

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

City of Issaquah January 1, 2017 through December 31, 2017

2017-001 The City's controls over financial statement preparation were inadequate to ensure accurate and complete financial reporting.

Background

City management is responsible for designing, implementing and maintaining internal controls to ensure financial statements are fairly presented and to provide reasonable assurance regarding the reliability of financial reporting.

The City prepares its financial statements in accordance with generally accepted accounting principles (GAAP). These financial statements are complex, and the reporting requirements change frequently.

In our previous three audits, we identified material weaknesses in controls over financial reporting that hindered the City's ability to produce accurate financial statements. In the past three years, the City has experienced turnover in key finance and accounting positions in addition to extensive employee trainings and process changes due to a new accounting software update. The employee primarily responsible for preparing the City's financial statements left the City in April 2018, leading the City to hire an external consultant to prepare the financial statements. Additionally, the employee primarily responsible for reviewing the complete financial statements was on leave, so a thorough review did not occur. Although the City has taken steps to improve its financial reporting process, it has been unable to correct all deficiencies given the significant changes experienced in the past three years. During the current audit, we continued to identify misstatements that we consider to be material weaknesses in controls over financial reporting.

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

Description of Condition

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

- Due to employee turnover and staffing shortage at the finance department, a thorough review of the financial statements and required schedules was not completed. The employee who was temporally assigned this task was unable to dedicate sufficient time and resources to ensure the underlining accounting records to be included in the final reported numbers were accurate and complete.
- City procedures for performing a final review of the financial statements and required schedules were not effective or adequate to detect and correct errors before our audit.

Cause of Condition

The City continued to experience turnovers in the Finance department while adjusting to its new Enterprise Resources Planning (ERP) system. As a result, the City could not dedicate the necessary time and resources to ensure the financial statements were free from material misstatements.

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.

We identified the following misstatements during the audit:

- The City incorrectly classified \$4,607,480 as Cash and Cash Equivalent in the General Fund when it should have been reported as Taxes Receivables. This was subsequently corrected as a result of our audit.
- The City overstated the Current Receivables balance in the Street Capital Fund by \$2,339,243 due to a duplicate accounting entry. This was subsequently corrected as a result of our audit.
- The City overstated Liabilities Payable from Restricted Assets in the Agency Fund by \$1,181,363. The account is used to hold monies on behalf of external parties for the purpose of a future deposit refund and also used to temporarily hold funds to other state agencies. Some of the transactions in this balance have existed since 1983, while some of the accounts appeared to be invalid due to lack of records and inactivity. During 2017 and in previous years, reconciliation and review of individual accounts were

inadequate to ensure the accounts represent actual liabilities payable of the City.

We also noted additional less significant errors in the financial statements that we communicated to the City's management during the audit.

Recommendations

We recommend the City continue to establish and follow effective internal controls over financial statement reporting. Specifically, we recommend the City:

- Ensure staff responsible for preparing financial statements have the necessary resources and training to prepare accurate and complete financial statements in accordance with reporting standards
- Conduct an effective, independent financial statement review that ensure the required financial statement package is accurate and comply with reporting standards

City's Response

The City of Issaquah appreciates the opportunity to respond to the conclusions drawn by the staff of the Washington State Auditor's Office. We would like to thank the audit staff for the open communication throughout the audit. The City is committed to internal control processes and management oversight review procedures over financial statement preparation.

The City is committed to continuing to improve processes and procedures over the preparation and review of the financial statements to ensure their accuracy. Unfortunately, the City continues to experience turnover in key finance and accounting staff positions. The City Administration is taking this turnover trend seriously and is looking closely at the organizational structure to curb this trend and to ensure that staff is being deployed effectively to meet the City's fiduciary responsibilities. In addition, the City Administration is actively exploring opportunities to bring in outside resources to examine the City's accounting practices, accounting records, policies and procedures to ensure that internal controls and other financial management practices conform to best practices. The City is also considering additional resources to complete a final review of prepared financials.

The City understands its responsibility to have adequate procedures in place for the preparation and review of the financial statements to ensure the accuracy of the financial statements.

Auditor's Remarks

We appreciate the City's commitment to resolve this finding and thank the City for its cooperation and assistance during the audit. We will review the corrective action taken during our next regular audit.

Applicable Laws and Regulations

Government Auditing Standards, December 2011 Revision, paragraph 4.23 establishes reporting requirements related to significant deficiencies or material weaknesses in internal control, instances of fraud or abuse, and noncompliance with provisions of law, regulations, contracts, or grant agreements.

The American Institute of Certified Public Accountants defines significant deficiencies and material weaknesses in its Codification of Statements on Auditing Standards, section 265, Communicating Internal Control Related Matters Identified in an Audit, paragraph 7.

RCW 43.09.200 – Local government accounting – Uniform system of accounting, gives the state auditor the authority to formulate, prescribe and install a uniform system of accounting and reporting for all local governments.

Budgeting, Accounting and Reporting System (BARS) manual, 3.1.3, Internal Control describes the responsibilities of governments and their management regarding internal controls.