

# Schedule of Audit Findings and Responses

**City of Lynnwood  
Snohomish County  
January 1, 2010 through December 31, 2010**

- 1. The City's internal controls over accounting and financial reporting are not adequate to ensure the financial statements are accurate, complete and timely.**

## **Background**

It is the responsibility of City management to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting.

In each of our four previous audits, we have identified and communicated deficiencies in controls that adversely affect the City's ability to produce reliable financial statements.

## **Description of Condition**

We identified the following deficiencies in internal control over accounting and financial reporting that, when taken together, represent a material weakness:

- Staff responsible for financial statement preparation and oversight lack the level of technical knowledge needed to ensure the City's financial reporting is accurate and complete according to Generally Accepted Accounting Principles (GAAP).
- Although the City has procedures to perform a final review of the prepared financial statements prior to audit, the review is not detailed enough to detect significant or material errors. For example, the review did not include steps to ensure that the same amounts presented on multiple statements were the same.
- The City does not have a procedure to perform a reconciliation of its inventory of capital assets to the general ledger in accordance with the *Budgeting, Accounting and Reporting Systems Manual* (BARS Part 3, Chapter 7, Page 5, Section c (2)).

## **Cause of Condition**

City management has not dedicated the necessary time and resources to make completing the financial statements accurately and timely a priority. Further, the City chose to begin using new reporting software prior to preparing the financial statements. Financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP) 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.

Additionally, the City experienced turnover in key financial positions including the Finance Director, Assistant Finance Director and the Accounting Manager at the end of the fiscal year.

### **Effect of Condition**

Inaccurate financial reports limit access to financial information used by City officials, the public, state and federal agencies and other interested parties. It also hinders the audit process and increases audit costs.

The following errors were not detected by the City but were identified during our audit::

- The City overstated the value of its land by at least \$4,322,991 by reporting assets that it no longer owns.
- The City chose to record several transactions using the invoice date and deposit date rather than accruing the transactions to the year they were incurred or earned, as required by GAAP. We identified at least \$1,489,421 in expenditures coded to the wrong fiscal year.
- The City did not correctly calculate its balances for Invested in Capital Assets, Net of Related Debt by removing all related debt balances. It overstated the balance in the Water and Sewer Utility Fund by \$15,825,000. This error did not impact ending net assets for the fund.
- The City did not eliminate \$2,295,213 in inter-fund activity when it combined funds to represent the Water and Sewer Utility fund on the financial statements. This error did not impact ending net assets for the fund.
- The City did not ensure several note disclosures, the government-wide reconciliations and the Schedule of Expenditures of Federal Awards (SEFA) were accurate and complete.

Additionally, the City did not complete its financial statements and submit the final version for audit until December 9, 2011. As a result, the City missed its federal audit deadline for 2010 and did not have its statements completed within 150 days past year end as required by state law (RCW 43.09.230).

### **Recommendation**

We recommend the City:

- Provide staff the necessary resources, training, and oversight to prepare accurate and complete financial statements.
- Ensure a person knowledgeable of GAAP and reporting requirements performs a detailed, technical review of the financial statements to ensure accurate preparation and reporting.
- Have procedures to reconcile general ledger balances to adequate supporting documentation.

- Prepares its financial statements by the required state and federal deadlines.

## **City's Response**

*The City of Lynnwood generally agrees with the audit finding, and we have taken steps to remedy the comments therein. We would like to summarize our action plan thus far:*

- *From 2010-2011, the City lost five significant employees, the Accounting Manager, Fiscal Systems Accountant, Assistant Finance Director, and two Finance Directors. During this same time period the city hired a new Accounting Manager and a new Finance Director. It is our position that the two new incumbents will provide continuity and consistency to the City's financial reporting processes.*
- *The City's Administrative Services Department will approach City leadership during the next budget cycle regarding additional resources for the Accounting Department to: 1) ensure the adequacy of staffing and resources necessary for financial statement preparation, and 2) ensure resources and procedures are available to foster proper reconciliation between the capital asset inventory and the general ledger.*
- *For the 2011 statements and onward, the Finance Director and the City Budget coordinator (both Certified Public Accountants) will primarily review the financial statements developed by the Accounting staff. This will ensure that adequate staffing with technical knowledge is available to review statements and document procedures.*
- *The City's accounting staff will be sent to financial statement preparation training annually to ensure that staff remains current on GASB financial reporting requirements. This will ensure that staffing with technical knowledge is available to prepare the financial statements.*
- *In 2012, the City hired a Fiscal Systems Accountant who is formerly the Accounting Manager with another City here in Snohomish County. She also brings a wealth of financial reporting experience. Her tenure at her former position includes producing five years of City financial statements in which no Washington State Auditor findings were noted. This action provides additional staffing with technical knowledge to assist in the preparation of the financial statements.*
- *Most of the 2010 statements were produced utilizing a stand-alone financial reporting software package, previously purchased, but not utilized by the City until 2011. This new software allows City staff to produce consistent statements and the auditors to easily verify the validity of any requested line in the statements. The City's current accounting staff, recognizing the importance of utilizing the financial software, has spent the past year configuring and implementing the new software.*

*It is our contention that the points mentioned above will allow us to continue to pursue the standard of accurate and timely financial statements from the City of Lynnwood.*

## Auditor's Remarks

We appreciate the steps the City is taking to resolve this issue. We will review the condition during our next 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 C, 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.

2010 *Budget Accounting and Reporting System* (BARS) Manual Part 3, Chapter 7, Page 5, Section c (2), states:

A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years.

RCW 43.09.230, Local Government Accounting – Annual Reports, states in part:

The state auditor shall require from every local government financial reports covering the full period of each fiscal year, in accordance with the forms and methods prescribed by the state auditor, which shall be uniform for all accounts of the same class.

Such reports shall be prepared, certified, and filed with the state auditor within one hundred fifty days after the close of each fiscal year.

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, states in part:

Section 200:

(a) Audit required.

Non-Federal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part. Guidance on determining Federal awards expended is provided in §\_\_\_\_.205.

(b) Single audit.

Non-Federal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards shall have a single audit conducted in accordance with §\_\_\_\_.500 except when they elect to have a program-specific audit conducted in accordance with paragraph (c) of this section.

Section 300:

The auditee shall:

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

(c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.

(d) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with §\_\_\_\_.310.

(e) Ensure that the audits required by this part are properly performed and submitted when due. When extensions to the report submission due date required by §\_\_\_\_.320(a) are granted by the cognizant or oversight agency for audit, promptly notify the Federal clearinghouse designated by OMB and each pass-through entity providing Federal awards of the extension.

Section 320:

a) General. The audit shall be completed and the data collection form described in paragraph (b) of this section and reporting package described in paragraph (c) of this section shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.

# Status of Prior Audit Findings

## **City of Lynnwood Snohomish County January 1, 2009 through December 31, 2009**

The status of findings contained in the prior years' audit reports of the City of Lynnwood is provided below:

- 1. The City needs to improve its internal controls over financial statement preparation to ensure accurate financial reporting.**

Report No. 1004322, dated September 30, 2010

### **Background**

During 2009, the City experienced turnover in key accounting positions which delayed the completion of its annual report. As a result, the financial statements were not submitted for audit in a timely manner and delayed the audit process.

Additionally, the City's financial statement process is complex involving multiple people and departments. These conditions led to multiple errors going undetected in the financial statements submitted for audit, including errors involving the reporting of capital assets. The City's review process was not detailed enough to catch the errors prior to the start of the audit.

### **Status**

The condition reported during the 2009 audit remains unresolved. The City continued to experience turnover through early 2011 in key accounting positions such as Finance Director, Accounting Manager and Treasurer. Additionally, current staff responsible for preparing the financial statements does not possess adequate knowledge of Generally Accepted Accounting Principles (GAAP) or have instituted a detailed review process of the completed financial statements. Although efforts have been made to increase communication between departments, the ongoing deficiencies in the City's internal control process continue to make it reasonably possible that a misstatement would remain undetected until the audit. Lastly, material errors were identified during the current audit.