

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### City of Mountlake Terrace Snohomish County January 1, 2014 through December 31, 2014

**2014-001 The City's internal controls over year-end closing procedures for payables were not adequate to ensure the financial statements were accurate and complete.**

#### *Background*

In the prior audit, we reported deficiencies in the internal controls related to the City's preparation of financial statements. Following our audit, City staff took significant steps to improve internal controls and address the weaknesses identified. All of the errors identified in the prior audit were corrected and the City received an unmodified opinion on its financial statements.

#### *Description of Condition*

Our current audit identified a weakness in the City's procedures for processing year-end accruals over accounts and wages payables which represents a significant deficiency. Governmental Auditing Standards, prescribed by the Comptroller General of the United States, require the auditor to communicate significant deficiencies, defined in the Applicable Laws and Regulations section below, as a finding.

The purpose of the year-end accrual process is to recognize expenses in the period in which the economic events are incurred, regardless of when the payment is paid, to ensure accurate presentation of expenses. Accrual basis accounting records expenses at the time when services or goods are received rather than when cash is actually paid to vendors or employees.

City staff did not correctly accrue expenses that occurred prior to December 31, 2014 but were paid in January and February 2015 by reducing cash and the corresponding accounts payable balances. This method of accounting is not in accordance with Generally Accepted Accounting Principles (GAAP) and does not accurately reflect the status of cash and payables as of the fiscal year-end

#### *Cause of Condition*

In approximately fiscal year 2000, the City changed its basis of accounting and reporting from cash basis to Generally Accepted Accounting Principles (GAAP). However, City staff continued to utilize an open period which does not apply to

assets and liabilities reported on the financial statements. The City’s practice of continuing to use an open period was not detected until our current audit.

***Effect of Condition***

Our audit identified the following significant errors in the original financial statements we received for audit. Although errors were identified, the City corrected all of the errors identified and received an unmodified opinion on its financial statements in whole.

Significant Errors Identified:

In the following funds, the City understated its cash and accounts payable accounts in their year-end financial statements by reducing the balances for payments, such as wages and other expenses, made after the year-end:

General Fund	\$424,072
Street Construction Fund	\$107,221
Water Fund	\$212,059

The City also understated cash and accounts payable for less significant amounts in the Capital Improvements, City Streets, Sewer, Storm Water and Equipment Rental Funds.

***Recommendation***

We recommend the City discontinue the practice of reducing cash and accounts payable for expenses paid after the end of the fiscal year to ensure its financial statements comply with Generally Accepted Accounting Principles (GAAP) reporting requirements.

***City’s Response***

*The City of Mountlake Terrace disagrees and disputes this finding. The following outlines our practice since 1954.*

*The practice of crediting cash instead of accounts payable for year-end expenditures paid in the following year has been used annually at the City of Mountlake Terrace since its incorporation in 1954. In all of these years the cash balance has been reconciled and then reviewed and audited by the State Auditor's office without any issues.*

*The financial statements have been corrected for this misstatement, increasing cash and increasing accounts and wages payable for the same amount. There was no change to the Net Position of the City, as the net effect of the change was zero.*

*The amount of the change, when compared to total expenditures, is immaterial. However, due to the relatively small General Fund Balance at the end of the year, the change appears material to the General Fund's net position and balance sheet, even though the two accounts "wash" each other out and the net effect is zero. The change is immaterial when compared to the total Net Position of the City.*

*If the auditors had mentioned any concerns about this practice during any of the previous years' audits, this practice would have been changed. We relied on the clean audits we have received for many years that reviewed and approved of our year-end voucher process. The finance department designed the voucher process to credit cash instead of accounts payable. We had assumed this was an approved method of processing year-end payments based on previous clean audits of reviews of the cash reconciliation process.*

*On behalf of the City, I would request that the Finding be reduced to a Management Letter based on the fact we have relied on the State Auditor's Office audits for over 60 years, and this has not been noted until now. From this Audit forward we will comply fully with any recommendations.*

### ***Auditor's Remarks***

We acknowledge the City's response above and commend the City for its commitment to comply fully with audit recommendations. As noted in the enclosed report, our audits are not designed to identify all deficiencies in internal controls or errors presented in the financial statements submitted for audit. When deficiencies and errors are identified, auditing standards dictate the reporting of such matters. We reaffirm our finding.

### ***Applicable Laws and Regulations***

*Government Auditing Standards, December 2011 Revision, paragraph 4.23, states:*

**4.23** When performing GAGAS financial audits, auditors should communicate in the report on internal control over financial reporting and compliance, based upon the work performed, (1) significant deficiencies and material weaknesses in internal control; (2) instances of fraud and noncompliance with provisions of laws or regulations that have a material effect on the audit and any other instances that warrant the attention of those charged with governance; (3) noncompliance with provisions of contracts or

grant agreements that has a material effect on the audit; and (4) abuse that has a material effect on the audit.

The American Institute of Certified Public Accountants defines material weaknesses and significant deficiencies in its *Codification of Statements on Auditing Standards*, Section 265 as follows:

**.07** For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

**Material weakness.** A deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

**Significant deficiency.** A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.