

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

City of Sammamish King County January 1, 2016 through December 31, 2016

2016-001 The City's internal controls were not adequate when valuing contributed assets.

Background

City management is responsible for designing and following internal controls that provide reasonable assurance regarding the reliability of financial reporting. Our audit identified a material weakness in internal controls over financial reporting that resulted in errors in the City's financial statements.

Government Auditing Standards requires that the auditor communicate a material weakness, as defined below in the Applicable Laws and Regulations section, as a finding.

The City recorded a capital asset contribution because it annexed the Klahanie neighborhood from King County. The annexation consisted of transferring ownership of assets including land, streets and storm water systems. The Governmental Accounting Standards Board Statement No. 69 requires all annexed assets to be valued at carrying value of the transferring government.

Description of Condition

We evaluated the internal controls over the recording of \$396,619,405 in contributed assets relating to the annexation and identified the following internal control deficiency that represents a material weakness over financial reporting:

- The City was unable to obtain values of the assets from the transferring government, so it performed research to determine values for each asset acquired. The City valued the assets at fair market value and did not detect errors in its calculations. Also, the City did not adjust the values to record the assets at the estimated carrying value.

Cause of Condition

The City attempted to obtain the values from King County. However, was unable to obtain the values in a timely manner to ensure that the annexation, an unusual transaction for the City, was properly valued and recorded.

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.

Our audit of the City's financial statements identified the following errors related to the recording of the contributed assets:

- Governmental activities revenue and capital assets were overstated by \$302,502,662.
- Business type activities revenue and capital assets were overstated by \$17,624,456.
- Storm Water Fund revenue and capital assets were overstated by \$17,624,456.
- Governmental activities depreciation expense was overstated by \$3,614,975.
- Business type activities depreciation expense was overstated by \$409,871.
- Storm Water Fund depreciation expense was overstated by \$389,134.

Recommendations

We recommend the City establish internal controls to ensure:

- Adequate reviews are performed over managerial estimates before being recorded in the City's general ledger
- Valuation of contributed capital assets is appropriate and fully supported
- Adequate resources are dedicated when unusual transactions occur to ensure they are accurately recorded and valued

City's Response

The City of Sammamish values the State Auditor's Office's attention to our financial records and accounting practices. The City endeavors to produce reliable and accurate financial statements by continuous attention to staff training and industry best practices. This is the first finding the City has received since 2008.

While the City has experienced annexations in the past, the annexation of the Klahanie area was extraordinary in the size and value of assets received. The City is unlikely to face such a significant annexation in the future.

In the past, King County was unable to provide the City with data relating to the value of assets annexed to the City, and this held true for the park and stormwater

assets for the Klahanie annexation. In regards to the Klahanie annexation, the City was only able to obtain values from King County for the transportation assets. In addition, those assets were removed from King County's books and reported as such in 2015, this was before the effective date of the annexation and the City had no reason to look for the data in the County's 2015 CAFR. The City determined the King County data was incomplete and so pursued an additional valuation method to achieve overall fair presentation of the financial statements.

The City calculated the value of the annexation assets similar to contributed capital received from developers, however the calculation used current values instead of values based on the age of the assets. The City will develop a more robust procedure for determining the value of assets going forward, with the finance and engineering teams coordinating more closely. Additionally, in the future, the City will scrutinize unusual transactions to ensure they are properly valued and recorded.

Auditor's Remarks

We appreciate the City's commitment to resolve this finding. We will review the corrective action taken during our next regular audit. We thank the City for its cooperation and assistance during the 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 Systems 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 statements 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 Accountants defines significant deficiencies and material weaknesses 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:

Deficiency in internal control. A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing, or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or competence to perform the control effectively.

Material weakness. A deficiency, or a combination of deficiencies, in internal control over financial reporting, 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. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probably as defined as follows:

Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

Probable. The future event or events are likely to occur.