

# **Schedule of Audit Findings and Responses**

## **Public Utility District No. 1 of Skagit County January 1, 2009 through December 31, 2009**

### **1. The District should improve internal controls over financial statement accounting and reporting.**

#### **Background**

District management, the state Legislature, state and federal agencies and bondholders rely on financial statement information to make decisions. It is the responsibility of District management to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting. Our audit identified significant deficiencies in controls that adversely affect 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 a significant deficiency, as defined below in the Applicable Laws and Regulations section, as a finding.

#### **Description of Condition**

We identified the following weaknesses in internal controls over financial reporting that, when taken together, represent a significant deficiency in controls:

- District officials do not perform a timely review of supporting documentation for journal entries. The District does not have a procedure to ensure journal entries are reviewed and approved prior to being entered into the general ledger system by accounting staff.
- The District does not have a procedure that will allow it to prevent or detect unauthorized adjustments to prior accounting periods by users with access to the general ledger system.
- The District does not perform an annual inventory of its capital assets. There is no compensating internal control to ensure all capital assets exist and are properly valued.

#### **Cause of Condition**

District management was aware of the internal controls weaknesses in its accounting system but has not taken sufficient steps to monitor or reduce those risks. Further, District management was not aware of the requirement to perform an annual inventory of capital assets.

## Effect of Condition

Our audit did not identify any material misstatements in the financial statements we audited. However, these deficiencies in internal controls make it possible that significant misstatements could occur and not be prevented, or detected and corrected, by the District in a timely manner.

**Journal entries:** Without a timely review of journal entries and closure of general ledger reporting periods, the opportunity for errors in the general ledger and misstatement in financial reporting increases significantly. The District performed a detailed review of its financial statements in April and May; however, not all journal entries were reviewed and approved prior to the review. The District completed its review and approval of journal entries and performed a second review of the financial statements, but not until approximately 10 months after the end of the audit period.

**Capital assets:** The District's capital assets include land, plant such as buildings and water system infrastructure, and equipment valued at approximately \$150 million. Because these assets are not regularly inventoried, the District did not have a procedure to ensure they were properly valued.

## Recommendation

We recommend the District:

- Review all journal entries entered in the accounting system as they occur to verify that each is valid, posted in the correct amount, adequately supported and properly approved timely.
- Implement controls to ensure and document that adjustments are not made to prior accounting periods without proper authorization.
- Comply with asset inventory and reconciliation requirements as prescribed by the *Budgeting, Accounting and Reporting System (BARS) Reporting Package for Public Utility Districts* by performing an asset inventory and reconciliation, and update District asset records accordingly.

## District's Response

*The Skagit Public Utility District has a well-established system of internal controls in place and we have a long history of excellent audit results. Prior to the audit, PUD management conducted a thorough review of its 2009 financial statements and found no significant errors. As noted in the finding, the auditors did not find any significant errors either. The audit did reveal areas in which we can improve our internal controls, specifically related to more stringent auditing standards related to internal controls over financial reporting. The District is fully committed to working with the State Auditor's Office in making the changes necessary to ensure all recommendations are addressed.*

## Auditor's Remarks

We appreciate the District's commitment to correcting the condition described. We will determine the status of the finding during the next audit.

## Applicable Laws and Regulations

RCW 43.09.200 states:

The state auditor shall formulate, prescribe, and install a system of accounting and reporting for all local governments, which shall be uniform for every public institution, and every public office, and every public account of the same class.

The system shall exhibit true accounts and detailed statements of funds collected, received, and expended for account of the public for any purpose whatever, and by all public officers, employees, or other persons.

The accounts shall show the receipt, use, and disposition of all public property, and the income, if any, derived therefrom; all sources of public income, and the amounts due and received from each source; all receipts, vouchers, and other documents kept, or required to be kept, necessary to isolate and prove the validity of every transaction; all statements and reports made or required to be made, for the internal administration of the office to which they pertain; and all reports published or required to be published, for the information of the people regarding any and all details of the financial administration of public affairs.

Budgeting, Accounting and Reporting System (BARS) Reporting Package for GAAP PUDs – Chapter 1, General Procedures, Section B. Internal Control, states in part:

Management and the governing body are responsible for the government's performance, compliance and financial reporting. Therefore, the adequacy of internal control to provide reasonable assurance of achieving these objectives is also the responsibility of management and the governing body. The governing body has *ultimate* responsibility for ensuring adequate controls to achieve objectives, even though *primary* responsibility has been delegated to management.

*Government Auditing Standards*, July 2007 Revision – Section 5.11, provides that auditors should report significant deficiencies and material weaknesses in internal control.

Statement on Auditing Standards No. 115, issued by the Auditing Standards Board of the American Institute of Certified Public Accountants, defines material weakness and significant deficiency as follows:

- a. Material weakness: A material weakness is 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.
- b. Significant deficiency: A significant deficiency is 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.

*Budgeting, Accounting and Reporting System (BARS) Reporting Package for GAAP PUDs – Chapter 6, Capital Assets, Section E. Updating the Capital Asset System: Physical Inventory, states in part:*

A physical inventory of the capital assets is necessary to verify that the assets still exist; it also provides updates on the condition of the assets. This information demonstrates that the district is exercising its custodial responsibility for the asset and is beneficial when establishing an insurance claim because it substantiates both the existence and the condition of the asset near the time of loss or damage . . . Policies and procedures governing the taking of regular physical inventories must be documented. These inventories must be taken not less often than once a year . . . Once the physical inventories are complete, they must be reconciled to the individual capital asset records or the listings of small attractive assets.