

Schedule of Audit Findings and Responses

**City of Burlington
Skagit County
January 1, 2008 through December 31, 2008**

1. The City's controls are inadequate to ensure accurate accounting and financial reporting.

Background

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 a significant deficiency in controls that 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 significant deficiencies as a finding, as defined below in the Applicable Laws and Regulations section.

Description of Condition

In our audit of the City, we identified the following weaknesses in internal controls that, when taken together, represent a significant deficiency in controls over financial reporting:

- Segregation of duties: One employee is responsible for preparing the financial statements, reconciling bank statements to supporting documents, functioning as a signer on all accounts and has the capability to perform cash receipting functions and process manual warrants.
- This employee also has administrator-level rights to the City's accounting and budgeting software, allowing unrestricted access. The City's software has several functions that include budgeting, utility billings, business licenses, cemetery, receipting and payroll. No compensating controls are in place to offset this concentration of duties with one person.
- Accounting system access: Our audit found staff members had access to the accounting system beyond what was necessary to perform their jobs. Employees in the Accounting Department have the access needed to receipt money, adjust accounts and have full access to the billing system. Access to the City accounting software should be limited to what employees need to do their assigned work and monitored by supervisory personnel.

- Billing system adjustments: City staff did not print reports from the accounting system showing all adjustments made to ensure they were accounted for and independently reviewed by an authorized employee.
- Financial statement preparation: The City's review process of the year-end financial statements is not adequate to detect and correct errors.

We did not identify compensating controls for the weaknesses described above.

Cause of Condition

The controls established by the City over financial functions are not effective to detect errors and ensure the accuracy and reasonableness of the financial reporting.

Effect of Condition

The control deficiencies identified above increase the risk that:

- Misappropriation, misuse and errors could occur by not limiting or monitoring staff's software capabilities and lacking appropriate independent review of critical control processes such as bank statement reconciliations.
- The City's financial information is not secure. Without limitation of access and effective monitoring, the City cannot ensure unauthorized entries or changes to the accounting system have not occurred.
- Account adjustments in the billing system are not accurate, properly authorized and accounted for.
- The City's financial information may contain errors that will not be detected by City personnel. We noted a number of errors in the presentation of the financial statements and supporting schedules that were not detected by City personnel, including:
 - A \$6,950,000 general obligation bond was left off of the City's Schedule of Long-Term Debt.
 - The City incorrectly classified \$1,525,000 in other financing uses as capital outlay expenditures within the Sewer Fund.
 - The City incorrectly classified \$300,000 in other financing uses as non-expenditures within the Capital Improvement Fund.

The errors noted above were subsequently corrected by the City.

Recommendation

We recommend the City:

- Establish and follow internal controls to ensure adequate oversight and independent review over financial reporting, including a detailed review of critical internal control processes and the City's financial statements.
- Ensure employees' access to the City's accounting software is limited to only those capabilities necessary to perform their assigned duties and that the system access is adequately monitored.

- Establish policies and procedures governing the preparation and review of account adjustments to ensure the City can demonstrate that all adjustments have been independently reviewed for accuracy and appropriateness and properly recorded.

City's Response

Under the "Descriptions of Condition" section, the State Auditor has outlined four internal control weaknesses, that, when taken together, represent a deficiency in controls over financial reporting. Presented below are the individual conditions (in bold), followed by the City's response to each.

1. **Segregation of duties:** *One employee is responsible for preparing the financial statements, reconciling bank statements to supporting documents, processing manual warrants, functioning as a signer on all accounts and has the capability to perform cash receipting functions. This employee also has administrator-level rights to the City's accounting/budgeting software, allowing unrestricted access. The City's software has several functions that include budgeting, utility billings, business licenses, cemetery, receipting and payroll. No compensating controls are in place to offset this concentration of duties with one person.*

The City concurs that improvements should be made in this area. To address the State Auditor's concern, the City will implement the following procedures to bolster internal controls and improve oversight and review:

- *It has been the City's longstanding practice for the accounting manager to reconcile the monthly bank statements, which are then reviewed by the Finance Director. The Finance Director will now reconcile the monthly bank statements, and then someone independent of the accounting function will review said reconciliations.*
 - *The City is now getting by with antiquated financial software that is no longer supported by the company that wrote it. For the past couple of years, the City has budgeted for new financial software, but due to the economic downturn, budgets have been tight, and we have deferred this expenditure. The accounting manager is familiar with the current software, and thus has assumed the role of administering the financial software function. This role perhaps could be reassigned to another department, such as information services, but it would involve a steep learning curve; it would be more effective to transfer this administrator role upon purchase of a new financial software package, which is now long overdue.*
2. **Accounting system access:** *Our audit found staff members had access to the accounting system beyond what was necessary to perform their jobs. Employees in the Accounting Department have the access needed to receipt money, adjust accounts and have full access to the accounting system. Access to the City accounting software should be limited to what employees need to do their assigned work and monitored by supervisory personnel.*
- *It has been the City's longstanding practice to cross-train its finance staff so that there is adequate back up for each function; good customer service requires that when, for example, the person responsible for utility billings is out of the office*

due to vacation or illness, another staff person can step into this role and perform this function in their absence. This same concept applies to the other finance functions such as business licenses, cemetery, receipting and payroll. However, the City will review its current software access and limit access to the extent possible. Again, the City may have to assume some degree of internal control risk in order to provide quality customer service to its citizens through a well cross-trained staff.

3. *Billing system adjustments: City staff did not print reports from the accounting system showing all adjustments made to ensure that they were accounted for and independently reviewed by an authorized employee.*
 - *The City concurs and will review all authorized adjustments to ensure that they were accurately coded in the accounting system.*

4. *Financial statement preparation: The City's review process of the year-end financial statements is not adequate to detect and correct errors.*
 - *The City acknowledges that certain items were either omitted or not classified correctly, as detailed above under the section "Effect of Condition." To prevent this in the future, Statements C-4 and C-5 (Fund Resources & Uses Arising from Cash Transactions) will be independently prepared by the finance director and the accounting manager, and then compared to detect any potential misclassified items. Also, we will follow the checklist as provided by the State Auditor to ensure that debt as listed in the notes to the financial statements reconciles to the schedule of long-term debt.*

In closing, the City takes the issues described in this Schedule of Audit Findings and Responses seriously and will work diligently to get them resolved. We would like to thank the State Auditor for working with the City in a cooperative manner to address and improve our system of internal controls.

Auditor's Remarks

We appreciate the City's commitment to correcting the condition described. We will determine the status of the finding during 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 detected.