

Schedule of Audit Findings and Responses

Public Utility District No. 1 of Wahkiakum County January 1, 2009 through December 31, 2010

1. **The District's internal controls over accounting and reporting are inadequate to ensure the financial statements are accurate and complete.**

Background

District management, the state Legislature, state and federal agencies and bondholders rely on the information included in financial statements and reports 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. We identified significant deficiencies in controls that could adversely affect the District's ability to produce reliable and accurate financial statements.

Government Auditing Standards, prescribed by the Comptroller General of the United States, require the auditor to communicate significant deficiencies, as defined in the Applicable Laws and Regulations section below, as a finding.

On February 25, 2008, we reported a finding recommending the District improve internal controls over financial reporting relating to the audit covering fiscal years 2004-2006.

On October 15, 2009, we reported to the District's Board that while improvements had been made in fiscal years 2007 and 2008, District needed to continue to strengthen internal controls over financial reporting.

Description of Condition

We identified the following deficiencies that, when taken together, result in a material weakness in internal controls over financial reporting:

- The District lacks a reconciliation process for some general ledger accounts to corresponding support to ensure balance and/or activity is accurate and complete. During the audit, we found balances contained outdated or incomplete information.
- District employees responsible for financial statement preparation and review lack the level of technical knowledge needed to ensure financial reporting is accurate and complete under Generally Accepted Accounting Principles (GAAP). During preparation, the District did not ensure all appropriate accruals and adjustments were made to the financial statements. Without adequate technical knowledge, the District is at risk for not complying with or properly implementing changing accounting guidance.

- The District's final review process of the prepared financial statements is not detailed enough. For example, it did not include steps to ensure that key relationships between the statements agreed where appropriate.

Cause of Condition

The District has not dedicated the necessary resources to ensure accurate financial reporting. Financial statements prepared in accordance with Generally Accepted Accounting Practices are more challenging due to the changing nature of the standards and at times, the complexity of the guidance. Therefore, more resources are required to ensure accurate and complete statements.

Effect of Condition

As a result of the identified control deficiencies, District staff did not detect errors in its financial information. We identified the following errors in the original financial statements we received for audit:

- The District did not accrue unbilled revenues, resulting in an understatement of accounts receivable of \$222,384 and \$248,759 in 2009 and 2010, respectively.
- Payroll liabilities were overstated by \$148,622 and \$143,151 in 2009 and 2010, respectively.
- The plant materials and supplies balance could not be supported or verified during the audit in the amounts of \$337,659 and \$335,919 in 2009 and 2010, respectively.
- Beginning cash reported in the 2010 Statement of Cash Flows did not agree with the prior year's ending cash.

The District corrected all items except the plant and materials balance.

These deficiencies in internal controls make it reasonably possible that material misstatements could occur and not be prevented or detected by the District in the future.

Recommendation

We recommend the District:

- Ensure staff is provided the necessary resources, training, and oversight to ensure financial statements are prepared accurately.
- Ensure general ledger balances are reconciled to adequate support.
- Establish a technical review process of the financial statements by a person knowledgeable of Generally Accepted Accounting Principles and reporting requirements to ensure accurate preparation and reporting of the District's financial statements. The review process should be at the appropriate level of detail.

District's Response

The management personnel of Public Utility District No. 1 of Wahkiakum County, Washington, have always worked to ensure that the District is in sound and stable financial condition and that customers have an understanding of the District's financial situation. The District welcomes the State Auditor's recommendations regarding how the District can continue to effectively monitor controls over its financial reporting. This response addresses audit issues. Before the State Auditor had completed review of the audit covering fiscal years 2009-2010, District personnel responded to control concerns and corrected identified errors in initial financial statements as explained herein:

Non-accrual of Unbilled Revenues

The District Auditor was notified that the District's accounts receivable should include an estimation of revenue that has been recognized but not yet billed to customers. The Auditor has adopted this practice and is currently providing estimations for fiscal years 2011-2012.

Overstatement of Payroll Liabilities

The District Auditor corrected this issue during the audit and is currently reflecting payroll liabilities according to the State's requirements.

Agreement of 2009 Ending Cash and 2010 Beginning Cash

The District Auditor has corrected this issue.

With regard to the Auditor's assertion that plant materials and supplies balance could not be supported or verified during the audit, it has not been determined that the plant materials balance needs to be corrected.

The District is committed to ensuring that the District's Auditor has the resources and support necessary to maintain an accurate and complete picture of the District's finances and continues to receive relevant training. In 2011, the District implemented new accounting software that provides more detailed reporting capabilities. In addition, the District will be seeking proposals from accounting firms and certified public accountants to review the District's accounting and reporting practices, and recommend policies and procedures to improve the District's preparation and reporting of financial statements according to Generally Accepted Accounting Practices and applicable laws and regulations.

Auditor's Remarks

We appreciate the actions taken by the District to resolve this concern and we will review it during our next regularly scheduled audit.

Applicable Laws and Regulations

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.

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

RCW 43.09.200, Local government accounting -- Uniform system of accounting, 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 there from; 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. 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.

Budget Accounting and Reporting System (BARS) Manual – Part 3, Accounting, Chapter 1, Accounting Principles and General Procedures, Section N, Internal control, states in part:

Controls over Financial Reporting

This objective refers to fair presentation of financial statements and required schedules in all material respects in accordance with the stated basis of accounting. In meeting this objective, the government should have controls that accomplish the following key functions:

- Identification of financial events – Controls should ensure financial events and transactions are properly identified and recorded.
- Properly applying accounting standards – Controls should ensure correct criteria and methodology is applied when accounting for financial events. When the correct method of accounting for or reporting a transaction is unclear, the government should seek clarification by performing research, contracting for accounting assistance, or communicating with the State Auditor’s Office or standard setting bodies.
- Correctly accounting for all financial events – Controls should ensure that:
 - Only valid transactions are recorded and reported.
 - All transactions occurred during the period are recorded and reported.
 - Transactions are recorded and reported at properly valued and calculated amounts.
 - Recorded and reported transactions accurately reflect legal rights and obligations.
 - Transactions are recorded and reported in the account and fund to which they apply.
- Preparation of the annual report – Controls should ensure that financial statements and required schedules are properly compiled and prepared from source accounting records. Controls should also ensure correct presentation of statements and schedules.

Controls and processes should generate adequate documentation to demonstrate achievement of objectives. This is not only important for audit, oversight and public records purposes, but also to enable effective monitoring of controls over financial reporting by management.