

# Schedule of Audit Findings and Responses

## City of Lakewood Pierce County January 1, 2006 through December 31, 2006

### 1. The City of Lakewood had inadequate controls over financial reporting.

#### Background

The City of Lakewood is the second largest city in Pierce County with a population of approximately 59,000. The City collected \$42.9 million in revenues and spent \$35.6 million in expenditures in 2006.

City management, the state Legislature, state and federal agencies and bondholders rely on financial statement information to reflect the entities position - enabling accurate decisions to be made. It is the responsibility of City management to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting. Our audit identified material weaknesses in controls that adversely affect the City's ability to produce accurate financial statements.

*Government Auditing Standards*, prescribed by the Comptroller General of the United States, require the auditor to communicate material weaknesses as a finding, as defined below in the Applicable Laws and Regulations section.

#### Description of Condition

We identified the following deficiencies in internal controls over financial reporting that represent a material weakness in accounting of financial transactions and the preparation of the 2006 financial statements:

- The City was unable to provide us with its 2006 financial statements until October 29, 2007, ten months after year end.
- Transaction-level and month-end controls over revenue recording did not prevent or detect numerous significant fund and account coding errors. Adjusting debit entries for the General, Hotel/Motel, and City Streets funds totaled \$536,146.55. Adjusting credit entries for the General, Hotel/Motel, and Arterial Streets Funds totaled \$282,279.79.
- The City was unable to provide accurate supporting documentation for the prior period adjustment of \$1.1 million and increases of \$4.8 million to the Governmental capital asset balances. The City was unable to identify or correct these errors without hiring a financial consultant.
- Our initial review of the financial statements, notes and the management's discussion and analysis revealed formula errors and omissions of required information that had not been detected by management. The City was unable to identify or correct these errors without hiring a financial consultant.
- The City reported a year end cash balance of \$39.3 million. At the time of our audit, the City was six months behind in ensuring general ledger balances matched those reported by its bank.

## **Cause of Condition**

In addition to key financial staff turnover, the City's internal controls were not sufficient to ensure accounting and financial reporting was performed in accordance with generally accepted accounting principles.

## **Effect of Condition**

Failure to ensure internal controls were in place and working as intended prevented the City from maintaining accurate and complete accounting records resulting in the City's inability to produce its 2006 financial statements. Deficiencies in internal controls make it reasonably possible that more significant misstatements could occur and not be prevented or detected by the City. Further, this lapse has prevented the City's citizens from effectively monitoring their government.

After our initial attempt to audit the City's financial statements, the City hired a consultant to aid in its correction. Our subsequent audit found the revised statements to be fairly presented and adequately supported. An unqualified opinion was issued.

## **Recommendation**

We recommend City management:

- Produce financial statements in a timely manner.
- Initiate review processes that will prevent financial statement errors.
- Ensure internal controls overseeing financial recording are working as intended.
- Perform bank reconciliations in a timely manner.

## **City's Response**

*The City of Lakewood appreciates the work the Auditor's Office has done in its audit. While the new SAS 112 standards bring to light weaknesses in financial controls that would not have been singled out for findings in the past, it is understood by the City that this new standard is aimed at strengthening public trust in the fiscal operations of its governing bodies.*

*The City found itself in the midst of a key personnel change at the time that the 2006 financial statements were due; the Chief Financial Officer had been in his position for less than two weeks at the initial filing deadline, and the City was in the process of searching for a new Finance Manager.*

*These conditions were not conducive to the seamless flow of information in a timely manner, and that lack of internal communication exacerbated the problems in generating accurate financial statements. Additional challenges were posed by the discovery of miscoding and other errors in initial bookings of ledger entries.*

*The City has undertaken steps to correct each of the deficiencies identified by the audit finding, and will continue to make improvements in internal processes to prevent these types of issues in the future. The City is currently*

- *Providing regular and continuing training on aspects of coding revenues and expenditures to all staff who receipt or code transactions, including those staff not directly in the finance department,*
- *Updating its procedures on documentation and communication of prior period corrections,*
- *Increasing resources to ensure catch up and continuous currency in its bank statement reconciliations,*

- *Updating internal controls in all aspects of transaction monitoring and adjusting journal entry approval, and*
- *Recoding and correcting transactions for fiscal year 2007 to ensure accuracy and timeliness in the Fiscal Year 2007 financial statements.*

*There is one statement that the City does not agree with in the Auditor's Office finding. The Auditor's Office states that "The City was unable to identify or correct these errors [in the 2006 financial statements] without hiring a financial consultant." This statement is an example of a "post hoc ergo propter hoc" logical error. The reason for the hiring of the consultant for work on corrections to the financial statements was simply one of workload and efficiency, not lack of skill or knowledge.*

*Additionally, the City would like to stress that the end result of the activities that the City undertook yielded financial statements that the Auditor's Office identified as "fairly presented and adequately supported" and those statements were granted an unqualified opinion.*

*Finally, the City would like to point out that during the audit process, there was not any identified evidence of fraud, any findings related to legal or regulatory compliance, nor any findings related to inappropriate use of public funds. These issues are also at the heart of public trust in their governing bodies, just as much as timely financial statements.*

### **Auditor's Remarks**

We thank the City for its response and appreciate the steps it is taking to resolve this issue. We will review this issue in the next audit.

### **Applicable Laws and Regulations**

RCW 43.09.200 states:

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. The system shall exhibit true accounts and detailed statements of funds collected, received, and expended for account of the public for any purpose whatever, and by all public officers, employees, and other persons. The accounts shall show the receipt, use, and disposition of all public funds properly, and the income, if any, derived there from; all sources of public income, and the amounts due and received from each source; all receipts, vouchers, and other documents kept, or required to be kept, necessary to isolate and prove the validity of every transaction; all statements and reports made or required to be made, for the internal administration of the office to which they pertain; and all reports published or required to be published, for the information of the people regarding any and all details of the financial administration of public affairs.

*Budget Accounting and Reporting System (BARS) manual – Part 3, Accounting, Chapter 1, Accounting Principles and General Procedures, Section B, Internal Control, states in part:*

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*, July 2007 Revision, Section 5.11, states in part:

For all financial audits, auditors should report the following deficiencies in internal control:

- a. Significant deficiency: a deficiency in internal control, or a combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.
- b. Material weakness: a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.