2015-001 The Authority's internal controls over financial statement preparation were inadequate to ensure accurate and complete reporting.

Background

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

Our audit identified deficiencies in internal controls over financial reporting that affected the Authority's ability to produce reliable financial statements.

Description of Condition

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

- The Authority did not have procedures in place to ensure all revenues and expenditures were properly recognized and reported in its financial statements. Staff responsible for financial statement preparation incorrectly reported restaurant operation revenues net of expenditures, and incorrectly netted loan proceeds with repayments during the year. Our audit found that additional revenues and expenditures related to rental and leasing operations were omitted from the financial statements.

- The Authority maintained its general ledger on an accrual basis of accounting, and converted to cash-basis for financial reporting purposes. The Authority did not have adequate procedures in place to ensure the conversion was executed correctly.

Cause of Condition

The Authority was established in 2011 and became fully operational in 2014. This was the Authority's first time preparing financial statements complying with the *Budgeting, Accounting and Reporting System* (BARS) Manual. Staff responsible for financial statement preparation lacked the technical knowledge necessary to ensure the financial statements were prepared accurately and in accordance with the BARS Manual.

Effect of Condition

The material weakness in internal controls resulted in the following misstatements found in the financial statements submitted for audit:

2014

- Beginning cash was understated by $13,274.
- Revenues were understated by $630,071.
- Expenditures were understated by $307,662.
- Ending cash was understated by $335,682.

2015

- Beginning cash was understated by $44,630.
- Revenues were understated by $1,027,634.
- Expenditures were understated by $1,075,342.
- Ending cash was overstated by $3,310.

Recommendation

We recommend the Authority:

- Provide adequate training to staff responsible for financial reporting to ensure compliance with the BARS Manual.
- Establish procedures to ensure the conversion from the accrual basis general ledger to the cash-basis financial reports is properly executed. Alternatively, the Authority may choose to report its financial statements in accordance with Generally Accepted Accounting Principles (GAAP).

Authority's Response

Fort Worden Public Development Authority (PDA) and staff thank the State Auditor's Office for their time in conducting a thorough and complete audit.

The PDA and staff also thank the State Auditor's office for understanding that the PDA went from a state (WA State Parks) financial reporting system to a municipal financial reporting system virtually overnight. As a new start-up public entity with employees transferring from the State to the PDA, there were necessary transitions that were needed to be made in the PDA's finance team, which resulted in bringing in an outside consultant help to develop new internal controls in 2015.

This PDA and staff appreciate that the auditors helped staff understand during the audit process how this finding occurred and helped to identify that accounts receivables, the PT Hospitality contract and advance deposits and other minor revenues and expenditure were incorrectly applied to the proper BARS accounts in its conversion from accrual to cash basis in its initial filings. The corrections were made during the audit process and the annual reports are now complete and correct.

While the PDA appreciates the need to post transactions in a BARS-compliant manner, we believe it is important to note that the net income reported in both 2014 and 2015, along with our annual cash reconciliations for those same years, were accurate and did not require adjustments.

As a result of this audit, the PDA is implementing necessary training, policies and procedures to ensure internal controls are put in place and adhere to in order to address this finding is our priority. The PDA has also established an Audit Committee to oversee future annual reporting as an extra measure to make sure accurate reporting takes place.

Auditor's Remarks

We appreciate the steps the Authority is taking to resolve this issue. We will review the condition during our next audit.

Applicable Laws and Regulations

RCW 43.09.200 Local government accounting—Uniform system of accounting, states in part:

> 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.

Budgeting Accounting and Reporting System (BARS) Manual; Accounting, Accounting Principles and General Procedures, Internal Control, states:

> Internal control is a management process for keeping an entity on course in achieving its business objectives, as adopted by the governing body. This management control system should ensure that resources are guarded against waste, loss and misuse; that reliable data is obtained, maintained, and fairly disclosed in financial statement and other reports; and resource use is consistent with laws, regulations and policies.
>
> Each entity is responsible for establishing and maintaining an effective system of internal control throughout their government.

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 Accounts defines significant deficiencies and material weaknesses in its Codification of Statements on Auditing Standards section 265 as follows:

> 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.
>
> 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 financial statements will not be prevented, or detected and corrected on a timely basis.