



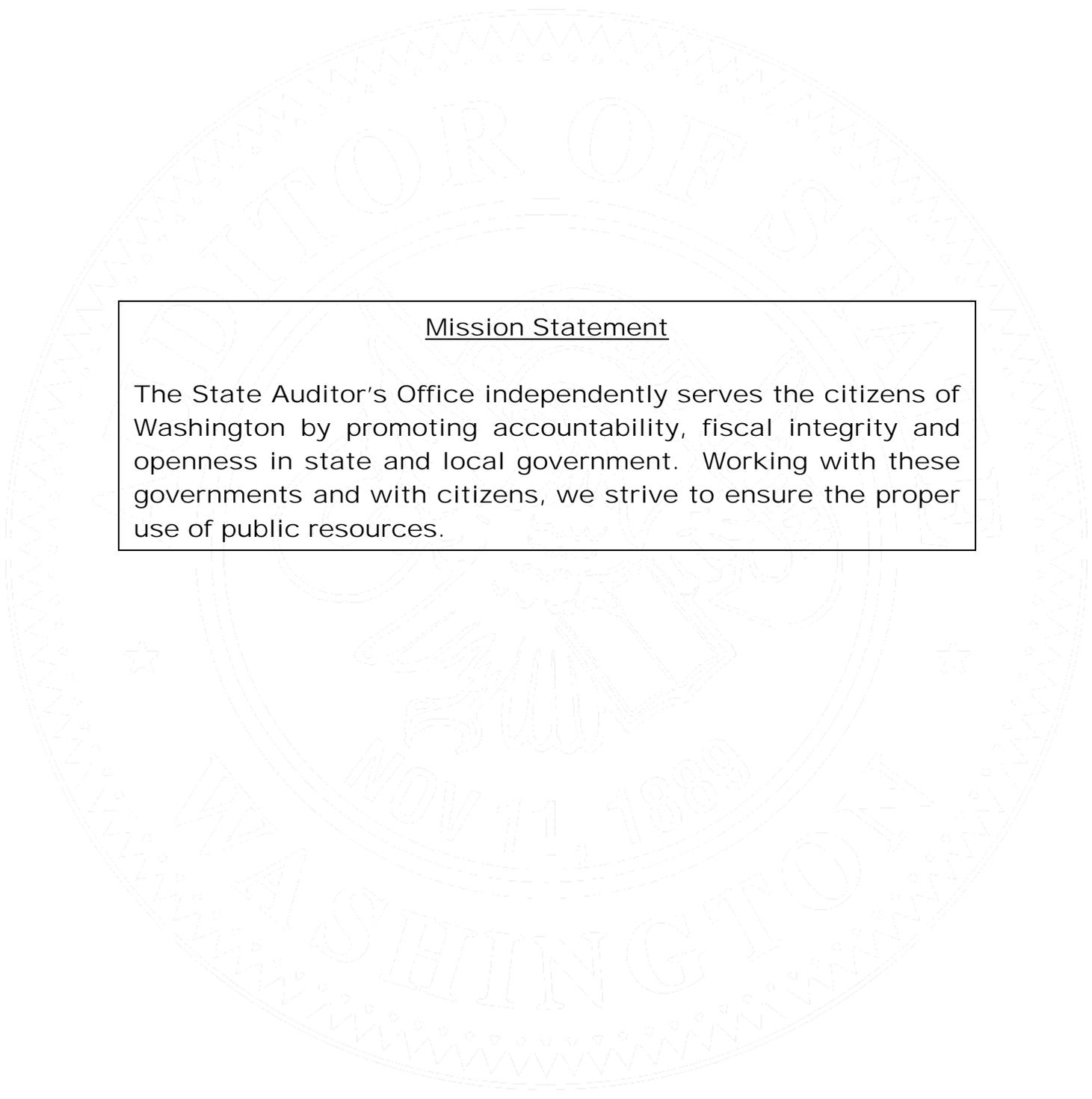
Washington State Auditor's Office

**State Government and Higher Education
Audit Report Summary**

July 1, 2004 through June 30, 2005



Washington _____
State Auditor
_____ Brian Sonntag



Mission Statement

The State Auditor's Office independently serves the citizens of Washington by promoting accountability, fiscal integrity and openness in state and local government. Working with these governments and with citizens, we strive to ensure the proper use of public resources.

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**Washington State Auditor
Brian Sonntag**

July 31, 2006

Since issuing our last statewide Accountability Report in 2005, we have noted state agencies are continuing to make improvements to their operations to make them more accountable to citizens. We hope this overview of our state agency audit work in the past year will be used as a tool to further promote accountability and improve services.

Each of the reports referenced in this report can be viewed in their entirety at our Web page, www.sao.wa.gov.

If you have questions regarding this report, please contact Mindy Chambers, Communications Manager, at (360) 902-0091 or e-mail chamberm@sao.wa.gov.

Copies of this report also are available on our Web site, www.sao.wa.gov in the Reports / Statewide Accountability section.

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR



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Financial Accountability Roles and Responsibilities

The duties of public officers and agencies as they pertain to accountability over public resources are spelled out in state law, as are enforcement powers and penalties for noncompliance with financially related laws and regulations.

These responsibilities are designed as a system of checks and balances that provide the foundation for effective fiscal management, including efficient accounting and reporting, and that promote more efficient public management.

Governor, Director of the Office of Financial Management (OFM)

The Governor, through the OFM director, is to "devise and supervise a modern and complete accounting system for each agency to the end that all revenues, expenditures, receipts, disbursements, resources, and obligations of the state shall be properly and systematically accounted for." (RCW 43.88.160(1))

The accounting system is to provide accurate, timely records and reports of all financial affairs of the state and to do it in detail sufficient to allow OFM to provide a centralized financial management system. To this end, OFM maintains the accounting procedures manual to be used by state agencies.

OFM also is responsible for developing and maintaining a system of internal controls and internal audits to safeguard state resources; to ensure the accuracy and reliability of accounting data; to promote operational efficiency; and to encourage adherence to accounting and financial control policies.

The law requires OFM to report by December 31 of each year on the status of audit resolution to the appropriate committees of the Legislature, the State Auditor's Office and the Attorney General's Office. The Audit Resolution Report is to include information on the actions taken as a result of an audit, including types of personnel actions, costs and types of litigation, and the value of recouped goods or services.

The law states the Director of the Office of Financial Management will "cause corrective action to be taken within six months, such action to include, as appropriate, the withholding of funds as provided in RCW 43.88.110." (RCW 43.88.160(6)(d))

State Treasurer

The State Treasurer also has a role in management of the state's financial resources. As the chief fiscal officer, the State Treasurer is responsible for keeping the books and managing taxpayers' money from the time it is collected until it is spent on programs funded by the Legislature. The Treasurer's Office provides banking, cash management, investment, debt issuance, and accounting services for state agencies.

Importantly, the Office is to keep a correct and current account of all money it receives and disburses, by fund or account. This information is regularly updated and reported.



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State Auditor

The State Auditor's Office is responsible for audits of state agencies. The Auditor's Office examines the financial transactions of agencies and compliance with state laws and agency policies. The Office also performs the annual State of Washington Single Audit of federal money spent by agencies.

The Office has the authority to take exception to specific expenditures by agencies or to other practices related to an agency's financial transactions.

The results of these audits are reported to the agencies, the public, the Legislature and OFM. The Auditor's Office reports instances of possible misappropriation, misfeasance, malfeasance or nonfeasance to the Attorney General's Office. We also refer reports of actions that may be violations of the state ethics laws to the state Executive Ethics Board.

In November 2005, the voters of Washington approved Initiative 900, which requires the State Auditor to conduct independent, comprehensive performance audits of state and local governments. It specifies that the performance audits be conducted in accordance with Governmental Auditing Standards, which are issued by the Comptroller General of the United States Government Accountability Office. Information regarding performance audits can be found at www.sao.wa.gov/performanceaudit.

Joint Legislative Audit and Review Committee (JLARC)

This Committee is part of the Legislative Branch and may audit the financial transactions of any agency and perform management surveys and program reviews, as well as performance audits and program evaluations. It has the authority to examine the financial records of any agency, official, or employee.

JLARC makes reports to the Legislature regarding whether agencies are making expenditures consistent with legislative intent. It may take exception to specific expenditures or financial practices of any agencies and also may make recommendations for promoting frugality and economy in agency affairs to improve fiscal management.

Higher Education

Higher Education entities are divided into two groups: two-year community and technical colleges and four-year colleges and universities.

Community and Technical Colleges

The community and technical college system is generally controlled and supervised by the State Board for Community and Technical Colleges, whose duties include preparation of a single budget for the system, establishment of guidelines for disbursement of funds and other financial procedures necessary to supplement general requirements set forth by the Office of Financial Management, the ability to sell, exchange, or convey any or all interest in any community college real and personal property, and the establishment of minimum standards for community college admission and enrollment policies, curriculum content, and instructional and key administrative personnel qualifications.



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The community and technical colleges range in size from very small to the third largest higher education institution in the state. Many of the controls in these colleges are moving to decentralized locations, which increases audit risk depending upon the amount of monitoring performed by the institution.

Four-Year Colleges and Universities

Washington's four-year universities/colleges were created by state law. Each institution has adopted rules governing operations and is subject to certain federal regulations regarding grant expenditures.

These institutions range in complexity from fairly simple and small in size to very complex. Operations may include instruction, research, police, broadcasting, printing and publications, stores, patents and licensing agreements, facilities construction and maintenance and various operations that provide goods and services for a fee to students and the general public (housing and food services, hospitals, museums, libraries, intercollegiate athletics, parking, creamery, motor pools, laundries, bookstores, etc.). Many of the controls in these institutions are decentralized.

In addition, many two and four-year colleges and universities have established nonprofit organizations (foundations) that engage in fundraising on their behalf. Their activities are governed in part by an Attorney General's Office opinion issued in 1993.

State Employees

State law is clear on the responsibility of state employees to comply with the law. It says:

"No state officer or employee shall intentionally or negligently: Over-expend or over-encumber any appropriation made by law; fail to properly account for any expenditures by fund, program, or fiscal period; or expend funds contrary to the terms, limits, or conditions of any appropriation made by law." (RCW 43.88.290)

The law also details the penalties for violations. It states that the Attorney General may initiate a civil action to prevent any such violation. It allows judges to assess damages, and fines from an employee found to be in violation, and possible job loss.

In addition, the Legislative Auditor, with the agreement of the Joint Legislative Audit Review Committee, may refer audit findings stemming from a performance audit or its other work to the Attorney General's Office if the Legislative Auditor suspects a violation of state law, or misfeasance, or nonfeasance on the part of any state officer or employee.



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Our Audit Approach

State Auditor's Office Audits

The Washington State Auditor's Office regularly audits over 160 state agencies ranging in size from the Department of Social and Health Services to the Red Raspberry Commission. All public colleges and universities in Washington are considered state agencies, and we also audit them.

The scope of our audits is twofold. First, financial records are audited to ensure public funds are accounted for and controls are in place to protect public resources from misappropriation, loss or misuse. Second, we audit to ensure agencies adhere to laws and regulations relating to financial matters.

For state agencies, the Office performs audits on:

- Areas that pose the highest risk for misappropriation, misuse or loss of public funds or for noncompliance with state laws and regulations. This report includes a summary of the results of such audits.
- The State of Washington's General Purpose Financial Statements. The most recent Comprehensive Annual Financial Report, which includes these statements, was issued by the Office of Financial Management in December 2005 and is available at www.ofm.wa.gov/cafr/2005
- More than \$9 billion in federal funds received by the state. The fiscal year 2005 State of Washington Single Audit Report will be issued by the Office of Financial Management in the spring of 2006 and will be available at www.ofm.wa.gov/singleaudit
- Local funds kept by agencies that are not in the care or custody of the Office of State Treasurer. Our most recent Local Funds Report was issued in November 2005 and is available at www.sao.wa.gov/reports/LocalFunds.
- With the passage of Initiative 900, the State Auditor's Office is required to conduct performance audits of state governments. More information can be found at www.sao.wa.gov/performanceaudit.

We also have responsibilities in two other areas:

- Investigations of potential frauds found in our audits or reported to us by state agencies.
- Investigations of whistleblower assertions filed by state employees.
- Issues of concern regarding state government reported to us by citizens.

Legal Compliance/Accountability Audits

The State Auditor's Office has many competing responsibilities when conducting audits. Our risk-based approach helps ensure our efforts are properly balanced in order to fulfill these responsibilities. We look at areas that are the most important to the citizens of Washington, our audit clients, the Legislature, and other policymakers.



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The concept of risk-based auditing is driven by the fact that an auditor can not audit all activities of an entity. This is compounded by the fact that audit resources are limited and audit risk is not. An auditor must therefore decide what is most important to audit. This is done by conducting a risk assessment, which is designed to identify areas of risks, to prioritize those risks and to allocate audit resources accordingly. Properly designed risk-based auditing will ensure the significant areas are audited in the most effective and efficient manner.

The public expects that the State Auditor's Office will detect important financial and compliance related events. We focus our audits on areas where taxpayers dollars are most vulnerable to misuse, abuse and misappropriation.

Although an entity's risk assessment is substantially done as part of the planning process at the beginning of an audit, it is very much an on-going effort and may result in changes or adjustments to audit strategies/objectives in response to new information found during the audit.

An auditor's professional judgment drives the risk assessment decision process, which is based on audit knowledge and experience, and on gaining an understanding of an entity's unique operation and audit history, among other things, as elaborated below.

Professional Judgment

In planning an audit, auditors perform a risk assessment by evaluating many factors, including:

- Areas of interest to potential users of the audit report.
- An agency's unique mission and function, and the related audit risks.
- An agency's control environment or "tone at the top" regarding accountability for public resources.
- An agency's internal controls over financial statement reporting and safeguarding of public assets.
- An agency's audit history, including management's cooperation and responsiveness to prior audit recommendations.
- An agency's fiscal activity for unusual patterns as compared to its history and established auditor expectations.

We use many techniques to detect misappropriation or misuse of public assets and violations of state laws. Some of those are described below.

- Computer-assisted auditing techniques help us assess risk and accountability. Once we download an audit client's financial transactions, we have software applications that can help us find transactions that are most likely to be fraudulent or out of compliance with laws and regulations. These techniques often help us audit expenditures, but they can be used for any type of financial transaction.



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- We use analytical procedures to identify account balances that differ from an informed expectation. We often use these procedures to audit revenue streams, looking for activity that could point to a loss or misuse of public assets. These techniques tend to be very efficient and provide strong indicators that additional work may be needed to determine whether loss or misappropriation has occurred.
- We audit computer applications looking for security over access and other safeguards. These audits are of enormous value in pointing out conditions that could allow misappropriation or loss to occur without detection by management or conditions that could allow destruction of data. Recommendations from these audits have helped state agencies tighten controls over access to computer systems. These audits also have helped our auditors identify areas in which assets are most at risk.

Risk-based auditing allows the State Auditor's Office to optimize the use of our limited audit resources and produce practical and value-added recommendations that help improve state government. The State Auditor's Office is proud to have been a pioneer in developing the art of risk-based auditing over the past 12 years. We are also pleased that risk-based auditing is widely recognized today as the best method for conducting efficient and effective audits, as evidenced by continuing changes in professional auditing standards that emphasize its importance and value.

Comprehensive Annual Financial Report (CAFR)

The State Auditor's Office performs an annual audit of the statewide combined financial statements as required by state law (RCW 43.09.310). These financial statements are included in the Comprehensive Annual Financial Report (CAFR) prepared by, and available from, the Office of Financial Management. This report is designed to present the financial position and the results of operations of the state of Washington. The Office of Financial Management prepared the first CAFR in 1982 and released the fiscal year 2005 report in December of 2005. Our Office has audited this report since its inception and has issued unqualified opinions every year since 1987. An unqualified opinion means that the financial statements are fairly stated.

The CAFR reflects the financial activities of all funds, organizations, institutions, agencies, departments and offices that are part of the state's financial operations. For the fiscal year ended June 30, 2005, total state revenues were approximately \$40 billion and total state expenditures/expenses were approximately \$34 billion. Most of this difference was caused by investment gains that resulted in pension fund revenues exceeding expenses by more than \$5 billion.

Since 1987, the state has received a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association. This award recognizes conformance with the highest standards for preparation of state and local government financial reports.



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Our audit of the financial statements is conducted in accordance with governmental auditing standards generally accepted in the United States of America. These standards require us to plan and perform audits to obtain reasonable assurance about whether financial statements are free of significant misstatement. An audit includes examining 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 evaluation of the overall financial statement presentation.

Federal Compliance

The Single Audit Act of 1984 (and subsequent amendments) established uniform entity-wide audit requirements for state and local governments receiving Federal financial assistance. Pursuant to the Act, our Office audits the State's expenditures of Federal funds in accordance with the Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Single audits, as they are known, include an assessment of agencies' internal controls over Federal programs, tests of those controls, and tests of compliance with Federal requirements. The State reported almost \$10 billion in Federal assistance for fiscal year 2005, including grants, loans, commodities, vaccines, and other forms of aid.

We audited the following Federal programs administered by various State agencies for the fiscal year ended June 30, 2005:

Department of Social and Health Services

- Medicaid Cluster Grants
- Food Stamp Cluster Grants
- Temporary Assistance for Needy Families
- Child Care Cluster Grants
- Foster Care Title IV
- Block Grants for Prevention and Treatment of Substance Abuse
- Vocational Rehabilitation Grants to States
- Disability Insurance/Supplemental Security Income
- State Children's Health Insurance Program
- Promoting Safe and Stable Families
- Adoption Assistance

Employment Security Department

- Unemployment Insurance
- Workforce Investment Act Cluster Grants
- Trade Adjustment Assistance - Workers

Department of Health

- Special Supplemental Nutrition Program for Women, Infants, and Children
- Immunization Grants



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- Centers for Disease Control – Investigations and Technical Assistance

University of Washington

- Research and Development Programs
- National Center for Research Resources

Office of Superintendent of Public Instruction

- Title 1 Grants to Local Educational Agencies

Department of Community, Trade, and Economic Development

- Low Income Home Energy Assistance Program

Military Department

- National Guard Military Operations & Maintenance Projects

Department of Veterans' Affairs

- Grants to States for Construction of State Home Facilities

Department of Transportation

- Highway Planning and Construction

State Higher Education System

- Student Financial Assistance Programs

Department of Ecology

- Capitalization Grants for Clean Water State Revolving Funds

Our audit identified 59 conditions or concerns significant enough to be reported as Federal Findings. The 2005 Single Audit Report, which contains the details of those findings as well as the overall results of our single audit, is issued by the state Office of Financial Management and can be found at www.ofm.wa.gov/singleaudit/.

Federal finding captions are also included in this report. For more in-depth analysis of the results of our work on the Federal Medicaid program, please see our Special Report on Medicaid by going to www.sao.wa.gov and search for report number 6534.

Fraud Program

The State Auditor's Office maintains an exceptional program of fraud prevention, detection and education.

Our Special Investigations Manager monitors all fraud cases throughout the state. In addition, each of our audit teams has designated a fraud specialist.

Fraud prevention and detection are integral parts of our risk-based audit approach. This approach has produced more meaningful information and more recommendations on how to improve accountability in government.



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Our fraud training for our own staff and for financial managers in state agencies and local governments provides real value. Annually, we train more than 2,500 government employees on fraud prevention and detection. While it is difficult to quantify how much fraud is prevented by these efforts, we believe it to be significant.

More information on our Fraud Program is available on our Web site: www.sao.wa.gov/fraud

Whistleblower Program

The State Auditor's Office administers the State Employee Whistleblower Program, which was created in 1982. The goal of this program is to give state employees a vehicle to report suspected improper governmental actions, with protection against retaliation. The Washington State Human Rights Commission is responsible for investigating claims of retaliation filed under the Act.

Under the Whistleblower Act (RCW 42.40), an improper governmental action is defined as an action by a state employee that results in a gross waste of public funds, violates a state or federal law or rule, or poses a significant danger to public health or safety. Personnel-related actions such as dismissals, grievances and disciplinary actions are specifically excluded as other avenues are available to address these issues.

As the definition of an improper governmental action can be any violation of a state or federal law or rule, we investigate a broad range of cases, ranging from misuse of public resources to determining if appropriate permits were obtained for a project.

Information regarding the Whistleblower Program, including reports, can be obtained at the program's Web site, www.sao.wa.gov/whistleblower.

Statewide Technology Audit Team

When performing audits at state agencies, auditors use our Statewide Technology Audit Team to review internal controls related to information technology. When reviewing information systems, we look for computer controls that ensure:

- Integrity of information.
- Availability of information.
- Management's control over information, which includes access to the data and programs, as well as confidentiality issues.
- Audit trails that show the source of the information, including who entered the information into the system, and how it was entered.

In order to assess whether controls are present to address these areas, a review may cover both application-specific controls and general controls.

Application Controls

During a review of a specific application, the information technology auditor seeks to identify controls that ensure the accuracy and completeness of entry, processing and output of information.



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General Controls

During a review of general controls in place at an agency, the information technology auditor identifies controls in the following areas:

- Organization of the agency.
- Physical security of the data.
- Electronic access.
- Backup/recovery plans.
- Application design.
- How software changes are managed.
- How the operating system is configured.

Our information technology auditors typically do not perform full application or general control reviews in which all aspects are reviewed. As with other audits performed by the State Auditor's Office, the Statewide Technology Audit Team takes a risk-based approach and looks at areas in which state resources are at the highest risk. The team also takes a cycled approach to audits, where areas not reviewed in one audit cycle may be reviewed in another.

Audit Approach

When identifying controls in the above areas, the information technology auditor determines risks that may be present in the system and develops expectations of controls that could be put in place to address those risks. Generally, the information technology auditor is looking for controls that are programmed. Where programmed controls are not found, the auditor seeks to identify compensating controls. In the absence of compensating controls, the information technology auditor reports a control weakness to other auditors and to the agency.

Computer Assisted Audit Techniques

The Statewide Technology Audit Team assists our other auditors by obtaining information from agency computer systems that are used in our audits of individual agencies. The Team assists the other audit teams in performing computer-assisted audit techniques related to the statewide issues audits, agency legal compliance audits, local government audits, the financial statement audit and the State of Washington Single Audit.

Quality Assurance Program

Our quality assurance program focuses on the effectiveness of our system for ensuring audit policies, procedures, and other centralized audit guidance reflect current professional standards and risk-based audit philosophy. The system for achieving these objectives is a team called Team Audit Support.



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In addition to independently assessing the effectiveness of Team Audit Support's processes for providing audit guidance to all audit personnel around the state, Quality Assurance assesses the staff's understanding and application of the Office's centralized audit policies by conducting quality assurance reviews of audits conducted throughout the year. These reviews consist of an analysis of actual audit work using specialized check lists designed to help identify items such as opportunities to improve staff training in specialized audit areas; develop better audit tools to increase audit efficiency; and clarify existing (or develop new) audit policies and procedures.

The Office's quality assurance program provides an objective and effective process for evaluating audit quality on an on-going basis. This helps ensure audits of governmental entities in Washington state reflect the highest professional auditing standards, and provide citizens with accurate and reliable financial information about their government.



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Agency Relationships

The Governor's Office has played a key role in improving relations between our Office and other agencies. Her leadership through the Government Management, Accountability and Performance program is encouraging and is beginning to produce results.

Open communications will be even more important as we begin our performance audit work under Initiative 900. We want our suggestions to be positive and constructive.

We also look forward to sharing information we gather from citizens, front-line employees, legislators, policy makers and others during our continuing performance audit outreach work.



State Agencies with Findings

This section encompasses all state agencies which we reported findings during fiscal year 2005. After each Agency is a list containing the titles to the findings we reported. You may read the entire text of these findings by going to www.sao.wa.gov and clicking on reports.

Community, Trade and Economic Development (Report No. 6536)

- 1) The Department of Community, Trade, and Economic Development, Housing Division, does not adequately monitor the Housing Trust Fund loan contracts.
- 2) The Department of Community, Trade, and Economic Development did not comply with state and federal regulations when contracting for services paid with federal Low Income Home Energy Assistance Program funds.
- 3) The Department of Community, Trade, and Economic Development did not comply with earmarking requirements for the Low Income Home Energy Assistance Program.
- 4) The Department of Community, Trade and Economic Development is not complying with federal requirements for time and effort reporting for the Low Income Home Energy Assistance Program.
- 5) The Department of Community, Trade, and Economic Development, Energy Assistance Section, is not complying with subrecipient monitoring requirements for the Low Income Home Energy Assistance Program.
- 6) The Department of Community, Trade and Economic Development did not comply with federal requirements for suspension and debarment for the Home Investment Partnership Program.

Department of Ecology (Report No. 6509)

- 1) The Department of Ecology is not complying with subrecipient monitoring requirements for the Clean Water State Revolving Loan Funds Program.

Employment Security Department (Report No. 6516)

- 1) The Department of Employment Security has inadequate internal controls over payments to claimants for unemployment insurance benefits.

Department of General Administration (Report No. 6538)

- 1) The Department of General Administration's Motor Pool Division does not have adequate internal controls in place to ensure gasoline purchased is for authorized purposes.

Department of Health (Report No. 6513)

- 1) The Department of Health is not adequately monitoring contract requirements to ensure it is receiving the designated services.
- 2) The Department of Health is not complying with federal requirements for time and effort reporting for some of the programs it administers.



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Department of Labor and Industries (Report No. 6541)

- 1) The Department of Labor and Industries paid more than \$600,000 in pension benefits to claimants and survivors who were not eligible for the benefits. In addition, the Department paid more than \$1 million to claimants and survivors who may not be eligible.
- 2) The Department of Labor and Industries lost 105 items in two years, which originally were purchased for more than \$180,000.
- 3) The Department of Labor and Industries appears to have circumvented bid laws for 12 personal service contracts valued at \$134,988.
- 4) The Department of Labor and Industries' Accounts Receivable System lacks adequate internal controls to ensure that public resources are safeguarded.
- 5) The Department of Labor and Industries' Pension Payment System lacks adequate internal controls to ensure that public resources are safeguarded.

Military Department (Contained in the Statewide Single Audit Report)

- 1) The Military Department is not properly accounting for and safeguarding assets purchased by the National Guard Military Operations and Maintenance Projects Program
- 2) The Military Department is not in compliance with subrecipient monitoring requirements for the State Domestic Preparedness Equipment Support Program.
- 3) The Military Department was reimbursed for unallowable charges for the National Guard Military Operations and Maintenance Projects Program

Pollution Liability Insurance Agency (Report No. 6532)

- 1) The Washington Pollution Liability Insurance Agency did not enforce grant agreement terms when grantees defaulted.

Department of Retirement Systems (Report No. 6533)

- 1) The Department of Retirement Systems is holding approximately \$3.1 million in accounts for beneficiaries of members who have been deceased for up to 40 years.

Department of Social and Health Services (Report No. 6539)

- 1) The Department of Social and Health Services does not have adequate internal controls over the processing of expenditures through the Agency Financial Reporting System.
- 2) The Department of Social and Health Services, Division of Child Care and Early Learning, does not have adequate internal controls over support for payments to child care providers
- 3) The Department of Social and Health Services, Division of Child Care and Early Learning and Children's Administration, did not perform adequate background checks
- 4) The Department of Social and Health Services, Economic Services Administration, reimbursed contractors for services that were not adequately supported.



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- 5) The Department of Social and Health Services made unallowable duplicate payments through the Social Services Payment System
- 6) The Department of Social and Health Services does not ensure that all recovered overpayments are credited to the appropriate funding source.
- 7) The Department of Social and Health Services does not have adequate internal controls over the Social Service Payment System.
- 8) The Department of Social and Health Services, Economic Services Administration, should improve compliance with eligibility requirements for the Temporary Assistance for Needy Families Program.
- 9) The Department of Social and Health Services, Division of Developmental Disabilities, should establish adequate internal controls to ensure that vehicles used to transport clients of supported living services are properly insured.
- 10) The Department of Social and Health Services, Economic Services Administration, does not adequately monitor other state agencies to which it provides funds from the federal Temporary Assistance to Needy Families Program.
- 11) The Department of Social and Health Services, Economic Services Administration, did not comply with state and federal regulations requiring a monthly inventory of electronic benefit transfer cards used by the Food Stamp Program.
- 12) The Department of Social and Health Services, Division of Disability Determination Services, received reimbursement for unallowable costs for the Social Security Disability Insurance Program
- 13) The Department of Social and Health Services, Division of Disability Determination Services, reported incorrect expenditures for the Social Security Disability Insurance Program on several reports, including the Schedule of Expenditures of Federal Awards
- 14) The Department of Social and Health Services, Health and Recovery Services Administration, claimed costs for unallowable activities under the State Children's Health Insurance Program.
- 15) The Department of Social and Health Services, Mental Health Division, is not complying with subrecipient monitoring requirements for the Community Mental Health Services Block Grant.
- 16) The Department of Social and Health Services, Mental Health Division, did not comply with state laws or the Department's policies and procedures for recovering a Community Mental Health Services Block Grant overpayment reported in the previous audit.
- 17) The Department of Social and Health Services, Mental Health Division, did not comply with state and federal regulations when contracting for services paid with federal Community Mental Health Services Block Grant funds.
- 18) The Department of Social and Health Services, Mental Health Division, did not comply with federal requirements for independent peer reviews of the Community Mental Health Services Block Grant.
- 19) The Department of Social and Health Services, Juvenile Rehabilitation Administration, is not complying with federal requirements for time and effort reporting for the Juvenile Accountability Incentive Block Grant Program.



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- 20) The Department of Social and Health Services, Division of Vocational Rehabilitation, is not complying with federal requirements for time and effort reporting for the Rehabilitation Services Vocational Rehabilitation Grants to States.
- 21) The Department of Social and Health Services, Division of Disability Determination Services, did not comply with state and federal regulations when contracting for services paid with Social Security Disability Insurance Program funds.

Department of Social and Health Services – Medicaid (Report No. 6534)

- 1) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), does not have procedures to identify treatments and services that may not be allowable for reimbursement under the State Medicaid Plan.
- 2) The Department of Social and Health Services, Aging and Disability Services Administration, does not have adequate controls to ensure that all alleged violations and complaints of abuse and neglect are investigated in accordance with federal law.
- 3) The Department of Social and Health Services, Aging and Disability Services Administration, does not perform certification surveys of Intermediate Care Facilities for the developmentally disabled according to federal law.
- 4) The Department of Social and Health Services, Aging and Disability Services Administration does not have a process to impose sanctions, recover funds, schedule or hold hearings for Intermediate Care Facilities for the Developmentally Disabled that are not in substantial compliance with federal health and safety standards.
- 5) The Department of Health is not conducting hospital surveys according to the frequency stipulated by state law and the Medicaid State Plan.
- 6) The Department of Health and the Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), are not ensuring compliance with federal law regarding hospital surveys.
- 7) The Department of Health and the Department of Social and Health Services, Health and Recovery Services Administration, agreement covering hospitals' survey activities does not comply with federal requirements.
- 8) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), received federal Medicaid funds for unallowable services provided to undocumented aliens.
- 9) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), is not complying with federal requirements to defer Medicaid expenditures related to undocumented aliens.
- 10) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), has not established sufficient internal controls to support its decisions on eligibility of clients enrolled in Medicaid's Basic Health Plus Program.



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- 11) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), does not have procedures to determine whether expenditures for anabolic steroids are allowable under the Medicaid program.
- 12) The Department of Social and Health Services is not adequately reviewing pharmaceutical claims to identify patterns of fraud and abuse.
- 13) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), is not in compliance with the federal Medicaid requirements for reporting adult victims of residential abuse to the Medicaid Fraud Control Unit.
- 14) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), does not perform adequate reviews of providers of durable medical equipment to ensure the providers exist, are properly licensed and have submitted accurate information.
- 15) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), has not established sufficient internal controls to prevent Medicaid payments for services provided after a client's death or to prevent payments for services provided to individuals using the Social Security number of a deceased person.
- 16) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), did not ensure that home health agencies providing services under the Medicaid program complied with federal surety bond requirements.
- 17) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), does not have adequate reviews of home health agencies to ensure providers are licensed, Medicare certified and have signed a Core Provider Agreement as required by law.
- 18) The Department of Health does not retain documentation that would provide evidence to ensure all home health agency providers performed criminal background checks and obtained disclosures on employees having unsupervised access to vulnerable adults, as the law requires.
- 19) The Department of Social and Health Services, Aging and Disability Services Administration, does not ensure providers of home health care services are Medicare-certified as required by the Medicaid State Plan.
- 20) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), is not complying with federal regulations that require people receiving Medicaid benefits to have valid Social Security numbers.
- 21) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), has not established internal controls sufficient to ensure payment rates to its Healthy Options managed care providers are based on accurate data.
- 22) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), made supplemental Medicaid payments to public hospital districts totaling \$41,154,000 without a federally approved payment methodology.



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- 23) The Department of Social and Health Services, Health and Recovery Services Administration (formerly Medical Assistance Administration), does not ensure that providers of motorized wheelchairs have the documentation required to substantiate claims for payment.
- 24) The Department of Social and Health Services, Office of Financial Recovery and Health and Recovery Services Administration (formerly Medical Assistance Administration), does not have adequate internal controls to ensure that final settlement amounts are refunded to the federal government and in a timely manner.
- 25) The Department of Social and Health Services' Office of Accounting Services does not have adequate internal controls to ensure the federal portion of uncashed and cancelled warrants is refunded at the appropriate rate to the federal Medicaid Program.
- 26) The Department of Social and Health Services' Office of Accounting Services does not have sufficient controls to ensure that the federal portion of uncashed warrants is refunded to the Medicaid Program in a timely manner.
- 27) The Department of Social and Health Services, Aging and Disability Services Administration and Health and Recovery Services Administration (formerly Medical Assistance Administration), has not set up an effective system to ensure Medicaid payments are not being made to nursing homes that are not in compliance with federally mandated health and safety standards.
- 28) The Department of Social and Health Services paid providers with Medicaid funds through the Social Services Payment System for services to clients using Social Security numbers belonging to deceased persons.

Department of Transportation (Report No. 6544)

- 1) The Department of Transportation's Washington State Ferries Division does not have adequate controls over ticket sales and revenue collection.
- 2) The Department of Transportation's Washington State Ferries Division made travel payments to employees in excess of written contract amounts.
- 3) The Department of Transportation does not have adequate internal controls to ensure compliance with federal and state laws for 167 leased properties on a timely basis.

Department of Veterans Affairs (Report No. 6535)

- 1) The Department is not complying with federal requirements for time and effort reporting for the Grants to State Construction State Home Facilities (CFDA 64.005)



Colleges and Universities with Findings

This section summarizes findings for all institutions of higher education whose audit reports we issued during fiscal year 2005. The entire text of these reports is available at www.sao.wa.gov, under the reports section.

Everett Community College (Report No. 6542)

- 1) The College does not have adequate controls over cash receipting.
- 2) The College has not performed bank reconciliations for five months.

The Evergreen State College (Report No. 6464)

- 1) Public funds were misappropriated by the former Head Basketball Coach

Skagit Valley College (Report No. 6479)

- 1) Public funds were misappropriated from the College cashier's office

University of Washington (Report No. 6498)

- 1) Certain University departments' controls are not working effectively to ensure time and effort certification forms are completed in a timely manner and to ensure monthly certifications of salaries and wages paid for federal programs are completed as required.
- 2) The University did not submit financial status reports in a timely manner.
- 3) The University paid contractors without intent to pay prevailing wage forms on file as required by state law.

Western Washington University (Report No. 6540)

- 1) Western Washington University's Box Office does not have sufficient controls in place to ensure funds received are safeguarded, reconciled and all discrepancies are tracked and reviewed in a timely manner.
- 2) Public funds were misappropriated from the Cashier's Office at Western Washington University.
- 3) Public funds were misappropriated from Campus Police at Western Washington University.



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Fiscal Year 2005 Audits of State Agencies without Findings

Accountancy Board	Washington State Housing Finance Commission
Actuary Office	Office of Insurance Commissioner
Department of Agriculture	Office of the Lieutenant Governor
Washington State Asparagus Commission	Department of Licensing
Office of Attorney General	Washington State Lottery Commission
Washington State Barley Commission	Office of Minority and Women's Business Enterprises
Washington State Beef Commission	Department of Natural Resources
Caseload Forecast Council	Parks and Recreation Commission
Columbia River Gorge Commission	Department of Personnel
State Convention and Trade Center	Public Disclosure Commission
Department of Corrections	Department of Revenue
Washington State Dry Pea and Lentil Commission	State Investment Board
Eastern Washington State Historical Society	Washington State Patrol
Office of Financial Management	Office of Superintendent of Public Instruction
Department of Fish and Wildlife	Office of State Treasurer
Office of Forecast Council	Washington State Tree Fruit Research Commission
Washington State Fruit Commission	Washington State Apple Commission
Gambling Commission	Washington State Wheat Commission
Growth Management Hearings Boards	Workforce Training and Education Coordinating Board
Higher Education Coordinating Board	

Fiscal Year 2005 Audits of Colleges and Universities without Findings

Bates Technical College	Eastern Washington University
Bellevue Community College	Green River Community College
Bellingham Technical College	Highline Community College
Big Bend Community College	Lake Washington Technical College
Cascadia Community College	Olympic College
Central Washington University	Seattle Community Colleges
Centralia College	South Puget Sound Community College
Clark College	Tacoma Community College
Clover Park Technical College	Walla Walla Community College
Columbia Basin Community College	Washington State University
Community Colleges of Spokane	Whatcom Community College

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Schedule of Audit Findings

State of Washington Department of Community, Trade and Economic Development

1. **The Department of Community, Trade, and Economic Development, Housing Division, does not adequately monitor the Housing Trust Fund loan contracts.**

Background

The Housing Division of the Agency manages the Housing Trust Fund, a \$351 million portfolio of loans that provide low-income housing throughout the state. No federal funds are involved in these loans.

The loans contain specific requirements for borrowers including provisions pertaining to tenant income levels, rent levels, property condition and safety and financial management. Many of the loans also contain terms advantageous to the borrowers, such as low- or no-interest terms and payments deferred for as much as the entire term of the loan. Many of the loans are forgiven after 25 to 50 years of compliance with loan conditions. Some loans establish revolving loan accounts for home purchases. The Division also awards what it calls "recoverable grants", or grants that sometimes must be partially repaid if the terms of the awards are not fully met.

To help ensure that funds are spent appropriately, the state requires agencies to monitor the contracts for compliance. Monitoring activities are to be based on a borrower's risk factors, such as the size and complexity of the housing project, amount of the loan and financial history of the borrower. Monitoring may take various forms, such as reviewing reports submitted by borrowers, contacting management of the low-income housing regularly and performing on-site reviews of financial records and operations. The Division also must ensure it receives and reviews audit reports from borrowers and must follow-up on any issues identified in those reports.

For the fiscal year 2004 audit, we communicated to management some monitoring issues we found and recommended strengthening these controls.

Description of Condition

We reviewed the Housing Trust Fund contract monitoring by examining the Division's policies, procedures, internal controls and evidence of monitoring. We found the Division had established adequate written procedures for the monitoring process. Part of the process includes the requirement that a borrower submit a specific annual report to the Division. We found the Division established a good system for tracking receipt of these reports. The system resulted in 67 percent of the requested contractors' annual reports being received on time; the rest were received within 110 days after the due date.

To review internal controls over monitoring and evidence of monitoring, we selected 20 high-risk contracts totaling \$12.6 million, which we identified as contracts with large loans, contracts that were not in compliance in some manner, contractors with several outstanding contracts and contractors included on the Division's "work out" report. This report lists low-income housing projects that are experiencing financial, physical and/or management challenges. The projects remain on the report until a solution is found.

We compared the monitoring of these 20 contracts to the monitoring requirements in the Division's written procedures. We found the Division:

- Had not evaluated any of the 20 contractors' annual reports for all seven criteria it established to use as a basis for evaluating these reports.
- Had not completed any risk assessments because the annual report evaluation process was not finished.
- Had not developed standards and/or procedures for monitoring home ownership loans.
- Did not request annual reports for three of the 20 contracts tested.
- Received only nine of 20 contractor's audit reports on time. Two of the reports still had not been received at the time of our review in October 2005. One of these was one year late, while none had been received for the second contractor since 1998.
- Did not comply with its own on-site monitoring procedures in almost half of the contracts we reviewed. The Division's frequency requirement for on-site monitoring is once every five years. This schedule was not met for eight of the contracts.
- Did no follow-up on identified problems for eight of the contracts to ensure corrective action had occurred.

Cause of Condition

The Division stated that no time remained in the fiscal year for monitoring after designing the monitoring procedures and the annual report process.

Effect of Condition

These conditions impair the Division's ability to prevent or detect errors and irregularities in a timely manner and increase the risk of loss of public funds.

Recommendation

We recommend the Division devote the resources necessary to ensure it follows its own procedures for monitoring contracts.

Agency's Response

We partially agree with the finding. The Department has had a long-standing recognition of its responsibility to monitor the Housing Trust Fund portfolio and has been diligently pursuing continuous improvement in asset management and monitoring. As a result, new guidelines and procedures were adopted July 1, 2005. The State Auditor's Office applied these new guidelines and procedures retroactively to contracts that had not been recently monitored or were terminated.

It will take some time to become completely compliant with these new guidelines and procedures, due to both the size of the portfolio and the capacity of the Housing Division. Effective July 2005, the Housing Division consolidated all of the on-site contract monitoring responsibilities into a single functional work team. Also, effective January 2006, the Division added an FTE to concentrate on site inspections and another FTE to concentrate on asset management activities. These resources, along with the further development and refinement of supporting systems, will allow the Division to continue moving toward full compliance with its

new guidelines and procedures. We appreciate the acknowledgement of the State Auditor's Office that this effort requires a commitment of additional resources.

General conclusions about the portfolio as a whole should not be made based on issues related to a small sampling of projects that are already acknowledged to have compliance issues by virtue of being on the HTF "workout list." Of the twenty projects reviewed by the SAO, sixty-five percent (13) were from the "workout list" and would naturally be assumed to have compliance issues. The HTF portfolio contains both grants and loans, all of which are made to non-profit agencies that develop housing for low-income individuals. Issues with a single project are often diminished by the overall health of the organization that is managing the project - a factor that is taken into consideration as HTF staff evaluate risk. The HTF portfolio is very healthy, with only five-percent (40 projects of over 800) of the total portfolio on a "workout list" at any given point in time. Given the twenty to fifty year term of these contracts it is natural to have compliance issues for a portfolio of this size. Overall, the fact that the department has developed an administrative review process for accessing risk should serve as assurance that the HTF portfolio is being managed proactively and that the public's interests are being protected.

Auditor's Concluding Remarks

We thank the Agency for its comments and for the substantial improvement it has made by providing adequate procedures for contract monitoring.

As we stated, we selected high-risk contracts for review. High-risk contracts are ones that, due to their nature, should receive the strongest and most timely monitoring. However, eight of these high-risk contracts had not been monitored on-site in over five years.

We identified specific weaknesses in order to identify specific areas in which the Agency could improve. We will review the Agency's work to resolve these issues in our next audit.

Applicable Laws and Regulations

The Revised Code of Washington 43.185.090, Housing Assistance Program, states in part:

Compliance Monitoring: The director shall monitor the activities of recipients of grants and loans under this chapter to determine compliance with the terms and conditions set forth in its application or stated by the department in connection with the grant or loan.

RCW 43.185.120 states:

Protection of state's interest: The department shall adopt policies to ensure that the state's interest will be protected upon either the sale or change of use of projects financed in whole or in part under RCW 43.185.050(2) (a), (i), and (j). These policies may include, but are not limited to: (1) Requiring a share of the appreciation in the project in proportion to the state's contribution to the project; (2) requiring a lump-sum repayment of the loan or grant upon the sale or change of use of the project; or (3) requiring a deferred payment of principal or principal and interest on loans after a specified time period.

The State Office of Financial Management's *State Administrative and Accounting Manual*, Section 16.10.42, states in part:

Managing and monitoring contracts

State agency staff are responsible to proactively manage and monitor their contracts. Effective management and monitoring of client service contracts is key to successful contracting results. Contract management includes any activity related to contracting for client services, including the decision to

contract, contractor screening, contractor selection, contract preparation, contract monitoring, auditing, and post-contract follow up. Contract monitoring includes the planned, ongoing, or periodic activity that measures and ensures contractor compliance with the terms, conditions, and requirements of the contract. The level of contract monitoring should be based on a risk assessment by the contract manager considering such factors as: amount of funding (large or small), complexity or sensitivity of contract services, vulnerability of clients, contractor experience and capability, multiple funding sources, contractor's prior audit experience, contractor's financial health, etc.

The Department of Community, Trade, and Economic Development, Housing Division, *Housing Trust Fund Guideline and Procedure Handbook*, Chapter 5, Compliance and Asset Management, states in part:

Section 500 Purpose

It is critical that the invested dollars yield what is expected, and the only way one can know that yield is being realized, is to regularly and methodically monitor . . .

The Compliance and Asset Management Unit is responsible for monitoring all projects that have been placed in service . . .

On-site monitoring is a critical aspect of compliance and asset management. On-site inspections of files and property condition will take place regularly for all projects in the portfolio. The frequency of on-site visits will depend on the funding source for the project as well as information gained from review of the annual report.

Section 501 Monitoring Housing Contractors, 501.1 Desk Monitoring, 501.1(a) Annual Reports

The Combined Funders Annual Report is the primary tool for monitoring the health of housing contracts and determining compliance with contract terms. . .

The Annual Report is due to the State's Housing Services Division no later than June 30 each year. The annual reporting period is for the calendar year beginning January 1st and ending on December 31st. Submitting annual reports is an important term and condition of housing contracts and failure to submit means the contractor is out of compliance.

Within 90 days of receiving the report, asset managers will conduct an initial review.

The Asset Managers assess the annual reports on the basis of seven criteria, which can be categorized into tenant and financial information . . .

Section 501.1(b) Records and Payments

As stated in housing contracts, organizations are required to submit audits and proof of insurance annually. Audits must be submitted no later than nine months after the end of the contractor's fiscal year. Contractors failing to provide audits or current proof of insurance will be out of compliance.

Section 501.1(c) Organizational Reviews

Organizations with five or more projects in the state portfolio will undergo an organizational review, which will include assessing all of the organization's annual reports together and reviewing audited financial information.

Section 501.2 On-site Monitoring

. . . The purpose of on-site monitoring is to verify information reported on the annual report and assess the physical condition of the property.

A portion of site visits may include time spent reviewing documents and policies and procedures . . . will usually involve "testing" a sample of tenant files to see how the organization would handle particular cases . . . including income certification, calculations of income and rent limits, and general file management and organization.

The second purpose of on-site monitoring is met by a physical inspection of the property and a sample of funded units. Inspections will be conducted in accordance with the standards set by the U.S. Department of Housing and Urban Development's Uniform Physical Conditions Standards . . . Generally, an inspection will look at between 15 – 20 percent of the units, with more being included if there appears to be compliance issues.

For HOME general purpose, multi-family funded projects, monitoring visits will be scheduled in accordance with HUD requirements . . .

Every three years for projects of one to four units;
Every two years for projects of five to 25 units;

Annually for projects with 26 or more units.

State funded projects will be visited no less than every five years.

Schedule of Audit Findings

State of Washington Department of Community, Trade and Economic Development

2. **The Department of Community, Trade, and Economic Development did not comply with state and federal regulations when contracting for services paid with federal Low Income Home Energy Assistance Program funds.**

Background

The Agency administers the Low Income Home Energy Assistance Program (CFDA 93.568), which provides funds for eligible low-income families and individuals to help pay home energy bills and weatherization projects. The Agency funds local governmental and non-profit organizations that directly serve these low-income residents.

In fiscal year 2005, the Agency spent grant funds of \$38.9 million: \$5.9 million through the Weatherization Section of the Agency and \$33 million through the Energy Assistance Section.

Federal regulations require states to follow their own policies and procedures when procuring services with federal funds. State contracting law and procedures require personal service contracts of \$20,000 or greater to be procured through a competitive process and, in some cases, to be filed with the Office of Financial Management before any contract work begins. Using an information technology master contract for the state does not permit an agency to bypass the competitive procurement process.

Description of Condition

The Agency did not comply with state law and regulations regarding competitive procurement for personal service contracts and, therefore, was not in compliance with federal regulations when it procured software consulting work totaling \$60,000. The Agency treated this as a purchased services contract when it more properly met the definition of personal services: professional or technical expertise provided by a consultant to accomplish a specific study, project, task or other work statement.

The Agency stated it selected a consultant from a list of pre-qualified contractors for a master contract maintained by the Department of General Administration. The Agency then prepared a field order for \$60,000 to the consultant for a study of database integration. We found the following issues with this process:

- According to General Administration contract specialists, this consultant has not been on the pre-qualified list cited by the Agency for the past few years.
- The Agency could not provide documentation to demonstrate it used a competitive process that allowed each consultant on the list an opportunity to bid for the contract.
- The contract, in the form of a field order, was not complete. It did not include signatures binding the parties, contract execution dates, due dates for the project, terms and conditions of the work required and budgeted amounts to be paid.
- The contract was never filed with the Office of Financial Management as a personal services contract.

- All payments were coded incorrectly to purchased services, rather than to personal services.

Cause of Condition

Staff members lacked knowledge regarding state procurement regulations.

Effect of Condition

- The Agency cannot ensure the state's resources were used in the most economical manner possible because the acquisition was not subject to competitive procurement procedures.
- Without proper documentation and signing of a contract, the Agency has no accurate record of binding contract terms. This could place the Agency in a situation in which the parties differ on the terms of the agreement, with a potential liability to the state.
- Purchased and personal service payments in the Agency's accounting records are both misstated.

We question the \$60,000 in federal funds paid for this software development in fiscal year 2005.

Recommendation

We recommend the Agency:

- More carefully analyze services to be provided to determine whether rules for purchased services or for personal services should be followed.
- Follow state procurement policies and procedures set out by the Office of Financial Management for personal service contracts.

Agency's Response

We agree with the finding that CTED did not comply with state law and regulations regarding the competitive procurement for personal service contracts. However, we made the initial determination that this was a purchased service and accessed the General Administration (GA) pre-qualified contractors listing to obtain a consultant. Based on our understanding at the time, we followed GA's competitive procurement process, which resulted in a Purchased Services Work Contract being executed. The Work Contract was for a survey of LIHEAP subrecipients with standalone data systems to create a common data dictionary and collect application schemas to facilitate integration with the Department's data system. The Work Contract contained a statement of work which included dates, terms and conditions, and a budget. The terms and conditions of the work contract were satisfactorily completed and the deliverables have benefited the LIHEAP program.

Subsequently the Department hired a Contracts Specialist to develop contracting policies and procedures. The Department's draft policies and procedures require a review of requests to issue a contract. The review includes a determination of contract type and classification.

Auditor's Concluding Remarks

We appreciate the Agency's commitment to resolving the issues identified in the finding and will review this area in our fiscal year 2006 audit. We also appreciate the cooperation extended to us throughout the audit by the Agency staff.

Applicable Laws and Regulations

The U.S. Office of Management and Budget's *Cost Principles for State, Local and Indian Tribal Governments*, Circular A-87, Attachment A, Section C, states in part:

1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:
 - c. Be authorized or not prohibited under State or local laws or regulations.

RCW 39.29.006 states in part:

(3) "Competitive solicitation" means a documented formal process providing an equal and open opportunity to qualified parties and culminating in a selection based on criteria which may include such factors as the consultant's fees or costs, ability, capacity, experience, reputation, responsiveness to time limitations, responsiveness to solicitation requirements, quality of previous performance, and compliance with statutes and rules relating to contracts or services.

(4) "Consultant" means an independent individual or firm contracting with an agency to perform a service or render an opinion or recommendation according to the consultant's methods and without being subject to the control of the agency except as to the result of the work. The agency monitors progress under the contract and authorizes payment.

(7) "Personal service" means professional or technical expertise provided by a consultant to accomplish a specific study, project, task, or other work statement . . .

(8) "Personal service contract" means an agreement, or any amendment thereto, with a consultant for the rendering of personal services to the state which is consistent with RCW 41.06.142.

The Office of Financial Management's *State Administrative and Accounting Manual*, states in part:

Section 15.10.10:

Personal services are to be procured and awarded by state agencies in accordance with the requirements of Chapter 39.29 RCW.

Section 15.10.15 states in part:

Personal Service – Professional or technical expertise provided by a consultant to accomplish a specific study, project, task, or other work statement.

Section 15.10.45 states in part:

Agencies shall not structure contracts to avoid the competitive procurement or other requirements of this policy.

Section 15.20.10 states in part:

. . . a documented, formal, competitive process called "competitive solicitation" is required for contracts of \$20,000 or greater.

Section 15.20.40 states in part:

Master Contracts. The term “master” personal service contracts, as used in this policy, refers to competitively solicited personal service contracts awarded by the Department of General Administration and the Department of Personnel for use by other state agencies. The Department of General Administration (GA), Office of State Procurement (OSP), Professional Service Solutions (PS2) unit, uses two separate processes – one for personal service contracts that are not for information technology (IT) services and one for information technology personal service contracts.

. . . For IT personal service contracts, GA conducts the initial competition and awards the master contracts (also referred to as primary agreements), but does NOT file them with OFM. To procure personal services under the IT master contracts, a second-tier competition is conducted. GA (or the agency) sends a Work Request to consultants/vendors for the applicable category. The agency evaluates responses, awards a Work Contract between the agency and the contractor, files the Work Contract with OFM, and provides a fully executed copy of the Work Contract to GA. GA’s competitive processes for . . . IT personal services meet OFM’s requirements for formal solicitation.

Agencies are responsible to maintain adequate documentation of the second-tier competitive process when using GA’s master personal service contracts to substantiate that all bidders were treated equally and fairly and that an equitable and impartial competition was conducted.

Simply accessing names of firms from GA’s list of master contractors in a particular category does not satisfy the requirement for second-tier competition. Also, just awarding a contract to a firm from GA’s list does not satisfy the requirement for second-tier competition.

Section 20.20.20 states in part:

Each agency director is responsible for establishing and maintaining an effective system of internal control throughout the agency.

Schedule of Audit Findings

State of Washington Department of Community, Trade and Economic Development

3. The Department of Community, Trade, and Economic Development did not comply with earmarking requirements for the Low Income Home Energy Assistance Program.

Background

The Agency administers funds from the Low Income Home Energy Assistance Program (CFDA 93.568) and disburses these funds to local governmental and non-profit organizations that directly serve low-income residents. The Program provides funds to help eligible low-income families and individuals pay for their home energy bills and for weatherizing their homes.

In fiscal year 2005, the Agency spent Program funds of \$38.9 million: \$5.9 million through the Weatherization Section of the Agency and \$33 million through the Energy Assistance Section.

State agencies receiving federal funds often must agree to federally specified funding limits, either minimum or maximum dollar amounts or percentages, for certain types of activities. This is known as earmarking and helps ensure funds are spent in a manner consistent with Program requirements. The earmarking computation for this Program can only be made at the end of each two-year grant period.

The federal government specifies that payments for weatherization activities in this Program may not exceed 15 percent of the award, less any adjustment for leveraging incentive awards, unless the Agency applies for, and is granted, a waiver. The leveraging incentive awards are incentive payments that the state receives for obtaining funds from other sources that contribute to home energy resources. Examples of such sources include contributions from utility companies or individuals.

Description of Condition

We used the 2003 Program grant to review earmarking, since it was the only two-year grant that ended during the audit period. The 2003 grant covered October 1, 2002 through September 30, 2004.

The earmarking calculation for the 2003 grant, which included adjustment for leveraging incentive awards, resulted in \$5,705,493 as the maximum the Agency could spend on weatherization. The Agency spent \$6,182,102 for weatherization, exceeding the earmarking requirement by \$476,609.

Cause of Condition

Since 1988, the Agency has interpreted "the State", in the Low-Income Home Energy Assistance Act of 1981, Public Law 97-35, to mean the state of Washington and all Indian tribes in the state, even though the tribes receive separate awards. Based on this interpretation, the Agency has included both the funds for the state and the funds for the tribes in Washington to calculate its earmarking amount.

Effect of Condition

This method of calculating the earmarking amount increases the maximum beyond the amount allowed by federal regulations. The calculation resulted in expenditures of \$476,609 more than were allowed. We are questioning these costs.

Recommendation

We recommend the Agency:

- Calculate the weatherization earmarking requirement in compliance with Program laws and regulations.
- Contact the grantor, U.S. Department of Health and Human Services, to determine if repayment of the federal funds is required.

Agency's Response

We disagree with the finding. The Department of Health and Human Services (HHS), by national formula, allocates LIHEAP funds to each state, which includes an allocation to the state and a tribal set-aside. For at least the past eighteen years, CTED has used the total amount allocated to all Washington recipients as the basis for computing the maximum amount to be spent on the Weatherization Program. The calculation has been a part of the Annual Plan submitted to and approved by HHS each year.

No Indian tribe in the state provides Weatherization activities because the start-up costs are too expensive. Tribes use their allotment of LIHEAP funds solely for heating assistance. Tribal members receive Weatherization assistance from the funds distributed to CTED's subrecipients for that purpose.

The 15 percent limitation pertains to Weatherization Assistance Benefits only, not total program expenditures. Total expenditures include administrative costs, which are calculated separately. Administrative costs are limited to 10 percent of total available funds. For the 2003 grant period, total Weatherization program expenditures (including administration) exceeded 15 percent of total available funds, but Weatherization Assistance Benefits expenditures, as calculated by HHS, did not exceed 15 percent of total available funds, therefore there are not questioned costs.

Auditor's Concluding Remarks

As part of our review, we re-performed the earmarking calculation according to federal criterion and compared the result to the amount actually spent for weatherization. We concluded that the Agency was not in compliance with that criterion.

After re-evaluating our calculations based upon the Agency's response and other information it provided at the exit conference, we reaffirm our conclusion. We appreciate the cooperation extended to us throughout the audit by Agency staff and will review this issue in our fiscal year 2006 audit.

Applicable Laws and Regulations

The U.S. Office of Management and Budget's Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, Attachment A, Section C, states in part:

1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

d. Conform to any limitations or exclusions set forth in these principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

The Low-Income Home Energy Assistance Act of 1981 (Title XXVI Of The Omnibus Budget Reconciliation Act of 1981, Public Law 97-35, as amended) states in part:

Section 2603 [42 USC section 8622] Definitions Paragraph (10)

The term "State" means each of the several States and the District of Columbia.

Section 2605 [42 USC section 8624] Applications and Requirements Paragraph (k)

Paragraph (k) (1) states:

Except as provided in paragraph (2), not more than 15 percent of the greater of—

- (A) the funds allotted to a State under this subchapter for any fiscal year; or
- (B) the funds available to such State under this subchapter for such fiscal year;

may be used by the State for low-cost residential weatherization or other energy-related home repair for low-income households, particularly those low-income households with the lowest incomes that pay a high proportion of household income for home energy.

(2)(B) . . . the Secretary may grant a waiver to a State for a fiscal year if the State submits a written request to the Secretary after March 31 of such fiscal year . . .

The 2003 Detailed Washington State Plan, in effect during 2004 and 2005, states in part:

Statutory Reference: 2605(c)(l)(C)

Please estimate what amount of available LIHEAP funds will be used for each component that you will operate: (The total of all percentages must add up to 100%.)

70.83 % heating assistance	
2605(k)(1)	14.04% weatherization assistance
2605(b)(9)	10.00% administrative and planning costs
2605(b)(16)	5.00% services to reduce home energy needs including needs assessment (assurance 16)
	0.13% (\$35,000) used to develop and implement leveraging activities (limited to the greater of 0.08% or \$35,000 for States, the greater of 2% or \$100 for territories, tribes and tribal organizations).
	100% TOTAL

The Washington State Abbreviated Plans for 2004 and 2005, state in part:

2004 Use of Funds: Please estimate what amount of available LIHEAP funds will be used for each component that you will operate:

2605(c)(1)(C) 70% heating assistance
2605(k)(1) 15% weatherization assistance

2005 Use of Funds: Please estimate what amount of available LIHEAP funds will be used for each component that you will operate:

2605(c)(1)(C) 70.83% heating assistance

2605(k)(1) 14.04% weatherization assistance

Schedule of Audit Findings

State of Washington Department of Community, Trade and Economic Development

4. **The Department of Community, Trade and Economic Development is not complying with federal requirements for time and effort reporting for the Low Income Home Energy Assistance Program.**

Background

For payroll costs charged directly to federal awards, federal regulations require employees to document their time and effort spent on each federal activity monthly. These monthly records must reflect the actual distribution of the employee's activities between two or more programs and are used as a basis for requesting federal funds. If an employee works solely on one federal activity, semi-annual certifications signed by the employee or a supervisor meet federal requirements. Budget estimates, as a basis for requesting funds, are allowable on an interim basis only if adjustments to actual costs are made at least quarterly.

The Office of Financial Management has delegated to each applicable agency the responsibility for determining the best method for fulfilling these requirements.

Description and Cause of Condition

In our fiscal years 2003 and 2004 state Accountability Reports and state of Washington Single Audit Reports, we reported the Agency was not complying with time and effort requirements for this Program. Time charged to Program funds was based on budgeted rather than actual amounts.

During our audit of the corrective action plan for the previous findings, we found the Agency had corrected time and effort problems in this Program. We reported this result to the Agency. Then, in an adjustment made at the end of the fiscal year to correct charges to the indirect cost plan, the Agency moved payroll charges for three employees from state funds to these federal Program funds. The adjustment for the payroll charges was not supported by the employee time records.

We question the \$16,843 in federal funds charged to this Program as a result of the adjustment.

Effect of Condition

Without adequate time and effort documentation to include time records and certifications, the federal grantor cannot be assured that salaries and wages charged to its program are accurate and valid. This could jeopardize future federal funding to the state.

Recommendation

We recommend state agencies receiving federal funds maintain time and effort records that comply with federal regulations and consult with the federal grantor to determine whether any questioned costs should be repaid.

Agency's Response

We agree with the finding. At the end of the fiscal year, five journal voucher entries were made to transfer salary and benefit expenditures between programs. The affected employee's timesheets were not corrected. The adjustments were not to correct charges to the indirect cost plan. Immediately upon being notified of the issue, the Department enhanced procedures by (1) re-focusing resources to implement tighter controls over the review and approval of journal voucher entries and (2) identifying procedures to ensure all corrections of salaries and benefits include the necessary corrections to employee timesheets.

Auditor's Concluding Remarks

We appreciate the Agency's efforts to address this issue. For our audit of fiscal year 2006, we look forward to reviewing procedures that ensure time and effort charges are maintained on an actual basis, that corrections to reflect actual usage are adequately documented and that approved adjustments are prepared for those corrections. We also appreciate the cooperation extended to us throughout the audit by the Agency staff.

Applicable Laws and Regulations

For certain block grant programs, like LIHEAP, federal regulations give an exemption from federal cost principles, provided the state adopts its own cost principles consistent with federal requirements. The federal Department of Health and Human Services, Office of the Inspector General, provided us with guidance that it considers the U.S. Office of Management and Budget's Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, to be the benchmark for state cost principles since the state of Washington has not adopted its own cost principles in conformance with this Circular.

Attachment A, Section C.3 of the Circular requires allocable costs to be chargeable or assignable in accordance with the relative benefits received.

Attachment B, Section 8(h) of the Circular, states in part:

(a) Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.

(1) Charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit.

(2) No further documentation is required for the salaries and wages of employees who work in a single indirect cost activity.

(3) Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee.

(4) Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation which meets the standards

in subsection (5) unless a statistical sampling system (see subsection (6)) or other substitute system has been approved by the cognizant Federal agency. Such documentary support will be required where employees work on:

- (a) More than one Federal award,
- (b) A Federal award and a non Federal award,
- (c) An indirect cost activity and a direct cost activity,
- (d) Two or more indirect activities which are allocated using different allocation bases, or
- (e) An unallowable activity and a direct or indirect cost activity.

(5) Personnel activity reports or equivalent documentation must meet the following standards:

- (a) They must reflect an after the fact distribution of the actual activity of each employee,
- (b) They must account for the total activity for which each employee is compensated,
- (c) They must be prepared at least monthly and must coincide with one or more pay periods, and
- (d) They must be signed by the employee.
- (e) Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards but may be used for interim accounting purposes, provided that:

- (i) The governmental unit's system for establishing the estimates produces reasonable approximations of the activity actually performed;
- (ii) At least quarterly, comparisons of actual costs to budgeted distributions based on the monthly activity reports are made. Costs charged to Federal awards to reflect adjustments made as a result of the activity actually performed may be recorded annually if the quarterly comparisons show the differences between budgeted and actual costs are less than ten percent; and
- (iii) The budget estimates or other distribution percentages are revised at least quarterly, if necessary, to reflect changed circumstances.

(6) Substitute systems for allocating salaries and wages to Federal awards may be used in place of activity reports. These systems are subject to approval if required by the cognizant agency. Such systems may include, but are not limited to, random moment sampling, case counts, or other quantifiable measures of employee effort.

(a) Substitute systems which use sampling methods (primarily for Temporary Assistance to Needy Families (TANF), Medicaid, and other public assistance programs) must meet acceptable statistical sampling standards including:

- (i) The sampling universe must include all of the employees whose salaries and wages are to be allocated based on sample results except as provided in subsection (c);
- (ii) The entire time period involved must be covered by the sample; and

(iii) The results must be statistically valid and applied to the period being sampled.

(b) Allocating charges for the sampled employees' supervisors, clerical and support staffs, based on the results of the sampled employees, will be acceptable.

(c) Less than full compliance with the statistical sampling standards noted in subsection (a) may be accepted by the cognizant agency if it concludes that the amounts to be allocated to Federal awards will be minimal, or if it concludes that the system proposed by the governmental unit will result in lower costs to Federal awards than a system which complies with the standards.

(7) Salaries and wages of employees used in meeting cost sharing or matching requirements of Federal awards must be supported in the same manner as those claimed as allowable costs under Federal awards.

Schedule of Audit Findings

State of Washington Department of Community, Trade and Economic Development

5. The Department of Community, Trade, and Economic Development, Energy Assistance Section, is not complying with subrecipient monitoring requirements for the Low Income Home Energy Assistance Program.

Background

State agencies often award federal funds to organizations that provide services needed to accomplish federal program objectives. These organizations are known as subrecipients, while the state agencies are called pass-through agencies.

To help ensure funds are spent appropriately, the federal government requires pass-through agencies to monitor the activities of subrecipients to provide reasonable assurance that they are complying with federal requirements. Monitoring should be based upon the risk at the subrecipient level and may take various forms, such as reviewing reports submitted by subrecipients, maintaining regular contact with subrecipients, and performing on-site reviews of subrecipient financial, operations and program records.

Risk factors that may affect the degree of monitoring include program complexity, amount of the award and risks directly related to the subrecipient. Pass-through entities must also ensure they receive and review applicable audit reports from subrecipients and follow-up on any problems identified in those reports.

In the Program's current Washington State Plan, the Agency provides assurances related to its subrecipient monitoring and describes the methods it uses for this activity. In fiscal year 2004, we suggested improvements to the Agency's subrecipient monitoring documentation.

In fiscal year 2005, the Agency spent \$38.9 million from the Low Income Home Energy Assistance Program; the Energy Assistance Section spent \$33 million of this amount. Of the \$38.9 million in payments, 91.5 percent was passed through to subrecipients.

Description of Condition

For 2005, we reviewed Program subrecipient monitoring activities and found the Energy Assistance Section does not perform adequate subrecipient monitoring. We found:

- Risk assessments were not adequately and consistently performed and did not always include a review of:
 - Subrecipient single audit reports to identify weaknesses that could affect the Program.
 - Subrecipient cost allocation plans and indirect cost classifications to determine if these areas required review during on-site visits.
 - Staff correspondence to evaluate observations of potential weaknesses with subrecipient operations.

- Monitoring plans were not always adjusted to include the effect of issues such as those above.
- Documentation was not always sufficiently complete to establish that on-site visits were adequately performed.

We also found the Program and fiscal office subsidiary records that track advance payments to subrecipients did not always reconcile with each other or with the state's accounting records.

Cause of Condition

The Energy Assistance Section has not established and put into place adequate policies and procedures for monitoring subrecipient activities and payments.

Effect of Condition

The Agency cannot ensure its subrecipients are complying with federal requirements and using the funding for allowable purposes. This could jeopardize future federal funding for the Program.

Recommendation

We recommend the Agency develop subrecipient monitoring policies and procedures that include requirements that:

- Risk assessments address significant risk areas.
- Monitoring plans address risk assessments and change as conditions change.
- Desk monitoring and site visits be sufficiently documented.
- Employees receive adequate training as to what constitutes sufficient monitoring documentation to be retained.
- Proper reconciliations are made between Agency records and the state's accounting system for payments made in advance to subrecipients.

Agency's Response

We partially agree with the finding. The LIHEAP block grant has policies and procedures in place for monitoring subrecipient activities and payments. These policies and procedures apply to LIHEAP and are coordinated with other federal and state programs administered by CTED. In some cases, documentation was not totally completed because the program has a 25 year on-going relationship with the network of Community Action Agencies, who are the subrecipients. This statewide network of subrecipients is assessed, reviewed and monitored by a variety of programs within CTED and the information is shared among all the programs. This sharing of information was not always fully documented, but did contribute to adequately managing risk of all of the Community Action Agencies in our contracting portfolio.

In response to auditor concerns, the LIHEAP program has consolidated several policies, procedures and protocols into one comprehensive document. This will ensure better and more complete documentation of risk assessment and monitoring activities. Additionally, the risk assessment of all of the Community Action Agencies in the closely aligned Community Services Block Grant will be enhanced.

Payments and advances to contractors are reconciled monthly and any concerns noted by the auditors were explained. All contractor payments were verified before draws of federal funds were made.

Auditor's Concluding Remarks

We appreciate the Agency's commitment to resolving the issues identified in the finding and will review these areas in our fiscal year 2006 audit. We also appreciate the cooperation extended to us throughout the audit by Agency staff.

Applicable Laws and Regulations

The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Section .400(d), states in part:

(d) Pass-through entity responsibilities. A pass-through entity shall perform the following for the Federal awards it makes:

(3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

(4) Ensure that subrecipients expending \$300,000 (*\$500,000 for fiscal years ending after December 31, 2003*) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

The Washington State Plan in effect for the Program during fiscal year 2005 states in part:

Assurances:

The Department of Community, Trade and Economic Development agrees to:

(10) provide that such fiscal control and fund accounting procedures will be established as may be necessary to assure the proper disbursement of and accounting for Federal funds paid to the State under this title, including procedures for monitoring the assistance provided under this title, and provide that the State will comply with the provisions of chapter 75 of title 31, United States Code (commonly known as the "Single Audit Act")

The Plan continues in question-and-answer format:

Statutory Reference: 2605(b)(10) **PROGRAM, FISCAL MONITORING, AND AUDIT**

How do you ensure good fiscal accounting and tracking of LIHEAP funds? (Please describe. Include a description of how you monitor fiscal activities.)

CTED internal control systems include: annual contractor financial and compliance audits, monthly budget-to-expenditure controls, and periodic monitoring of contractors by CTED staff.

An initial advance payment will be issued if: sufficient funds are available from HHS; CTED has received from a contractor the signed contract and a payment request for the first half of October; and the

previous Program Year contract has been adequately reconciled. If funds from HHS are delayed or awarded incrementally, CTED will impose a spending limit. Payments made under the contract will be limited until complete funding is awarded and the spending limit is eliminated.

Advance and reimbursement payment systems will be used after the initial advance payment. The Policies and Procedures for EAP specify the payment systems to be used by CTED and its contractors. Upon final reconciliation at the end of the program year, unspent funds will be recovered by CTED and a plan for their use developed and submitted to HHS.

CTED maintains a system that ensures fiscal control internally and with its local contractors.

How do you monitor program activities? (Please be sure to include a description of how you monitor eligibility and benefit determination.)

CTED representatives periodically monitor each local program contractor on site to ensure that LIHEAP is managed effectively, and complies with federal and state statutes and regulations and the program policies and procedures. This includes reviewing financial management systems, reporting practices, outreach activities, eligibility determination and documentation, and other service delivery activities. A corrective action plan may be required to address issues raised during the review. A monitoring review report sent to the contractor's Executive Director includes findings and correction action plan items to be addressed. A statewide computerized screening system which includes data taken from the client intake form prevents duplication of service. A summary of the demographic data compiled from the client intake forms will be submitted to CTED.

Schedule of Audit Findings

State of Washington Department of Community, Trade and Economic Development

6. The Department of Community, Trade and Economic Development did not comply with federal requirements for suspension and debarment for the Home Investment Partnership Program.

Background

The Agency administers the federal Home Investment Partnership Program (CFDA 14.239), also referred to as the HOME program. The objectives of the HOME program are to:

- Expand the supply of decent and affordable housing, particularly to low- and very low-income residents.
- Strengthen the abilities of state and local governments to provide adequate supplies of affordable housing.
- Provide financial and technical assistance to states.
- Strengthen partnerships among governments involved with providing affordable housing.

The Agency reported total HOME expenditures of \$13,412,319 for fiscal year 2005. Approximately 91 percent of these expenditures were awards passed through to subgrantees, such as local governments and non-profit organizations.

Federal grantors prohibit recipients of federal awards from contracting with entities that have been suspended or debarred from receiving federal funds. The federal government can debar a party with convictions for fraud, anti-trust violations, forgery or other offenses indicating a lack of business integrity or honesty, a history of failure to perform agreements or a failure to pay a substantial debt. Suspension is usually a preliminary step that may lead to debarment.

New federal regulations, effective in November 2003, offer three options for grant recipients to verify that proposed contractors are not suspended or debarred. In addition, grant recipients must inform their subgrantees that they are responsible for following the same suspension and debarment requirements.

Description of Condition

The Agency is not in compliance with federal suspension and debarment requirements. The Agency included a descriptive clause or condition in the contracts for two sections of the HOME program: Tenant Based Rental Assistance and Housing Repairs and Rehabilitation Program. However, the Agency failed to include a notification that the subgrantees also have responsibilities regarding suspension and debarment when they make further awards or vendor payments. We estimate the payments related to these two sections of HOME during fiscal year 2005 totaled \$4.9 million. This condition was previously reported in the fiscal years 2003 and 2004 state Accountability Reports and state of Washington Single Audit Reports.

Cause of Condition

Agency management stated the Tenant Based Rental Assistance Section did not believe its contracts required this prescribed language regarding suspension and debarment. The Housing

Repairs and Rehabilitation Program contracts did not have the correct version of the language because the Program Manager was not told about the revised language requirement in time to insert it into the contracts. The Agency stated the next round of contracts will have the correct suspension and debarment language.

Effect of Condition

Subgrantees' lack of knowledge could make them susceptible to receiving their own audit findings if they also fail to follow suspension and debarment requirements. The Agency may be liable for any amounts paid by the subgrantees to contractors who have been suspended or debarred from receiving federal funds.

Recommendation

We recommend the Agency review its contracts for the HOME program to ensure they comply with the new suspension and debarment requirements

Agency's Response

We partially agree with the finding. The Housing Division's Housing Repairs and Rehabilitation program (HRRP) believed they were in compliance and did not update contract language to include the specific lower tier notification requirements. All HRRP contractors have now signed certifications acknowledging the suspension and debarment requirements, including the lower tier notifications. This was completed on February 28, 2006.

The Housing Division's contractors for the Tenant Based Rental Assistance program (TBRA) are responsible for the determination of low-income family eligibility to receive rental assistance and pay for the family's rent with vouchers directly to landlords. They do not deal with lower tier contractors, so notification is not warranted. However, in response to auditor concerns, as of February 10, 2006, the notification language has been included in all existing contracts.

Auditor's Concluding Remarks

We appreciate the Agency's commitment to resolving the issue identified in the finding and will review this area in our fiscal year 2006 audit.

Applicable Laws and Regulations

Title 24 of the Code of Federal Regulations, Section 24.220, regarding procurement contracts included as covered transactions, states in part:

(b) Specifically, a contract for goods or services is a covered transaction if any of the following applies:

(1) The contract is awarded by a participant in a nonprocurement transaction that is covered under Sec. 24.210, and the amount of the contract is expected to equal or exceed \$25,000.

24 CFR 24.300 states:

When you enter into a covered transaction with another person at the next lower tier, you must verify that the person with whom you intend to do business is not excluded or disqualified. You do this by:

- a) Checking the EPLS (Excluded Parties List System)
- b) Collecting a certification from that person if allowed by this rule
- c) Adding a clause or condition to the covered transaction with that person.

24 CFR 24.330, subpart C, states:

Before entering into a covered transaction with a participant at the next lower tier, you must require that participant to -

- a) Comply with this subpart as a condition of participation in the transaction. You may do so using any method unless section 24.440 requires a specific method be used.
- b) Pass the requirement to comply with this subpart to each person with whom the participant enters into a covered transaction at the next lower tier."

24 CFR 24.440 states:

To communicate the requirements to participants, you must include a term or condition in the transaction requiring the participant's compliance with subpart C of this part and requiring them to include a similar term or condition in lower tier covered transactions.

Schedule of Audit Findings

State of Washington Department of Ecology

1. The Department of Ecology is not complying with subrecipient monitoring requirements for the Clean Water State Revolving Loan Funds Program.

Background

State agencies often award federal funds to organizations that provide services needed to accomplish federal program objectives. These organizations are known as subrecipients, while the state agencies are known as pass-through agencies.

The federal Clean Water State Revolving Loan Fund Program (CFDA 66.458), which the Agency administers providing low-interest loans to subrecipient state agencies, local governments and Indian tribes for wastewater treatment facilities, and related activities, and for reduction of water pollution sources. Typical program projects are site-specific facilities planning, design and construction, land acquisition and collection and side sewer installations. In fiscal year 2005, the Agency spent program funds totaling \$22,179,915. Of that amount, 96 percent was in the form of loans to subrecipients.

To help ensure funds are spent appropriately, the federal government requires pass-through agencies to monitor the activities of subrecipients providing reasonable assurance they are in compliance with federal requirements. Monitoring includes reviewing documentation such as billings, subrecipient progress reports and audits of subrecipients, and performing on-site reviews of subrecipient financial, operational and program records.

To help comply with this requirement, the Agency established policies and procedures to identify conditions that could increase risk for loan recipients and warrant the consideration of increased subrecipient oversight. This process requires:

- Selected loan recipients to provide the Agency with copies of invoices and receipts to verify costs submitted on payment requests.
- The establishment of requirements for site visits and related documentation.

Description of Condition

The Agency could not demonstrate that it was complying with its policy and the subrecipient monitoring requirements for this grant.

We noted the following:

- The active workload spreadsheet, which is used to track projects, did not include time frames identified as appropriate for oversight.
- Staff members could not clearly identify why projects were placed on increased oversight or when and why they were removed from the active workload spreadsheet.
- Documentation in the file of the extent and frequency of monitoring was not sufficient to determine if the increased oversight requirement was met.

Cause of Condition

Program staff members believed that keeping a current list of projects to be monitored was sufficient to document the monitoring process. They also believed project files were adequately documented to support the increased oversight process.

Effect of Condition

The Agency cannot ensure its subrecipients are complying with federal requirements and using the funding for allowable purposes. This could jeopardize future federal funding for the program.

Recommendation

We recommend the Agency provide adequate documentation to support monitoring of subrecipients through reports and site visits as identified in the policy on increased oversight.

Department's Response

The Department takes its grant and loan tracking and subrecipient monitoring responsibility very seriously and has developed a number of procedures to implement its Risk Based Determination Policy. The Department does agree that more can be done to improve how the tracking and reporting aspects of the policy are being documented in the files and is actively taking steps to address more thoroughly the subrecipient monitoring condition noted in this audit.

- *The active workload spreadsheet is being updated to handle dates and time frames for projects identified for increased oversight.*
- *Staff is currently developing a new project tracking form for increased oversight and payment request processing. The form will include the reason/determination, effective dates, increased oversight conditions and requirements (payment backup and site visit schedule), payment request processing dates, check boxes for meeting requirements, and the method in which the Financial Manager verified costs.*

The Department looks forward to working with staff from the Office of the State Auditor to ensure that the improvements being made are adequate to address the outstanding issues.

Auditor's Remarks

We appreciate the Agency's commitment to resolving the issues identified in the finding and will review this issue in our fiscal year 2006 audit. We also appreciate the cooperation extended to us throughout the audit by Agency staff.

Applicable Laws and Regulations

The U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Section .400(d), states in part:

Pass-through entity responsibilities. A pass-through entity shall perform the following for the Federal awards it makes . . .

- (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

Title 40 Code of Federal Regulations, Section 30.51, "Monitoring and reporting program performance", states:

(a) Recipients are responsible for managing and monitoring each project, program, subaward, function or activity supported by the award. Recipients shall monitor subawards to ensure subrecipients have met the audit requirements as delineated in Sec. 30.26.

The Department's Water Quality Program Project Management WQP Policy 2-07 provides procedures for risk-based determination for increased oversight process of these loans.



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