

REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Independent Auditors' Report

To the Housing, Health, Energy and Workers' Rights Committee
The City of Seattle - City Light Department
Seattle, Washington

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the City of Seattle - City Light Department (the "Department") as of and for the year ended December 31, 2018, and have issued our report thereon dated May 16, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is 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. *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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described below, that we consider to be significant deficiencies.

The Department has certain financial reporting processes and related internal controls that are completed by and dependent on the City of Seattle management. The following significant deficiency relative to financial reporting was determined as a result of procedures performed by the State Auditor of Washington over the City of Seattle's control environment and is included below in its entirety.

2018-001 The City's internal controls over accounting and financial statement preparation were inadequate to ensure accurate and complete financial reporting.

Criteria

The Mayor, City Council, state and federal agencies, and the public rely on the information included in the financial statements and reports to make decisions.

City management is responsible for designing, implementing and maintaining internal controls to ensure financial statements are prepared and fairly presented in accordance with generally accepted accounting principles (GAAP).

Condition

Government Auditing Standards requires the auditor to communicate significant deficiencies as a finding. We identified the following deficiencies in internal controls over financial reporting that, when taken together, represent a significant deficiency:

Controls over cash and investments

Bank accounts

The City did not provide us with a complete list of all its active bank accounts. Without a complete list, the City cannot ensure accurate tracking and monitoring of all its established bank accounts for financial reporting purposes.

Bank reconciliations

The bank reconciliation process serves to verify the integrity of the data between bank records and the City's financial records by comparing actual bank statements to the City's accounting records. The goal of the process is to ascertain the differences between the two and to adjust the City's records as appropriate for the period to determine the actual amount of cash on hand.

Timeliness of bank reconciliations

The City did not perform fully complete monthly bank reconciliations during the 2018 fiscal year. The City completed the reconciliation of the entire 2018 fiscal year early in 2019 instead of the past practice of performing monthly reconciliations. With this approach, there was not a timely formal review to support management approval of the reconciliations to detect and correct possible errors in a timely manner.

The City has high volumes of cash transactions occurring monthly. In December 2018, the City had over 6,000 transactions with about \$1.4 billion of cash deposited and credited to its primary accounts. With the City's size and cash volume, monthly reconciliations are essential to help identify any unusual transactions that can be caused by misappropriation, accounting errors, or bank errors.

Accuracy of bank reconciliations

The City did not present accurate monthly bank reconciliations. For the past several years, staff performing the reconciliation have balanced City accounting records and bank amounts without presenting whether reconciling items belong in the same period. Staff reconciliations included deposits in transit and outstanding checks that have already cleared the bank on the bank side and reconciling items for adjustments that have already been included in the City's accounting records. Period dates were recognized and captured in the reconciliation process, but were not clearly presented in the final documentation.

Payroll and voucher funds reconciliation

The City did not perform monthly reconciliations for its payroll and voucher funds during the 2018 fiscal year, but rather at the end of the calendar year.

The City had various zero-balance accounts used for its clearing funds, two of which included the payroll and voucher funds. The Budgeting, Accounting and Reporting System (BARS) Manual requires GAAP entities to perform monthly reconciliations between the funds and the zero-balance accounts to help identify and resolve any differences for the period.

Comprehensive bank reconciliation

The City did not perform a comprehensive cash reconciliation, but rather performed separate reconciliations of categories of cash such as the operating cash, petty cash and change funds, revolving funds, and investments.

With a cash and investments portfolio of \$2.3 billion, and multiple bank accounts deposited with several financial institutions handled by various department custodians, a comprehensive cash reconciliation between City records and bank records is necessary to ensure the City reports its cash and investments completely.

Reporting of cash and investments

Custodial funds

The City did not completely report all money held in a custodial capacity in its financial statements. Entities reporting under GAAP must report custodial funds in their financial statements.

Cause

- The City implemented a new financial system at the beginning of the year. With this launch came learning opportunities in how the City should bill and transfer funds between the business units. While the City has been working to stabilize its process, departments have been booking cash receipts from other departments that have not been recognized as cash disbursements from the payor department.
- The City Finance Division did not have formal procedures in place for establishing new bank accounts.

- The City Finance Division relies on City departments to accurately record entries in the City's accounting records in order to perform its reconciliation and this was challenging in 2018 with a complete change in chart of account values and business processes as a result of the financial system replacement.
- The City changed its accounting software at the beginning of 2018, and departments found it challenging to adapt to the new modules and business processes. As a result, City Finance staff were not able to run accurate monthly cash reports to perform timely bank reconciliations, nor was management able to perform timely reviews.
- The City Finance Division's purpose for performing the reconciliation bank to cash receipt system entries was to match City accounting records and bank amounts on a transactional level for management's assessment and not for financial statement reporting purposes. As a result, staff reconciliations did not include true reconciling items pertaining to the period.
- The City's Finance Division experienced turnover in its accounting staff over the past several years; at the same time, staff continued efforts to integrate a new accounting system into the City's existing processes. As a result, staff have not been able to dedicate sufficient time to perform timely reconciliations of its clearing funds or year-end investments.
- The City's controls over cash entries are highly decentralized which contributes to the complexity of timing differences. As a result, the City did not perform a timely comprehensive cash reconciliation to substantiate its cash and investments portfolio.
- The City Finance Division prepares the City's comprehensive financial statements, consisting of over 150 funds belonging to 40 City departments, in accordance with GAAP. These statements are complex, with frequently changing requirements. The Division did not have the formal authority to enforce reporting and accounting policies for the City and relied on other City departments to report transactions and events accurately in the general ledger. As a result, City departments made decisions on the reporting status of certain funds and balances that were inconsistent with GAAP.

Effect

Inaccurate financial reports limit access to financial information used by City officials, the public, state and federal agencies, and other interested parties. They also hinder the audit process and increase audit costs. A lack of a timely formal review of bank reconciliations also reduces the opportunity for management to detect and correct possible errors in a timely manner.

We identified the following misstatements during the audit:

- The City overstated its cash by \$5,434,693; the amount reported on the financial statements is higher than amounts confirmed by external bank confirmations. The City could not provide supporting documentation to substantiate the variance.
- The City did not report a total of \$6,869,330 funds held in a custodial capacity by the Seattle City Light, Seattle Police, and Seattle Municipal Courts departments. This amount is independent from the City's overstated cash balance.

- The City Finance Division did not track five bank accounts. These accounts do not have City funds deposit activity.

Recommendations

We recommend the City:

- Dedicate adequate resources for staff to gain the technical knowledge needed to perform adequate bank reconciliations and reconcile City bank statements to financial activity monthly to ensure accurate financial reporting.
- Perform a Citywide comprehensive bank reconciliation to ensure adequate substantiation of cash and investment amounts presented on the financial statements.
- Grant the City Finance Division formal authority over the accounting and reporting process, including implementation of accounting policies, to ensure financial statements are prepared and reported in accordance with GAAP.
- Establish a policy to ensure the proper establishment of new bank accounts and to ensure accurate tracking and monitoring of all of its established bank accounts for financial reporting purposes.

City of Seattle's Response

We thank the State Auditor's (SAO) staff for their assessment and recommendations. We agree with the SAO staff assessment of our capacity to complete monthly reconciliations during the first half of 2018.

The City implemented a new financial system in 2018. The new system requires City staff across all departments to use standard chart of account values and comply with standard financial business processes. As SAO staff point out, prior to 2018 the execution of financial transactions was the responsibility of department staff with only partial oversight by the City Finance Division (CFD). The implementation of the new financial system required all City staff in 2018 to adjust to new standards and processes, including CFD staff.

We concur that at the start of 2018 the CFD was not fully prepared to execute reconciliations necessary to ensure completely the integrity of financial data on a monthly basis. CFD staff implemented more complete reconciliation processes by mid-year 2018 and share with SAO staff confidence in the City's financial reporting for 2018.

In addition, CFD staff have identified specific causes that led to the overstatement described by SAO staff. These causes have to do with accounts receivable processing and interdepartmental billing. CFD staff will implement new streamlined procedures for these areas by the third quarter of 2019.

In 2019 the City completes monthly cash reconciliations on a timely basis and continues to look for opportunities to create efficiencies in reconciliation and improvements in presentation along with mastery of the processes by CFD staff. In addition, the City will complete *comprehensive* cash reconciliations in a manner consistent to what SAO staff recommend. Finally, the City agrees with the recommendation to create a formal policy for the establishment and reconciliation of all bank accounts. This policy is in the final stages of adoption and will govern accounts holding non-City money described by SAO staff as well as accounts for City funds.

City of Seattle - City Light Department's Response

The Department's management has reviewed the observations and recommendations noted by SAO. The Department's Accounting Division staff will work and coordinate with CFD to address all information and other requests. The goal will be for CFD to be able to perform cash related reconciliations and financial reporting timely and consistently for all departments effective in 2019. The Department will also request copies of monthly bank reconciliations performed by CFD so that the Department's Accounting Division staff can perform a reasonable review of the bank reconciliations to ensure amounts allocated to the Department agree with the Department's general ledger for cash related accounts monthly.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the Department are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Department in a separate letter dated May 16, 2019.

The Organization's Responses to Finding

The Organization's responses to the finding identified in our audit are described in the accompanying schedule of findings and questioned costs. The Organization's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
May 16, 2019