Schedule of Audit Findings and Responses

City of Seattle
King County
January 1, 2009 through December 31, 2009

1. The City of Seattle's internal controls over financial statement preparation are inadequate.

Background

City management including the Council and Mayor, the state Legislature, state and federal agencies, bondholders and other interested parties rely on the information in financial statements and reports to make decisions. The City Department of Executive Administration is responsible for the preparation of the Comprehensive Annual Financial Report (CAFR) that presents the City's financial position and results of its operations. The Department prescribes city-wide accounting policies and compiles the accounting information maintained by City departments. City management is responsible for designing and following internal controls that provide reasonable assurance regarding the reliability of financial reporting.

Our audit identified deficiencies in controls that adversely affect the City's ability to timely produce reliable financial statements. *Government Auditing Standards*, prescribed by the Comptroller General of the United States, require the auditor to communicate significant deficiencies, as defined below in the Applicable Laws and Regulations section, as a finding.

Description of Condition

We identified internal control deficiencies over preparation of the City's financial statements that resulted in the City having to correct financial information in the CAFR and other required reports. These errors generally were caused by an insufficiently detailed review of the financial information provided by decentralized departments for preparation of city-wide financial statements.

- The City has year-end accounts payable cutoff procedures which, if consistently applied by all the City departments, would increase the likelihood of all expenditures being accurately included in the financial statements. To ensure expenditures are accounted for in the appropriate period, the Department of Executive Administration's Accounting Services Division identifies 2010 payments of more than $100,000 potentially attributable to 2009 and requests the individual departments verify that they are charged to the correct year. However, we examined a selection of those transactions and noted the Division did not have sufficiently detailed information about the transactions to determine whether the departments are accurately accounting for them.

- Accounting Services Division's internal controls were not effective in preventing errors in reported capital assets of the Seattle Department of Transportation. The Accounting Services Division provides general procedures to departments to account for capital assets, but has no processes to ensure they are effective. The Department of Transportation currently has different processes for determining reportable capital assets and Accounting Services Division has insufficient resources to do a detailed review of Transportation's year end capitalization procedures and results.

- The Acounting Services Division's internal controls over preparation of financial statement includes a review. The Division uses a checklist as part of the review. However, the review was performed at a level that was not detailed enough to be effective in identifying errors in classification of interfund loans and capital expenditures in the Governmental Funds Balance Sheet. Also, the review process did not identify several presentation and classification errors in the budgetary comparison information required by accounting standards.

- The Accounting Services Division's internal controls were not effective in preventing errors in the Schedule of Expenditures of Federal Awards required by the U.S Office of Management and Budget. The Division has procedures for City departments to identify and report federal assistance program expenditures, but does not monitor their use to ensure the procedures are followed. As a result, Accounting Services is unable to verify the accuracy of financial information received from the departments before entering it on the Schedule.

Cause of Condition

Accounting Services Division employees do not have sufficient knowledge of each department's accounting practices and how the financial information used for the City's financial statements is generated. This was especially apparent for the Transportation Fund and the utility funds, as the Division referred our inquiries regarding specific transactions to individual departments.

City-wide accounting procedures for reporting of federal grant expenditures were not fully communicated to and understood by Seattle Public Utilities project managers and accountants. The Division does not follow up with City departments to ensure they understand accounting procedures and the method for determining current year federal grant expenditures.

Effect of Condition

The City is not fully able to prepare reliable financial statements. Financial statement users need accurate information in order to make informed decisions.

- Liabilities were reported in the wrong year and were underreported in the General Fund, Transportation Fund, and the Parks Fund.

    - Errors in the General Fund liabilities were about $1 million,

    - Transportation Fund's liabilities are understated by $146,147, and
    - Parks Fund underreported liabilities by $67,907.

- Assets and liabilities of the Low Income Housing Fund were underreported by more than $22 million because the once-a-year journal entry to record year-end balances was erroneous; the journal debit and credit lines were reversed.

- Expenditures of $2.4 million in federal funds were inaccurately reported on the Schedule of Expenditures of Federal Awards. The information identyfing the grant and the grant amount required correction.

- The Governmental Activities capital assets were misstated by about $743,040 in the Statement of Net Assets.

- The classification of actual expenses and revenues in the budgetary comparison information did not match the same information presented in other statements.

The corrections have been included in the final financial statements. However, the deficiencies in internal controls over financial reporting make it reasonably possible that other errors could occur and not be detected and corrected by City management.

Recommendation

Because the Accounting Services Division has responsiblity for the accounting practices of the entire City, the Division should have more in-depth involvement in ensuring decentralized departments' practices are consistent with city-wide policies. In addition, we recommend that the Division's financial statement review process be performed at a more detailed level.

Specifically, the Accounting Services Division:

- Should periodically reconcile the asset management system and the general ledger to ensure accounting records are up to date. Accounting Services' review of capital asset journal entries should include a comparison to source documentation.

- Should confirm the departments are providing accurate federal grant information by reviewing the award information first hand.

City's Response

Auditor's Remarks

Applicable Laws and Regulations

Budgeting, Accounting and Reporting System, Vol 1, Part 3, Chapter 1 provides guidance for establishing effective internal controls. It states, in part:

Internal control is a process – affected by those charged with governance, management and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Compliance with applicable laws and regulations
- Reliability of financial reporting

Management and the governing body are responsible for the government's performance, compliance and financial reporting. Therefore, the adequacy of internal control to provide reasonable assurance of achieving these objectives is also the responsibility of management and the governing body. The governing body has ultimate responsibility for ensuring adequate controls to achieve objectives, even though primary responsibility has been delegated to management.

Controls are normally most effective when built into the government's infrastructure rather than being treated as supplemental or separate processes. In the same way, implementation and monitoring of internal controls should not be viewed as a singular event, but rather a continuous or iterative process.

The Washington State Auditor's Office does not require specific controls to be implemented by entities. The State Auditor only requires that whatever controls entities choose to implement be adequate to provide reasonable assurance regarding compliance and financial reporting risks. The burden of demonstrating the adequacy of internal controls rests on management, since management is responsible both for the achievement of objectives and the determination of the design and operation of controls.

Ultimately, providing reasonable assurance of achieving compliance and financial reporting objectives is within the government's control and depends primarily on how well controls are designed and operated. Achievement of operational performance objectives also depends in large part on effective internal controls. By implementing effective controls a government can have reasonable assurance that it is doing all it can to meet its objectives.

Government Auditing Standards, July 2007 Revision – Paragraph 5.11 provides that auditors should report material weaknesses and significant deficiencies in internal control.

Statement on Auditing Standards No. 115, issued by the Auditing Standards Board of the American Institute of Certified Public Accountants, defines significant deficiency as follows:

a. Significant deficiency: A significant deficiency is 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.