

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### Public Utility District No. 1 of Mason County January 1, 2015 through December 31, 2015

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

#### ***Background***

It is the responsibility of District management to design, implement and maintain internal controls to ensure financial statements are fairly presented and that provide reasonable assurance regarding the financial reporting's reliability. Our audit identified internal control deficiencies that adversely affected the District's ability to produce reliable and accurate financial statements.

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

Our audit identified the following internal control deficiencies that, when taken together, represent a material weakness:

- The District did not have adequate procedures in place to implement new accounting standards correctly.
- The financial statement review process was inadequate to ensure financial information was accurate.
- The District lacked adequate procedures to ensure adjusting journal entries were made for a valid purpose and independently reviewed, and that documentation was retained. The controls were not effective to detect journal entries related to misappropriation in a timely manner.

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

The District contracted with a certified public accounting firm to calculate amounts related to implementation of *Governmental Accounting Standards Board* (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions*. However, District staff did not interpret or implement the new standard correctly, and the calculations District staff relied on contained errors.

The District did not review the financial statements to ensure accurate preparation and presentation. Management responsible for overseeing journal entries did not

adequately monitor activity nor ensure staff consistently followed procedures for retention of journal entry supporting documentation.

### ***Effect of Condition***

The material weakness resulted in multiple misstatements on the District's financial statements, including:

- The following misstatements were due to incorrect implementation of GASB Statement No. 68. The District:
  - Misclassified the Cumulative Change in Accounting Principle of \$1,743,069 as a Net Pension Asset, and understated the balance by \$5,879.
  - Understated deferred Outflow related to pensions by \$113,496.
  - Overstated deferred Inflow related to pensions by \$14,533.
  - Improperly included the required supplementary information as part of its Notes to the Financial Statements.
- Additional less-significant misstatements ranged from \$16,308 to \$174,759, and numerous immaterial presentation errors were identified throughout the financial statements.
- Management did not detect journal entries related to misappropriation in a timely manner.

### ***Recommendation***

We recommend the District strengthen internal controls over financial reporting, including:

- Provide the resources and training on new accounting standards necessary for staff responsible for preparing financial statements to prepare accurate and complete financial statements.
- Assign an independent review of the financial statements, notes and additional schedules to a person knowledgeable of the reporting requirements to ensure those documents are complete and accurate.
- Review all journal entries to ensure they are for a valid financial purpose, adequately supported and properly reviewed.

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

Thank you for the opportunity to comment on the audit finding for the period of January 1, 2015 through December 31, 2015.

The District concurs with the finding that the internal controls over accounting processes and the preparation of financial statements were inadequate to ensure accurate financial reporting and oversight. We concur that the former District Auditor/Director of Finance did not follow proper accounting procedures to certify that the information on the financial statements was accurate and he did not have the capacity to correctly implement the GASB accounting standards. The District Auditor also did not have financial controls in place for the independent review of journal entries made by his employees to ensure that the entries were valid, which resulted in misappropriation of public resources by one of his employees. The general manager and governing body of the District corrected this by terminating the employment of both the District Auditor and the employee that was misappropriating District resources.

In working closely with the SAO the last half of 2016, the District immediately implemented stronger controls that now require appropriate journal entry supporting documentation as well as a review process by an individual other than the employee making the journal entry. Documentation is also required to verify month-end and year-end GL balancing, which is reviewed by the new independent District Auditor. **This meets the recommendation by the SAO to ensure that all journal entries are properly reviewed for validity, accuracy and contain supporting documentation.**

The District solicited proposals from outside accounting firms and appointed Michael Wittenberg as the District Auditor. His office now is an independent party that has not only amended 2015's financial reports to ensure their accuracy, they have also implemented new accounting procedures and controls, as well as made recommendations for financial policies for the commission. In working with the in-house bookkeeper, credit & collections person, and payroll officer, the financial statements for year-end 2015 and year-end 2016 are now accurate. **This meets the recommendation by the SAO to have properly trained staff preparing accurate and complete financial statements.**

With regard to the GASB 68 implementation, while it is correct that the lack of accuracy in our internal financial statements contributed to errors in the calculations for the pension liability, the misclassification and improperly stated pension amounts were provided by Moss Adams, an independent CPA firm that was hired to produce these reports. They had an inaccuracy in their computations, which led to incorrect data being used by the District. Moss Adams

*has since been informed of their error and the GASB 68 has been corrected, revised and resubmitted by Michael Wittenberg's office. **This meets the recommendation from the SAO to have a knowledgeable individual perform a review of financial statements and supporting materials to ensure completion and accuracy.***

*The District appreciates the time and consideration that the SAO dedicated to determining the root causes of the misappropriations and financial errors, and for making immediate recommendations to fix the weaknesses. It took considerable research from the Auditor in Charge to understand our processes and constraints and develop a new control plan that would be sensitive to our staffing limitations but also ensure compliance. As a result, the majority of the weaknesses surrounding controls and reporting inaccuracies were immediately remedied on the spot. All of our new processes were implemented before the audit process was even completed. We are very pleased and encouraged with these new processes and appreciate the continued feedback from the SAO.*

*The management and governing board of Mason County PUD No. 1 are very open to recommendations and criticisms when they lead to stronger financial controls and processes to ensure we are protecting our public's resources. We hope in the future that any concerns, no matter how minor, will be openly shared on all levels. We want to have a level of trust not just with our public but also between the SAO and District management. We feel as though that trust was established during this last audit and we again appreciate the work and assistance to help us bring our processes into compliance.*

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

We appreciate the District's commitment to resolve this finding and thank the District for its cooperation and assistance during the audit. We will review the corrective action taken during our next regular 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 Internal Control, Internal Control states in part:*

3.1.3.20 Internal control is a process – affected by those charged with governance, management and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Compliance with applicable laws and regulations
- Reliability of financial reporting

3.1.3.30 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. Since management and the governing body are assumed to work in harmony, both parties are collectively referred to as “management” throughout the rest of this section.

3.1.3.140 This objective refers to fair presentation of financial statements and required schedules in all material respects in accordance with the stated basis of accounting.

3.1.3.150 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.

3.1.3.160 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.

*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 Accountants defines material weaknesses and significant deficiencies in its Codification of Statements on Auditing Standards Section 265 as follows:

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

Material weakness. A deficiency or a 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.

*Governmental Accounting Standards Board (GASB) Statement No. 68 Accounting and Financial Reporting for Pensions* states in part:

1. The principal objective of this Statement is to improve the usefulness of information for decisions made by the various users of the general purpose external financial reports (financial reports) of governments whose employees - both active employees and inactive employees – are provided with pensions. One aspect of that objective is to provide information about the effects of pension-related transactions and other events on the elements of the basic financial statements of state and local governmental employers. This information will assist users in assessing the relationship between a government's inflows of resources and its total cost (including pension expense) of providing government services each period. Another aspect of that objective is to provide users with information about the government's pension obligations and the resources available to satisfy those obligations statements.