



# PAULY, ROGERS AND CO., P.C.

CERTIFIED PUBLIC ACCOUNTANTS

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October 25, 2008

To the Board of Directors  
Pacific City Joint Water-Sanitary Authority

In planning and performing our audit of the basic financial statements of Pacific City Joint Water-Sanitary Authority as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered Pacific City Joint Water-Sanitary Authority's internal control over financial reporting (internal control) 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 Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified certain deficiencies in internal control 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 a combination of control deficiencies, that adversely affects the Authority'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 Authority's financial statements that is more than inconsequential will not be prevented or detected by the Authority's internal control.

The Auditing Standards Board issued SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, effective for audits of financial statements for periods ending on or after December 15, 2006. This statement requires auditors to evaluate identified control deficiencies and determine whether those deficiencies, individually or in combination, are significant deficiencies or material weaknesses, and if so communicate them in writing to those charged with governance.

SAS No. 112 specifically identifies a few common control deficiencies which must be addressed in each audit to determine if a significant deficiency exists, and based on our evaluation we have identified significant deficiencies in the design or implementation of internal controls, which are noted below.

We consider the following deficiencies to be significant deficiencies in internal control:

1. Internal controls have always been a critical management function; however changes in audit reporting requirements now emphasize the importance management should place on the design and implementation of effective internal controls. A control system should not only include (among other things) a properly designed accounting system, source document retention, anti-fraud controls, safeguards over assets, and controls to ensure accurate financial reporting, but also documentation of internal controls within a well-maintained policies and procedures manual.

We noted that the Authority has policies in place documenting certain internal controls. However, in applying SAS 112 we believe that the Authority should expand formal policies to document internal controls for certain accounting areas. Our audit did not uncover significant deficiencies pertaining to these areas; however the documentation of policies/procedures in place could be expanded in these areas.

We recommend at a minimum that the following areas be addressed (this constitutes a partial list; other areas of internal control could be addressed):

- a. The Authority should review and evaluate their internal control system primarily to address the risk associated with the inability to fully segregate all accounting functions. We recommend documentation of oversight review procedures/controls currently in place be expanded within the control policies documents. Documentation of oversight reviews and controls should include, but not be limited to, the following:
  - i. Documentation of who reviews bank reconciliations, how many employees are required to open/close an account, controls over wire transfers, who tracks check sequences, who reviews canceled checks back from the bank, and controls over who has custody of checks.
  - ii. What internal controls and monitoring is used for reviewing and ensuring that the financial statements are accurate and in conformance with GAAP (the control procedure here could be sending staff to training on new pronouncements, etc.)
  - iii. Consideration of what amount and type of documentation is necessary in order to monitor internal controls, by both management and the governing body, to ensure that controls are functioning properly and are evaluated when systems, the environment, and employees change.
  - iv. Any internal audit functions, antifraud programs, etc.
2. During our testing of journal entries we noted that there was no documentation of approval or review of journal entries. We recommend that journal entries be review and approved on a regular basis.
3. Because of a limited number of available personnel, it is not always possible to adequately segregate certain incompatible duties so that no one employee has access to both physical assets and the related accounting records or to all phases of a transaction. Consequently, the possibility exists that unintentional or intentional errors or irregularities could exist and not be promptly detected. We recommend that the Board and Manager continually monitor the financial activities of the Authority.

#### Other Matters – Not Significant Deficiencies

In reviewing the fidelity insurance coverage we noticed that the Authority often carries cash and investment balances well above the coverage amount. We recommend that the Board examine this exposure risk and make a determination as to the amount of coverage they feel is prudent in regard to their oversight.

A material weakness is a significant deficiency, or a 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 Authority's internal control. We did not identify any significant deficiencies that are considered to be material weaknesses.

This communication is intended solely for the information and use of management, the Board, and others within the Authority, and is not intended to be and should not be used by anyone other than these specified parties.

*Pauly, Rogers and Co. P. C.*  
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