

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

**Moses Lake School District No. 161**

**Grant County**

**September 1, 2015 through August 31, 2016**

**2016-001    The District's internal controls over financial statement preparation were inadequate to ensure accurate and complete reporting.**

### ***Background***

District management is responsible for designing, implementing, and maintaining internal controls that provide reasonable assurance regarding the reliability of financial reporting. Our audit identified a material weakness in internal controls that adversely affects the District's ability to produce reliable financial statements.

Government auditing standards prescribed by the Comptroller General of the United States require the auditor to communicate material weaknesses, as defined below in the Applicable Laws and Regulations section, as a finding.

### ***Description of Condition***

We identified a deficiency in internal controls over financial reporting that represents a material weakness. The District did not adequately research or seek technical guidance over specific transactions to ensure accurate and complete financial statements. Specifically, the District did not follow school accounting manual guidance when preparing financial statements to reflect a bond refunding. Accounting guidance for bond refunding transactions is contained in the Office of Superintendent of Public Instruction's *Accounting Manual for Public School Districts in the State of Washington*, which requires the District to record and present the inflow of proceeds from the new debt and the outflow of money to retire the old debt.

### ***Cause of Condition***

District management did not dedicate the necessary resources including training for staff or seek technical guidance regarding financial reporting of bond refunding.

## ***Effect of Condition***

We identified the following errors, which were not detected by the District:

- The District did not report activity related to bond refunding, resulting in a \$28 million understatement of revenues and expenses.
- The District also improperly netted the increase and decrease for voted bond debt, which understated its Schedule of Long Term Liabilities by about \$28 million.

We also found less serious errors on the District's financial statements, notes and other supplementary schedules.

## ***Recommendation***

We recommend the District establish and implement procedures to ensure:

- It provides the individuals involved in the preparation of the financial reports with necessary resources, time, training and oversight to facilitate the preparation of accurate and supported financial statements
- Individuals responsible for financial reporting adequately research and seek technical guidance for reported transactions to ensure compliance with reporting requirements, including following guidance from the *Accounting Manual for Public School District in the State of Washington*

## ***District's Response***

*Accurate financial reporting is a high priority for the Moses Lake School District. The \$28M transaction was an external refunding or exchange of money done through our fiscal agents bank that nets to zero, but reduces the interest rate on outstanding bonds saving our taxpayers over \$2.9M in interest over the next 12 years. Bond refunding is an infrequent financial activity for the District, and the District engaged bond counsel to assist with the transaction. The activity related to the bond refunding was fully and completely disclosed in the Notes to the Financial Statements.*

*We believe our controls are adequate to detect any material misstatements in our ending balances that have an effect on the users of our financial statements. We concur that the School District Accounting Manual requires the recording of this transaction as Other Financing Sources and Uses, but it did not impact revenues or expenditures. The transaction*

*netted to zero and had no effect on any beginning or ending fund balances on the District's financial statements. Beginning and ending outstanding debt balances were also correctly reported.*

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

We appreciate the steps the District is taking to resolve this issue. We will review the District's internal controls over financial reporting in the next audit.

### ***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

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

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

Material weakness: A deficiency, or 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.

A11 Indicators of material weaknesses in internal control include:

- Identification of fraud, whether or not material, on the part of senior management...
- Restatement of previously issued financial statements due to fraud or error;
- Identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected by the entity's internal control; and
- Ineffective oversight of the entity's financial reporting and internal control by those charge with governance.

WAC 392-123-010 The accounting manual, states:

The superintendent of public instruction and the office of the state auditor shall publish and distribute to each school district and charter school an accounting manual which shall be referred to as The Accounting Manual for Public School Districts of the State of Washington. Such accounting manual, as now or hereafter amended, shall govern the accounting procedures of each school district and charter school and is hereby incorporated into this chapter by this reference. Prior to any revision thereof, the superintendent of public instruction shall publish notice of such proposed action and shall hold at least one public hearing.

*The Accounting Manual for Public School Districts in the State of Washington*, Chapter 7, Bond Refundings chapter states in part:

Often bonds that have been issued are replaced by a new issue of bonds. This is called a refunding. Some of the common reasons why a district would refund bonds are to take advantage of better interest rates or to avoid cumbersome bond covenants.

GAAP require that the proceeds of current or advance refunding be reported as an Other Financing Uses (Budget and Actual) in GL 535. However, in an advance refunding, if an additional amount is required to be placed in an escrow together with the proceeds of

the new debt (refunding debt), the additional amount must be reported as a debt service expenditure (GL 530). [. . .]

**Principal Amount or Par Value:** This is the amount the bonds are worth. In a refunding, the principal amount is credited to General Ledger Account 965 Other Financing Sources and Revenue Account 9600 Sale of Refunding Bonds in the Debt Service Fund; this replaces the old debt.[. . .]

**Original Issue Premium:** As with a bond issue, sometimes bonds are sold for more than their “par value.” This is due to interest rates and fluctuations in the market. If the bond is offering an interest rate that is better than the going market rate, this will make the bonds more attractive to the purchaser who may be willing to pay more than the bonds par value due to the better rate of return they would get on their investment. This premium is recorded in the Debt Service Fund again as a credit to General Ledger Account 965 Other Financing Sources. [. . .]

**Underwriter’s Discount (Fees):** A portion of the proceeds may be withheld for underwriter’s fees (most commonly called underwriter discount), due in connection with the debt issuance. This should not be netted against the proceeds of the bonds. The discount resulting from the withholding should be recorded as an expenditure by debiting General Ledger Account 530 Expenditures in the Debt Service Fund. [. . .]

**Additional Proceeds:** Funds received in the Debt Service Fund as a result of the bonds being sold at a premium. This is cash received; therefore, is recorded as a debit to General Ledger Account 240 Cash on Deposit with County Treasurer in the Debt Service Fund. [. . .]

**Escrow Amount:** This is the total amount of the refunding which is deposited to the escrow account. This amount is debited to General Ledger Account 535 Other Financing Uses (Actual) in the Debt Service Fund. [. . .]

**Escrow Beginning Cash Deposit:** Many banks require a small deposit to open the escrow account. This amount on the closing memorandum is recorded as a debit to General Ledger Account 535 Other Financing Uses (Actual) in the Debt Service Fund. [. . .]

Cost of Issuance: Fees or other costs associated with issuance of the bonds. This is an actual expenditure and should be recorded as such. The district will record a debit to General Ledger Account 530 Expenditures in the Debt Service Fund. [. . .]

Bond Insurance Premium: This is an expenditure that the bond insurance company will charge for their part in the bond issue. The district will record a debit to General Ledger Account 530 Expenditures in the Debt Service Fund. [. . .]