

Schedule of Audit Findings and Responses

City of Lakewood Pierce County January 1, 2007 through December 31, 2007

1. The City of Lakewood's internal controls over the preparation of its financial statements are inadequate.

Background

The City of Lakewood is the second largest city in Pierce County with a population of approximately 59,000. Budgeted revenues for 2007 were \$91.9 million.

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 ensure the reliability of financial reporting. Our audit identified a material weakness in controls that adversely affect the City's ability to produce accurate financial statements.

The City received a similar finding during the previous audit of their 2006 financial statements and has made improvements to the internal controls and continues to improve and correct many of the issues that occurred in the past.

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 significant deficiencies in internal controls over financial operations and reporting that represent a material weakness.

- The City did not have adequate internal controls to ensure accurate financial statements. A certified public accountant was hired to prepare the City's financial statements, but City personnel did not perform a final review of the statements for accuracy. As a result, multiple material errors were not found.
- In the past, the City did not have appropriate controls to ensure transactions were coded to the proper accounts. Current staff responsible for financial statement oversight were unable to correct these errors in a timely manner, which caused delays in reporting.

Cause of Condition

The City's management did not provide adequate oversight of the financial reporting process. Financial statements are the responsibility of management. As part of this responsibility, management has the obligation to ensure it has knowledgeable staff and internal controls and processes sufficient to accurately and completely present financial information.

Effect of Condition

The deficiencies noted above resulted in the City's inability to produce its annual financial report in a timely manner and without material errors. These deficiencies make it reasonably possible that significant misstatements could occur and not be prevented or detected timely by City management. We found the following errors in the original financial statements received for audit.

- A mathematical formula error in the Statement of Net Assets – Governmental liabilities resulting in a \$2.5 million understatement.
- Failure to reconcile changes made to the Reconciliation of Governmental Fund Balances to Net Assets of Governmental Activities resulted in a difference of \$2.1 million.
- The Statement of Revenues, Expenditures, and Changes in fund balances for Governmental funds misclassified revenue tax totals of \$458,988 and \$756,189.
- Non-current assets were not included in the Surface Water Management fund resulting in an understatement of \$24 million.
- The local improvement district, construction in progress fund should have been reported as a major fund but was erroneously reported as a non-major fund.

These errors were subsequently corrected by the City, which enabled us to issue an unqualified opinion.

The City's lack of internal controls over timely preparation of its financial information also resulted in the late filing of its annual financial report. The deadline specified in state law for filing the annual financial report is 150 days after the close of the fiscal year. However, we did not receive the City's 2007 financial statements until November 2008. This delay caused the City's 2007 audit to extend into January 2009.

Additionally, these delays forced the City to apply for multiple extensions of its federal audit due date, resulting in a "high risk" status for its 2008 and 2009 audits. This status could add significantly to future federal audit costs.

Recommendation

We recommend City management:

- Ensure procedures are in place in order to produce financial statements in a timely manner.
- Initiate review processes that will detect or prevent financial statement errors.
- Ensure finance staff receives sufficient training in the proper processing of accounting transactions and financial reporting requirements.

City's Response

The City of Lakewood appreciates the work the State Auditor's Office does in its service to the citizens of the City and the State. However, the SAS 112 finding that the Auditor's Office has issued as a result of its review of the City of Lakewood's 2007 Annual Financial Report does not accurately reflect the work that the City has done to correct many issues that occurred in the past.

Last year, the City was also cited for a SAS 112 finding, and in the City's response, we stated that we would make the following improvements:

- *Provide 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,*
- *Update its procedures on documentation and communication of prior period corrections,*

- *Increase resources to ensure catch up and continuous currency in its bank statement reconciliations,*
- *Update internal controls in all aspects of transaction monitoring and adjusting journal entry approval, and*
- *Recode and correct transactions for fiscal year 2007 to ensure accuracy and timeliness in the Fiscal Year 2007 financial statements.*

We feel that we have taken the steps to vastly improve all of these areas. The errors being singled out for the SAS 112 finding were arithmetic and formulaic in nature, not due to internal controls and procedures.

We thank the Auditor's office for its unqualified opinion on the 2007 Financial Statements, and the City of Lakewood looks forward to working on additional improvements in the future.

Auditor's Remarks

We thank City management for their cooperation and their efforts in the resolution of this issue. We will review the changes made during our 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 detected.

RCW 43.09.230 states in part:

The state auditor shall require from every local government financial reports covering the full period of each fiscal year, in accordance with the forms and methods prescribed by the state auditor, which shall be uniform for all accounts of the same class.

Such reports shall be prepared, certified, and filed with the state auditor within one hundred fifty days after the close of each fiscal year.