for approval.
 - Recurring invoices routed to accounting to pay.
- Approved invoices are entered into the accounting system and properly coded to expense line items.
- Checks are processed weekly (or on a regularly scheduled basis).
- Checks are attached to invoices.
- Checks, with supporting invoices, are directed to Board Member for review and signature.
- Checks are mailed & invoices are filed.

Finding #9: Consider hiring an experienced bookkeeper or accountant.

During my review of the financial statements, I noted that the entry of financial transactions into the accounting system did not contain proper information or were not properly coded to an expense account. I understand that an accounting software transition was occurring, but many of the errors did not appear to be a result of the software transition.

Recommendation: Consider hiring a part time bookkeeper or accounts payable clerk who can manage all incoming vendor invoices, timely record approved expenditures in the accounting system, manage credit card receipts, issue checks, and maintain a proper filing system.

Finding #10: General Manager does not take earned or sick days off.

The EWUA Handbook is clear that all employees are expected to use their days off, including holidays. The General Manager plays a key role in setting the “tone at the top” of an organization. The mishandling of the General Manager’s time off sends a signal that all employees can also take time off without properly deducting it from their personal time banks.

Recommendation: An audit of the General Manager’s time off in 2021 and 2022 should be conducted and deductions from his personal time bank should be considered. If the General Manager was overpaid on the payroll payout, those amounts should be reimbursed. In the future, the General Manager should be required to provide the Board with a bi-weekly or monthly summary of hours or days taken off in advance of payroll being processed.

Finding #11: Processed Payroll Reports not being monitored by EWUA Board.

A financial best practice is to ensure that all payroll is reviewed and approved by an appropriate level of management or the Board. It does not appear that the EWUA Board has a regular practice of reviewing payroll.

Recommendation: A detailed payroll report showing gross wages, hours paid, personal time used, paycheck deductions, and net pay should be part of the Board Treasurer’s (or a Board Designee) review each month.

Finding #12: Employee Rent Payments not Traceable.

I understand that EWUA allegedly collects rent from employees for employee housing. I say allegedly because there is no accounting for these deposits in the accounting system. I was informed that all payments have been made but was not provided with documents to support this statement. It appears that if rent payments have been made, they have been commingled with water deposits and recorded as water revenue. On occasion, amounts are reclassified in a lump sum from the water revenue account to the rental income account, but there is no accounting for a unit number, employee name, or any other identifying information supporting the reclassification.

Recommendation: Employee housing payments should be set up as after-tax deductions from employee payroll checks. This will ensure that all amounts are paid on a regular basis and are accounted for in a proper rental income ledger account.

Closing Comments

It is my professional opinion that the General Manager position at EWUA has too much financial control without proper oversight by the Board. This lack of oversight led to the likely overpayment of payroll to the current general manager and the potential overspending of EWUA funds.

There are opportunities for EWUA to improve its financial controls and budgeting process to reduce its future risk of improper financial activity. This includes reviewing bank statements, cancelled check images, credit card statements, and payroll reports on a monthly basis. It also includes revamping the expense approval process for both credit cards and regular vendor payments.

The installation of proper internal controls should be seen as a mechanism to keep employees safe in their jobs, and to ensure the safety of EWUA's funds, not a message of mistrust or punishment to any employee.

I appreciate the opportunity to work with you on this matter.

Respectfully,

A handwritten signature in blue ink that reads "Tiffany R. Couch". The signature is written in a cursive, flowing style.

Tiffany R. Couch, CPA/CFF, CFE