Schedule of Audit Findings and Responses

Whitman County
January 1, 2013 through December 31, 2013

1. The County's internal controls over accounting and financial statement preparation are inadequate to ensure accurate reporting.

Background

County management is responsible for designing and following internal controls that provide reasonable assurance regarding the reliability of financial reporting. Our audit identified deficiencies in internal controls that adversely affected the County's ability to produce reliable financial statements.

Prior audits identified weaknesses in the financial statement preparation process that were reported to management. The County was unable to prepare materially accurate financial statements for fiscal years 2004 through 2007 and fiscal year 2012. Our audits also identified internal control deficiencies for fiscal years 2008 through 2011.

The County made improvements to its financial statement preparation controls, which reduced the impact of the internal control weaknesses, however, deficiencies still remain. The County was able to prepare materially accurate financial statements for fiscal year 2013.

Description of Condition

Our audit identified the following deficiencies in internal controls that, when taken together, represent a significant weakness:

- Departments responsible for preparing the financial information for the annual report do not fully and effectively communicate and collaborate to ensure the report is accurate and complete.
- Although improvement was noted, the County still lacks procedures to ensure monthly bank reconciliations are completed timely and discrepancies between the bank and accounting records are researched and resolved.
- The County lacks written policies outlining the expectations for journal entry authorization, documentation and review.
- The County does not have controls in place to ensure its financial transactions are accurately recorded in accordance with *Budgeting Accounting and Reporting*

System Manual (BARS) requirements. The County relies heavily on the year-end annual report preparation process to identify and correct errors, but this control is not effective.

- Personnel responsible for recording financial transactions did not fully understand the accounting software used and how the recording of cash transactions and journal vouchers impacts the accuracy of the accounting records.

- The County's internal control process for the review of the completed annual report is not effective. The process did not identify significant errors and inconsistences in the compiled financial information.

- Employees from three departments share the responsibility for preparing the annual report. County personnel responsible for the preparation of the supplemental schedules and portions of the footnote disclosures did not attend training and do not fully understanding the BARS manual requirements to ensure accurate reporting.

Cause of Condition

The County put forth significant efforts to improve accounting and reporting internal controls and processes; however, it has still not achieved effective controls in preventing significant errors and ensuring accurate financial management and reporting.

The County has a complex banking process which affects the County's ability to accurately record financial transactions and properly reconcile the accounting records to the bank records.

The accounting software does not have the functionality to close the accounting records each month. Accounting transactions can be dated and recorded in prior months, which provides additional opportunities for errors to occur.

The County's accounting software is intended for accrual accounting and the County reports on the cash basis. Further, the County established its own account code structure that is not aligned with BARS requirements. This requires a significant number of complex adjustments to the accounting records in order to prepare the annual financial report.

The County has assigned administrative rights in the computerized accounting system to the key personal responsible for financial activity recording and reporting. These rights allow the employee to circumvent the automated review process when posting financial data.

Effect of Condition

Inaccurate accounting records and financial reports limit access to financial information used by County officials, the public, state and federal agencies, and other interested parties. In addition, these conditions delay the audit process and result in increased audit costs. However the County's efforts to improve its accounting and reporting internal controls allowed it to improve the timeliness of its financial reporting by more than six months. We noted the following:

Accounting Records

- Since the accounting system does not have the functionality to close the accounting records, the County is unable to ensure the reports it generates to prepare the statements include only the financial activity for the reporting period. Depending on the report criteria selected, reports include differing amounts of financial activity. We were unable to determine which report was an accurate representation of the financial activity for the year.

- During the audit process over $200,000 of inaccurate accounts were identified in the general ledger.

Bank Reconciliations

- There is no evidence that bank reconciliations were prepared timely or reviewed for accuracy. Numerous errors were identified when reconciling cash and investments to general ledger activities.

- The Treasurer's Office prepares annual report schedules detailing receipt, disbursement, transfer and warrant activity. These schedules are used to support the financial activity reported in the bank reconciliations and financial statements. Inappropriate classification of transactions within the schedules categories limits the County's ability to ensure the financial statements are accurate.

- A comprehensive bank reconciliation compiled by a consultant and used by the Treasurer's Office to determine the accuracy of its bank reconciliation included unsupported and inaccurate reconciling items.

Journal Vouchers

- Two of the seven journal vouchers tested were not properly approved prior to recording to the general ledger.

- Reports generated by the computerized accounting system and used to validate the accuracy of the accounting records include amounts from proposed journal entries that have not actually been approved and recorded.

Financial Statements

- The County initially under-reported Beginning and Ending Cash and Investments by more than $800,000 due to the exclusion of some County funds and financial activity recording errors. After revisions, the County was still unable to identify the cause for an estimated understatement of $200,000 in Beginning Cash and Investments but Ending Cash and Investments was within $3,000.

- When comparing bank activity to amounts recorded in the financial statements, the County was unable to identify the cause for $200,000 in under-reported revenues and $600,000 in over-reported expenditures.

- Compensated Absences in the Schedule of Liabilities was originally under-reported by $47,594. This error was corrected

- Amounts reported in the notes including investments and reserved fund balances did not agree to the financial statements. These inconsistencies were partially corrected

Recommendation

We recommend the County continue with its efforts to improve its control structure by performing the following:

- Gaining an adequate understanding of the accounting system and its reports to ensure financial statements are based on accurate financial activity for each reporting period.

- Ensuring departments responsible for financial statement preparation collaborate to produce accurate accounting records and financial reports.

- Ensuring bank reconciliations for all bank accounts are completed timely and reconcile to the accounting records.

- Establishing and following written policies and procedures on the expectations and responsibilities related to the authorization, document and review of journal entries.

- Requiring all employees responsible for the preparation of components of the financial statements to attend training and utilize available tools and resources for financial statement preparation.

- Ensuring the prescribed controls and resources to prepare and review the financial statements and schedules result in accurate reporting.

County's Response

One major issue surrounding Whitman County's recent financial reporting issues was the fact that the county historically attempted to report on GAAP and within the last few years has reported on a Cash-Basis; however, many of the county processes never fully changed from accrual-based accounting to cash-basis. This created many incorrect background accounts within the system and many incorrect processes.

- *During 2013, the Auditor's office went through many of our accounting processes and singled out liability accounts that had been used to book revenue and expense into our accounting system. The Auditor's office was previously unaware of these transactions. Along with the 2013 BARS restructure, new accounts were created and the balances of these liability accounts moved to reportable accounts.*

- *We are continuing to update our processes to correctly report under cash-basis accounting. We have met with the State Auditor's Office Performance Center to review our processes and are contracting with the Government Finance Officers Association to work with us in updating our accounting policies and processes.*

Another issue leading to problems with our internal controls surrounds the fact that the Auditor's office has historically not had the ability to review and identify external cash movement transactions within county and non-county funds.

- *The county has begun to review accounts within the system that include comingled county and non-county funds. Updating these accounts and the processes that use these accounts will make it easier for the county to identify external cash movement. In addition, the county is reviewing the funds within the accounting system to ensure that correct background accounts are in use. The county has met with New World Systems, the county's accounting system vendor, to discuss modifications to the general ledger to update and correct these background accounts.*

Untimely and inaccurate bank reconciliations make it difficult to ensure that bank activity and our accounting system agree with each other before creation of the financial reports.

Auditor's Remarks

We appreciate the County's commitment to resolving these issues. 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.

Budget Accounting and Reporting System (BARS) Manual - Part 3, Accounting, Chapter 3. Accounting Principles and Internal Controls, Section 3. Controls over Financial Reporting, states:

> This objective refers to fair presentation of financial statement and required schedules in all material respects in accordance in with the stated basis of accounting.
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> In meeting this objective, the government should have controls that accomplish the following key functions:
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> - 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.

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:
>
> 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.