CITY OF KIRKLAND
Department of Finance & Administration
123 Fifth Avenue, Kirkland, WA 98033 425.587.3100
www.ci.kirkland.wa.us

MEMORANDUM

To: David Ramsay, City Manager

From: Tracey Dunlap, Director of Finance and Administration

Date: December 13, 2007

Subject: 2006 Audit Report, Performance Audit, and Comprehensive Annual Financial Report (CAFR)

BACKGROUND DISCUSSION:

The State Auditor's Office (SAO) performs an annual audit to determine whether the City complied with state laws and regulations, its own policies and procedures, and Generally Accepted Accounting Principles (GAAP). City management's accountability of public resources is also examined. On June 27, 2007, the SAO issued an unqualified opinion following the completion of their audit for the period of January 1, 2006 through December 31, 2006.

This memo provides information on the CAFR, an overview of the audit results, and an update on the fire overtime performance audit.

Comprehensive Annual Financial Report (CAFR)

The CAFR represents the City's financial position as of December 31, 2006. In addition to the "numbers", the Notes to the Financial Statements and the Statistical Section provide a great deal of written information on various aspects of the City's finances. Copies of the 2006 CAFR document have been placed in the City Council mailboxes and the document is available on the City's website and at City Hall. We have applied for the GFOA Excellence in Financial Reporting award and hope to be notified of the results shortly. The City has received this award for the previous two years.

2006 Audit Results

As part of the audit, the State Auditor's Office performed 3 separate reviews, which are summarized in the Financial Statements Audit Report and Accountability Audit Report. The areas examined include:

- Financial Statements
- Compliance with state laws and regulations and entity policies
- Accountability for public resources

The Accountability Audit Report stated that the City complied with state laws and regulations and its own policies and procedures in the areas examined and that internal controls were adequate to safeguard public assets.

As noted earlier, the City received an unqualified ("clean") opinion on the 2006 Comprehensive Annual Financial Report.

In May 2006, the American Institute of Certified Public Accountants issued its Statement on Auditing Standards (SAS) No. 112, Communicating Internal Control Related Matters Identified in an Audit. Background descriptions of SAS 112 and its impacts are provided in Attachment A. There was a finding issued as part of the City's 2006 audit that is based on the SAS 112 standard, which is a different type of finding from those issued in the past (note that the City last received a finding in the 2000 audit).

In brief, the finding is based on the fact that services provided but not billed at the end of the period have not been recorded in the Solid Waste Fund accounts receivable. Historically, the City has reported accounts receivable based on services billed but not collected at the end of the period. The change increased the Accounts Receivable by $883,968, an increase in Fund Assets of 63%, which was determined to be material. In essence, the financial position of the fund was understated. The significance of the percentage change in Fund Assets occurs because the City contracts with a private provider for the majority of services accounted for in the Solid Waste Fund. As a result, the City has minimal assets in the Solid Waste Fund, accounting for the large percentage change. Due to the materiality of this change, the City made this correction.

This new audit standard has resulted in a larger number of this type of finding in government audits. We believe that the items identified by the audit, which reflect long-standing City practices, would not have been a finding under the previous standards (the State Auditor's Office has acknowledged this verbally). That said, we appreciate the identification of the issue and will take steps to review our utility accounting practices and, as needed, improve internal controls. The draft audit reports (which only contains portions of the final audit report) are included as Attachment B and includes the details of the finding and the City's response.

The 2006 audit was officially concluded with the exit conference on November 28, 2007. At the exit conference auditors discuss items of concern which are not significant enough to include in the audit report. There was one exit item which was highlighted as follows: As authorized under RCW 35.21.685, the City purchased a condominium in the Plaza on State complex that was being sold as part of the property owner's bankruptcy to place it back into the City's affordable housing stock for those with an income of less than 80% of median income. The auditor's review uncovered the fact that the covenant the purchaser signed only required that he be at 90% of median income. Further investigation by the City Attorney's office indicated that the purchaser was actually at or below 80% of median so it was a "no harm, no foul" situation. It is the State Auditor's contention that although the purchaser met the statutory requirements, the City should have controls in place to ensure contracts comply with state statutes. The City will enter into discussions with A Regional Coalition for Housing (ARCH) to explore ways in which the controls required by the Auditor's office can be exercised by the City without impacting the mission and efficiency of ARCH.

Performance Audit – Fire Overtime

The passage of Initiative 900 (I-900) authorized the State Auditor to conduct independent, comprehensive performance audits of state and local government. The City of Kirkland was one of the jurisdictions selected to be audited for its use of overtime in the Fire Department. The State Auditor has chosen to suspend activity on this audit and, while they did not actually provide a report of their review, they provided input on their observations regarding public safety overtime at the November 28, 2007 exit conference (see Attachment C). Since no report is expected to be issued, there is no requirement to hold a public hearing. It is important to note that significant City staff time, in the Finance, IT, and Fire departments, was invested in providing information for this effort and we appreciate the support of all City staff involved.

Conclusion

The City takes great care to prepare financial statements that are accurate and reliable. The City of Kirkland prides itself on its strong financial condition and sound management, both of which are recognized in our bond rating, the certification of our investment policies, and the receipt of distinguished budgeting and financial reporting awards. We strongly believe that appropriate steps have been taken to address identified issues and we will keep the Finance Committee informed as we enter into the 2007 audit process.

Attachments

GFOA Recommended Practice

Mitigating the Negative Effects of Statement on Auditing Standards No. 112 (2007) (CAAFR)

Background. In May 2006, the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) issued Statement on Auditing Standards No. 112, *Communicating Internal Control Related Matters Identified in an Audit*. This new pronouncement significantly increases the likelihood that a government's independent auditors may be required to report either a *significant deficiency*[1] or a *material weakness*[2] in conjunction with the financial statement audit.

SAS No. 112 clarifies that it is *not* sufficient that the independent auditor determine that the financial statements under audit are, in fact, *fairly presented* in accordance with generally accepted accounting principles (GAAP). Generally accepted auditing standards (GAAS) also require that the financial statements be the product of a financial reporting system that offers reasonable assurance that management is able to produce financial statements that comply with GAAP.

Independent auditors often assist clients with the preparation of their financial statements. Such assistance poses no problem if it is provided merely a matter of convenience (i.e., management could produce the financial statements, but chooses not to). However, such assistance will constitute either a significant deficiency or a material weakness under SAS No. 112 if it is provided as a matter of necessity rather than of convenience (i.e., management does not have the skills needed to prepare GAAP financial statements).

If management does not possess the skills to prepare GAAP financial statements on its own, the government could always choose to engage the services of someone other than the independent auditor to provide the needed assistance. Because such contractors would work for management (unlike the *independent* auditors) they would qualify as part of the government's financial reporting system, thus avoiding an automatic finding of a significant deficiency or material weakness.

SAS No. 112 also makes it clear that material auditor-identified audit adjustments typically will require that a significant deficiency or material weakness be reported.

Recommendation. The GFOA recommends that governments take into account the following considerations in crafting a strategy for minimizing any potential negative effect resulting from the implementation of SAS No. 112.

- ***Be prepared to provide evidence that the government has a sound financial reporting system in place.*** GFOA recommends that a government establish and document a system of financial reporting that is sufficient to provide reasonable assurance that management is able to prepare financial statements in conformity with GAAP. Appropriate criteria for evaluating the adequacy of a government's financial reporting system can be found in *Internal Control: Integrated Framework*, published by the Council of

[1]"A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles 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."

[2]"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."

Sponsoring Organizations of the Treadway Commission (COSO).[3] In particular, the financial reporting system should incorporate an anti-fraud program and controls, as well as ongoing internal audit/risk assessment activity commensurate with the size and complexity of the entity.

- ***Minimize the likelihood of material audit adjustments.*** Every practical step should be taken to minimize the possibility of material auditor-initiated audit adjustments. For example, a government should carefully review its cutoff procedures and the method it uses to uncover unrecorded liabilities at the end of the fiscal period (items found by the auditor rather than by management could result in a significant deficiency or material weakness being reported). Special care also should be taken to ensure the timely and effective implementation of new accounting standards.

- ***Review any financial statement preparation assistance provided by the independent auditors.*** If management chooses to make use of the services of the independent auditors in helping to prepare the financial statements as a matter of convenience, it should carefully document that a staff member with the requisite skills has reviewed all of the work performed by the auditor (e.g., by completing the GFOA financial reporting checklist or by using some similar review tool). If management does *not* have the skills necessary to prepare GAAP financial statements and desires the assistance of its independent auditors to help it do so, but without exposing itself to the risk of an automatic significant deficiency or material weakness, it may wish to consider obtaining the services of a consultant or some other outside party (e.g., retiree volunteer) to review the auditor's work on the government's behalf.

The GFOA does *not* recommend that governments engage the services of a second accounting firm to assist in preparing its financial statements solely to avoid having a significant deficiency or material weakness reported. It is by no means assured that the benefits of engaging a second firm would outweigh the costs. Moreover, a significant deficiency or material weakness might still be reported as the result of some other weakness in the financial reporting system (e.g., auditor-discovered audit adjustment), which could defeat the purpose of hiring the second firm.

If management decides that the costs of remedying a significant deficiency or material weakness in its financial reporting system cannot be justified by the benefits to be obtained, it should take care to alert the governing body as early as possible to explain its conclusion. In that case, governments subject to a Single Audit should explore the possibility of obtaining a waiver pursuant to paragraph 530c of U.S. Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," so as not to jeopardize the audit's "low risk" status.

Approved by the GFOA's Executive Board, October 19, 2007.

[3] The guidance offered in this report is discussed and applied specifically to local governments in the GFOA publication *Evaluating Internal Controls: A Local Government Manager's Guide.*

Attachment B
DRAFT

Washington State Auditor's Office

Financial Statements Audit Report

City of Kirkland
King County

Audit Period
January 1, 2006 through December 31, 2006

Report No.

Issue Date
September 2, 2007

Washington State Auditor
Brian Sonntag

Issue Date – (Issued by OS)

Council
City of Kirkland
Kirkland, Washington

Report on Financial Statements

Please find attached our report on the City of Kirkland's financial statements.

We are issuing this report in order to provide information on the City's financial condition.

In addition to this work, we look at other areas of our audit client's operations for compliance with state laws and regulations. The results of that audit will be included in a separately issued accountability report.

Sincerely,
Signature Here (Please do not remove this line)
BRIAN SONNTAG, CGFM
STATE AUDITOR

Insurance Building, P.O. Box 40021 • Olympia, Washington 98504-0021 • (360) 902-0370 • TDD Relay (800) 833-6388
FAX (360) 753-0646 • http://www.sao.wa.gov

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King County
January 1, 2006 through December 31, 2006

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Schedule of Audit Findings and Responses

City of Kirkland
King County
January 1, 2006 through December 31, 2006

1. The City should improve internal controls over its financial statement preparation.

Background

City management, the state Legislature, state and federal agencies and bondholders rely on the information included in financial statements and reports to make decisions. It is the responsibility of City management to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting. Controls must ensure that financial data is reliably authorized, processed and reported. Our audit identified a significant deficiency in controls that adversely affects the City's ability to 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. This guidance became effective during the City's fiscal year 2006 audit. The new standard sets a lower threshold for the types of control deficiencies that are reported.

Description of Condition

We identified the following weaknesses in internal controls that, when taken together, represent a significant deficiency in controls over financial reporting:

- The City did not provide sufficient analysis over the composition of accounts receivable. As a result, services provided but not billed at the end of the period were not recorded in the Water/Sewer Fund, the Solid Waste Fund and the General Fund. This is a departure from generally accepted accounting principles, set by the American Institute of Certified Public Accountants which require unbilled revenues to be recorded at the end of the period. The discrepancy affects utility revenues for the year and accounts receivable balances at the end of the year.

- The City did not perform a sufficient detailed review and reconciliation of the financial statements to ensure they were accurate, complete and adequately supported.

Cause of Condition

The City's review process was not adequate to detect errors in the financial statements and notes; and ensure the utility receivables were reported in accordance with generally accepted accounting principles.

Effect of Condition

The City's financial information contained errors that were not detected by City personnel. During our review of the City's financial statements, we found the following significant error in the original financial statements we received for audit.

- For the Solid Waste Fund, the accrual of revenues increased revenues by $883,968; which is an increase in Fund Revenues of 1.2%, an increase to Accounts Receivable by $883,968, which is an increase in Fund Assets of 63%. .

We also found the following related immaterial errors

- For the Water/Sewer Fund, the accrual of revenues would increase revenues by $66,326; which would be an increase in Fund Revenues of .43%, an increase to Accounts Receivable of $2,081,600; which is an increase in Fund Assets of 2%

- The City collects a Utility Tax for the General Fund, which was also not accrued. The affect of this discrepancy is an increase in Revenues of $163,212; which is an increase of Fund Revenues of .45%, which is an increase in Fund Assets of 2.5%.

Due to the significance of the error in the Solid Waste Fund Accounts Receivable, the City made this correction. The remaining errors were considered immaterial and were not corrected.

There were additional immaterial errors noted that were corrected by the City. These deficiencies in internal controls make it reasonably possible that more serious misstatements could occur and not be prevented or detected by the City in the future.

Recommendation

We recommend the City's management implement internal controls to ensure adequate oversight of financial reporting, including a detailed review of the financial statements. The City should consult with the State Auditor's Office Budgeting Accounting and Reporting System Manual to ensure financial statements are properly presented.

City's Response

The City appreciates the efforts of the State Auditor's Office to work with the City to understand recent changes in audit standards which form the basis for this finding and for the opportunity to provide this response. In May 2006, the American Institute of Certified Public Accountants issued its Statement on Auditing Standards (SAS) No. 112, Communicating Internal Control Related Matters Identified in an Audit. SAS 112 has lowered the bar to the extent that errors that may not have been previously reportable may now be considered reportable simply because there is the potential for misstatement. The City believes that the items identified by the audit would not have been a finding under the previous standards and, in fact, the accounts receivable issue identified reflects a long-standing practice of the City. That said, we appreciate the identification of the issue and will take steps to review our utility accounting practices and, as needed, improve internal controls, as described below.

As a matter of clarification, the error determined to be material for the Solid Waste Fund is based on an increase to Accounts Receivable by $883,968, which is an increase in Fund Assets of 63%. The significance of the percentage change in Fund Assets occurs because the City contracts with a private provider for the majority of services accounted for in the Solid Waste Fund. As a result, the City has minimal assets in the Solid Waste Fund, accounting for the large percentage change. Due to the materiality of this change, the City made this correction. A similar condition existed in the Water/Sewer Fund and in the Utility Tax revenues for the General Fund, although the

magnitude of the impacts was immaterial to those funds. As a result, no change was made in these statements but will be addressed in the next reporting period.

The utility statements are prepared by the Public Works Department and reviewed by the Finance Department, although this review has not previously included a "bottom up" review from the base data. The utility receivables reporting inconsistency resulted from the use of utility billing reports that summarized revenues "billed but not collected" rather than service provided but "unbilled." This inconsistency has existed for many years but was only detected in this audit cycle due to a review of the base data in response to a different issue. As a result, the Finance Department will undertake a detailed review of the utility accounting practices and will provide a greater level of oversight to the utility accounting function in the future.

A contributing factor to the "additional immaterial errors" was the departure of the Financial Operations Manager, responsible for oversight of statement preparation, at the beginning of the audit (March 2007). This resulted in the Senior Accountant (who has prepared the statements for the past six years) filling the position on an interim basis during the audit. While the statements were prepared consistent with the City's past practices, without any significant accounting changes, and the statements were reviewed by the Finance Director, the lack of the additional level of review may have contributed to the immaterial errors. Several of the immaterial errors were presentation issues that existed in prior statements.

The City believes that both of these conditions have been addressed by the results of a re-organization of the Department of Finance and Administration that was implemented by management effective July 1, 2007. This change in the organization structure increases the focus on internal controls in accounting by:

- *Creating a Deputy Director of Finance position that will oversee day-to-day operations, including accounting and audit functions;*
- *Changing the Financial Operations Manager position to an Accounting Supervisor position focused only on accounting and audit functions and responsible for review of the statements prepared by the Senior Accountant; and*
- *Adding resources in the accounting division to help absorb the impacts of increased review of internal controls and performance audit preparation.*

The City takes great care to prepare financial statements that are accurate and reliable. The City staff responsible for preparing the statements are competent and have never intentionally failed to follow proper accounting and reporting guidelines. The City of Kirkland prides itself on its strong financial condition and sound management, both of which are recognized in our bond rating, the certification of our investment policies, and the receipt of distinguished budgeting and financial reporting awards. The City appreciates the SAO's critical review and insights as to how we can improve the presentation of our financial condition.

Auditor's Remarks

We thank City officials for the assistance we received during the 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, or other persons.
>
> The accounts shall show the receipt, use, and disposition of all public property, and the income, if any, derived therefrom; 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 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, January 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 combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is a more than 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...

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters in Accordance with *Government Auditing Standards*

I-2
City of Kirkland
King County
January 1, 2006 through December 31, 2006

Council
City of Kirkland
Kirkland, Washington

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Kirkland, King County, Washington, as of and for the year ended December 31, 2006, which collectively comprise the City's basic financial statements, and have issued our report thereon dated June 26, 2007.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies involving the internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control over financial reporting. We consider the deficiency described in the accompanying Schedule of Audit Findings and Responses to be a significant deficiency in internal control over financial reporting, and is reported as Finding 1.

A material weakness is 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 by the City's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of the City's 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.*

This report is intended for the information and use of management and the Council. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

Signature Here (Please do not remove this line)
BRIAN SONNTAG, CGFM
STATE AUDITOR

June 26, 2007

Independent Auditor's Report on Financial Statements

F-1
City of Kirkland
King County
January 1, 2006 through December 31, 2006

Council
City of Kirkland
Kirkland, Washington

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Kirkland, King County, Washington, as of and for the year ended December 31, 2006, which collectively comprise the City's basic financial statements as listed on page { }. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Kirkland, as of December 31, 2006, and the respective changes in financial position and, where applicable, cash flows thereof and the respective budgetary comparison for the General Fund, Street Operating Special Revenue Fund, Parks and Municipal Reserve Special Revenue Fund, and Excise Tax Capital Improvement Special Revenue Fund funds, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages through is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Signature Here (Please do not remove this line)
BRIAN SONNTAG, CGFM
STATE AUDITOR

June 26, 2007

Financial Section

City of Kirkland
King County
January 1, 2006 through December 31, 2006

REQUIRED SUPPLEMENTAL INFORMATION

Management's Discussion and Analysis – 2006

BASIC FINANCIAL STATEMENTS

Statement of Net Assets – 2006
Statement of Activities – 2006
Balance Sheet – Governmental Funds – 2006
Statement of Revenues, Expenditures and Changes in Fund Balance – Governmental Funds – 2006
Reconciliation of Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balance to the Statement of Activities – 2006
General and Major Special Revenue Fund Budgetary Comparisons – 2006
Statement of Net Assets – Proprietary Funds – 2006
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Statement of Fiduciary Net Assets – 2006
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Notes to Basic Financial Statements – 2006

SUPPLEMENTAL INFORMATION

Attachment B
DRAFT

Washington State Auditor's Office

Accountability Audit Report

City of Kirkland

King County

Report Date
July 26, 2007

Report No.

Issue Date

WASHINGTON
BRIAN SONNTAG
STATE AUDITOR

Washington State Auditor
Brian Sonntag

{Issue Date – (Issued by OS)}

Council
City of Kirkland
Kirkland, Washington

Report on Accountability

Please find attached our report on the City of Kirkland's accountability and compliance with state laws and regulations and its own policies and procedures.

In addition to this work, we also audit the City's financial statements. The results of that audit will be included in a separately issued audit report.

Sincerely,
Signature Here (Please do not remove this line)
BRIAN SONNTAG, CGFM
STATE AUDITOR

Insurance Building, P.O. Box 40021 • Olympia, Washington 98504-0021 • (360) 902-0370 • TDD Relay (800) 833-6388
FAX (360) 753-0646 • http://www.sao.wa.gov

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King County
July 26, 2007

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Audit Summary

City of Kirkland
King County
July 26, 2007

ABOUT THE AUDIT

This report contains the results of our independent accountability audit of the City of Kirkland.

We performed audit procedures to determine whether the City complied with state laws and regulations and its own policies and procedures. We also examined City management's accountability for public resources. Our work focused on specific areas that have potential for abuse and misuse of public resources.

Areas examined during the audit were selected using financial transactions from January 1, 2006, through December 31, 2006.

RESULTS

The City complied with state laws and regulations and its own policies and procedures in the areas we examined. Internal controls were adequate to safeguard public assets.

RELATED REPORTS

Our opinion on the City's financial statements {and compliance with federal program requirements} is provided in a separate report, which includes the City's financial statements.

CLOSING REMARKS

We thank City officials and personnel for their assistance and cooperation during the audit.

Description of the City

City of Kirkland
King County
July 26, 2007

ABOUT THE CITY

The City of Kirkland serves approximately 45,790 residents within King County. The City is located on the east shore of Lake Washington, off Interstate 405 in northern King county, 10 miles east of downtown Seattle, west of Redmond, and just north of Bellevue. The City has a council-manager form of government, with seven part-time, nonpartisan members, elected at large every two years to staggered, four-year terms, who in turn, elect a Mayor from one of their members to serve a two-year term. The City adopts a two-year budget. For 2005-2006, budgeted expenditures were approximately $295.2 million. The City has approximately 446 full-time equivalent employees and provides the following services: fire, police, municipal court, water/sewer/storm water utilities, public works, community and economic development, parks and recreation, and human services.

AUDIT HISTORY

We audit the City annually. In the past five audits, we have not reported any findings.

ELECTED OFFICIALS

These officials served during the audit period:

Mayor	James L. Lauinger
Deputy Mayor	Joan McBride
Council	David Asher
	Mary-Alyce Burleigh
	Jessica Greenway
	Thomas Hodgson
	Robert Sternoff

APPOINTED OFFICIALS

City Manager	David Ramsay
City Attorney	Robin Jenkinson
Director of Finance & Administration	Tracey Dunlap (as of July 2006)
Director of Fire & Building/Fire Chief	Jeff Blake
Chief Information Officer	Brenda Cooper
Director of Parks & Community Services	Jennifer Schroder
Director of Planning & Community Development	Eric Shields
Chief of Police	Stan Aston
Director of Public Works	Daryl Grigsby
Director of Human Resources	Bill Kenny

Municipal Court Administrator	Tracy Jeffries

ADDRESS

City	123 5th Ave. Kirkland, WA 98033-6189 (425) 587-3000 www.ci.kirkland.wa.us/home.htm

Audit Areas Examined

City of Kirkland
King County
July 26, 2007

In keeping with general auditing practices, we do not examine every portion of the City of Kirkland's financial activities during each audit. The areas examined were those representing the highest risk of noncompliance, misappropriation or misuse. Other areas are audited on a rotating basis over the course of several years. The following areas of the City were examined during this audit period:

ACCOUNTABILITY

We evaluated the City's accountability in the following areas:

- Accounting/financial reporting
- Open public meetings/records laws
- Procurement (bidding/prevailing wage)
- Disbursements/expenditures
- Interfund transactions
- Compensation of public officials

FINANCIAL AREAS

Our opinion on the City's financial statements is provided in a separate report. That report includes the City's financial statements and other required financial information. We examined the financial activity and balances of the City including:

- Cash and investments
- Revenues
- Expenditures/expenses
- Financial condition
- Long-term debt
- Overall presentation of the financial statements
- Financial statement preparation

Topical Guide
Washington Cities and Counties
Overtime Practices

When reviewing overtime practices, cities and counties should consider risk indicators such as departments with the highest total overtime; the highest number of employees; amount of overtime per employee; and wage gaps between highest- and lowest-paid employees. Cities and counties should also consider the following possible improvements in their efforts to manage departmental overtime.

Policies and internal controls
Local governments have contracts with employees that prescribe how overtime is earned. Some contracts allow employees to earn compensatory time in place of overtime. Contracts typically contain provisions related to overtime and compensatory time. Cities and counties must couple these contracts with good internal controls in order to effectively monitor and manage departmental overtime activity. Policies and internal controls work hand-in-hand to ensure compensation costs are properly managed.

We recommend local governments develop a comprehensive overtime and compensatory time policy for managers. An effective overtime and compensatory time policy outlines the process for recording, analyzing, managing and supervising overtime, requires on-going budget monitoring including staffing levels, identifies when employees are eligible for overtime or compensatory time, identifies the overtime pay-rate and the rate of accruing compensatory time.

Potential for Cost Savings
All public safety departments will encounter unavoidable overtime. Our planning efforts focused on the avoidable overtime, or that which can be largely avoided by accurately identifying staffing needs and then fully meeting these needs though hiring. For example, nearly every shift for jail or law enforcement services has to be covered. In the areas of jail or law enforcement, most avoidable overtime corresponds with low staffing levels resulting from difficulty in finding qualified candidates.

Once avoidable overtime is determined, it should be compared to the cost of hiring staff to work these avoidable overtime hours. When making these comparisons, cities and counties should consider the following to determine the potential for cost savings:

1. Ensure avoidable overtime calculations factor in all variables,

including vacation time, sick time and training time.

2. Determine the cost of hiring staff to cover avoidable overtime hours. When calculating the cost of hiring, include one-time training costs, on-going training costs and the annual cost of salary and benefits.
3. Compare the cost of unavoidable overtime (time-and-a-half) to the cost of hiring more employees (straight time at a lower rate plus additional training and benefit costs).

Compensatory Time Off

When employees work more than 40 hours, they can sometimes choose between compensatory time or overtime. Like overtime, compensatory time is expensive because every hour worked must be repaid at time-and-a-half or double time. In fact, compensatory time is often a more expensive option. One employee's compensatory time is often covered by a second employee who must work overtime. Under these conditions, compensatory time can increase payroll costs from 50 percent to100 percent more than if the first employee had instead received overtime pay.

Understanding that compensatory time is more expensive than overtime and how optimal staffing levels can minimize payroll costs is a key to managing those payroll costs within each department.

Recruitment and Retention

Many cities and counties are struggling to recruit and retain law enforcement and correctional officers. Best practices for recruitment and retention of public safety employees include:

Recruitment*

1. Develop a recruitment plan
2. Properly train the right people as recruiters
3. Build strong partnerships with the military, community colleges, universities, high schools and other organizations
4. Properly advertise vacancies
5. Develop an Employee Referral Program
6. Improve the selection process

Retention*

1. Develop a retention plan
2. Engage employees
3. Improve communication

*See the following sources for a more details:
http://www.post.ca.gov/training/bestpractices/bestpractices-recruitment.asp
http://www.post.ca.gov/training/bestpractices/RecruitmentBestPrac.pdf