



Washington State Auditor's Office

2002 Statewide Accountability Report



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.

**STATE AUDITOR'S OFFICE
STATE OF WASHINGTON ACCOUNTABILITY REPORT
FISCAL YEAR 2002**

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February 10, 2003

Dear citizens, policymakers and other interested parties:

We are pleased to issue our 2002 statewide report on state government accountability.

This report looks at what we found during our audits in 2002. It reflects our continuing efforts to look at issues on a statewide, rather than agency-by-agency basis. We believe this approach gives a more balanced and comprehensive view of state government operations.

In 2002, we continued to look at whether people receiving benefits from the state were eligible to do so; state contracts; and controls over cash-handling and computer access, among other areas. We did identify several areas in which improvements could be made, and also recognized areas in which agencies had made improvements. We appreciate our good working relationship with agencies that want to ensure they are accounting for precious public dollars.

Finally, I would like to thank our staff for their diligence and professionalism as they go about their work each day, finding issues and making suggestions for improvements to agencies' financial operations. Their expertise is invaluable to the state's citizens.

I hope you find this report useful. I encourage you to contact our Office with any questions or comments you may have.

Sincerely,

**BRIAN SONNTAG, CGFM
STATE AUDITOR**

State Auditor's Office Mission

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

State Auditor's Office Audits

The Washington State Auditor's Office regularly audits 175 state agencies ranging from the largest, such as the Department of Social and Health Services, to the smallest, such as the Asparagus Commission. State agencies include all public colleges and universities in Washington.

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 that agencies adhere to laws and regulations relating to financial matters.

The Office performs audits on:

- Areas that pose the highest risk for the misappropriation, misuse or loss of public funds or for noncompliance with state laws and regulations.
- The State of Washington's General Purpose Financial Statements.
- More than \$9 billion in federal funds received by the state.
- Funds kept by agencies that are not in the care or custody of the Office of State Treasurer. These are known as local funds.

We also have responsibilities in two other areas:

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

High Risk/Legal Compliance Audit

The Office has many competing responsibilities in conducting audits. Our high-risk approach helps ensure a proper balance of our efforts with these responsibilities, enabling us to look at areas that are the most important to the citizens of Washington, our audit clients, the Legislature, and other policymakers.

An important part of our audits comes through the recommendations we make on how agencies can best safeguard public assets. This can include everything from improved cash-handling procedures to tagging inventory to prevent loss.

We use many techniques to detect misappropriation or misuse of public assets and violations of state laws. Some of those are listed below. However, none would be effective without the strong communication skills of our auditors and a solid understanding of the financial processes of each agency we audit.

Computer-assisted auditing techniques have given us a new tool to assess 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.

We also use analytical procedures throughout an audit. The different types of analyses are too numerous to mention here. However, they typically have a common purpose: to identify account balances that differ from an informed expectation. We often use these procedures to audit revenue streams, looking for activity outside our expectations that can 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 perform surprise cash counts, which are a powerful tool for assessing the state of controls over money collected at a given location and for finding indications that a fraud may have occurred.

We audit certain computer applications for security over access and for 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 misuse or destruction of data. Recommendations from these audits over the past year have helped many state agencies tighten controls over access to computer systems. This improves their chances of preventing misappropriation or loss or detecting it in a timely manner. These audits also have helped our auditors identify areas in which assets are most at risk.

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 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 2002 report in December of 2002. 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, 2002, total state revenues were \$28 billion and expenditures/expenses in all funds were \$33 billion. Most of this difference was caused by stock market losses that resulted in pension fund expenses exceeding revenues by more than \$4 billion.

For the last 15 years, the state has received a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officer's Association. This award recognizes conformance with the highest standards for preparation of state and local government financial reports.

Our audit of the financial statements is conducted in accordance with governmental auditing standards generally accepted in the United States of America, which 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.

The State Auditor's Office has achieved a significant reduction in audit costs in recent years by adopting a risk-based approach to our audits. Evidence obtained from high-risk audits of state agencies, which are designed to detect misappropriation, misuse or loss, also is used to support our opinion on financial statements. By leveraging the results of the high-risk work, we perform only the level of review needed to give an opinion on the financial statements. This approach allows us to complete the audit in the most efficient manner possible.

State of Washington Single Audit

The State Auditor's Office audits federal grant expenditures made by the state of Washington. That audit is performed in accordance with the federal Office of Management and Budget's Circular A-133 and is referred to as the State of Washington Single Audit (SWSA). The Auditor's Office has been performing this single audit since 1987. Prior to that time, federal grants were audited as a part of each agency's individual audit.

For the fiscal year ended June 30, 2002, the state spent more than \$9 billion in federal assistance. The largest single grantor was the Department of Health and Human Services, which provides funding for programs such as Medicaid and Temporary Assistance for Needy Families. In the last five years, we have reported 58 findings related to federal grants. Historically, the majority of the federal findings have been in the area of allowable activities and allowable costs. Other areas with frequent findings are cash management, eligibility, reporting, and subrecipient monitoring.

We reviewed internal controls and compliance with grant requirements for 24 programs for the fiscal year 2002 SWSA. The federal grant findings we identified are included in this report, as they relate to legal compliance and high risk. These federal findings will also be presented in a separate single audit report to be prepared by the Office of Financial Management and issued to the federal government sometime in February.

Whistleblower Program

The State Employee Whistleblower Protection Program, administered by our Office, provides state employees with a safe and confidential means to report those actions that can impair the integrity of public government and undermine the public's confidence.

The law authorizes our Office to investigate and report on assertions of improper governmental action that result from violations of federal or state law or rule; a gross waste of public funds; or actions which are of substantial and specific danger to public health or safety. The law also provides remedies to state employees who believe that workplace reprisal or retaliatory action has occurred as a result of having filed, or provided information in connection with, a report of improper governmental action that results in a whistleblower investigation. The Human Rights Commission is responsible for handling retaliation issues.

During the calendar year 2002, the Whistleblower Program substantiated 54 percent of the 74 cases investigated. For those cases involving expenditures, we sought recovery of more than \$39,000 and were instrumental in recovering more than \$14,000. We continue to work hard to complete our investigations in a timely manner. We currently average 114 days per investigation.

In addition to recovery, the Whistleblower Program collaboratively works with state agencies to develop plans of resolution to prevent improper governmental actions from recurring. For example, we have reviewed or helped create agency policies and procedures regarding personal use of state resources. We also have made recommendations on agency internal controls and agency-wide training. In addition to improvements in policies, procedures and internal controls, our investigations have resulted in formal training, terminations, demotions, reductions in pay, formal training, and letters of reprimand. This proactive approach results in greater public accountability, and ensures that public resources are appropriately used.

The Fraud Program

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

We deal with an average annual workload of 33 frauds averaging approximately \$620,000 in losses each year. In the past 16 years, we have investigated over 530 frauds totaling almost \$10 million in losses.

In the past year, we have reported on more than \$1.1 million in fraud in state agencies and local governments. This includes the largest fraud (\$839,707) ever investigated by our Office.

Our Fraud Investigations Manager monitors all fraud cases throughout the state. In addition, each of our 17 audit teams has designated a fraud specialist.

Fraud prevention and detection is an integral part of our risk-based audit approach. This improved audit direction has produced more meaningful information and more recommendations on how to improve accountability in government.

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 2,000 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 a significant amount. Over the years, we have seen the number of frauds detected by managers grow, an indication that our training has helped managers detect

fraud early and keep losses to a minimum. This tells us that our fraud training is extremely successful.

Following are the fraud statistics for state government for January 1, 2002 through December 31, 2002. The amounts are: state agencies (\$840,798) and colleges and universities (\$111,307) for a total of \$952,105 in losses during this period. Excluding the very large case, the average loss was \$4,887.

Category	Total Fraud Cases	Detection by Entity	Detection by Others
State Agencies	4	2	2
Colleges and Universities	20	15	5
Total Fraud Cases	24	17	7
Percent of Fraud Cases	100%	71%	29%

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 use four high-level control objectives to develop specific audit objectives. Information technology auditors look for computer controls that ensure the following:

- Integrity of the information.
- Availability of the information.
- Management’s control over the information, which includes access to the data and programs, as well as confidentiality issues.
- Audit trails showing 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 addresses the four high-level objectives by seeking to identify controls that ensure the accuracy and completeness of entry, processing and output of information.

General Controls

During a review of general controls in place at an agency, the information technology auditor addresses the four high-level objectives by identifying controls in the following areas:

- Organization of agency.
- Physical security.
- 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 where 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 also 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 (CAATS) related to the statewide issues audit, agency legal compliance audits, local government audits, the financial statement audit (CAFR) and the State of Washington Single Audit (SWSA). Some of the specific tests included this year were:

- Payments to ineligible and ghost clients.
- Payments for non-allowable costs and incorrect amounts.
- Payments to false vendors.
- Payments to deceased people.
- Payments to individuals with invalid identification numbers.

- Pension payments to widows/widowers who have remarried.
- Duplicate payments.
- Payments to “pseudo vendor numbers” (vendor numbers that should only be used for one-time payments).
- Reconciliation testing of the state’s investment portfolios.

Significance of Reviews

Internet. In the past decade, the transition of the state’s computer environments from dedicated networks to the Internet has created an increase in security risks. The CERT Coordination Center of Carnegie Mellon University tracks and traces cyber attacks around the globe and has statistics that show an upward trend in security threats (hacking), as more systems become Internet based.

Distributed Computing Environment. In addition to the increase in risks that the Internet creates, agencies continue to move their applications from mainframe computers to client servers, creating a higher risk because desktop and networking software are designed for user-friendliness rather than security. New software vulnerabilities and exploits are identified every day. With this increase in risk, the need for highly trained IT security staff grows. Tighter budgets at the state agencies frequently result in less training for staff, which also increases risk. These responsibilities increasingly are falling to our IT auditors, who audit the security features of operating systems, database systems, firewalls, routers, and much more.

Revised ISB Security Policies and Standards. To address these new concerns, the Information Services Board revised the state’s Information Technology Security Policy and Standards. The policy includes a requirement that every agency conduct an IT Security Policy and Standards Compliance Audit once every three years, with the first audit deadline set for October 2003. The audit requires a review of each agency’s IT security program to ensure that the program has addressed all the required elements. Our information technology auditors will be performing many of these reviews, adding an extra layer of independence to the process.

We recently contacted all state agencies with information on how to prepare for this audit. The letter encouraged them to contact our Technology Audit Team to schedule their audits in order to meet the 2003 deadline. The Team also has given presentations to groups such as the local chapter of the Institute of Internal Auditors to help agencies prepare for these audits. These presentations have been well received by both internal audit staff and IT security staff.

Performance Audit

In a state government setting, a performance audit is an examination of evidence to assess the performance of a government organization, program, activity or function. Such an audit typically determines if an agency is acquiring, protecting and using resources economically and efficiently and/or whether it is achieving the results established by the governing body in an effective manner while complying with applicable laws and regulations. Financially related audits, which the State Auditor's Office is authorized to perform, differ significantly from performance audits. Fiscal audits determine whether financial statements are fairly presented and whether agencies complied with laws and regulations related to the use of funds provided by the Legislature.

In the state of Washington, the State Auditor's Office is authorized to conduct performance audits only when expressly authorized by the Legislature. The 2002 Washington State Legislature appropriated funds for a performance audit of the administration of claims and benefits at five agencies and provided that the State Auditor's Office should contract with a private firm to perform this audit. We contracted with Miller and Miller Consulting Services, which completed the Legislative objectives, under our supervision and with our assistance, and released a final report in November 2002.

Miller and Miller focused its work on the required five agencies, which were also the major focus of claims and benefits work we performed in 2001 and 2002:

- Department of Social and Health Services.
- Department of Community, Trade, and Economic Development.
- Employment Security Department.
- Department of Labor and Industries.
- Health Care Authority.

Within these agencies, Miller and Miller reviewed the performance of seven programs, which again were the major focus of our review: Medicaid, Food Stamps, Vocational Rehabilitation, Work First, Unemployment Compensation, Worker's Compensation and the Basic Health Plan.

For each program, Miller and Miller reviewed the performance measurements of planning, budgeting, operations management, input (resources provided), output (number of units of service provided), outcome (effectiveness of the service provided) and efficiency (cost per unit of output). The firm's report reached six overall conclusions, one of which relates directly to our claims and benefits audit. This conclusion states:

“The state's structure does not enhance benefit coordination...the federal government sets overall guidelines for certain programs, and then the state sets up its own departments to administer them. This process has happened over a long period of time, without an overall design...we know that the current governance design creates issues

with benefit coordination and information sharing among the agencies that deliver the services.

“Information about benefits individuals or families are receiving from other programs either is not available or is not used by programs in granting eligibility status to program participants. In addition, federal and state program designs contribute to an attitude whereby state management is not concerned with, and doesn’t understand, other benefit programs and whether an overlap of benefits is appropriate. As a result, there is little, if any, focus on the overall support level given to any specific individual. The state should consider whether its legislative and executive branch functions are aligned to provide the appropriate level of oversight of benefit coordination issues.”

Statewide Audit Areas

Introduction

We identified six high-risk areas for statewide reviews during our fiscal year 2002 audit:

- Claims and benefits
- Billings and accounts receivable
- Contracting
- Indirect cost allocations in restricted funds
- State grants
- Internal controls.

Below are discussions of the results of each of these statewide areas; of any other areas we reviewed; and of the federal compliance work we performed. Significant issues mentioned in the following sections are included in the Schedule of Findings in this report. In addition, we also noted some less significant issues that we communicated directly to agency managers.

Claims and Benefits

The state of Washington provides about \$10 billion per year in benefits through various programs. The following agencies are responsible for the majority of the state's claims and benefit programs:

- Department of Social and Health Services
- Department of Labor and Industries
- Health Care Authority
- Employment Security Department

During our audit, we reviewed several areas of internal control and compliance and found that the state overpaid claimants, providers and other recipients by approximately \$1.2 million. These overpayments were caused by a variety of factors. Additionally, we question the validity of payments to claimants and service providers of approximately \$1.9 million.

Further, we could not determine whether benefit payments totaling several million dollars were paid to eligible recipients since claimants are not always required to provide a valid Social Security number or other identification number.

We recommend that agencies responsible for processing claims and benefit payments:

- Establish and follow adequate internal control policies and procedures to ensure that all claimants, providers and other recipients are eligible for benefits.
- Initiate data sharing to detect benefit recipients who are receiving, but are not eligible, for benefits.
- Ensure that employees involved in the claims and benefit process obtain adequate training.

- Separate the duties of employees processing claim payments.
- Ensure that management provides adequate monitoring over claims processing.
- Instruct employees to obtain recipient Social Security numbers, when required, and investigate when alerted by the Social Security Administration that a number is invalid.
- Ensure timely and accurate payment of benefits.
- Ensure all disbursements have adequate supporting documentation.
- Attempt recovery of all unallowable payments identified by our audit or the agency.

Billings and Accounts Receivable

Billing and accounts receivable operations are directly associated with cash collection. Inadequate internal controls over accounts receivable increase the risk that cash collected could be misappropriated without being detected in a timely manner, if at all, and increases the risk the state will not collect all receivables due. Section 85.54 of the *State Administrative and Accounting Manual* issued by the Office of Management prescribes accounts receivable procedures for all state agencies.

During our audit, we reviewed internal controls over accounts receivable. We reviewed agency policies and procedures for conformance with state laws and regulations. In addition, we verified that reports showing past due accounts were produced, collection efforts were documented, write-offs were approved, monitoring was adequate, interest was assessed where required, and that detail records reconciled to summary accounts. We also verified that duties were separated between cash handling, access to the accounts receivable system, adjusting accounts, initiating and approving write-offs and resolving customer complaints.

To verify that established procedures were being followed, we selected some receivable accounts to verify that all payments posted to the accounts were included in the bank deposit. We selected a second group of receivable accounts that had been adjusted to verify that the adjustments and write-offs were for valid reasons and that they were approved. Finally, we selected a group of delinquent receivable accounts to verify that all collection efforts were documented.

Overall, we found that agencies were managing accounts receivable properly and according to state guidelines. However, we did note some areas that could be improved. Some agencies lacked adequate policies addressing collecting and writing off past due accounts. Some agencies either did not pursue collection or did not document all collection efforts for past due or written off accounts. Interest was not charged by some agencies for certain receivables, as required by state law. Finally, a few agencies did not have adequate oversight or monitoring functions in place.

We detected some errors that resulted in misstatement of some agencies' accounts receivable balances. This results in a misstatement of the accounts receivable balance reflected in the state's financial statements. Although the errors were not large enough to affect our audit

opinion, we did find some incorrect balances due to not allowing for potentially uncollectible accounts or misclassifying or not recording some valid receivables.

We recommend agencies:

- Maintain and follow current policies and procedures that address internal controls as well as state requirements.
- Reconcile detail records to summary accounts on a monthly basis.
- Follow up on past due accounts in a timely manner.
- Document all collection efforts.
- Charge interest on past due accounts, when required.
- Provide adequate management oversight.

Contracting

For fiscal year 2000, we performed a special comprehensive audit of the State's contracting practices relating to construction, architecture and engineering, personal services and purchased services. At that time we made the following recommendations:

1. The state provide change order criteria to help ensure the proper safeguarding of state assets.
2. The state consider establishing guidance for agencies to use when completing project plans and specifications so that costs aren't split to avoid contracting requirements.
3. The state consider establishing some restrictions regarding the ability of general contractors/construction managers to bid for subcontractor work, as current laws may actually have a limiting effect on open and fair competition.
4. The state consider requiring long-term architecture and engineering contracts to go through a formal process for renewal after a certain number of years.
5. Training be provided to state agency employees to ensure the proper accounting for contract expenditures.

We reaffirm these recommendations.

During fiscal year 2002 the state of Washington spent \$210 million on personal service contracts, \$325 million in building purchase and construction contracts, \$420 million in highway construction contracts, \$1.7 billion in purchased goods and services, and \$7 billion in client service contracts with providers. For fiscal year 2002, we assessed the various kinds of contracting risks for individual agencies and included these issues in the audits when risk was assessed as high. The contracting processes were reviewed at 26 state agencies for compliance with state laws and regulations.

We found in general that state agencies are operating in compliance with the laws and regulations governing contracting. Weaknesses, however, were found pertaining to compliance with bid laws, the purchase of services and monitoring.

The Department of General Administration, which administers contracts for goods and services on behalf of state agencies and other governmental entities, asked us to review how its staff followed state laws, regulations, and Department policies and procedures in awarding certain contracts. During our review, we found some areas where the Department could improve. In our letter to management, we made recommendations related to the bid process, awarding of contracts, and procurement officer training.

Less significant weaknesses were also noted at 10 other state agencies, including account miscoding of personal service contracts as purchased service contracts; inadequate bidding of contracts; inadequate contractor selection documentation; and inadequate review of contract payment documentation.

Restricted Funds and Indirect Cost Allocations

State law does not allow one fund (monies set aside for specific activities or objectives) to be used to pay for the activities of another. Further, restricted funds may only be used for specific purposes as determined by the Legislature. When the Legislature places spending restrictions on state funds, there is a greater risk that one fund may be used to benefit another fund. In addition, the state revenue shortfall further increases the risk that funds restricted to a specific purpose will be used to benefit another fund outside their intended use.

During the audit, we reviewed both direct and indirect costs charged to restricted funds with a focus on determining whether expenditures were made in compliance with state law. Direct costs are easily associated with a particular fund or program, as distinguished from indirect costs, which must be shared among several funds based on a reasonable allocation method. Where indirect costs comprised a significant portion of a restricted fund's expenditures, we also looked at whether the agencies were allocating indirect costs to restricted funds in an appropriate and equitable manner. We used computer-assisted audit techniques to analyze the accounting records to identify high-risk transactions.

We found the direct costs charged to restricted funds were legal and appropriate. We also found the methods of allocating indirect costs to restricted funds varied widely. Some agencies had no allocation method in place to ensure that restricted funds were being charged their fair share. In other cases, we found reasonable allocation methods; however, the estimates used in the allocations were significantly different than actual figures. We also found instances in which the allocation method was either not documented or not considered reasonable.

We recommend agencies:

- Use restricted funds for allowable purposes, as determined by the Legislature.
- Develop and document indirect cost allocation methods that ensure restricted funds pay their fair share of allocated indirect costs.
- Monitor allocations of indirect costs to ensure that estimates used in the allocation are reasonable in relation to actual figures.

- Reimburse restricted funds for unallowable allocated indirect costs paid.
- Ensure one fund does not benefit another where prohibited by state law.

In response to these issues and recommendations, some agencies already have determined more appropriate and reasonable methods to allocate indirect costs, including one that now uses an allocation method derived from actual figures rather than estimates. Agencies have begun monitoring restricted funds so that variances can be managed and adjusted in a timely manner. Some agencies have adjusted current overcharges to restricted funds; however, differences found for prior years have not yet been adjusted due to lack of funding available to pay back overcharges and the closing date of the two-year budget period.

State Grants

The state of Washington pays out hundreds of millions of dollars in state grants each year to governmental and nongovernmental entities. These grants are intended for a number of purposes, including roads and highways, schools, recreational areas, and support of social programs. In performing this audit, we focused on determining whether state agencies have adequate controls over awarding and monitoring state grants, and we tested whether expenditures were allowable under the grant agreements.

The risks associated with state grants, primarily allowability of costs and eligibility of recipients, are similar to the risks associated with federal grants. Numerous federal rules and regulations outline the state's responsibilities; these rules and regulations also apply to any subgrants of these funds. However, for grants that consist of state funds only, little or no criteria, guidelines or procedures are in place regarding what steps agencies must take to ensure state grants are awarded, administered, and spent properly.

As a result, we found a wide disparity in how agencies are administering these grants. At several agencies, we noted instances of inadequate grant monitoring, including lack of onsite visits, reimbursements that had been made based on insufficient documentation, and no examination of original supporting documents on a spot basis.

We also found that agencies sometimes have difficulty distinguishing state grant expenditure activities from non-grant activities. This occurs in part because the state has not provided either a clear definition of state grants or account coding that distinguishes state grant activities from other agency activities.

We recommend that the state establish criteria and guidelines to help ensure state grants are awarded, administered, and spent properly. We also recommend the state define and describe state grants and establish account coding that will allow agencies to easily identify and report on the spending of state grant money.

Internal Controls

Internal control is broadly defined as a process designed to provide reasonable assurance about the achievement of objectives in:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

It includes the policies and procedures that provide reasonable assurance that management's specific objectives will be achieved and is comprised of the following:

- Control environment – overall management attitude towards the importance of controls.
- Risk assessment – management's process to identify and analyze relevant risks related to objectives.
- Control activities – management's procedures to ensure the occurrence of such actions as review of reports for accuracy, completeness and authorization; physical controls over cash receipts and equipment; monitoring contractor performance; and segregation of duties when handling assets.
- Information and communication – the methods used by management to identify and communicate on a timely basis information employees need to perform their duties.
- Monitoring – management's evaluation of whether controls are operating as intended and whether they are achieving objectives.

We did not develop specific procedures, as we did for the other statewide areas, to review internal controls in all areas at all agencies. However, almost every agency audit we performed included at least some review of the applicable controls in effect and a determination as to whether these controls were adequate and operating effectively. In general, we found this to be the case. However, many of our findings relate in some way to weaknesses in controls.

In this time of scarce state resources, internal controls are often the first activities to be discarded. We recommend to management that it consider carefully the potential results before deciding to accept the risk of fewer controls. For instance, ignoring controls over eligibility determinations can result in higher costs when funds are provided to those who are not eligible to receive benefits. We also recommend the Office of Financial Management, which has oversight of state government budgeting and accounting, analyze the Schedule of Findings for areas in which additional guidance or training relating to internal controls may be helpful to agencies.

Other Areas

In addition to the statewide high risk areas already described, we identified other areas of risk specific to each agency audited and reviewed the internal controls and compliance as appropriate. These included such areas as cash handling, inventory protection, expenditure procedures, financial monitoring and reporting, and accounting systems.

Federal Compliance

For the fiscal year ended June 30, 2002, the state spent more than \$9 billion in federal assistance. The largest single grantor was the U.S. Department of Health and Human Services, which provides funding for programs such as Medicaid and Temporary Assistance for Needy Families.

We reviewed internal controls and compliance with grant requirements for 24 programs for the fiscal year 2002 SWSA. The federal grant findings we identified are included in this report, as they relate to legal compliance and high risk. These federal findings will also be presented in a separate single audit report and issued to the federal government sometime in February.

Federal audit regulations require that we report known and likely questioned costs exceeding \$10,000 for a particular compliance area. Questioned costs are often reported for the following reasons:

- A violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds;
- Costs that are not supported by adequate documentation; or
- Costs that appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

Listed below are the federal questioned costs for fiscal year 2002:

Federal Grantor	State Agency	CFDA No.	Federal Program	Questioned Costs	Finding No.
U.S. Department of Defense	State Military Department	12.401	National Guard Military Operations and Maintenance	\$51,527	02-23
U.S. Department of Labor	Employment Security Department	17.207	Employment Service	\$89,069	02-21
		17.225	Unemployment Insurance	45,456	02-01E & 02-21
		17.258	Workforce Investment Act Adult Program	105,125	02-21
		17.260	Workforce Investment Act Dislocated Workers	48,403	02-21
U.S. Department of Health and Human Services	Department of Social and Health Services	93.558	Temporary Assistance to Needy Families	\$10,106	02-21D
		93.563	Child Support Enforcement	38,086	02-16
		93.575	Child Care Development Fund	1,271,592	02-01C & 02-24
		93.778	Medicaid	430,682	02-01A
TOTAL QUESTIONED COSTS				\$2,090,046	

Recommendation to the Legislature

Because of its significance to the state's expenditures, we wish to highlight for the Legislature our overarching recommendation regarding claims and benefits.

In our fiscal year 2001 State Accountability Report, we disclosed that the state lacks a centralized process to determine whether individuals are eligible for benefits or whether they are receiving benefits through some programs that would make them ineligible for others. At that time, we recommended that the state develop a centralized process to determine if individuals are eligible to receive benefits and to cross match information between agencies.

During the current audit, we found the lack of a centralized process continues. Because of the difficulty involved and the amount of time required, agencies are often unwilling to prepare, review and investigate data matches that can flag possible problems. Additionally, sometimes data matches are impossible. For instance, Social Security numbers could be used in this process; however, some state programs do not require that these numbers be provided as a condition for receiving assistance, while others that require them sometimes do not ensure their accuracy.

While we make a number of recommendations above that would help to ensure that agencies provide assistance only to those eligible to receive it, we believe an additional and significant step could make all of those recommendations easier for agencies to follow. However, that step can be taken only by the Legislature.

We recommend the Legislature consider requiring any person receiving state resources to be given, on first contact, an individual identifying number. From then on, individuals would be required to present this number whenever applying for any other state assistance or for employment with the state. With this kind of identification, any state agency could perform data matches for any of its clients with any other state agency to determine if continuing or additional assistance is proper and necessary.

Schedule of Findings

Finding Number	Finding Caption	Page Number
02-01	The state of Washington overpaid claimants and service providers by approximately \$1.2 million due to poor internal controls and a lack of data sharing between agencies to determine whether individuals are eligible for benefits. Additionally, we question the validity of payments to claimants and service providers of approximately \$1.9 million.	22
02-01A	The Department of Social and Health Services, Medical Assistance Administration, has not established sufficient internal controls to ensure compliance with Medicaid provisions.	24
02-01B	The Department of Labor and Industries paid at least \$725,774 in workers compensation benefits to claimants and survivors who were no longer eligible for the benefits. Additionally, the Department does not verify dependents claimed when calculating time loss benefits.	38
02-01C	The Department of Social and Health Services, Economic Services Administration does not perform adequate or timely reviews to ensure the allowability of child care payments made to clients and vendors from federal and state funds.	42
02-01D	The Department of Social and Health Services, Economic Services Administration, is not in compliance with eligibility requirements for the Temporary Assistance to Needy Families Program.	48
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02-01G	The Washington State Health Care Authority has not established sufficient internal controls to ensure that all of those who are receiving health insurance coverage are eligible to do so.	60
02-02	The Department of Community, Trade and Economic Development is not in compliance with state accounting and financial reporting requirements for accounts receivable.	63
02-03	More than \$4.7 million in employer industrial insurance premium payments recorded as being received by the Department of Labor and Industries between July 2001 and December 2001 were not reflected as being deposited in the industrial insurance financial accounts. The Department was unable to account for this difference.	66
02-04	Community Colleges of Spokane should improve internal controls over amounts owed to and collected.	69
02-05	Western Washington University did not comply with state bid law requirements.	72
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02-07	Some restricted funds administered by the Department of Natural Resources were charged more than their share of overhead costs.	78

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02-17	Seattle Community Colleges is not enforcing its leave policy for administrative employees.	113
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02-19	The Department of Transportation's Washington State Ferries Division lacks adequate internal controls over ferry vessel equipment and items that are small and susceptible to misappropriation.	118
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02-21	The Employment Security Department did not comply with regulations for allocating payroll costs for four Department of Labor federal programs.	127
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Schedule of Findings

Claims and Benefits (Please see the description of this area on page 11-12.)

02-01 The state of Washington overpaid claimants and service providers by approximately \$1.2 million due to poor internal controls and a lack of data sharing between agencies to determine whether individuals are eligible for benefits. Additionally, we question the validity of payments to claimants and service providers of approximately \$1.9 million.

Background

Each year, the state of Washington provides about \$10 billion in benefits through various programs. Each program has different requirements regarding eligibility, timeliness of payments, calculation methods and whether valid Social Security or other identification numbers are required in order to receive benefits. In performing this year's audit, we reviewed claims and benefit payments that we believed were at highest risk for misappropriation or noncompliance with laws and regulations. The following agencies are responsible for the majority of the state's claims and benefit programs:

- Department of Social and Health Services
- Department of Labor and Industries
- Health Care Authority
- Employment Security Department

Description of Condition

During our audit, we reviewed the state's internal controls and compliance in several areas including eligibility; accuracy of calculations; Social Security number use; timeliness of payment; and monitoring. We found that the state overpaid claimants, providers and other recipients by at least \$1,169,986 due to weaknesses in the internal control structure and a lack of data sharing between agencies to determine whether individuals are, and/or continue to be, eligible for benefits. However, because we were unable to test all claims and benefits due to the high volume of payments and because claimants do not always provide an accurate Social Security number, the actual amount of overpayments could be substantially higher. In addition, we also question the validity of payments totaling \$1,947,378. This represents payments to claimants or providers that lacked adequate support documentation and instances in which the claimant did not provide a valid Social Security number when it was required.

Cause of Condition

Many of these conditions were caused by staff turnover, lack of training, lack of management monitoring, human error or management placing a higher priority on other areas. In some cases, computer system limitations or transmission errors contributed to the overpayments.

Many of the overpayments that occurred after the claimant was deceased, remarried or incarcerated were caused by a lack of coordination with other agencies that could have provided data to match to benefit payment data.

Effect of Condition

Without adequate internal controls, claimants and other recipients receive benefits for which they are not eligible.

Recommendations

We recommend that agencies responsible for processing claims and benefit payments:

- Establish and follow adequate internal control policies and procedures to ensure that all claimants, providers and other recipients are eligible for benefits.
- Initiate data sharing to detect benefit recipients who are receiving, but are not eligible, for benefits.
- Ensure that employees involved in the claims and benefit process obtain adequate training.
- Separate the duties of employees processing claim payments.
- Ensure that management provides adequate monitoring over claims processing.
- Instruct employees to obtain recipient Social Security numbers, when required, and investigate when alerted by the Social Security Administration that a number is invalid.
- Ensure timely and accurate payment of benefits.
- Ensure all disbursements have adequate supporting documentation.
- Attempt recovery of all unallowable payments identified by our audit or the agency.

Agencies' Responses

Please refer to the seven specific findings below.

Auditor's Remarks

Please refer to the seven specific findings below.

Applicable Laws and Regulations

Please refer to the seven specific findings below.

02-01A The Department of Social and Health Services, Medical Assistance Administration, has not established sufficient internal controls to ensure compliance with Medicaid provisions.

Background

The Washington State Department of Social and Health Services is responsible for administering the state of Washington Title XIX Medicaid program (CFDA 93.778), which receives more than \$2 billion in federal funds annually. These funds, matched almost entirely by state funding, pay providers for health care services to certain low-income individuals. Medicaid expenditures include medical assistance payments for eligible recipients for such services as hospitalization, prescription drugs, nursing home stays, outpatient hospital care, and physicians' services. Eligibility for Medicaid assistance is based on categorical (e.g., families and children, aged, blind, and disabled) and financial (e.g., income and resources) status.

Description of Condition

During our audit, we reviewed the Department's internal controls and compliance in several areas including allowable activities, client eligibility, provider eligibility and provider health and safety standards. We found reportable internal control weaknesses and instances of noncompliance that were significant to our audit. These conditions are described below.

a. Payments made for persons with invalid Social Security numbers or made on behalf of deceased individuals.

A valid social security number (SSN) is required for an individual to be eligible for Medicaid. If a child or any individual does not have a SSN, benefits cannot be denied to such persons, however, the Department is charged with the responsibility of assisting the client in obtaining one. Upon re-certification, the Department must ensure that the client has received a SSN and that it is valid.

To test this requirement, we selected individuals who were Medicaid beneficiaries from July 2001 through October 2001. We analyzed the validity of their SSNs using specialized audit software and records from the U.S. Social Security Administration (SSA). We also analyzed claims that could have been paid after a person had died and identified individuals that could be using a SSN that was assigned to a person reported as being deceased. For this review, we obtained a valid sample of 639 recipients. This sample was obtained pursuant to the standards set forth by the American Institute of Certified Public Accountants for audit sampling. Our population was categorized into the following groups:

- SSNs that were assigned to persons who were reported as being deceased.
- SSNs that begin with a "9," and therefore invalid.
- SSNs that have never been assigned by SSA.
- SSNs that are outside the bounds of a discontinued series.
- SSNs whose first three digits not issued to any state.
- SSNs that were issued by SSA but not yet assigned to an individual.

After performing calculations on each of the above categories, we also stratified each of the groups by amount. We individually tested all large transactions in each category and selected a random sample from the remaining balance. We are reporting known questioned costs from the large transactions and have projected the test results obtained from the sample to the entire population in the category. The results are provided below.

Total Number of Social Security Numbers in Population	3,769
Number of Social Security Numbers Tested	639
Total Dollars Reviewed	\$3,070,406
Total Dollars Subject to Projection	\$7,067,119
Total Percentage of SSN in the Test Population that were associated with actual internal control and compliance exceptions	50.0%
Total Percentage of Dollars Reviewed that were associated with actual internal control and compliance exceptions	25.4%

Category of Exception	Number Tested	Number of Compliance Exceptions Resulting in Questioned Costs	Known and Projected Questioned Costs
Recipient SSN reported as deceased before 2001	124	48	\$269,915
Recipient SSN reported as deceased during 2001	276	57	354,851
SSN begins with a "9"	70	35	43,547
SSN that has never been assigned by SSA	97	26	136,422
SSN that is outside the bounds of a discontinued series	10	8	1,629
SSN issued but not assigned	27	5	1,318
SSN with first three digits not issued to any state	35	25	12,205
TOTAL	639	204	\$819,887

The questioned costs listed above include both the state and federal share of the claim. The federal share was calculated using an overall federal reimbursement rate of 0.5037, although the rate was higher for some types of services. The total federal portion is \$412,977; the total state portion is the remaining \$406,910.

Of the amount questioned in the deceased categories, seven exceptions totaling \$107,985 relate to individuals who were listed as deceased in the SSA Death Master File, but were also listed as living and receiving SSA benefits in other SSA databases. The Department has taken the position that if a person is reported as receiving SSA benefits, this is sufficient evidence that the individual is alive and thus should not be considered an exception. We have discussed the inconsistency between its databases with SSA and believe that these cases should be questioned. This opinion is predicated on the fact that the Department could give

us no other evidence to the contrary, other than an individual’s receipt of SSA benefits. However, we also acknowledge that SSA should research these cases before a final determination is made.

In addition to the compliance exceptions noted above, we found numerous instances where invalid SSNs were caused by data entry errors. Based on our review, we are satisfied that these particular invalid numbers were caused by data entry errors and we will not question the costs associated with these errors. However, we are quantifying these costs because these errors were pervasive. These errors indicate multiple control weaknesses both at the level of the worker and at the management level.

Number of Invalid Social Security Numbers Within the Test Population Due To Input Errors	98
Total Dollars Associated with Input Errors	\$273,034

The amount listed above includes both the state and federal share of the claim. The federal share was \$137,526 using a federal reimbursement of .5037; the state share was the remaining \$135,508.

For the remainder of the transactions, we either found no exception or we disclaimed because the charge was represented to have been paid solely with state funds.

Other Exceptions Not Included in Sample

When reviewing claims as part of our annual state compliance audit, we found three Medicaid clients with invalid SSNs and three clients who had claims paid for services rendered after the date of death. We are questioning \$17,705 in costs paid for these individuals.

Cause and Effect

Factors contributing to this condition include the following:

- In 50 percent of the cases we reviewed, Department employees were not heeding or investigating the alerts sent by SSA after the Department received notification from SSA that a social security number was invalid or that an individual was deceased. The Department cites the high number of client cases per employee and a lack of training as the reason. Another factor is the perceived need by employees to serve the client even though some eligibility requirements may not have been fully documented.
- The Department is largely dependent on family members and health care facilities to voluntarily inform it of the date of death. This lack of timely notification can lead to cases in which claims are paid after the recipient has died. Our review showed that the majority of claims paid after death were for drug-related claims.
- We also found cases in which errors occurred when client data was being transmitted between the Department’s client eligibility system and the MMIS system.

If recipients do not have valid social security numbers, they are not eligible to receive federal assistance. Further, claims paid for services rendered after the date of death, with some exceptions, are unallowable. These control weaknesses have broad ramifications. They leave the Department susceptible to client and provider fraud and can subject unknowing citizens to identity theft. As a result of our testing, we are questioning a total of \$430,682 charged to federal funds.

b. Basic Health Plus

Basic Health Plus is a Medicaid program for children in low-income households. Program members pay no monthly premiums or co-payments. The Department, with federal participation, pays the entire cost of coverage. Basic Health members are required to report any change in income to the Washington State Health Care Authority. Changes greater than 200 percent of the Federal Poverty Level are reported to the Department. A child's continued eligibility for Basic Health Plus and Medicaid is reviewed once a year through a form that is sent to the parent or guardian. On this form the parent/guardian must disclose any income changes. Our audit of fiscal year 2001 revealed multiple weaknesses in the internal control system used by the Department to ensure the continuing eligibility of children participating in the state's Basic Health Plus plan. We reported the following weaknesses in Finding 01-13 of our fiscal year 2001 report:

- The Department did not require the annual re-certification form to be returned unless the parent/guardian's income changes. It assumed there was no income change if the form was not returned.
- The Department performed an inadequate number of re-certification reviews to determine compliance with eligibility requirements. Every month the Department reviewed only 100 of the potential re-certifications.
- When it did perform re-certification reviews, the Department did not require proof of income from participants.
- The Department did not ensure that it received relevant information from the state Health Care Authority to determine if participants had income changes that would affect Medicaid benefits.

During our current audit, we reviewed the actions taken by the Department to address these weaknesses and found it had made some significant improvements. For example, it is making technological changes to the Department's client eligibility systems. These changes will require that all households complete and return the form at the time of their annual review in order to remain eligible. The Department has also increased the random reviews from 100 to 400 monthly.

Declarations of income will be required for all clients whose reported income is close to 200 percent of Federal Poverty Level. This will not be required for those under 200 percent of the poverty level. Additionally, there are no plans at this time to corroborate a client's income declaration with an independent source. We see these issues as continued control weaknesses. However, the *Declaration of Income* policy is currently under review. These

controls may yet be incorporated into the control environment pending the recommendations of the review committee.

The majority of corrective actions did not take place before fiscal year 2002 had ended, and consequently, the internal control weaknesses described above were still in existence during our audit period. As a result, we this is a reportable condition for fiscal year 2002.

c. Provider licensing

To be eligible for Medicaid payments, federal regulations require that health care professionals such as nurses, doctors, and pharmacists be licensed according to state laws and that hospitals, nursing facilities, and intermediate care facilities meet prescribed health and safety standards.

During our audit of fiscal year 2001, we found significant weaknesses in internal controls used by the Department to ensure that providers continue to meet licensing requirements. We reported the following deficiencies in Finding 01-12 of our fiscal year 2001 report:

- The Department's Medical Assistance Administration (MAA) reviews the status of a provider's license when it first establishes a provider in its records. However, the initial approval process was not supervised adequately, and the Department did not follow-up to ensure that providers continued to be licensed and meet other criteria in the standard Core Provider Agreement. We performed a review of 121 selected licenses and found that 13 were not in the records of the Department of Health or the professional licensing boards, 11 of the licenses had expired or belonged to individuals who were deceased, and five of the licenses were in the names of individuals other than those listed on the applications. These exceptions resulted in \$9,837,143 in questioned costs in fiscal year 2001.
- During our current audit, we reviewed the actions taken by the Department to address these weaknesses and found it had made significant improvements. For example, it has initiated a massive reenrollment of all the providers in its system and is making changes to provider contracts as well as developing a new provider expiration report and adding controls to the Medical Management Information System (MMIS) that would prevent a claim from an ineligible provider from being paid.

However, the majority of these corrective actions had not taken place before fiscal year 2002 had ended, and consequently, the internal control weaknesses described above were still in existence during our audit period. As a result, we this is a reportable condition for fiscal year 2002.

d. Provider Health and Safety Standards – Hospitals

To be eligible for Medicaid payments, federal regulations require that hospital, nursing facilities and intermediate care facilities meet prescribed health and safety standards. The Department of Health inspects for hospitals and Aging and Adult Services (AASA) inspects nursing homes and intermediate care facilities. The Medical Assistance Administration pays the claims to hospitals and nursing homes for their services.

During our audit of fiscal year 2001, we determined that the Department of Social and Health Services had no established protocol to ensure that hospitals serving Medicaid patients meet the prescribed health and safety standards. At that time we found the Department of Health to be performing the hospital inspections. However, we also found that there was no communication between the Health Department, the agency performing the inspections, and the Department of Social and Health Services, the agency paying the claims rendered by the hospitals for their services. Thus it would be possible for a hospital to be noncompliant with the state's health and safety standards yet be paid for its services to Medicaid patients.

During our audit this year we reviewed the actions taken by the Department to address these weaknesses. We were informed that communications have not yet been instituted between the agencies for the audit period but were in the process of being formalized. Since no corrective action took place before fiscal year 2002 had ended, the internal control weaknesses described above were still in existence during our audit period. As a result, this is be a reportable condition for fiscal year 2002.

e. Provider Health and Safety Standards – Nursing Homes

Under the Medicaid program, states can provide federal financial assistance for patients receiving services in nursing homes. To qualify for federal participation, the nursing home must meet certain health and safety standards. The Department's Aging and Adult Services Administration (AASA) has primary responsibility for conducting health and safety inspections at nursing facilities. The Department's Medical Assistance Administration (MAA) has primary responsibility for reviewing and paying claims of medical providers. Should AASA find that a nursing facility is not meeting federal standards, the federal grantor (U.S. Department of Health and Human Services) will send the facility a Denial of Payment Notice, with a copy to the Administration. This Notice prohibits the payment of federal funds for any new Medicaid admissions to the facility until the condition is corrected. Payments may still be made for existing Medicaid patients.

During our audit, we found that AASA and MAA did not have a complete record of the nursing homes that were placed on denial of payment status. We selected 21 Denial of Payment Notices issued by the federal grantor between July 1, 2001, and January 31, 2002, and compared them with AASA documentation. We found three notices, or 14 percent of the total, that were not recorded by this Administration. Similarly, we compared the same Notices with MAA logs and found seven, or 33 percent of the total, that were not recorded by this administration, including the three noted above.

Cause and Effect

We found the method of communicating denial of payment information between AASA and MAA to be inconsistent and lacking effectiveness. Further, management of MAA did not take the needed steps to ensure that its staff was provided with the information required to prevent inappropriate payments. Because it did not have adequate controls to identify and monitor all nursing homes placed on denial of payment status, there is a risk that the Department paid claims for ineligible patients.

It should be noted that AASA has informed us that it has designed an alternate system of tracking the facilities on denial of payment status and reporting these to MAA and believe these changes should remedy this condition.

Recommendations

Invalid Social Security Numbers

We recommend the Department:

- a. Develop internal controls that would require employees to heed alerts sent by the Social Security Administration pertaining to invalid SSNs.
- b. Require that workers access the State on Line Query to determine the validity of a SSN when enrolling a client. We feel that this would eliminate the data entry errors and greatly reduce invalid SSNs.
- c. Provide training for staff and management on the federal requirements for SSN and the tools that would enable them to determine invalid SSNs.
- d. Perform regular periodic reviews of all SSNs to determine which clients have died during the interim period.
- e. Establish communications between the Department of Social and Health Services and the Department of Health to determine client deaths.
- f. Remedy known problems between the client eligibility systems and the claims processing systems.
- g. Attempt recovery of unallowable payments already made on behalf of clients having invalid SSN or SSN of deceased individuals and consult with the federal grantor to determine whether questioned costs must be returned to the grantor.

Basic Health Plus Plan

We recommend the Department:

- a. Require declarations of income for all clients not just those close to 200 percent of the poverty level.
- b. Establish procedures that would corroborate a client's income declaration with an independent source.

Provider Licensing

We have no additional recommendations beyond the actions already planned by the Department.

Provider Health and Safety – Hospitals

- a. Establish communications with the Department of Health.
- b. Establish adequate policies between the Department of Health and the Medical Assistance Administration that would facilitate the reporting of hospitals that are not in compliance with the applicable health and safety standards.

Provider Health and Safety – Nursing Homes

We recommend AASA reconcile its denial of payment records with the official HHS reports on a monthly basis to ensure its records are complete and notify MAA of all nursing homes placed on DOP status on a monthly basis.

Department’s Response

The Department partially concurs with the conditions noted in this finding.

Condition A. Payments made for persons with invalid social security numbers or made on behalf of deceased individuals.

The Department does not concur with this condition. Based on the data and research of both the Department and the SAO, the total questioned costs should be stated as \$48,854 rather than the \$819,887 as shown above. The reason for the difference is that SAO used a different test database and criteria when testing records in the following two areas:

- ***The Department does not agree with the audit exceptions for recipients classified as deceased and receiving benefits.*** *The department uses Social Security Administration (SSA) data to determine if persons are living or dead. For audit testing, the SAO used a system called VERIS, a commercial software package from Security Software Solutions (SSS), trademarked by S.G. Schoggen and Company. The VERIS package allows its customers (in this case, the SAO) to obtain Social Security number validation from Security Software Solutions, which gets information from SSA updated weekly. VERIS does not directly link to the SSA databases and Social Security Administration has repeatedly advised the Department to rely on data obtained directly from their databases, instead of secondary data sources such as those used by the SAO.*

To determine date of death, the SAO appears to have used the SSA Death Master File Index. However, DSHS found that persons listed as deceased on the SAO index were continuing to receive SSA and SSI benefits, according to the SSA databases and Master Benefits Record¹. The SAO refused to accept SSA payment information as evidence the recipient was still alive, despite the fact that the Department is required to accept such information as stated in 42 CFR 435.955. SAO also refused to accept any other collateral evidence, such as department visits to the home, facility statements of the person being alive, or statements from relatives and the recipient’s identification.

¹ SSA instructed DSHS to rely on these sources of information as more accurate than the data in the SSA Death Master File.

If DSHS receives information that conflicts with the SSA data, DSHS independently verifies the correct data. This allows DSHS to use the most accurate data in making their determinations, while complying with federal rules by using the SSA interface information. SSA states that the best source of data is SOLQ, which is real-time, accurate information as SSA records it. Using SSA data complies with 42 CFR 435.948, which requires State Medicaid agencies to interface with Federal agencies and use their data to make eligibility determinations.

The Department has complied with federal law in obtaining and verifying the questioned SSNs, and would have no authority under federal law to rely upon the database accessed by the SAO.

- ***The Department does not concur with the findings on invalid social security numbers.*** *The Department does agree that there are instances of recipients receiving benefits with incorrect social security numbers but this occurs under the Federal requirement (42 CFR 435.910(f)), “The agency [in this case, DSHS] must not deny or delay services to an otherwise eligible applicant pending issuance or verification of the individual’s SSN by SSA.”*

By Federal law, DSHS is prohibited from refusing benefits to possible ineligibles while waiting for issuance or verification of an SSN. This puts the state in the position of issuing benefits without verification of an eligibility factor, as required by federal law, and then having associated costs questioned by the SAO.

In addition to the questioned costs, *DSHS would like to provide additional information regarding some of the recommendations from the SAO. It is not possible for DSHS employees to review all alerts all the time given the current workload. However, we do think it is possible to provide training on the SSA interface systems and SSA alerts. The department does recognize there are system problems that adversely affect employee case review productivity. Specifically, the SOLQ tool needs improvements to its sign on process and accessibility to staff. It is a useful tool but has program flaws that inhibit the work process.*

Additionally, there are also SSN errors attributable to the conversion from the old system (ITIS) to the current eligibility system (ACES). The Department is looking into the possibility of the ACES producing quarterly SSN reports in order to do a comprehensive SSN review. If this can be accomplished in addition to SOLQ tool improvements, DSHS will be able to reduce some manual processes and improve case reviews.

The Department does not concur with “Other Exceptions Not Included in Sample.” The department was not provided information on the cases that pertain to the \$17,705 during or after the audit, therefore we cannot determine if these questioned costs are valid.

Condition B. Basic Health Plus

The Department does not concur with this condition. In the prior year audit response we stated that the audit test results did not support the need for a finding. In this follow up audit year, audit testing was not done and does not support additional audit recommendations. We reaffirm our SFY01 audit response with additional clarification to statements made in this audit finding:

- *All applicants and recipients are expected to declare their household income, regardless of whether their income is at or below 200% Federal Poverty Level (FPL).*
- *In addition to the 400 BH Plus random reviews, Medical Eligibility Determination Services (MEDS) receives an average of 1,200 BH Plus Household Change (DSHS 14-406) forms from households due for an annual review monthly. The 1,200 is based on the fact that three maintenance units receive between 400 – 450 DSHS 14-406 forms returned by clients each month. Each change form is reviewed by an eligibility worker to determine if the change affects continued eligibility.*
- *MEDS has always corroborated a client's income declaration if the declared income is at or above 200% FPL, by pending the application or review and requesting proof of income.*
- *Changes in income do not affect a child's Medicaid eligibility during their certification period.*
- *There is not a requirement to verify income unless it is questionable. Self-declaration of household circumstances is provided under MAA's policy distributed to the field on December 3, 1998. DSHS is notified of household by BH or via the DSHS 14-406 form.*
- *MEDS does work with HCA on reported income changes during the certification period and is followed up at annual review time. It is an expectation for both Basic Health (BH) and Medical Assistance Administration (MAA) staff to follow Chapter 5, section 5-02 Basic Health Plus Pregnancy Medical Change of Circumstances – Change in Household/Income in the BH/MAA Policy and Procedure Manual.*

With regard to the new audit recommendations from the SFY02 audit:

a. Require declarations of income for all clients not just those close to 200% FPL.

DSHS could not do more than it is already doing to verify client income. All clients applying for children's medical are required to declare their income on the application. DSHS policy requires all applicants requesting children's Medicaid to declare their household income, regardless of whether it is "close to 200% FPL". December 3, 1998, DSHS established the policy of declaration of income for children's medical programs. Those guidelines stated: ".....children applying for medical programsmust declare income on the application."

b. Establish procedures that would corroborate a client's income declaration with an independent source.

MEDS follows established DSHS policies for corroborating client income as outlined in the Eligibility A-Z Manual, WAC 388-406-0030 (3); WAC 388-490-0005 (2), (3), (4), (5) (a), (b), (c), (8) (a), (9), (10); WAC 388-458-0001; Clarifying Information (E A-Z manual, pg 4 & 5), "The federal requirements for Medicaid verifications are much less stringent than those for cash or food assistance. Except as noted in the chart below (see E A-Z manual) for specific programs, accept client's declaration of age, identity, and SSN. Ask for verification to be provided whenever the information is questionable." The chart specifically indicates that for children's Medicaid, we do not require verification unless questionable. For verifications, "Any source, including verbal, written, and email statements, can be used as long as it meets

the “Criteria for Evaluating Verification” (see E A-Z manual). Income can be verified via pay stubs, statement from employer, SEMS data, bank statements, collateral contact, SOLQ. These procedures are already established and staff follows them in order to corroborate a client’s income declaration if necessary.

Condition C. Provider Licensing

The Department did not concur with this finding in the SFY01 audit, nor do we concur with it for this fiscal year. We previously acknowledged that enhancements to the division’s internal controls and procedures could be made and the Department has done that. Post audit review of the providers questioned in the SFY01 report showed all were properly licensed in the audit period tested. The Department reaffirms its response to the SFY01 and emphasizes that the \$9,837,143 questioned was for properly licensed providers and should not have been cited as a questioned cost.

Condition D. Provider Health and Safety Standards - Hospitals.

The Department concurs with this condition. MAA plans to establish procedures that will be used when information comes from DOH, Aging and Adult Services or other established entities regarding health and safety standards not being met. However, given other priorities and the lack of additional staff, this area has not been addressed at this time.

Condition E. Provider Health and Safety Standards – Nursing Homes.

The Department concurs with this condition. However, the department believes a more effective method of tracking Denial of Payment Notice (DOP) is for CMS to directly notify MAA of the facility status. Corrective action has been identified and was implemented in November 2002.

Auditor’s Concluding Remarks

Condition A - Payments made for persons with invalid SSNs or made on behalf of deceased individuals.

The Department was informed from the outset of the audit that VERIS software and the SSDI were used only in our initial analytical work to lead us to SSNs that appeared to be invalid or belonging to people who were deceased. We did not predicate our opinion solely on the information derived from these sources. When our initial testing was complete, we presented the results to the Department. The Department was given an opportunity to provide additional information for the 228 exceptions that we found. We received supporting documentation for only 131 of our exceptions. For some of the exceptions for which the Department provided no supporting documentation, MAA had indicated that it concurred with our results.

With respect to the supporting documentation received from the Department, some of the information consisted of SOLQ verifications of SSNs, Department of Health records, print-outs from their Automated Client Eligibility System, and screen prints from Bendix status reports. These we accepted as adequate support if the documentation addressed the reason for the exception. However, we were also presented with other “proofs” such as bus passes, health insurance cards dating back to 1988, ID cards from other states and copies of Social Security

cards, the numbers of which did not verify in SOLQ. We did not accept these latter pieces of “collateral evidence” as support that a person was alive, or that an SSN was valid. We reviewed and considered every piece of information presented by the Department. In fact, we reduced our original estimate of questioned costs by \$216,030 based on the evidence provided by the Department.

Pursuant to 42 CFR 435.955 we have no dispute that “... *the agency may not terminate, deny, suspend or reduce medical assistance to that individual until it has taken appropriate steps to verify the information independently....*” However, the Department could not offer satisfactory evidence that it was verifying SSN information independently even when alerted by SSA that an SSN was invalid. Indeed, DSHS staff reported that workers may accumulate up to 2000 alerts in one month most of which are summarily deleted from their systems without further investigation due to heavy workloads. Staff, however, also reported that workers do not use the tools at their desktops. SAO contends that these tools would have averted many of these alerts by informing the worker that the SSN was invalid for the name under which it is offered. As a result of these control weaknesses and inadequate supervisory monitoring, we found that one out of every two SSNs accepted by the Department, for the clients we tested, were invalid or belonging to a deceased person.

Pursuant to 42 CFR 435.910 (f) we have no dispute in that “...*The agency must not deny or delay services to an otherwise eligible applicant pending issuance or verification of the individual’s SSN by SSA*”. However, the Agency could not provide evidence that it assisted the client in obtaining a valid SSN as directed in 42 CFR 435.910 (e) or that it acted when it was alerted by SSA that an SSN was invalid. Some of the clients that we questioned were receiving medical assistance with invalid SSNs since 1996 and did not appear to have undergone the periodic eligibility redetermination as directed in 42 CFR 435.916. Furthermore, we saw evidence in the Department’s case files where an MAA employee was aware that the SSN was invalid and accepted it nevertheless. Management is aware of this practice and reports that client need is the motivating factor in circumventing controls.

With respect to the “Other Exceptions Not Included in Sample”, the Department was provided with both verbal notification and written documentation of these exceptions at the exit conference with the State Medicaid Director on December 16, 2002. These Medicaid exceptions were found during our statewide audit of claims and benefits and included in this finding because the associated federal questioned costs were greater than \$10,000, which is the federal reporting threshold. Further, the Department had the opportunity to review these exceptions prior to the formal exit conference and to provide additional supporting documentation.

Our recommendations in the finding are consistent with the Governor’s current budget proposal before the Washington State Legislature that tighter controls be placed on screening for Medicaid eligibility.

Condition B - Basic Health Plus.

In its response, the Department stated that we did not perform testing to support our recommendations. As required by OMB Circular A-133, we performed follow-up work to determine the extent of the corrective action taken by the Department and evaluated whether a reportable condition that could lead to significant noncompliance still existed. The Department

indicated that the changes to their internal controls were extensive, in process, and the majority of them were not implemented for fiscal year 2002. Interviews were conducted with staff relative to the Department's changes in internal control. Our concerns about the continued control weaknesses were discussed with management.

We do not believe that self-declaration is a sufficient control, regardless of the individual's economic status relative to the poverty level. We also have concerns with the methods of income verification that the Department intends to use when it performs a review. The Department reported that its new procedures incorporated mostly self-declarations as proof of income or pay stubs when one is available. The Department has no plans to corroborate information with Employment Security Department or any other independent source to determine the accuracy of the representations made for the household in self-declaration. With respect to self-employed clients, the Department reported that, at times, it reviews the financial records of the business, but no evidence of these reviews could be obtained from Department management during our audit.

Condition C - Provider Licensing.

We reaffirm our fiscal year 2001 finding, in which we questioned costs of \$9,837,143 associated with 29 licensing deficiencies for eight providers. Thirteen of the licenses the Department had on file were not in the records of the Department of Health or the professional licensing board. Eleven of the licenses had expired or belonged to individuals who were deceased and five of the licenses were in the names of individuals other than those listed on the application. Name changes related to marriage or divorce could not explain these discrepancies.

Applicable Laws and Regulations

U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Subpart C, Section .300 states:

The auditee shall:...

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs....

Invalid Social Security Numbers

Title 42, Code of Federal Regulations, section 435.910(a) states:

The agency must require, as a condition of eligibility, that each individual (including children) requesting Medicaid services furnish each of his or her social security numbers (SSNs).

Title 42, Code of Federal Regulations, section 435.910(g) states:

The agency must verify each SSN of each applicant and recipient with SSA, as prescribed by the commissioner, to insure that each SSN furnished was issued to that individual and to determine whether any others were issued.

In cases where the Medicaid applicant cannot recall or has not been issued a SSN, Title 42, Code of Federal Regulations, section 435.910(e) states the agency must:

- (1) Assist the applicant in completing an application for an SSN;
- (2) Obtain evidence required under SSA regulations to establish the age, the citizenship or alien status, and the true identity of the applicant; and
- (3) Either send the application to SSA or, if there is evidence that the applicant has previously been issued a SSN, request SSA to furnish the number.

Title 42, Code of Federal Regulations, section 435.916 (a) states:

The agency must redetermine the eligibility of Medicaid recipients, with respect to circumstances that may change, at least every 12 months....

Title 42, Code of Federal Regulations, section 435.920 states:

- (a) In redetermining eligibility, the agency must review case records to determine whether they contain the recipient's SSN or, in the case of families, each family member's SSN.
- (b) If the case record does not contain the required SSNs, the agency must require the recipient to furnish them and meet other requirements of 435.910.

Title 42, Code of Federal Regulations, section 435.920(c) states:

For any recipient whose SSN was established as part of the case record without evidence required under the SSA regulations as to age, citizenship, alien status, or true identity, the agency must obtain verification of these factors in accordance with 435.910.

Hospitals, Nursing Facilities and Immediate Care Facilities

Title 42, Code of Federal Regulations, Section 442.112 (a)

The Medicaid agency may not execute a provider agreement or make Medicaid payments to a facility unless the Secretary or the State survey agency has certified the facility.

Title 42, Code of Federal Regulations, Section 442.119 states:

The denial of payments for new admissions will continue for 11 months after the month it was imposed unless, before the end of that period, the state finds the facility has corrected the deficiency or is making a good faith effort to achieve compliance.

02-01B The Department of Labor and Industries paid at least \$725,774 in workers compensation benefits to claimants and survivors who were no longer eligible for the benefits. Additionally, the Department does not verify dependents claimed when calculating time loss benefits.

Background

The Department pays more than \$877 million a year in workers compensation benefits to injured workers and their dependents in accordance with the state industrial insurance law.

Description of Condition

During our audit, we reviewed workers compensation benefit payments and found that at least \$725,774 in benefits were paid to claimants who were no longer eligible for benefits due to incarceration, death, wages earned or remarriage. The duration of these overpayments ranged between less than a year and 13 years. Of the total overpayments, those caused by potential recipient fraud totaled \$652,774 and those paid during the audit period totaled \$251,363.

We found:

- Two claimants received benefits while incarcerated, making them ineligible for workers compensation benefits. The claimants were overpaid by \$92,426.
- The Department continued to pay pension benefits to five claimants who were deceased. In one case, a family member notified the Department of the death, but staff failed to terminate the payments for two years after the death. Overpayments totaled \$387,700.
- One claimant earned wages that exceeded the eligibility limit, making the claimant ineligible for benefits. This claimant was overpaid by \$33,834.
- In some cases, a monthly benefit is paid to the surviving spouse after the death of an injured worker. Under certain circumstances, remarriage can make the recipient ineligible. We found that five claimants inappropriately continued to receive benefits after they remarried. The surviving spouses were overpaid by at least \$211,814.
- Annually, the Department requires recipients to complete and return a form certifying whether they are still alive, incarcerated, employed or remarried. If the form is not returned within 90 days, benefits are to be terminated. Pension payments are not being terminated in a timely manner when the forms are not returned. Of the 40 pensions reviewed, 12 (30 percent) did not have a current form on file and pension payments had not been terminated. At the time of our testing, the 12 forms that had not been received ranged from four months to four years late.
- The Department does not require the annual form discussed above to be notarized. Because of this, family members and friends have been able to falsify signatures in order to continue receiving benefits to which they are not entitled. We found four instances in which these

forms were falsified and resulted in overpayments of \$314,700. This amount is included in the \$387,700 overpayment described above.

Additionally, we found the Department does not have procedures regarding verification of the number of dependents claimed on the initial application for temporary disability benefits. The Department relies on the claimant's certification that they have a spouse and/or dependent children. Evidence, such as a marriage certificate or birth certificates, is not required unless a change in the number of dependents is made at a later date. The amount of dependents claimed has a direct affect on the calculation of temporary disability benefits paid to the injured worker. The Department does require proof of dependents if the injured worker subsequently receives pension benefits.

Cause of Condition

The Department performs computer-generated matches between claim data and other agencies' data to identify deceased, incarcerated and employed claimants. However, the results of the deceased and incarcerated matches did not identify all ineligible claimants. The Department is researching why this occurred and plans to resolve this issue. The match to detect employed claimants is working as intended, but employees do not always follow up in a timely manner on claimants who earn wages that exceed the eligibility limit.

Another internal control established to detect pension claimants that are no longer eligible is the annual form certifying that the claimant is still eligible for benefits. However, employees processing pension payments do not always follow the established procedures to terminate a pension when a claimant does not return the form by the deadline.

The delay in following up on data match results and annual forms is due to the heavy workload of the few employees in the pension section.

The Department has not initiated matches between claims data and marriage data. Therefore, it cannot detect when a claimant becomes ineligible due to a remarriage.

The Department does not require proof of dependents when an injured worker receives temporary disability benefits.

Effect of Condition

Without adequate internal controls over the disbursement of industrial insurance benefits, the Department cannot ensure that benefits are being paid to eligible claimants. This weakness increases the risk that claimants are paid in error or in excess of the amounts to which they are entitled.

Recommendations

We recommend the Department:

- Make more aggressive efforts to obtain proof of dependents for time loss claimants.

- Review the match process between pension data and Social Security Administration data to determine why some deceased claimants are not identified and take action to correct this issue.
- Review the match process between claims data and Department of Corrections data to determine why some incarcerated claimants are not identified and take action to correct this issue.
- Review claimants earning wages in a more timely manner so that those who are gainfully employed can be quickly identified and benefits terminated in a timely manner, including pension recipients for both self-insured employers and those who purchase coverage through the Department.
- Initiate a periodic match between pension data and marriage and divorce data to identify surviving spouses that have remarried.
- Terminate pension benefits when the annual form certifying eligibility is not received by the established deadline.
- Require annual eligibility forms to be notarized.

Department's Response

The Department will review its match parameters. The Department will be reviewing our data exchange agreements and will be looking into further expansion of those agreements in an effort to broaden our search capability to preclude the reoccurrence of these items in the future.

Additionally, we will be looking into our procedures to ensure they completely address the concerns raised by SAO and will be working to make any required modifications to either correct or mitigate the concerns raised by SAO.

Roughly 25 percent of the 160,000 industrial insurance claims filed each year require the Department to partially replace wages referred as timeloss payments. Most claims have fewer than 10 days of timeloss and are resolved with appropriate medical treatment. At any given time, there are about 17,500 (cumulative) active timeloss claims. Two-thirds of these claims are over one year old. Obtaining proof of dependent and marital status for timeloss claims would be a huge administrative burden for the agency. More importantly, we are concerned this requirement would place an undue economic and administrative hardship on the injured worker population.

The Department believes there is a better way to formulate the amount an injured worker receives each month for wage replacement. We are pursuing a legislative remedy. This proposal establishes a set percentage to be applied against the worker's wages used to determine a monthly compensation rate. The request legislation eliminates the need to obtain or verify the number of dependents and/or marital status of a worker.

If this legislative effort is unsuccessful, we will work with the Auditor's Office and others to improve our ability to obtain proof of dependents.

Auditor's Remarks

We appreciate the Department's willingness to address these issues. We will follow up on the Department's progress during our next audit.

Applicable Laws and Regulations

Revised Code of Washington 51.32.040 (3)(a) states in part:

Any worker or beneficiary receiving benefits under this title who is subsequently confined in, or who subsequently becomes eligible for benefits under this title while confined in, any institution under conviction and sentence shall have all payments of the compensation canceled during the period of confinement.

Revised Code of Washington 51.32.050 (2)(a) & (c) states in part:

Where death results from the injury, a surviving spouse of a deceased worker eligible for benefits under this title shall receive monthly for or until remarriage payments according to the following schedule....

Payments to the surviving spouse of the deceased worker shall cease at the end of the month in which remarriage occurs....

Revised Code of Washington 51.32.050 (6) states in part:

For claims filed prior to July 1, 1986, if the injured worker dies during the period of permanent total disability, whatever the cause of death, leaving a surviving spouse, or child, or children, the surviving spouse or child or children shall receive benefits as if death resulted from the injury as provided in subsections (2) through (4) of this section. Upon remarriage or death of such surviving spouse, the payments to such child or children shall be made as provided in subsection (2) of this section when the surviving spouse of a deceased worker remarries.

Revised Code of Washington 51.08.060 defines permanent total disability:

"Permanent total disability" means loss of both legs, or arms, or one leg and one arm, total loss of eyesight, paralysis or other condition permanently incapacitating the worker from performing any work at any gainful occupation.

Revised Code of Washington 51.32.210 states in part:

Claims of injured workers of employers who have secured the payment of compensation by insuring with the department shall be promptly acted upon by the department. Where temporary disability compensation is payable, the first payment thereof shall be mailed within fourteen days after receipt of the claim at the department's offices in Olympia and shall continue at regular semimonthly intervals.

02-01C The Department of Social and Health Services, Economic Services Administration does not perform adequate or timely reviews to ensure the allowability of child care payments made to clients and vendors from federal and state funds.

Background

The Department of Social and Health Services is responsible for making payments to child care providers for eligible clients and to clients on behalf of in-home providers. The majority of these payments are issued through the Working Connections Child Care Program and the Seasonal Child Care Program. The Economic Services Administration, Division of Child Care and Early Learning administers these programs and processes payments through the Social Services Payment System. During fiscal year 2002, these two programs were funded as follows:

Funding Source	Working Connections Child Care	Seasonal Child Care	Total by Source
State	\$46,000,000	\$690,236	\$46,690,236
Federal - CFDA 93.575 - Child Care Development Fund-Discretionary	99,338,663	8,474,891	107,813,554
Federal - CFDA 93.596 - Child Care Development Fund Mandatory / Matching	55,388,942		55,388,942
Federal - CFDA 93.558 -Temporary Assistance to Needy Families	89,951,410		89,951,410
Federal - CFDA 93.667 - Social Services Block Grant	25,890	85,605	111,495
Total by Program	\$290,704,905	\$9,250,732	\$299,955,637

During the fiscal year 1999 and 2000 audits, we identified and reported inadequate controls over payments from the Working Connections Child Care Program. The Department’s corrective action plan detailed the steps it would take to resolve the conditions.

The Department’s corrective action stated it would develop an electronic Supervisory Review Form (for monthly case file reviews) and an electronic Payment Alert Report (for identification of possible overpayments) and would provide training on the use these forms. The Department also stated its internal audit staff would complete five audits of child care providers, including reviews of billing documentation and attendance records.

The corrective action plan was followed by a management memorandum to all administrators, regional administrators, and regional program coordinators. This memorandum required that:

- Program supervisors, using the Supervisory Review Form, review a minimum of three child-care cases for each authorizing worker each month. (Data on this form is automatically collected into the Case Review Report.)

- Regional and headquarters staff access the Case Review Report on a regular basis to check for compliance with the above monitoring standard. (This report includes data from the Supervisory Review Forms for each applicable office.)
- Program supervisors access the Payment Alert Report on the last working day of the month and assign the authorizing worker the responsibility to review the cases, complete the electronic overpayment form, and submit the appropriate forms to the Department’s Office of Financial Recovery.
- Region and headquarters staff electronically review the Payment Alert Summary Report by the tenth of the following month. (This report lists the number and total amount of all overpayments identified on the Payment Alert Report for each Office.)

Description of Condition

Working Connections Child Care

During the current audit, we performed a follow-up review of the Department’s Working Connections corrective action plan at four Community Services offices in Region 6 (Kelso, Shelton, Chehalis and Aberdeen), Region 6 headquarters and the state office of the Division of Child Care and Early Learning.

1. We found the following conditions related to the Case Review Report:

- Three of six supervisors responsible for case file reviews in the four Community Services Offices were not using the required electronic Supervisory Review Form. This prevents data from being collected and stored electronically in the Case Review Report so the Region and headquarters offices can perform their required reviews.
- Neither Division headquarters staff members nor Region 6 staff members had performed timely reviews of the Reports to determine if the Offices were properly following procedures. Region 6 had not reviewed reports in the past eight months because the responsible staff member was assigned to another project and the Region did not assign a different staff member to perform the reviews.

2. We found the following conditions related to the Payment Alert and Summary Reports:

- Five of six supervisors responsible for the monthly review of the Payment Alert Report in the Community Services Offices were not performing timely reviews. Most of the reviews were months behind. This creates a very high risk that excess payments to clients and vendors are not being researched and recovered, if necessary. We did find that, on the occasions when completed reviews identified overpayments, the information was generally forwarded appropriately for recovery.
- Following an overpayment review, the Office staff member is to complete an electronic overpayment notice. If the worker does not electronically mark the box noting the overpayment was identified by use of the Payment Alert Report, the data is not captured on the Summary Report and is not available for review by Region 6 or headquarters.

- Neither Division headquarters staff members nor Region 6 staff members performed timely reviews of the Summary Report to determine if the Offices were properly following procedures. Region 6 had not reviewed summaries in the past eight months because the responsible staff member was assigned to another project during this time and the Region did not assign a different staff member to perform the reviews.
- Use of the Payment Alert Report is not sufficient by itself to identify all overpayments, because the Report cannot identify cases in which providers and clients may have billed for services not actually provided.

We also found the Department is not monitoring provider billings to ensure they are adequately supported by attendance records. The Department’s internal auditors, Operations Review and Consultation, did complete the audits of providers as called for in the Corrective Action Plan. The internal auditors notified us that they had identified significant Working Connections overpayments made within the last three fiscal years to four of the seven child care providers reviewed. The auditors found the overpayments when they compared provider attendance records to provider invoices and found inadequate documentation that the billed services were provided. We have reviewed the auditors’ reports and agree with the procedures completed and conclusions reached. The overpayments amounted to \$424,000. The Department was not able to identify the exact sources of funds used to pay these providers before the audit had concluded. However, we estimate the majority of these costs were charged to the federal programs listed above.

Seasonal Child Care

We found a similar monitoring weakness in the Seasonal Child Care program. The Department’s Division of Fraud Investigation currently is performing procedures similar to those described above at 47 Seasonal Child Care providers in Region 1. It has completed a records review of 11 providers for time spans ranging from 17 months to eight years. We have reviewed the Division’s work completed to date and agree with its procedures and its conclusion that the providers have maintained inadequate support for the actual provision of services to children. Currently, the Division has identified unsupported costs of \$810,000. The Department will complete a review to determine the exact source of funds used to pay these 11 providers; however, its preliminary estimate is as follows:

CFDA 93.575 Child Care Development Fund	\$809,919
CFDA 93.667 Social Services Block Grant	\$ 81

During our review, we found that the families we tested were, in fact, eligible for child care services. However, without adequate attendance records, the Department cannot verify that the eligible children actually attended on the days billed.

Cause of Condition

The Department stated these conditions are due to staff turnover, lack of training and placing a higher priority on other areas.

Effect of Condition

Without adequate or timely reviews of child care payments, the Department cannot be assured that the payments issued to clients and vendors are valid. This weakness increases the risk that clients and providers are paid in excess of the amounts to which they are entitled, with no subsequent recovery.

For Seasonal Child Care we are questioning the \$809,919 charged to the Child Care Development Fund. We estimate the total unsupported costs at the end of the Division's investigation will be at least \$1.5 million. For Working Connections Child Care we are questioning \$424,000 charged to the federal awards.

Recommendations

We recommend the Department:

- Ensure staff members perform all required reviews on a timely basis, including those for months not previously reviewed, and send identified overpayments to Financial Recovery immediately.
- Provide training on the use of electronic forms and required reports.
- Develop an adequate procedure to compare billings submitted for payment to attendance records.
- Continue its efforts to identify which grant funded the \$424,000 in questioned costs for the Working Connections Child Care program and the \$810,000 for the Seasonal Child Care program.

Department's Response

The Department concurs with the finding. The Economic Services Administration concurs with the auditor's finding that previous corrective action plans developed to ensure the performance of adequate and timely reviews of childcare payments were not sufficiently implemented nor monitored.

The Division of Child Care and Early Learning (DCCEL) and the Community Services Division (CSD) have issued a joint memo to regional management staff requiring the immediate implementation of the required supervisory reviews. DCCEL headquarters staff will monitor the reviews on a monthly basis and provide the CSD Director with routine reports on the compliance status of Community Service Office and Regional Office monitoring efforts. In addition, the CSD Director has established supervisory childcare case audits as one of nine performance issues to be monitored with Regional Administrators. Issues of non-compliance will be discussed with respective Regional Administrators during weekly phone calls designed to monitor regional performance in the identified performance areas. The Directors of the DCCEL and CSD will present additional oversight measures that address the training issues in the final corrective action plan established in response to the auditor's finding.

With regard to Working Connections Child Care questioned costs identified by State Auditors Office (SAO), we would like to add some additional information. As SAO describes in the finding, part of our corrective action plan was to have the internal audit staff complete five audits of child care providers. The Office of Review and Consultation (ORC) did these five audits; three had overpayments and two had underpayments with a total overpayment of \$48,917.98. Rather than address only these five audits, which were part of the agency's corrective action plan, SAO included seven ORC audits conducted over a three-year period (which includes a period outside of the agency's corrective action plan and fiscal year 2002). SAO's decision to include audits covering a three -year period, rather than the five audits conducted as part of the Corrective Action Plan skews the over-all picture. Therefore the actual questioned costs as part of the fiscal year 2002 audit should be stated as \$48,917.98, not the \$424,000 that is identified above.

The department will identify the funding sources in question and complete necessary collection action.

Auditor's Concluding Remarks

We have included three years of the Department's Office of Review and Consultation audit results to show the extent of the weaknesses. Including these results does not skew the overall picture, as these weaknesses are not isolated to fiscal year 2002, but, to our knowledge, have been in existence for at least three years.

We appreciate the Department's cooperation during the course of our audit and will review corrective action during our next audit.

Applicable Laws and Regulations

The federal Office of Management and Budget's Circular A-133, Audits of States, Local Governments, and Non-profit Organizations, Subpart A, Section 105, includes the following in the definition of a questioned cost:

- (2) Where the costs, at the time of the audit, are not supported by adequate documentation;...

The federal Office of Management and Budget's Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, Attachment A, Section C.1 states in part:

To be allowable under Federal awards, costs must meet the following general criteria:...

- (j) Be adequately documented.

The state of Washington Office of Financial Management's *State Administrative & Accounting Manual*, Section 85.32.10 states in part:

It is the responsibility of the agency head, or authorized designee, to certify that all expenditures/expenses and disbursements are proper and correct...At a minimum, agencies are also to establish and implement the following:

1. Controls to ensure that all expenditures/expenses and disbursements are for lawful and proper purposes...
2. Procedures to ensure prompt and accurate payment of authorized obligations, and
3. Procedures to control cash disbursements.

Washington Administrative Code 388-155-460 states in part:

Home records. The licensee must maintain the following documentation on the premises:

- (1) The attendance records, completed daily, including arrival and departure times...

02-01D The Department of Social and Health Services, Economic Services Administration, is not in compliance with eligibility requirements for the Temporary Assistance to Needy Families Program.

Background

The Department of Social and Health Services, Economic Services Administration is responsible for administering the federal Temporary Assistance to Needy Families program (CFDA 93.558). Federal regulations require each state to maintain a certain amount of state-funded expenditures each year or face financial penalties. The Program was funded during fiscal year 2002 with \$152,517,309 in federal funds and \$174,770,715 in state funds.

Major objectives of this program are to provide time-limited assistance to needy families with children and to promote job preparation and work opportunities for the parents. As long as minimum requirements are met, states have flexibility in designing programs and determining eligibility requirements and may use grant funds to provide cash or non-cash assistance. To be eligible under federal requirements, a family generally must include a child under 18 living with the parents and must qualify as needy under a state's criteria. The State of Washington has also specified that, with certain exceptions, applicants must provide Social Security numbers in order to receive Program benefits and cannot be incarcerated.

Description of Condition

During our audit of Program claims and benefits, we tested various eligibility requirements for the period January through March 2002. We found instances of noncompliance with eligibility requirements in the following areas:

We tested income requirements of 46 families by comparing income records from the Employment Security Department, along with the number of family members, with the amounts of Program assistance provided. We found 12 instances in which the Department paid families more Program funds than those to which they were actually entitled considering their incomes and number of family members. Total overpayments in these 12 cases for the three-month period amounted to \$14,628

We tested the validity of Social Security numbers for 92 Program recipients and found three cases in which benefits were paid even though the recipients had provided no numbers at all or had provided numbers that were invalid according to Social Security data. These latter cases occurred in spite of the fact that the Department receives Social Security alerts informing it which numbers provided by recipients are invalid. Total Program payments for these ineligible recipients for the three-month period amounted to \$5,371.50.

As a result of our testing, we also found six instances in which invalid numbers appeared to have been entered because of Departmental error, rather than because of inaccurate information provided by the clients. The errors were usually the result of number transposition when entering data to the records. Program payments in these instances, which we determined were probably valid in spite of the incorrect numbers, amounted to a total of \$7,096.

We compared the records of 19 recipients with Department of Corrections records and found one case in which a client received a total of \$212 in Program assistance during a two-month period when the client was in prison and otherwise ineligible for federal aid assistance.

Cause of Condition

The Department stated these conditions are due to staff turnover, lack of training and placing a higher priority on other areas.

Effect of Condition

Clients who may not be eligible are receiving benefits provided by both state and federal funds. In addition, failure to use all resources available for verifying eligibility could leave the Department susceptible to fraud and could lead to a reduction in federal grant funds. The Department estimates that, for the \$20,212 identified above, \$10,106 was charged to the federal program and \$10,106 was charged to state funds. Accordingly, we are questioning these amounts.

Recommendations

We recommend the Department:

- Institute periodic comparisons of information provided by recipients with applicable records maintained with other State agencies and investigate any discrepancies.
- Require employees to obtain Social Security numbers in all cases and investigate Social Security Administration alerts regarding invalid numbers.

Department's Response

The SAO audit involved three program areas; TANF income eligibility, validity of Social Security numbers used by recipients, and receipt of benefits by incarcerated persons.

Economic Services Administration concurs with the auditor's finding that it should use available information, some gathered and maintained by other State agencies, in periodic comparisons of client/recipient information. Discrepancies should be investigated and payment errors corrected. Improved use of technology and automation will aid in the detection of incorrect payments.

CSO field staff has a means available to validate SSN information. Operationally, we can manually verify questionable SSNs if necessary though a labor-intensive process. The solution and Corrective Action Plan (CAP) will address staff training on existing processes. All financial staff will be required to attend system interface and alerts training. Additional information that we would like to make available:

- *Local office staff already knew of several of the TANF income eligibility discrepancies prior to the auditor testing and corrective payment actions were in process.*

- *The automated eligibility system does run income related cross-matches on cases when a review is initiated. Reduced staffing levels may have contributed to staff's inability to react to all potential claims timely. ESA is exploring the possibility of contracting with "TALX", an automated system that instantly provides wage-based income verification.*
- *The automated alerts occur at application and every 5 months thereafter if the number is an error. ACES interface and alert training will help significantly as well as making the Social Security on-line query (SOLQ) process simpler.*
- *We are investigating the feasibility of building a cross-match to Department of Corrections data. Experience has shown that our clients often are incarcerated for short periods of time and their eligibility for benefits is unchanged. We will continue to gather information on this issue.*

Auditor's Concluding Remarks

We greatly appreciate the remarkable cooperation and assistance we received from the Department.

Applicable Laws and Regulations

U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Subpart C, Section .300 states in part:

The auditee shall:...

- (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs....

Washington Administrative Code 388-478-0035 describes the maximum earned income limits for Program beneficiaries relative to the number of family members.

Washington Administrative Code 388-476-0005 states in part:

- (1) With certain exceptions, each person who applies for or receives cash, medical or food assistance benefits must provide to the department a Social Security Number (SSN) or numbers if more than one has been issued.
- (2) If the person is unable to provide the SSN, either because it is not known or has not been issued, the person must:
 - (a) Apply for the SSN;
 - (b) Provide proof that the SSN has been applied for; and
 - (c) Provide the SSN when it is received.

- (3) Assistance will not be delayed, denied or terminated pending the issuance of an SSN by the Social Security Administration. However, a person who does not comply with these requirements is not eligible for assistance.

RCW 74.08.025 states in part:

- (1) Public assistance may be awarded to any applicant...(c) who is not an inmate of a public institution...(Auditor's note: There are some exceptions that do not apply in this case).

02-01E The Employment Security Department is not complying with client eligibility requirements for the Unemployment Insurance program.

Background

The Employment Security Department administers the Unemployment Insurance program (CFDA No. 17.225), which is partially funded by the U.S. Department of Labor. The program provides partial wage replacement for workers who are unemployed through no fault of their own. The majority of unemployment benefits received by claimants are paid under the regular compensation program. If claimants exhaust their regular compensation, they may be able to qualify for extended benefits or emergency compensation.

Description of Condition

The Department is required to determine whether its clients are eligible for the benefits they are receiving. Our audit of eligibility focused on regular compensation and extended benefits.

To receive extended benefits, claimants must make a systematic and sustained effort to seek work and must provide tangible evidence of such efforts. Federal regulations define tangible evidence as a written record which can be verified, and which includes the actions taken, methods of applying for work, types of work sought, dates and places where work was sought, the name of the employer or person who was contacted and the outcome of the contact.

We selected 119 extended benefit payments made to 20 claimants during January 2002 through March 2002. Of these 119 payments, we found 81 cases where claimants either did not submit work search records or submitted incomplete records. Benefits paid to these claimants totaled \$26,752 for the period tested. Of this amount, \$13,376 was paid from federal funds.

Cause of Condition

The Department notified claimants of the work search documentation requirements, but did not establish and follow an adequate method of monitoring compliance or retaining documentation of work search efforts.

Effect of Condition

Because the Department did not have adequate controls or documentation to ensure all claimants were eligible, we are questioning federal payments of \$13,376.

Recommendations

We recommend the Department continue to work on its system of monitoring and documenting work search efforts of claimants being paid extended benefits.

Department's Response

Background: During a high unemployment period in 1981, an amendment to Extended Benefits (EB) law added, among other things, the more stringent work search criteria requiring claimants

to provide tangible evidence of a systematic and sustained effort to find work. These requirements were suspended from March 13, 1993 until January 1, 1995. By that time the economy in Washington had recovered and the projection was that we would not be in an EB period for an extended period of time.

In 1995, Washington, along with the majority of other states, implemented the Interactive Voice Response (IVR) method of filing continued claims by telephone. The IVR allows claimants to call in their claim each week, answering the same questions they would answer if filing by paper. At the time IVR was implemented there was no longer work search on the paper claim. Since IVR mirrored the paper claim, work search reporting was not programmed as a part of IVR, the same as other states.

An issue paper was presented to the U.S. Department of Labor (DOL) approved by the UI Director's Committee at a UI Director's Conference in October of 1998, by the then Assistant Commissioner of Unemployment Insurance. The paper outlined the difficulties of complying with EB work search requirements using the IVR and call center environments. Though the committee agreed, no action was taken because everyone believed Congress would repeal the more stringent work search requirements.

Effective July 1, 1999, all claimants in Washington were held to a higher threshold regarding their work search activity because of a change in Washington law. Revised Code of Washington (RCW) 50.20.240 (the job search monitoring law) requires claimants to show they are actively seeking work each week by keeping a job search log providing the same elements of information that are in the federal EB law. Each week a random sample of claimants is contacted by letter telling them to report in person to a WorkSource office and present their work search log for review. A portion of these also has a second review during which work search contacts will be verified.

The UI Assistant Commissioner presented the work search-monitoring program to DOL as our proposal to meet the EB work search requirements. DOL said the plan made sense. Based on that information we designed our GUIDE system to have EB claimants use a work search log and to include EB claimants in the monitoring sample.

EB Implementation: On December 21, 2001, we were notified by DOL that we would enter an EB period beginning January 6, 2002. This was a very short time frame to implement a very complex program. Our primary goal, which we achieved, was to ensure that all claimants would receive timely EB payments.

After GUIDE design for EB was complete, the DOL regional office told us that they didn't think our plan met the requirement of EB work search regulations. We received final word from DOL on January 18, 2002, that we would be required to gather work search information from claimants each week as a part of the continued claim certification process. We immediately began redesign of the IVR and Internet weekly claim systems to capture all the work search elements required by federal. For those still using paper weekly claims, work search could be reported on the back of the form.

The continued claim form was revised and in use about February 8, 2002. The redesign requirements for IVR to record work search for all EB claimants were extensive, expensive and

had to be programmed by our IVR vendor. In addition, there were capacity problems with the 1-800 site, which delayed implementation at that location.

The gathering of work search information at the IVR locations began on February 16, 2002, and was completed by April 15, 2002. We sent letters at specific intervals to all claimants using IVR or the Internet to make their weekly claims, asking them to send us their work search logs from January 6, 2002, until the functionality on the IVR was implemented. We had to delay the requests for those logs because the work search logs could be requested for a work search monitoring interview by WorkSource and subsequently for verification as a part of our job search monitoring program required by RCW 50.20.240. All work search logs received for that period of time have been retained. We have a total of 53,570 EB work search logs with each log covering up to four weeks of work search.

Based on the review of EB work search records between January 6, 2002 and April 12, 2002, there were a total of 1,621 cases where we questioned claimants' EB work search and "issues" were set, examined and resolved.

The auditor's exception states: ". . . we found 81 cases where claimants either did not submit work search records or submitted incomplete records." It is likely that some of those not found were used for a different purpose such as job search monitoring. It does not mean that the claimants did not submit the work search. In addition this was a very busy time with our priority being, as always, timely payment of benefits. As a result many of the logs were boxed up and archived.

The state and federal eligibility requirements for work search require that each individual provides tangible evidence to the employment security department that he or she has engaged in a systematic and sustained effort to obtain work during each week. There has been considerable confusion and controversy regarding this requirement since its re-instatement in 1995. More than once, Congress has considered legislation that would repeal the stricter EB work search requirement. We feel we proceeded in good faith that our proposal for including EB claimants in the job search-monitoring program had DOL's approval and the EB work search requirement was going to be eliminated from the EB law. When told to the contrary, we quickly proceeded to implement a new system.

As soon as we received the new direction from Department of Labor on January 18, 2002, that the more stringent work search requirements would remain, we immediately started the programming changes that were required to comply. It is important to note that during this time we were already set up to pay EB in a timely manner and no EB payments were delayed due to the additional highly complex programming needed.

We continued with our plan to include EB claimants in the work search-monitoring program. Between January 6, 2002, the effective date of EB, and April 12, 2002, 1,882 claimants were called in to WorkSource Centers for work search monitoring which is more than the federal law requires.

We did not receive the final decision on work search from DOL until 12 days after the start of the EB program. We feel that we made a good faith effort to comply with the work search requirement. We were faced with complex programming and hardware and software changes to

GUIDE, the time necessary for the IVR vendor to make changes including the purchase and installing of a new server and notification to our claimants. It is important to remember that while all of this work was going on behind the scenes our claimants continued to receive the timely payment of benefits.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding. We also appreciate the cooperation extended to us throughout the audit by Department staff. We will review the status of corrective action during our next audit.

Applicable Laws and Regulations

Title 20, Code of Federal Regulations, Section 615.8(g) states:

The State law shall provide ... that an individual who claims Extended Benefits shall be required to make a systematic and sustained effort to search for work which is "suitable work"... throughout each week beginning with the week following the week in which the individual is furnished a written notice of classification of job prospects ... and to furnish to the State agency with each claim tangible evidence of such efforts.

If the individual fails to thus search for work, or to furnish tangible evidence of such efforts, he/she shall be ineligible for Extended Benefits for the week in which the failure occurred and thereafter until the individual is employed in at least four weeks with wages from such employment totaling not less than four times the individual's weekly benefit amount, as provided by the applicable State law.

02-01F The Washington State Health Care Authority has not established sufficient internal controls to ensure compliance with Basic Health Plan requirements.

Background

The Health Care Authority administers the state's Basic Health Plan, which was created by the 1987 Legislature to provide subsidized health care insurance to eligible citizens. The Basic Health Plan is available to any Washington resident who is not eligible for Medicare; who is not institutionalized at the time of enrollment; and who meets income requirements.

The amount of a subsidy is based on family size, income, age of dependents, and cost of the subscriber's health plan. According to the Authority, the Basic Health Plan had an average of 78,000 accounts during fiscal year 2002. Within these accounts, there were 122,000 enrollees receiving health insurance subsidies at a benefit cost of more than \$219 million in state funds. No federal funds are used for this Plan.

Subscriber accounts are managed through an automated billing system. We first reviewed this area in 1997, when we used computer-assisted auditing techniques to match the income reported by Basic Health Plan subscribers to income information reported by independent sources. The audit identified a significant number of subscribers who appeared to have under-reported their income. We communicated to the Health Care Authority that it needed policies and procedures to determine subscriber eligibility when enrolling and to determine continued eligibility, a process known as recertification.

In fiscal year 2001, we performed follow-up work in these areas to determine if adequate internal control policies and procedures had been developed and were being followed. We reported in the State Accountability Report that the Authority had not yet developed new policies and procedures. During fiscal year 2002, we performed a more limited review to determine progress on the Authority's corrective action plan. The Authority stated it had added significant new control activities, including:

- Significantly increasing the number of recertifications of subscriber accounts. Recertification was initiated on approximately 43,000 accounts between July 2001 and June 2002. Subsequently, the Authority stated it had initiated recertifications on all accounts as of December, 2002.
- Adding recertifications for those who are self-employed or who have reported no income.
- Analyzing data matches with the Employment Security Department and Department of Revenue income records.
- Developing and testing procedures for data matches with income records of Labor and Industries and the Internal Revenue Service.
- Increasing recovery of overpayments from 20 accounts a month to 250.

During our review, we noted evidence of the establishment of these additional controls. However, because of the limited time between the issuance of our fiscal year 2001 report and the

end of fiscal year 2002, we did not fully test their effectiveness. We will perform a more detailed review during our fiscal year 2003 audit.

Description of Condition

Although the Authority made significant progress in developing new policies and procedures, we found it still could not provide documentation from colleges confirming enrollment for student dependents between the ages of 19 and 23. In the cases tested, the Authority relied on subscriber self-certification statements and did not require enrollment documentation from the colleges. We selected 25 student dependents the Authority had verified as valid; however, we found no outside documentation confirming enrollment for any of them. Neither the Legislature nor the Authority has established that dependency for these students includes the need for subscriber financial support; therefore, the Authority does not require this type of documentation either.

Cause of Condition

The Authority has established a corrective action plan that will take at least a year to complete. Although it is current with that plan, the Authority will need additional time to resolve all internal control weaknesses.

Effect of Condition

The Authority may be paying health insurance premiums for some individuals who are not eligible to participate in the program or who should be receiving smaller subsidies. Therefore, the amount of money available to the Plan could be reduced, preventing other eligible subscribers from receiving health insurance benefits.

Recommendations

We recommend the Authority complete the establishment of adequate internal control policies and procedures to ensure that all of those who receive the Basic Health subsidy are eligible.

Authority's Response

As pointed out by the auditor, the Health Care Authority made significant improvements this past year in the development of control processes at Basic Health (BH) to ensure eligibility of those members served. Although having acknowledged this progress, the auditors nonetheless issued a finding regarding a low risk portion of the Basic Health population, student eligibility.

Two points that we wish to make regarding the auditor's finding:

- *The eligibility of the student population is of low risk to the state, since the students would be eligible for Basic Health coverage, based on their low income, even if they were not students.*
- *Current procedures, which the auditor declined to observe, are sufficient to ensure student eligibility.*

Low risk to state

Students make up just 2.5% of the Basic Health population. Eligibility for BH is not dependent on student status. Eligibility is determined by income and residency requirements. The loss of full time student status simply means the member cannot be included on the parent's account. However, the member may continue BH coverage under his or her own account. Our studies have shown the state portion of the premium is usually higher when this takes place.

Current procedures are sufficient

We believe our controls provide reasonable assurance that members, including those relating to the student eligibility processes, are eligible for the BH. The auditors did not determine any BH student members were ineligible for BH coverage.

Basic Health implemented an annual verification process for all dependent students, based on date of birth during fiscal year 2002. This is in addition to the regular annual re-certification process that takes place for all BH subscribers. Also, staff randomly called the schools listed on the students' self-certification forms submitted to the program to verify the information provided. While we do not dispute the auditor's assessment that we did not require written documentation from the schools, the auditors declined to review the processes described above, and did not consider them in evaluating our control procedures during the audit.

Auditor's Concluding Remarks

The Authority's response to this issue in the fiscal year 2001 finding indicated the control weakness had been corrected; however, we did not find this to be the case during our audit of fiscal year 2002, in which we found the Authority accepted a telephone call or letter from a family member, subscriber or dependent, as sufficient proof of full-time student enrollment. Student transcripts or other enrollment documentation were not required by the Authority. Other than the oral or written statement by the subscriber or family member, the Authority and the auditor could not determine whether the student was eligible for extended Basic Health coverage. All information provided by the Authority was considered during the audit.

Additionally, eligibility for Basic Health is not automatic but is subject to income and residency verification, and coverage is contingent on plan openings. It is possible that a dependent over the normal age limit might not qualify financially or might find no openings available, especially if budgets are reduced as proposed.

We reaffirm our finding and will review any new procedures and their effectiveness in our next audit.

Applicable Laws and Regulations

RCW 70.47.020(4) states in part:

“Subsidized enrollee” means an individual, or an individual plus the individual's spouse or dependent children...

RCW 70.47.060 states in part:

The administrator has the following powers and duties...(5) to limit the payment of subsidies to subsidized enrollees, as defined in RCW 70.47.020....

The Authority has adopted the following rules in the Washington Administrative Code:

WAC 182-25-010(9) defines dependent in part as:

(b) The unmarried child of the subscriber or the subscriber's dependent spouse, whether by birth, adoption, legal guardianship, or placement pending adoption, who is:...(ii) Younger than age twenty-three, and a registered student at an accredited secondary school, college, university, technical college, or school of nursing, attending full time, other than during holidays, summer and scheduled breaks....

The Office of Financial Management *State Administrative and Accounting Manual* states in Section 20.20.20.a:

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

02-01G The Washington State Health Care Authority has not established sufficient internal controls to ensure that all of those who are receiving health insurance coverage are eligible to do so.

Background

The Health Care Authority administers the health insurance plans provided to public employees and retirees throughout the state. Subscribers can select coverage through a private health maintenance organization or through the Uniform Medical Plan (the health insurance plan provided by the state) and pay a share of the premium. The Authority pays monthly insurance premiums to the plans based on the number of employees and retired subscribers. No federal funds are used to pay for these premiums.

An additional premium is required for coverage of subscribers' dependents. The state's share of this additional premium is \$176 per month for each subscriber with dependents, regardless of how many are claimed. Coverage for dependent children ends at age 20 but may be extended for children age 20 through 23 who are full-time registered students and dependent on the subscriber for maintenance and support. Currently, there are approximately 7,434 students in this category.

Description of Condition

Except for self-certifications, the Authority does not require documentation that a student is dependent on the subscriber for maintenance and support. Prior to the beginning of calendar year 2001, the health plans obtained enrollment documentation. Since that time, the Authority has not been requiring this documentation but has been relying on subscriber self-certifications of student enrollment. For both financial dependency and enrollment, we found insufficient monitoring to help ensure eligibility.

Cause of Condition

The Authority has considered that self-certifications by subscribers are sufficient proof of student status and financial dependency.

Effect of Condition

The Authority may be paying premiums for subscriber dependents who are not eligible because they either are not students or are not financially dependent. In addition, any medical costs paid by the plans for ineligible dependents will increase actual costs to the plans. These costs will then be included by the plans when negotiating insurance premium costs to be paid by the state in the future.

Recommendation

We recommend the Authority establish and follow adequate internal control policies and procedures to ensure the eligibility of public employee subscriber student dependents receiving health insurance benefits, including obtaining documentation from a source other than the subscriber.

Authority's Response

We do not concur with this finding. The HCA has established adequate controls to ensure PEBB members, including dependent students, are eligible for the benefits they receive. In developing these controls the HCA considered the requirements contained in the Office of Financial Management State Administrative and Accounting Manual, which states:

Section 20.20.20.b (emphasis added)

An internal control system should provide reasonable assurance that an organization will accomplish its objectives. The concept of reasonable assurance recognizes that the cost of an internal control activity should not exceed the benefit derived therefrom. Reasonable assurance equates to a satisfactory level of confidence given considerations of costs, benefits, and risks.

In developing internal controls for the PEBB student population, the HCA first took into account that dependent students make up a relatively small portion of total PEBB membership (about 2%), then tried to strike a balance between the potential risk and the administrative cost of managing that risk.

PEBB notifies employees of student eligibility requirements when they begin employment and requires employees to certify under penalty of perjury (and potential employment sanctions) that their dependent students meet all eligibility requirements before receiving benefits. HCA sends status of enrollment to all members on a semi annual basis and requires annual recertification. In addition, PEBB requires employees to include the name of the educational institution the child is attending, as well as the registrar's telephone number. Although not written in a formal policy, PEBB staff routinely calls the schools to verify attendance as certified by the parent.

The auditors were not aware of the monitoring function at HCA during their audit and did not test for this control. Their tests were designed to determine whether PEBB had written forms from the colleges, a control we do not employ. The auditor did not attempt to test or verify the control structure PEBB uses to ensure student eligibility, nor did the auditor provide HCA with the opportunity to describe these internal controls.

Taking into account the potential costs, risks and benefits, HCA has in place sufficient internal controls to provide reasonable assurance that PEBB only provides benefits to eligible dependent students. The auditors finding was based on a standard that goes beyond reasonable assurance as stated in the OFM manual cited above and the auditors methodology did not take into account the actual controls employed by HCA for this population.

During fiscal year 2002 HCA contracted with a national auditing firm to review potential risk at the HCA. The auditor concluded that the PEBB internal controls for determining student eligibility met or exceeded standard practices for other states and similar private employers offering student coverage.

Auditor's Concluding Remarks

We reviewed records for 124 student dependents during the period of September 2000 through March 2002 (one full school year plus a portion of the next) to determine whether the Authority

had documentation substantiating that the students met the financial dependency requirement for these extended benefits. Except for self-certifications, we found no documentation that the Authority had verified that students were dependent on subscribers for maintenance and support. Even when we accepted as adequate any documentation substantiating full-time enrollment for as little as two of the three or four semesters or three of the five quarters included in the selected time period, we found adequate documentation for only 12 percent of the student dependents.

Throughout our audit, we conducted discussions about eligibility processes and procedures with staff members designated by the Authority. We determined that, while the Authority may have informal policies in place, these policies were not evident in the accounts selected for review and were not adequate to ensure eligibility. We were not provided a copy of the audit report mentioned in the Authority's response.

We reaffirm our finding and will review any new procedures and their effectiveness in our next audit.

Applicable Laws and Regulations

RCW 41.05.160 states in part:

The authority may promulgate and adopt rules consistent with this chapter to carry out the purposes of this chapter....

WAC 182-12-119 states in part:

(3) Dependent children age 20 through age 23 who are dependent upon the employee/retiree for maintenance and support, and who are registered students in full-time attendance at an accredited secondary school, college, university, vocational school, or school of nursing. Dependent student eligibility continues year-round for those who attend three of four school quarters, or two semesters, and for the quarter following graduation....

The Office of Financial Management *State Administrative and Accounting Manual* states in Section 20.20.20.a:

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

Billings and Accounts Receivable (Please see the description of this area on page 12-13.)

02-02 The Department of Community, Trade and Economic Development is not in compliance with state accounting and financial reporting requirements for accounts receivable.

Background

The Department of Community, Trade and Economic Development manages loan programs, including Drinking Water Capitalization Grants, Home and Housing Assistance, Rural and Coastal Development, and Columbia River Gorge Development. These programs make loans to local governments and private entities. In the period under audit, the amount loaned totaled \$240,874,000.

The Office of Financial Management requires agencies to report outstanding loans to other governments separately for inclusion in the state's year-end financial statements. Agencies are also required to maintain subsidiary ledgers that track individual account financial information.

Description of Condition

Our review of accounts receivable found that the Department:

- Does not charge or waive interest on past due amounts in the Housing, Home, Rural Washington and timber programs.
- Has not obtained Office of Financial Management approval for its in-house receivable subsidiary systems.

We also found that in 2002 the Department did not report:

- Loans to local governments in the separate category "Due From Other Governments" for the Housing and Home programs. These loans, which totaled \$37.5 million, were incorrectly reported as "Loans Receivable".
- Any current receivables for any types of loans outstanding. All loans were reported as long-term, even though loan repayments are generally due monthly or quarterly.
- Any allowance for uncollectible accounts for private entity loans in the Housing, Timber and Home programs.

Cause of Condition

In 1999, the Department was split into two separate offices, which were merged again during 2002, resulting in a great deal of organizational change. The Department stated that these actions, coupled with reduced staffing resources, have limited the agency's ability to create consistent business practices across the 13 diverse loan programs.

Effect of Condition

The agency cannot ensure it is receiving all of the payments and interest to which it is entitled. Incorrect financial statement reporting provides misleading information to the Legislature, the Governor and the public.

Recommendations

We recommend the agency establish and follow procedures that will ensure its compliance with accounting and reporting requirements for outstanding loans.

Agency's Response

CTED is taking the following corrective actions to address the conditions noted in the finding:

- 1. The Department's practice of either charging or waiving interest on past due amounts varies by program and the needs and circumstances of the borrowers. All programs will demonstrate they have reviewed and formalized their procedures in writing; made those procedures and related contract provisions consistent; aligned both with overarching Department policy; and seek OFM waiver when appropriate.*
- 2. The Department and its loan programs will work with OFM to identify those systems that require OFM review to obtain necessary approval.*
- 3. In Housing and Home loan programs there are total of 729 loans to local governments and private entities. Of the 729 loans, 70 loans were not properly classified as "Due from Other Governments". The Administrative Services Division Accounting Services will change agency accounting practices to insure loans to local government are properly identified and recorded.*
- 4. During fiscal year 2002 closing, Accounting Services changed the Department's fiscal closing instructions and created the Department's receivable disclosure forms in our attempt to comply with the financial reporting requirements. Additional work on this issue will be done during the 2003 closing.*
- 5. The Administrative Service Division Accounting Services will review program specific policies and procedures and change agency accounting practices to insure the Department records uncollectible accounts for private entity loans.*

Auditor's Concluding Remarks

We appreciate the Department of Community, Trade and Economic Development's efforts in addressing this finding and will review the agency's progress during our next regular audit.

Applicable Laws and Regulations

The Office of Financial Management *State Administrative and Accounting Manual* sets forth regulations for control over and reporting of accounts receivable.

Section 85.54.10.c states in part:

Agencies are to maintain a general ledger system, by account, with a receivable control account for each type of receivable. Subsidiary records are also required. Agencies may either maintain an in-house receivable subsidiary system with the approval of OFM or utilize the central accounts receivable system, which is available through the Accounting Division of OFM....

Section 85.54.25 states in part:

- b. Loans to local governments and other receivables from local governments, that are due within twelve months, are recorded as GL Code 1352 "Due From Other Governments."
- c. Amounts due from other governments, that are not due within twelve months, are to be recorded as debits to the long-term GL Code 1652 "Due From Other Governments"....

Section 85.54.40.a states:

Monies lent by agencies in the form of notes or loans to private entities (e.g., economically disadvantaged areas) or individuals (e.g., student loans) that are due within twelve months, are classified as GL Code 1313 "Notes Receivable " or GL Code 1314 "Loans Receivable," as appropriate.

Section 85.54.40.b states:

Amounts due from private entities or individuals on loans that are not due within twelve months, are recorded as debits to the long-term GL Code 1614 "Loans Receivable" and the related amounts estimated to be uncollectible as credits to the GL Code 1644 "Allowance for Uncollectible Loans Receivable."

Section 85.54.50.c states:

Interest of one percent per month is to be charged on past due receivables in accordance with RCW 43.17.240 except when one of the following conditions are met:

Charging interest conflicts with the provisions of a contract, or with any other law.

The debt is to be paid by other governmental unit.

The debt became due prior to July 28, 1991.

Interest is waived based upon rules adopted by OFM found at Chapter 82-06 WAC describing the conditions under which interest may be waived on past due receivables.

02-03 More than \$4.7 million in employer industrial insurance premium payments recorded as being received by the Department of Labor and Industries between July 2001 and December 2001 were not reflected as being deposited in the industrial insurance financial accounts. The Department was unable to account for this difference.

Background

The Department collects industrial insurance premiums totaling more than \$1 billion per year from more than 166,000 businesses in Washington state in accordance with the state industrial insurance law. Premium assessments and the related payments are posted to employer accounts as they are received.

Description of Condition

During our audit, we attempted to reconcile premiums posted to employer accounts to amounts deposited in the bank. We found that the employer accounts system reflected payments received of \$4.7 million more than total deposits recorded in the industrial insurance financial accounts. Neither our staff nor Department personnel were able to determine what caused the difference. Possible explanations are that money came in and was not deposited or that the transaction was recorded as a payment received, when it was an adjustment to an account. Minor timing issues and misclassification of payments received may have contributed to this variance. Total payments received for the six-month period were \$545,082,064 per the employer account system and \$540,336,123 per bank deposit records.

We reviewed the internal controls over cash receipts and found:

- The Department does not perform a daily reconciliation between cash deposited and the records of the day's transactions. Cashier staff balance amounts to be deposited to the payments recorded in employer accounts daily, using a report produced by the employer accounts system. However, amounts to be deposited are hand-written on the report by the cashiers. Without documentation from the financial reporting system that transactions have been entered, this procedure does not provide assurance that amounts deposited balance with employer account records.
- The daily balancing procedure described above and the reconciliation of deposits to the mail logs' list of payments received had not been completed consistently for the last two years. We were told that these have now been completed. We will verify this in our next audit.
- The employer accounts report used to perform the daily balancing procedure does not include items that were entered using a transaction date prior to the current date. When we brought this to management's attention, a separate system-generated report was produced showing transactions dated a prior day. Since no report is generated when backdated transactions are not entered for a specific day, the supervisor responsible for monitoring cashier activity does not have assurance about whether the report was received. This provides an opportunity for a cashier to receive and later destroy the report, thereby concealing the backdated transaction.

- Duties are not segregated in the cashier's office. Cashiers handle cash, post payments to employer accounts and adjust employer accounts. Although the lead cashier monitors the activity of the cashiers, the lead cashier's transactions are not monitored daily.
- Security procedures over access to the employer accounts system are inadequate. Cashiers should be the only employees with the access rights needed to enter and correct errors in cash receipt batches. However, we found that seven other employees throughout the state had unnecessary access to some of this system. The cashiers also had access rights needed to change employer data, including the industrial accident report and business information. Department management indicated these rights would immediately be removed.

Cause of Condition

The employer accounts system was not designed to fully support reconciliation to the financial system. Also, the cashier's office experienced staff turnover and several process changes, making it difficult to perform duties designed to maintain good internal controls.

Effect of Condition

Without adequate internal controls over cash receipting, the Department cannot ensure that all payments received are deposited. This results in the risk that errors or misappropriation could occur and not be detected by management in a timely manner, if at all.

Recommendations

We recommend the Department reconcile payments posted to independent systems, including the employer accounts system, to amounts deposited. We also recommend that the Department establish and follow internal controls designed to safeguard cash receipts either by modifying the employer accounts system or by using other compensating controls. We also recommend the Department attempt to determine what accounts for the \$4.7 million discrepancy.

Department's Response

We agree that the reconciliation between the employer account system (EASE) and the state's accounting system (AFRS) should be performed and will develop internal controls to safeguard cash receipts.

To strengthen internal controls over agency receipting, the majority – over 90% – of the revenue is processed by the lockbox service provided by US Bank. US Bank deposits funds received and updates employer accounts through restricted access to the EASE system. The Cashier's office – located in the agency headquarters – and regional offices also receive premium payments. The agency encourages employers to use the US Bank service by addressing all quarterly reports directly to the lockbox service. Employers do not always do this; therefore some payments are received in headquarters and the agency regional offices.

We believe the variance between EASE and AFRS is most likely attributed to differences between system cycling times or "cutoffs" and variation in the way non-sufficient funds checks are recognized. Although reports from EASE were designed to provide for receipts reconciliation,

the process is very labor intensive. The corrective action for the finding will include possible EASE processing and reporting changes and will be an opportunity to make the reconciliation more efficient. The issues of the finding are based on comparison of employer account activity maintained in EASE, to the posting of the receipts and revenue that is recorded in AFRS, with funds deposited with the State Treasurer.

The agency is required to balance all cash activity – including receipts – with the State Treasurer’s Office on an ongoing basis. Since a contracted third party deposits the majority of the premium revenue, and because L&I stays current with the balancing of the State Treasurer’s Office, it is highly unlikely the variance amount was not deposited.

The Department recognizes the importance of this reconciliation and of controls over cash receipts and will work with the Auditor’s Office to bring this matter to a successful and timely conclusion.

Auditor’s Remarks

We thank the Department for their response.

Although we recognize that the majority of industrial insurance premium cash receipts are received and deposited by the lockbox service, the remaining 10 percent amounts to \$100 million. We feel that this is a significant amount and warrants strong internal controls.

We agree that some timing issues, including the non-sufficient fund timing issue, may have contributed to the \$4.7 million variance. However, during our audit we determined that the variance caused by timing issues was not significant. Additionally, the reconciliation of deposits with the State Treasurer’s Office does not provide assurance that the variance of \$4.7 million was not deposited and would not detect a misappropriation of funds.

We appreciate the Department’s willingness to implement a reconciliation process and to strengthen internal controls. We look forward to working with the Department to resolve these issues.

Applicable Laws and Regulations

The State of Washington Office of Financial Management’s *State Administrative and Accounting Manual*, section 85.50.40.a, states in part:

Daily, cash is to be counted and reconciled with the appropriate records reflecting the day’s transactions. All differences are to be investigated to ascertain the reason for the discrepancy.

Section 85.20.10.c, states that:

On a daily basis, collections are to be counted and reconciled with cash receipt records and local account deposit slips. Any differences between the deposits and records of receipts are to be investigated and resolved.

02-04 Community Colleges of Spokane should improve internal controls over amounts owed to and collected.

Description of Condition

Inquiry of accounting staff and a detailed review of accounts receivable records revealed the following internal control weaknesses:

- As of November 15, 2002, Community Colleges of Spokane had a total of \$2.57 million in accounts receivable. The District's financial accounting records indicated that at least \$1.15 million, or 44 percent, of the balance was over 120 days past due.
- The most reliable information supporting actual, collectible accounts receivable is maintained in manual paper files. These files have not been reconciled to the computerized customer accounts or to the sub-ledger system.
- New billing software was installed in 1996, but some of the outstanding receivable balances from the sub-ledger system were not transferred to the new program. The current outstanding balance of those receivables prior to 1996 is approximately \$110,000. Many of these receivables are likely uncollectible.
- The accounts receivable sub-ledger balances are not reconciled to the customer accounts aging report. The total of the sub-ledger accounts receivable balances does not reconcile to the detailed customer billing information by approximately \$300,000.
- Entries and adjustments can be made to the sub-ledger system without affect to a specific customer account, which increases the likelihood of errors. We found an entry of this nature had been done in November of 2002.
- Accounting staff state that receivables reported in the sub-ledger to the State Board for Community and Technical Colleges for inclusion in the statewide comprehensive annual report are likely overstated, but the amount of the overstatement cannot readily be determined.
- Except for students who receive emergency student loans, customers and students only receive an original invoice and a second payment notice. The District does not have a procedure for collection of amounts due after two billing cycles have passed. Lack of staff resources has prevented consistent collection efforts past these two billing cycles.
- Accounts receivable write-off procedures, recently were updated, but current staffing levels have made it difficult to implement these new controls.

Cause of Condition

Current staffing levels at the District have not allowed the monitoring and reconciliation of accounts receivable a priority. Staff shortages have hindered collection efforts of past due receivables.

Effect of Condition

The internal control weaknesses described above create the potential for District resources to be lost, misused or misappropriated without being detected in a timely manner. Additionally, these weaknesses create a potential for inaccurate and erroneous financial data to be included in the Comprehensive Annual Financial Report for the State of Washington.

Recommendations

We recommend the District:

- Establish and follow policies and monitor and reconcile accounts receivable balances.
- Establish and follow policies related to the collection of past due amounts.
- Consistently use accounts receivable write-off procedures.

District's Response

We agree with the auditors' conclusion that we have not consistently reconciled our files to the sub-ledger system. After accessing the level of risk created by not consistently performing this reconciliation, management has directed staff to focus available department resources on collections as the first priority. However, it has been determined that the unreconciled amounts do not have a material impact on the accuracy of the District's financial information.

The District is aware that the amounts reported from the accounts receivable sub-ledger to the State Board for Community and Technical Colleges may not agree to the manual accounts receivable records, and has determine that any discrepancy represents an immaterial amount that would not materially affect the overall financial statements of the Community Colleges of Spokane or the Statewide Comprehensive Annual Report.

The District uses a statewide system designed for all the community colleges in Washington to make entries and adjustments and this feature is used to correct errors in the sub-ledger balance so the reported amount on the annual statements is correct. Adjustments made to the sub-ledger are documented in journal vouchers and are subject to supervisor review.

The District has consistently used a third party collection agency for individual student receivables. As of December 4, 2002, the District has been able to successfully produce a third notice from the customer accounts system that is clearly labeled "Past Due Account". We will incorporate mailing the past due notice into our collection procedures. The District, while staffing is tight, is striving to dedicate more available resources to collection efforts.

The District is committed to ensuring appropriate controls are in place and will ensure attention is directed to accounts receivable processes and procedures. Even in times of limited resources, the District recognizes the importance of closely monitoring receivables. We appreciate the state auditors' comments on this important business function.

Auditor's Concluding Remarks

We appreciate the Colleges' commitment to strengthening controls. We will review the resolution of these conditions during our next audit.

Applicable Laws and Regulations

The Office of Financial Management's *State Administrative and Accounting Manual* prescribes concepts of internal controls for receivables.

Section 80.30.20

Agencies are to promptly record receivables when the asset or revenue recognition criteria have been met or the underlying accounting event has occurred and the amount is determinable.

Section 85.54.65

Agencies are to maintain a general ledger system, by account, with a receivable control account for each type of receivable. Subsidiary records are also required.

Section 80.30.88

Agencies may either maintain an in-house receivable subsidiary system with the approval of OFM (refer to or utilize the central accounts receivable system, which is available through the Accounting Division of OFM.) Detailed receivable subsidiary ledgers are to be established and maintained on an open item basis (i.e., an entry or entries in the subsidiary ledger for each outstanding amount due).

Contracting (Please see the description of this area on page 13-14.)

02-05 Western Washington University did not comply with state bid law requirements.

Description of Condition

Our audit of Western Washington University included a review of state competitive bidding requirements. We found the University contracted with a builder to purchase a building which was not yet constructed. The contract price was \$3,487,500 and included the land on which the building was to be constructed. The contract was signed by the building contractor and University officials on October 18, 1999. Title to the land was transferred to the building contractor by a third party two months after the contract was signed. The University took title of the land and building on October 23, 2000. The contract states in part, “The Seller agrees to perform and execute for the Purchaser all necessary and required work to complete construction of the Building, as described in this Agreement.” In addition, the University was required to make “installment payments” to the contractor during the course of construction. Final payment of the remaining balance was due at the time of closing, which was to occur within 30 days from issuance of the building certificate of occupancy.

The contract and a subsequent amendment identified “additional work” to be performed outside of the work described in the contract. This additional work was in the amount of \$775,000. The amendment required the University to make installment payments on these improvements.

Both the construction of the building and the subsequent improvements are considered to be public works. As a public work, state law requires the University to put the project out for public bids.

Cause of Condition

The University did not correctly interpret requirements related to public works projects.

Effect of Condition

Competitive bidding serves two purposes. First, and primarily, it provides accountability over public resources by enabling the agency to obtain the best work or supplies at the most reasonable prices. A secondary purpose of competitive bidding is to provide a fair forum for bidders. By protecting this secondary purpose, the primary benefits of the competitive bidding system will be insured to the general public.

Fair and equitable treatment was not given to allow other contractors the opportunity to contract with the University. Furthermore, the University is unable to assure the public the best price was received for the construction of the building.

Recommendations

We recommend the University ensure future compliance with state competitive bid requirements.

University's Response

The University strongly disagrees with this finding and "cause of condition". Those we consulted advised us that this was not a public works process.

In 1997-98, the University was facing a critical need to relocate administrative offices off-campus, in order to release space needed for classrooms and faculty offices. The legislature appropriated funds for real estate acquisition to support the University's efforts in the 1998 Capital Budget.

Initially the University conducted a search of existing nearby office space. Proposals from developers were sought and two were ultimately considered. The selected project was for the site at 32nd Street, which was already in the design phase for a commercial office building. The University, prior to pursuing the facilities and property, consulted with the Attorney General, and following the consultation and advice that interpreted the requirements not to be a public works process, the University followed the procedures for the purchase of a building with construction in progress (RCW 39.04.260).

The process was coordinated with the Higher Education Coordinating Board (as required by RCW 28b.10.020), the Office of Financial Management, and legislative offices. RCW 28B.35.120(6) and 28B.10.020 authorizes the University to purchase real estate. At all times the University was open about the process selected, and that the building was designed, but not yet constructed. All consulted were supportive and approval for the proposed purchase of the 32nd Street facility for its intended purpose was obtained. At no time was there a recommendation that this required a public works process.

The University is pleased that the purchase of this building accomplished the objective of adding much needed administrative off-campus space, and providing for academic needs on campus. The purchase was made in compliance with a provision for prevailing wages (RCW 39.04.206), and with the appropriate approvals as noted above.

Typically, installment payments cover the costs of construction. For this building, no installment payments were made. The University paid earnest money, and also paid four progress payments, totaling \$350,000, to indicate continued agreement to purchase the building. The balance of the purchase price, including the additional work for tenant improvements; represented 92% of the cost, was paid October 2000 at closing immediately prior to building occupancy.

The University expects that purchase of this type was a one-time event. In the three years since the contract was signed, the University has not pursued any additional purchases of real estate with buildings under construction, and has no plans to do so. We believe that it would be clearer to us and the auditors if we would be granted authority for design/build construction as has been granted to the University of Washington and to Washington State University.

The finding issued was a biennium after the entire project was completed and occupied. As there were no complaints lodged by business or labor as to failure to pay prevailing wages or failure to comply with public works laws, the first the University heard of a concern has been during this audit. The University hopes that in the future, if issues exist, the Auditor would raise concerns appropriately.

Auditor's Concluding Remarks

The State Auditor's Office does not question the University's need for additional space. However, the process used did not comply with the requirements to provide a competitive opportunity for other businesses and to ensure minimal cost to the taxpayers.

We affirm the finding as written.

Applicable Laws and Regulations

RCW 28B.10.350 states in part:

When the cost to...any regional university, or state university, of any building, construction, renovation, remodeling, or demolition, other than maintenance and repairs will equal or exceed the sum of thirty-five thousand dollars, complete plans and specifications for such work shall be prepared and such work shall be put out for public bids and the contract shall be awarded to the lowest responsive bidder if in accordance with the bid specifications...

02-06 The Department of Labor and Industries did not comply with state bid laws when purchasing medical services totaling more than \$1.5 million.

Background

The Department contracts with medical specialists for consulting services. These contracts ranged from one year to four years for amounts between \$34,000 and \$492,000. Payments during the audit period totaled \$287,991. Contractors:

- Review claim files and provide expert advice on the quality of medical care received by injured workers and crime victims.
- Determine the need for ongoing care to injured workers and crime victims.
- Advise the Department’s Medical Director on matters relating to the quality, cost and appropriateness of medical care received by the claimants.
- Provide training to Department staff on medical issues.

All of these services are provided directly to Department staff. There is no contact between contractors and claimants.

Description of Condition

The Department entered into eight personal service contracts with medical specialists and incorrectly classified them as client service, rather than personal service. This resulted in violations of the personal service contracting law requiring competitive bidding.

Cause of Condition

The Department incorrectly interpreted state law governing client service and personal service contracts. The law defines client services as services provided directly to agency clients. The Guide to Client Services Contracting publication issued by the Office of Financial Management further defines “direct” services as direct contacts with individual clients. Department officials believed that since the consultants were providing services to Department personnel on how to manage injured workers’ claims that this satisfied the requirement of services being provided directly to agency clients. Since the consulting services were provided to Department employees and not Department clients, they do not meet the definition of client services and should be classified as personal service contracts subject to bid law requirements.

Effect of Condition

Since these contracts were not competitively bid, other providers were not given the opportunity to compete to provide these services. Additionally, the Department cannot be assured that it received the best possible price and quality of services.

Recommendations

We recommend that the Department competitively bid personal service contracts, except for those that are exempt under state law.

Department's Response

We concur with this finding. The Department has contracted for these types of services since 1987. These particular contracts are over a four-year period. Actual expenditures totaled \$288,000 in fiscal year 2002. This represents .015% of total client services paid in fiscal year 2002.

The primary purpose of these eight contracts is to advise attending physicians on patient care. They review claim files and communicate, as necessary, with attending physicians, chiropractors, consultants, medical examiners, or other health care providers. Our interpretation of the OFM guidelines was that this satisfied the requirement of services being provided directly to agency clients. While some of the ancillary services these specialists provide are clearly person services, they are minimal, and well under \$5,000 limit in state bid laws.

The contracts were executed in accordance with the Revised Code of Washington (RCW) 51.36.010 and Washington Administrative Code (WAC) 296-20-015 "under the department rules". Congruently, RCW 39.29 includes "medical and dental services" in the client service definition and specifically exempts them from state bid laws.

Consults with medical specialists on care coordination is essential to patient care. Medical consults are clearly defined as direct care of a patient "without direct (face-to-face) patient contact" by the American Medical Association (AMA) in Current Procedural Terminology (CPT) codes. WAC 296-20-015 states that a physician must qualify under L&I rules, and evaluations requiring specialized skills will be limited to board certified physicians as specified by the AMA. L&I followed the standard industry definition for direct care and specifically named the AMA as the source for that definition in WAC. When the Office of Financial Management (OFM) guide was published in 2000 it did not say that direct service means the contractor is in "direct contact" with individual clients. OFM published an update to the definition in January 2002 in response to an audit recommendation. This audit finding relates to fiscal year 2002. The agency must have time to react to this clarification in definition in our contracting practices.

These health care experts are practicing physicians; board certified and experienced in occupational health, incorporating best practices into case management. They are at the highest level of expertise attainable statewide, often nationally acclaimed and recommended by an affiliate association. The Department of Labor and Industries and other state health care agencies have limited knowledge and facilities. Using public resources is not a viable option. The costs for these services are very reasonable and competitive.

In light of the OFM clarification of the statute in fiscal year 2002 and prior to this audit finding, we extended this group of contracts one year to review current business practices and make any changes necessary. This review is nearing completion. We plan to follow the personal service contracting process, advertise our intent for the next biennium early next month and execute new contracts by the end of this fiscal year.

Auditor's Remarks

We reaffirm our finding. State law required the eight contracts mentioned in the finding to be competitively bid. We will follow up on this issue during our next audit.

Applicable Laws and Regulations

The Revised Code of Washington (RCW) 39.29.011 states in part:

All personal service contracts shall be entered into pursuant to competitive solicitation, except for:

- Emergency contracts;
- Sole source contracts;
- Contract amendments;
- Contracts between a consultant and an agency of less than twenty thousand dollars. However, contracts of five thousand dollars or greater but less than twenty thousand dollars shall have documented evidence of competition. Agencies shall not structure contracts to evade these requirements;
- Other specific contracts or classes or groups of contracts exempted from the competitive solicitation process by the director of the office of financial management when it has been determined that a competitive solicitation process is not appropriate or cost-effective.

RCW 39.29.006(2) defines client services:

“Client services” means services provided directly to agency clients including, but not limited to, medical and dental services, employment and training programs, residential care, and subsidized housing.

RCW 39.29.040(6) exempts client service contracts. It states in part:

This chapter does not apply to ... (6) Contracts for client services except as otherwise indicated in this chapter...

The Guide to Client Service Contracting issued by the Office of Financial Management effective December 2000 defines client services. Page 2 states, in part:

“...the contractor must provide direct services to agency clients for the contracts to be classified as client service contracts. Direct services means the contractor is in direct contact with individual clients as part of providing the client service.”

Indirect Cost Allocations in Restricted Funds (Please see the description of this area on page 14-15.)

02-07 Some restricted funds administered by the Department of Natural Resources were charged more than their share of overhead costs.

Background

The Department's 2002 overhead costs were approximately \$26.4 million. Overhead consists of those costs associated with executive management, financial management, employee services, information technology, facilities operations and Natural Resources Building rent.

Description of Condition

The Department allocates overhead costs to its funds based upon an estimated number of full-time employees who directly charge each fund. The Department considers its method of allocating overhead based upon this estimate the most appropriate method available. Some of the smaller funds and accounts are legislatively capped to limit overhead charges. In the past, the Department's uncharged overhead was distributed to all remaining uncapped funds, including the restricted funds. The Department now appropriately redistributes overcharges from capped funds only to the general fund.

According to the Department's methods, the allocation of overhead costs should be based on actual employees who charge a given fund. In some cases, the difference between the estimate and the actual number of employees is substantial. Based on the Department's best information available at the end of our audit, seven restricted funds were charged approximately \$1.3 million more than their share of overhead costs for fiscal year 2002. The Department plans to start monitoring overhead charges to restricted funds on a monthly basis, and will adjust the excess charges for 2002 during fiscal year 2003. We will review its progress during our next audit.

During the 1997-1999 and the 1999-2001 biennium, we found that seven restricted funds were charged approximately \$5.5 million more than their share of overhead costs. Based upon the Department's method of allocating overhead, it overcharged the following restricted funds a total of \$6.8 million during the last five fiscal years:

- Forest Development Account.
- Aquatic Lands Enhancement Account.
- Resource Management Cost Account.
- Salmon Recovery Account.
- Aquatic Land Dredged Material Disposal Site Account.
- Forest Fire Protection Assessment Account.
- Agricultural College Trust Management Account.
- Access Road Revolving Fund.
- Air Pollution Control Account.

Cause of Condition

The Department charges overhead to its funds based upon estimated full-time employees and does not adjust those charges to actual numbers. The Department has many restricted funds. The Department's non-restricted general fund did not have adequate resources to cover overhead costs that should not have been charged to restricted funds.

Effect of Condition

State law does not allow one fund to be used to pay for activities of another. Further, restricted funds may only be used for specific purposes as determined by the Legislature. For example, the Forest Development Account is a restricted fund that receives its revenue primarily from timber sales on land that the Department manages for the county governments which is also referred to as Forest Board Land. Having a restricted fund overpay its share of overhead causes the Department to violate state laws regarding the use of money in those funds.

Recommendations

We recommend the Department:

- Use restricted funds for allowable purposes as determined by the Legislature.
- Reimburse the restricted funds for unallowable overhead paid over the last five fiscal years.
- Ensure that one fund does not benefit another where prohibited by state law. To accomplish this under the current method for allocating overhead costs, the Department should allocate those costs based on the actual employees who charge a given fund.

We appreciate the Department's commitment to monitoring its overhead charges to restricted funds on a monthly basis, and to correct excess charges for the current biennium. We look forward to reviewing their progress addressing current and prior biennium overhead charges during our next audit.

Agency's Response

Finding: *Some restricted funds administered by the Department of Natural Resources were charged more than their share of overhead costs.*

Description of Condition: *"...seven restricted funds were charged approximately \$1.3 million more than their share of overhead costs for fiscal year 2002."*

Response: *The fiscal year 2002 distribution of overhead costs was adjusted prior to the audit exit conference on December 20, 2002.*

Description of Condition: *The Department charged seven restricted funds more than their fair share of overhead costs during the 1997-1999 and 1999-2001 biennia.*

Response: *The Department requested the adjustment to these funds in the 2003-2005 Biennial Budget request. The Governor has included the adjustment in his Biennial Budget package.*

Auditor's Remarks

We appreciate the Department's efforts in addressing this finding and will review its progress toward resolving this issue during our next regular audit.

Applicable Laws and Regulations

RCW 43.09.210 provides that one fund cannot benefit another fund and states in part:

...no department, public improvement, undertaking, institution, or public service industry shall benefit, in any financial manner whatever by an appropriation of fund made for the support of another.

02-08 The Department of Labor and Industries did not allocate indirect costs equitably among its programs and funds.

Description of Condition

The Department has at least five divisions, the Director’s Office, Human Resources, Administrative Services, Regional Administration and Legal Services, that provide central administration services. Our review of the budget process at the Department found no reasonable process in place to allocate these indirect costs to each fund and program.

The Department charges 98 percent of its central administrative costs to the Workers’ Compensation accounts. We estimated an indirect cost allocation and determined that the following accounts were not paying their full share by the following amounts:

General Fund	\$ 686,440
Public Safety and Education Account	319,023
Electrical License Account	1,642,300
Farm Labor Revolving Account	1,712
Worker and Community Right to Know	55,700
Plumbing Certificate Account	59,033
Pressure Systems Safety Account	<u>132,047</u>
	\$2,896,255

These amounts are being charged in excess to:

<u>Workers’ Compensation Accounts</u>	
Accident Account	\$ 929,521
Medical Aid Account	<u>1,966,734</u>
	\$2,896,255

The Department did develop an indirect cost allocation methodology, but it did not result in correcting the problem.

Cause of Condition

Department officials indicated that revenue is not available to pay indirect costs in some programs without reducing direct services to customers, especially those that are funded by fees to the public since Initiative 601 limits fee increases. Officials also stated that state budget cuts have resulted in a decrease of general fund money, making it difficult to cover indirect costs.

Effect of Condition

When the Department does not use a reasonable indirect cost allocation plan, certain funds are supporting other funds, while others are not paying their share of these expenditures.

Recommendations

We recommend that the Department request additional money from the Legislature to cover indirect costs and/or seek legislative approval to raise fees, where necessary, in excess of the

fiscal growth factor so that it will be able to allocate its indirect costs equitably among its funds and programs. We also recommend that the Department reimburse indirect costs to the funds that paid more than their share.

Department's Response

The Department recognizes the need to develop a revised system for allocating costs to funding sources based on the benefits and functions being performed. The Department has been working to make a stronger connection between program funding sources and the work being performed to support those programs.

We believe the agency's use of medical aid/accident funding to cover indirect costs is actually a demonstration of our efforts to maximize our direct services in order to meet the demands of our customers. In addition, it is common practice that our non-medical aid/accident funded programs actively support the goals of worker safety and worker compensation (i.e., contractor compliance and electrical inspectors finding and referring to a Revenue Officer an employer that owes industrial insurance premiums).

While we agree that the Department has not implemented a method for allocating central administrative services costs to each fund and program, we do not agree with the methodology the State Auditor is using to determine the impacts by fund. This methodology only used the appropriated dollars in the agency budget when allocating indirect costs based on FTEs. There are many functions within the administrative services program that are directly linked to the non-appropriated workers' compensation funding in the agency. In fact, when the agency submitted the budget prioritization of activities to the Office of Financial Management (OFM) a few months ago, a different methodology was used to allocate indirect costs using two cost pools – one for appropriated fund-related administrative support and one for non-appropriated fund-related administrative support. The agency chose not to submit a decision package based on this methodology to redistribute the funding within the administrative services program because of the potential impacts to the general fund and other dedicated funds that have limited revenues available. There also has been a history of adjusting the mix of funding for increases in the final legislative budgets by moving the general fund portion to the medical aid and accident funds.

The Department is also concerned about the implications of any retrospective application of this finding. It appears that the retrospective application the SAO is recommending would require either a supplemental appropriation to reimburse funds that would be of questionable use or dramatic reduction in existing programs to generate funds to repay these amounts. They have stated that this repayment period would go back to fiscal year 2001. It is not clear how this proposed repayment would work and if an appropriation would be required or if it would be fund transfer. Either way, the Department would need to consider a 2004 supplemental budget request to repay funds for three years (fiscal years 2001 through 2003) and to adjust the funding by appropriation for fiscal years 2004 and 2005. This five-year impact could potentially devastate service delivery in programs such as electrical, pressure systems safety, community/worker right to know, prevailing wage plumbing certificate, contractor registration, factory assembled structure and elevator inspections. In addition, fees may need to increase above the fiscal growth factor.

The Department will work with the Auditor's Office, Legislature and the affected stakeholders to develop a revised allocation approach and to address any retrospective issues.

Auditor's Remarks

We reaffirm our finding.

Using the workers' compensation accounts to support other programs such as plumbing, prevailing wage and electrical, results in employers and employees paying more than their fair share in industrial insurance premiums. Instead, the users of these programs and/or government should bear the burden of supporting the costs of the programs, including indirect costs.

Our estimate of the impact of charging indirect costs to the workers' compensation accounts was developed using one of many possible methodologies. We are willing to review other proposed methodology to determine whether we believe it is reasonable.

The date we suggested for the retrospective reimbursement reflects the original audit period in which we notified management that they were not in compliance with state law.

We appreciate the Department's willingness to work with our Office to resolve this issue.

Applicable Laws and Regulations

The Revised Code of Washington (RCW) 43.09.210 prohibits one fund from supporting another. It states in part:

...no department, public improvement, undertaking, institution, or public service industry shall benefit in any financial manner whatever by an appropriation or fund made for the support of another.

The Attorney General's Office has determined that this law applies to state agencies as well as local governments. The State Supreme Court upheld this interpretation in 1983 (State v. Grays Harbor County, 98 Wn.2d 606 (1983)).

Accounting Systems (Please see Other Areas on page 16.)

02-09 The Department of Licensing's controls are not adequate to ensure information processed within the Unisys System is secure.

Background

The Department of Licensing runs in excess of 40 applications on its mainframe computer system, including the Revenue System, Refund System, Professional License System, Drivers Services System and Vehicle Services System. During our last audit, we found insufficient controls over access to the mainframe. For example, the Department could not generate a report from the mainframe indicating each system user's level of access, and therefore could not properly monitor access. We communicated this condition to the Department Director at the end of our last audit.

Description of Condition

During our current audit, we reviewed system access in more detail and confirmed the following weaknesses related to all applications run on the Unisys system:

- Not all users have a unique password and Operator Identification (ID) number. Because the number of available ID numbers is limited to 999 for the Department, users must share ID numbers and passwords. According to the Department, it is likely that all agency staff (approximately 1,200) could potentially have access to all applications run on the system.
- The system cannot produce a report of users and their assigned access rights. Knowing and monitoring individuals' access capabilities is vital to providing good control over expenditures of public funds. At our request, the Department compiled a list showing individuals' access rights, based upon the best information available. However, this information does not come directly from the mainframe. Therefore, we cannot verify that the Department's list of individuals' access rights is accurate or complete.
- The system does not record the creator or modifier of each transaction. It would be difficult for the Department to determine responsibility for transactions created or updated within the mainframe. The system would need the capability to assign unique individual passwords and IDs in order to record each user's activities and to establish individual accountability.
- An excessive number of users have access rights to add, update, or delete users. According to the Department, only two individuals have the access noted above. However, the Department of Information Services provided a list of 16 individuals with this level of access.

These weaknesses create the opportunity for employees to process an unauthorized transaction, for which the Department could not establish responsibility. Further, these system weaknesses do not allow the Department to properly monitor system access.

Because of the weaknesses described above, we reviewed one of the applications run on the system in more detail, the Refund application.

The Department's refund application is used by 15 program areas within the Department, to process approximately \$35 million in refunds every year. Some program areas have the access necessary to enter refund data directly, while others must forward documents to General Accounting for entry into the system. The refund activity is then sent to the Agency Financial Reporting System (AFRS), which produces refund payments.

We reviewed the Department's control procedures in four of the units that process refunds, and in General Accounting. During this review, we noted the following:

- Separation of important duties among users of the system is not adequate to ensure refunds are appropriate. Two supervisors in General Accounting had the access needed to enter, make changes to, and release refunds.
- Output reports from the refund process are not adequately secured. Refund Request Summaries are printed automatically overnight each time a refund payment batch is completed, or when a change is made to a batch. Allowing staff in General Accounting and the various refund units to review this report for improper refunds provides a compensating control, which is important, given the other weaknesses in access noted above. However, these reports were being produced in a location where anyone could retrieve them prior to distribution to appropriate staff for review.
- Within the Master License Refund Unit, there is no supervisory review of the output reports from Unisys to ensure the refunds processed were appropriate. Again, due to the inadequate controls noted above, the compensating control of reviewing the Refund Request Summary is critical to ensure all refunds are appropriate.

Cause of Condition

Department officials cite limitations of the computer system as the primary reason appropriate controls have not been established.

Effect of Condition

Controls over access are necessary to ensure proper use of the computer system. They also provide an automated ability to separate conflicting duties among users of the system that helps ensure one user cannot process an unauthorized transaction without detection.

Recommendations

We recommend the Department either make the following changes within Unisys or find another means to achieve the same control:

- Provide all users with a unique password and Operator ID number, or implement another means of uniquely identifying each user.
- Obtain a system-generated report of users and assigned access rights.

- Modify the system so it records the creator or modifier of each transaction record.
- Limit the number of users with access rights to add, update, or delete users within the system.
- Ensure the separation of duties between users within General Accounting is adequate to limit risk of an inappropriate transaction being processed and going undetected.
- Ensure output from the various applications run on the system is distributed to appropriate, authorized personnel only.
- Review the Refund Request Summaries in the Master License Refund unit.

Department's Response

Thank you for the opportunity to respond to the December 10, 2002 draft report of audit finding. The subject matter concerns controls of information processed on the Unisys mainframe system.

As documented during the audit, the Department has placed various compensating controls around this admittedly aged computer system. Considering the current finding, the agency will work to enhance controls in an attempt to further augment security. The last three bullets contained in the recommendation section of the draft have been addressed through implementation of such enhanced controls.

The Governor's budget supports Unisys replatforming, enhanced security and network system upgrades. Although not immediate, our strategic plan is designed to answer many of the problems noted that are inherent within the Unisys operations. Our current plans include short-term modifications to enhance, where possible, Unisys opportunities. We also have an overall commitment to have better solutions in the new replatformed environment.

Enclosed is copy of our corrective action plans covering the recommendations made in the draft report. As previously indicated, the last three bulleted recommendations have been addressed and are in attachment I-B. The first four recommendations are addressed in our corrective action plan attachment I-A.

Audit Resolution Disclosure – Form I (1A)

Auditor Recommendations:

1. *Uniquely identify and authenticate all individual users of the Unisys mainframe computer,*
2. *Create system-generated reports of users and assigned access rights,*
3. *Modify applications to record the creator or modifier of each transaction record,*
4. *Limit the number of users with access rights to add, update, or delete users within the system.*

Corrective Action:

The agency concurs with the auditor's findings and recommendations; is aware of technical limitations concerning the security of the Unisys system and legacy business applications; and has taken or will take action(s) to address Auditor Recommendations.

The agency's strategic direction involves migrating off the Unisys platform to a new environment, and FY 03-05 funding has been requested from the Legislature (with pre-approval of OFM, DIS, the ISB, and the Governor) to accomplish the migration.

The first (two-year) phase of the migration project is to re-platform, this should address the individual-identification-by-name recommendation; and the second (two-to-four year) phase re-engineering of business applications will be designed to address the system reporting and audit trail recommendations. The agency's backup strategy is to explore implementation of OTS1100 Unisys security and to re-engineer business applications to a preferred environment.

In the interim, the agency will implement the following compensating controls:

- Creation of a custom security reporting system, with ability to identify users by name,*
- Usage of individual logons within the technical constraints of the Unisys system,*
- Limitation of users with security rights to include essential personnel only, and,*
- Strengthening of existing compensating controls and identification of additional controls, based on the results of an internal risk assessment.*

Audit Resolution Disclosure – Form I (1B)

Auditor Recommendations:

- 5. Ensure separation of duties between users within General Accounting is adequate to limit risk of an inappropriate transaction being processed and going undetected.*
- 6. Ensure output from the various applications run on the system is distributed to appropriate, authorized personnel only.*
- 7. Review the Refund Request Summaries in the Master License Refund unit.*

Corrective Action:

The agency concurs with the auditor's findings and recommendations; is aware of technical limitations concerning the security of the Unisys system and legacy business applications; and has taken action(s) to address the enumerated (5 through 7) Auditor Recommendations delineated above.

The agency and/or units involved have implemented controls to provide for separation of duties in General Accounting, application output reports are now sent via Email to authorized personnel and the Master License Refund unit is reviewing the Refund Request Summaries.

- The agency will monitor the implementation of these compensating controls to manage compliance with the enumerated Auditor's recommendations.*

Auditor's Concluding Remarks

We appreciate the Department's efforts in addressing this finding and will review its progress toward resolving this issue during our next regular audit.

Applicable Laws and Regulations

The Office of Financial Management's *State Administrative and Accounting Manual*, Section 20.20.20.a states:

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

Section 20.20.70.a states:

Segregation of duties - Duties are divided, or segregated, among different people to reduce the risk of error or inappropriate actions. For example, responsibilities for authorizing transactions, recording them, and handling the related assets should be separated.

02-10 The Department of Corrections has not established and followed adequate controls over electronic access to the Trust Accounting System.

Background

State law requires the Department of Corrections to be the custodian of all funds in the possession of a convicted person at the time of incarceration, as well as funds that are sent to the person or are earned by the person while in custody. This money is placed in the Institutional Residents Deposit Account, from which the person's financial obligations and other bills are paid. Since 1999, the department has been managing these inmate funds of approximately \$5.3 million through the Trust Accounting System.

Description of Condition

Our review of the Trust Accounting System's access controls disclosed the following:

- Staff members are allowed to use passwords that have a high risk of being compromised.
- Staff members managing the system database use shared log-ons.
- No intruder lockout has been established to detect unsuccessful sign-on attempts.
- Intermittent and temporary warehouse employees use the log-ons of permanent employees to perform transactions at inmate stores.
- Employees have knowledge of one another's logons and passwords.
- Employees have computer access privileges they do not need to perform their job duties.
- Duties are not inadequately segregated. The trust system administrator also acts as security administrator. The types of access privileges employees have do not provide for adequate separation of duties between accounting, administrative and warehousing functions.
- At one institution reviewed, we noted that all seven members of the information technology group had administrative rights to the file server, as well as update access to object code on the server. This situation could allow them to circumvent system controls.
- Some headquarters employees have unnecessary access that could allow modification of critical server and database parameters.

Effect of Condition

These conditions increase the risk that unauthorized access could occur and hinder efforts to assign responsibility for any loss or misuse of inmate funds.

Cause of Condition

Agency management indicated that funding constraints have limited the agency's ability to correct these system weaknesses.

Recommendations

We recommend the Department develop and implement adequate controls over access to the Trust Accounting System.

Department's Response

The Department will work to improve access controls to the Trust Accounting System. Three of the conditions relate to the system design. The Department will request that the vendor makes the necessary improvements.

Auditor's Concluding Remarks

We appreciate the Department of Corrections' efforts in addressing this finding and will review the agency's progress during our next regular audit.

Applicable Laws and Regulations

The State of Washington Information Technology Standards state in part:

Hardened passwords should be used whenever technically and operationally feasible. Appropriate user training should be considered regarding the physical protection of hardened passwords that may be more difficult to remember. For those systems for which it would be technically infeasible or which would require modification to meet this requirement... agencies must document what other measures are to be taken to secure user access.

The Office of Financial Management's *State Administrative and Accounting Manual* addresses the principles of internal control as follows:

Section 20.20.20.a:

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

Section 20.20.70.a:

Segregation of duties - Duties are divided, or segregated, among different people to reduce the risk of error or inappropriate actions. For example, responsibilities for authorizing transactions, recording them, and handling the related assets should be separated.

02-11 The Department of Social and Health Services, Division of Vocational Rehabilitation does not have adequate internal controls over the processing of expenditures for client services.

Background

The Division of Vocational Rehabilitation assists people with disabilities in preparing for, obtaining or retaining employment. The Division provides vocational assessment; treatment for physical and mental disabilities that make it more difficult for its clients to find employment; job preparation and training; job placement; job site analysis and rehabilitation technology; follow-up services; and employment support. Other services include help with independent living and transition from school to work. The Division also provides technical assistance and staff education for businesses and industries. The Division stated its 40 field offices successfully placed 1,230 individuals in jobs during fiscal year 2002.

These services are provided with state and federal funds. The federal portion is awarded by the United States Department of Education under the Vocational Rehabilitation Services program (CFDA 84.126). In fiscal year 2002, the Department spent \$29 million from this grant and an additional \$11.8 million from state funds.

When the Division determines that a person is eligible for services, a counselor works with the client to determine goals and objectives and the resources needed to achieve them. The Division provides goods and/or services to clients by processing expenditures through the Service Tracking and Reporting System.

During the fiscal year 2001 audit, we identified weaknesses related to controls over the processing of expenditures for client services and reported them in the Statewide Accountability Report and in the State of Washington Single Audit Report.

Description of Condition

The Division continues to have inadequate internal controls over expenditures processed through the Service Tracking and Reporting System. We found:

- Duties are not properly separated:
 - Counselors have the access rights needed to establish a client in the system, authorize and issue an Authorization for Purchase and approve and make the payment.
 - Secretaries and counselor aides can draft and issue an Authorization for Purchase and make the payment without a counselor being involved.
 - Counselors, secretaries and counselor aides can have the payment warrant returned to them at the originating field office. This weakness provides the opportunity to create an inappropriate payment, as stated above, and have the warrant returned directly to them.

- Reviews of expenditure transactions, before or after payment, that may provide a compensating control for the inadequate separation of duties are not adequately performed or documented.
- Division policies and procedures for the review of expenditure transactions are not adequate.
- Payment warrants returned to Division field offices are not handled in a manner that provides accountability:
 - Field offices had only one person opening the mail and logging the warrants.
 - Entries to the logs were missing and incomplete.
 - Some returned warrants were not logged.
 - Cash controls policies and procedures, though incomplete, were not being followed.
 - There is no supervisory review of the cash accountability log.
 - Payments recorded in the system are not reconciled to supporting documentation in the field offices. Without this step output accuracy cannot be verified.
- Clients are not required to provide receipts for, certify to, or identify actual travel information to the Division. Travel can include lodging and mileage needed for individuals to have access to work and/or education.

Cause of Condition

The Division stated it has needed to employ available technology resources and the time of its staff members on other issues, such as the divisional reorganization. It has found it impossible to focus on training personnel about new internal control policies and procedures, including the retention of appropriate supporting documentation when processing payments.

Effect of Condition

These conditions increase the risk that misappropriation or loss could occur and not be detected in a timely manner, if at all. Without supporting documentation, the Division may be charging expenditures to federal funds that are not allowable under the regulations.

Recommendations

We recommend the Division:

- Develop and follow procedures that provide adequate internal controls for processing, documenting and reviewing expenditures.

- Separate the duties for processing payments by restricting access to payment functions in the system.
- Ensure disbursements have adequate supporting documentation.

Department's Response

The Department concurs with the finding. The Division of Vocational Rehabilitation will perform the following to address the auditor's recommendations:

- *The division will establish internal controls for the separation of duties within the STARS system. The STARS system will be updated to electronically ensure separation of duties are maintained beginning with the application phase. In terms of warrants sent to the originating office, the division will strengthen the cash controls and provide training to ensure separation of duties for the handling of cash items.*
- *The division will update the Supervisory AFP review policy. The division will also establish a STARS automated report to include STARS exceptions for Supervisors and Chiefs to review.*
- *The division will strengthen the cash controls policy and provide training to staff. The division will also establish policy for how small offices of 3 or less staff will handle cash controls.*
- *The division will establish a customer travel policy to include when receipts or certifications are required when purchasing customer travel such as mileage, meals and lodging payments. Procedures will be established to include what's required on the authorization for purchase (AFP) for proper documentation of what is being purchased.*

Auditor's Concluding Remarks

We appreciate the Department's efforts in addressing this finding and will review the agency's progress toward improving internal controls during our next regular audit.

Applicable Laws and Regulations

The Office of Financial Management *State Administrative and Accounting Manual* addresses basic principles of internal controls in Section 85.32.10 as follows:

It is the responsibility of the agency head, or authorized designee, to certify that all expenditures/expenses and disbursements are proper and correct. Agencies are responsible for processing payments to authorized vendors, contractors, and others providing goods and services to the agency. Agencies are to establish and implement procedures following generally accepted accounting principles. At a minimum, agencies are also to establish and implement the following:

1. Controls to ensure that all expenditures/expenses and disbursements are for lawful and proper purposes and recorded in a timely manner (refer to Chapter 20 of this manual for guidance related to internal control procedures),
2. Procedures to ensure prompt and accurate payment of authorized obligations, and

3. Procedures to control cash disbursements.

U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Subpart C, Section .300 states:

The auditee shall...

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs....

02-12 The Small Agency Client Services section of the Office of Financial Management (OFM) has inadequate password controls over financial systems to ensure assets are safeguarded.

Background

State agencies may contract with the Office of Financial Management’s Small Agency Client Services for accounting, budgeting and payroll services. The monthly fees charged to the agencies are based on a variety of factors, including how much work is done for the agency, the size and complexity of the agency’s budget and the number of employees. The Office contracts with 35 agencies on whose behalf it deposits and/or records revenue of approximately \$29 million per year and makes payments of approximately \$101 million per year. Eleven OFM employees perform these services.

Description of Condition

Small Agency Client Services uses a computerized financial system (AFRS) to provide financial services. Our audit found that controls over passwords are inadequate. Each client agency has one assigned logon identification and password. All 11 employees share the one logon identification and password, giving each one access needed to process all types of transactions, instead of only those they are authorized to perform. This condition creates the risk that unauthorized transactions could be processed without detection. This situation also would make it difficult to determine which employee processed a certain transaction.

Cause of Condition

Although the system is capable of handling multiple logon identifications and multiple passwords, Office personnel indicated that using this control would be too labor intensive since it would include the need to bill client agencies for costs associated with the additional logon identifications.

Effect of Condition

The practice of sharing logon identifications and passwords results in a risk of misappropriation and inability of management to determine who is responsible for any loss.

Recommendations

We recommend that the Office limit employees’ system access to only that needed to perform their duties.

We also recommend that the Office provide all users with a unique logon identification and password, or establish another means of uniquely identifying each user.

Office’s Response

The Office of Financial Management (OFM) does not concur with the finding. The applicable laws and regulations section of the finding states “Each agency director is responsible for

establishing and maintaining an effective system of internal control throughout the agency.” While staff sharing a logon ID and password may by itself be a weakness, the system of internal controls implemented by the OFM’s Small Agency Client Services (SACS) unit incorporates many compensating controls to mitigate the weakness:

- a. Client agencies begin the payment process by indicating their approval to pay invoices by signing or initialing each invoice prior to sending them to SACS. Agencies list each invoice and the amount to pay on an Agency Transmittal Form.*
- b. Four staff members in SACS review each payment transaction—two before the transaction is processed, and two after the transaction is entered into the state’s computerized financial system (AFRS).
 - (i) The first person reviews the invoice for compliance with state rules and regulations, and prepares the invoice for processing.*
 - (ii) The second person reviews and approves the first person’s work thereby authorizing the transaction to be entered into the state’s computerized financial system (AFRS).*
 - (iii) The third person reviews the entered transaction online and releases it for payment.*
 - (iv) The fourth person reviews the warrant registers generated the next day to ensure that all payments agree with the invoices listed on the Agency Transmittal Form. The warrant registers show the recipient’s name and the amount of the payment.**
- c. Support staff sends the warrant registers and Agency Transmittal Form to the originating agency for review.*
- d. Monthly, SACS sends financial reports to the agencies for which it pays invoices. The reports show the vendor name and the amount of every payment made on their behalf.*
- e. Quarterly, SACS visits agencies to discuss the financial status of each agency. This discussion includes going through the financial reports and explaining the variances between the estimated and actual expenditures. The OFM budget analyst and statewide accounting consultant assigned to the agency usually attend these quarterly meetings.*

We believe the results of the testing by SAO support the effectiveness of the system of internal controls implemented by SACS. The State Auditor’s Office (SAO) sent account confirmation requests to eleven SACS clients for whom we processed the most expenditure and revenue transactions. SAO requested and received from agencies copies of remittance forms sent to SACS to support all expenditures during March 2002, as well as any receipts they received from SACS. There were no discrepancies between what agencies sent to SACS and what was recorded in the financial records. Also, SAO audits each of the client agencies. There has never been an audit finding for fraud committed by staff in SACS.

OFM is committed to strong internal controls. We appreciate the feedback provided by the audit and, as a result, SACS has strengthened the existing system of controls by adding additional logon identifications to limit employees' system access to only that needed to perform their duties. We extend an offer to have SAO review the changes that have been made to strengthen our internal controls.

Auditor's Remarks

We reaffirm our finding and will review the Office's progress toward improving internal controls during our next regular audit.

Applicable Laws and Regulations

The State of Washington Office of Financial Management's *State Administrative and Accounting Manual*, section 20.20.20.a states:

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

Cash Receipts (Please see Other Areas on page 16.)

02-13 The Department of Transportation’s Washington State Ferries Division does not have adequate controls over ticket sales and revenue collection.

Background

The Washington State Ferries Division uses point-of-sale and automated revenue control systems to track money collected at ferry terminals. Revenue collected through the system last year was approximately \$107 million. Independent contractors at terminals in the San Juan Islands and in British Columbia collect an additional \$2.3 million. While the Ferry Division has worked to strengthen internal controls over recorded sales, additional controls are needed, primarily over potential unrecorded sales. Neither our Office nor the Ferry Division can estimate how much is lost due to unrecorded sales. We have reported issues with controls over revenue collection in Department audit reports dating back to 1986. Many of these, including the 1986 report, addressed the risk of unrecorded sales at ferry terminals.

Description of Condition

Our audit revealed that controls over revenue collected at the point of sale do not provide reasonable assurance that public funds are safeguarded. Improved controls are needed due to the large amount of money collected and the large volume of transactions processed by individual sellers. Currently, the Ferry Division must rely on seller entries into the system to determine how much has been collected.

Controls in place include the electronic display of amounts due and signs at each booth, notifying customers of the number to call if they do not receive a correctly printed receipt. However, these controls are inadequate to ensure that all money collected is recorded in the system.

Specifically:

- No system is in place to ensure that all sales are recorded. Money from unrecorded sales could be lost or misappropriated, without detection by management in a timely manner, if at all. The Ferry Division does not reconcile vehicle and passenger counts to revenue collected by individual sellers or in total. Inadequate compensating controls are in place to provide the necessary protection for public funds.
- During peak usage times at Pier 50 in Seattle, an agent stands outside the booth to assist the ticket seller by collecting fares for the passenger-only ferry. After the rush of customers has passed, the agent will give the cash and coupons he has collected to the ticket seller for entry into the point-of-sale system. This creates a potential for loss or misappropriation by the agent or ticket seller, especially in the absence of documentation that shows how many passengers paid to use the ferry, or some other compensating control. The facility at Pier 50 is not designed to safeguard money received during peak times when sales occur at a fast pace. The agent’s efforts to collect cash are preferable to allowing customers to set cash on the counter, awaiting entry into the system. However, these efforts can’t sufficiently mitigate the risk that money will be misappropriated without detection.

- Frequent-user ferry coupons collected by sellers in booths and ticket takers in the terminal traffic lanes are not adequately controlled. Historically, coupons represent about 45 percent of the total vehicle and passenger transactions. We noted the following condition:

Customers do not routinely receive a receipt when giving a frequent-user coupon to a seller. This increases the risk that a coupon can be used more than once. Further, the Ferry Division performs only limited reconciliation of coupons collected to what is entered in the point-of-sale system. Internal audits comparing coupons collected to point-of-sale entries were performed on a spot basis during the year. However, terminal agents do not do this daily. This increases the risk that a cash sale could be entered incorrectly as a coupon collection in order to misappropriate cash without detection.

- Ferry Division employees operate 15 ferry terminals. Independent contracted agents operate four terminals located in the San Juan Islands and one in Sidney, British Columbia, collecting approximately \$2.3 million for the past year.

The current revenue control system does not provide a practical means by which to compare actual versus expected collections at terminals operated by contracted agents.

Recent improvements by the Ferry Division

The following improvements to controls were reported by the Ferry Division's Internal Control Department during our audit:

Monitoring of sales activity

- The Ferry Division continues to increase its monitoring of recorded sales activity through the use of computer-assisted analysis. Variances between reported collections and deposits are monitored and followed up on.

Off-line sales

- The Ferry Division is using a pre-numbered, two-part, manual cash receipt form at all terminals that use the electronic point-of-sale system when the system is off-line.
- These receipts are pre-numbered, entered into an inventory system and assigned to individual selling stations.

Surprise cash counts and frequent-user coupons

- The Ferry Division has increased the frequency of the surprise coupon and cash counts. An independent count is made of coupons and/or cash collected in a day at a terminal and this is compared to what was entered into the point-of-sale system. Thirty coupon counts and 20 cash counts were conducted in fiscal year 2002.

Efforts to reduce cash collections at terminals

- The Ferry Division has increased efforts to reduce the need for cash collections at terminals, by allowing credit card purchases and coupon sales via the Internet.

These actions improve controls related to recorded sales. Stronger controls to prevent unrecorded sales still are needed.

Cause of Condition

Ferry Division management states that compensating controls used at the terminals and at contractor collection points, and the need for prompt transactions results in the possibility that all customer fares are not properly recorded or deposited.

Effect of Condition

The Ferry Division's inadequate internal controls increase the risk that the loss or misappropriation of public money may not be detected in a timely manner, if at all.

Recommendation

We recommend that the Ferry Division develop and follow additional controls to provide reasonable assurance that public funds are adequately safeguarded.

Agency's Response

Thank you for the opportunity to respond to the draft audit findings that focused on a number of Washington State Ferries activities during fiscal year 2002, including ticket sales and revenue collection, inventory control and travel. We appreciate the fact that the State Auditor has acknowledged our continued efforts in tracking consumables, improving the sales activity area (including cash counts) and reducing cash collections at terminals. WSDOT is committed to the safeguarding of public assets under our control and maintaining the highest level of integrity and accountability.

WSDOT will provide our corrective action plan to the Washington State Office of Financial Management within the allotted 30-day time frame after your organization issues the final Statewide Accountability Report for FY02.

We would also like to note that even though your Audit Team expressed concern over the Department's payments to UIW/Bechtel on the Tacoma Narrows Bridge project, we did in fact go beyond the attestation report in confirming the supporting justifications for the payment. Our activities included holding discussions with the external auditing firm, the financial representative for Bechtel and our own managers involved in the project regarding the products/services delivered over the years. These issues are very important to us and we had already scheduled an appropriate audit level of review before your office also raised the issue.

We value your office's contributions and assistance.

Auditor's Concluding Remarks

We appreciate the Department of Transportation's efforts in addressing this finding and will review the agency's progress toward improving internal controls during our next regular audit.

02-14 Olympic College Food Service Department has weak internal controls over cash receipting.

Description of Condition

Each year, the Food Service Department at Olympic College collects approximately \$500,000 in payments. In our review of internal controls over cash receipting at the Department, we looked at transactions in May and June 2002. We noted the following:

- Voided transactions were not always sufficiently documented.
- Voided transactions were not always approved by supervisors.
- Payments received were not always deposited intact and did not always have adequate supporting documents.
- Twelve cash register Z-tapes were missing from the May and June 2002 cash receipts.
- Cash received, once reconciled to supporting documents and prepared for deposit, was kept in open bags in the Food Service office and was used to make change during the day.
- In October 2002, during our review, we discovered that money received on June 12 was not deposited in the bank and was not recorded in the College's accounting system. The funds, totaling \$575, were later located in the safe of the Food Service Department.
- The Food Service Department had not reconciled money received and deposits to the College's accounting records for June 2002.
- Customers were not routinely provided with cash register receipts for their purchases.

Cause of Condition

Food Service employees were unaware of the necessary internal controls and procedures needed to properly safeguard and account for collected revenues.

Effect of Condition

These internal control weaknesses resulted in decreased accountability and increased the risk that errors and irregularities could occur and not be detected by management in a timely manner, if at all.

Recommendations

We recommend the College improve internal controls as follows:

- Require supervisory approval of voids and original receipts to document these.

- Deposit cash and checks intact as recorded on cash register Z-tapes, and retain all the Z-tape records.
- Seal deposit bags once payments have been counted and reconciled.
- Deposit all cash and checks within 24 hours of receipt.
- Reconcile payments and deposits to the accounting records monthly to ensure all deposits are properly recorded.
- Provide every customer with a cash register receipt to ensure that cash received is properly recorded in the cash receipting system.

College's Response

Food Services is now providing every customer with a receipt to ensure that cash receipts are properly recorded in the cash receipting system. Food Services had a policy of requiring original receipts to document voids. However, a vacancy in personnel had left a weakness in approval of voided transactions. Food Services since replaced the position and are reviewing the job description and plans to include the void approval responsibility in the job duties.

Food Services is planning on increasing start-up cash to eliminate the need for making change during the day. It was discovered the advent of two ATM machines lead to an increase in the need for change. Food Services will deposit cash and checks intact and as recorded on the Z-tapes daily. Reconciliation of the receipts and deposits to the accounting records will occur on a monthly basis. Currently, the fiscal technician is off during the summer months, arrangements will be made for staff to reconcile to the accounting records during the summer months.

The Finance Officer will establish policies on cash receipting, petty cash reimbursement and deposit preparation. The Finance Officer will also review the existing Food Services fiscal policies and procedures to ensure compatibility with the rest of Olympic College's fiscal policies and procedures.

Auditor's Concluding Remarks

We thank the College for its response. We will review these new procedures in our next audit.

Applicable Laws and Regulations

The state of Washington Office of Financial Management *State Administrative and Accounting Manual* provides guidelines for cash handling activities.

Section 85.20.10.a states in part that:

Collections made over the counter or in the field are to be documented by issuance of an official receipt or through cash registers or automated cashiering systems.

Section 85.20.10.b states that:

Record of Cash Receipts - Agencies are to maintain daily cash receipt records reflecting all daily receipts by account and source. Where cash registers or automated cashiering systems are used, this could be the machine generated control tape.

Section 85.20.10.c states that:

Reconciliation of Cash Receipts - On a daily basis, collections are to be counted and reconciled with cash receipt records and local account deposit slips. Any differences between the deposits and records of receipts are to be investigated and resolved.

Section 85.50.20.a states that:

Cash receipts for deposit in local accounts established pursuant to RCW 43.88.195 or other statutory provision are to be deposited intact within 24 hours of receipt . . . unless:

- A specific written waiver is granted by OFM, or
- Total cash receipts on hand (exclusive of change accounts) are under \$500. However regardless of the amount on hand, local account receipts are to be deposited weekly.

Section 85.50.40.a states in part that:

Daily, cash is to be counted and reconciled with the appropriate records reflecting the day's transactions. All differences are to be investigated to ascertain the reason for the discrepancy.

Section 20.20.70.a states in part that:

- Physical controls - Equipment, inventories, securities, cash, and other assets should be secured physically, and periodically counted and compared with amounts shown on control records.

Cash Disbursements (Please see Other Areas on page 16.)

02-15 The Department of Transportation's Washington State Ferries Division lacks adequate internal controls over travel payments.

Background

The Department's Ferry Division pays its employees for travel time and mileage. We audited these payments, which are governed by a contract between the Ferry Division and the National Marine Engineers Beneficial Association, the union representing some Ferry Division workers.

Payment for travel time and mileage is processed through the payroll system. Employees record hours spent traveling and related mileage on their time sheets.

We reviewed pay for travel time for two Ferry Division employees who received a significant amount of travel pay from fiscal year 1999 through 2002.

Description of Condition

Management's review of employee time sheets for travel (time and mileage) is not adequate to detect whether payments are allowed under the contract. Further, the Ferry Division does not have adequate policies or other documentation guiding its practices to address payment for employee travel when it believes that relevant union contract does not address the type of travel performed. In one instance, we found an employee claimed mileage in excess of the maximum distance allowed by contract. In another instance, an employee claimed more than the number of trips per week allowed by the contract. While reviewing travel documents with officials from the Ferry's Division for this second instance, neither the Ferry System nor the Auditor's Office was able to determine how some of the travel could actually have taken place. Those responsible for reviewing time sheets did not find the discrepancies or document why these payments were appropriate.

Further, management does not routinely monitor employee travel expenditures based upon travel payment dollar thresholds, to determine which employee claims, if any, require further review for compliance with the contract.

Cause of Condition

- The Ferry Division does not have a policy or other documentation to address how employees who work under union contracts will be paid for travel that is not addressed by these contracts.
- Employees are not required to include details about each trip claimed on their time sheets. Requiring this detail would allow the Port Engineers Office to perform an adequate review of these time sheets before approving travel pay. Further, the Port
- Engineers Office did not discover the questionable travel claims during its review.

- Ferry Division management does not adequately monitor individual employee travel pay, looking for those at the highest levels and highest risk for payments not allowed by the contract.

Effect of Condition

Two Staff Chief Engineers may have been paid at least \$100,000 in excess of what was allowed by the contract.

Recommendation

We recommend that the Ferry Division:

- Work to include those undocumented but binding compensation practices in a contract that is negotiated through collective bargaining. Otherwise, document by policy, or other method, any binding compensation practices not addressed in the contract. Additionally, when employees are working on special projects that management believes are not addressed in the travel provisions of the union contract, this should be documented as an official work assignment.
- Require that time sheets provide sufficient detail to show actual travel routes as well as the time each trip began and ended. Management review of travel documentation should include follow up on whether the travel was actually performed for any documented travel that looks unreasonable or unusual.
- Routinely monitor employee travel expenditures based upon travel payment dollar thresholds, to determine which employee claims, if any, require further review for compliance with union rules.

Agency's Response

Thank you for the opportunity to respond to the draft audit findings that focused on a number of Washington State Ferries activities during fiscal year 2002, including ticket sales and revenue collection, inventory control and travel. We appreciate the fact that the State Auditor has acknowledged our continued efforts in tracking consumables, improving the sales activity area (including cash counts) and reducing cash collections at terminals. WSDOT is committed to the safeguarding of public assets under our control and maintaining the highest level of integrity and accountability.

WSDOT will provide our corrective action plan to the Washington State Office of Financial Management within the allotted 30-day time frame after your organization issues the final Statewide Accountability Report for FY02.

We would also like to note that even though your Audit Team expressed concern over the Department's payments to UIW/Bechtel on the Tacoma Narrows Bridge project, we did in fact go beyond the attestation report in confirming the supporting justifications for the payment. Our activities included holding discussions with the external auditing firm, the financial representative for Bechtel and our own managers involved in the project regarding the

products/services delivered over the years. These issues are very important to us and we had already scheduled an appropriate audit level of review before your office also raised the issue.

We value your office's contributions and assistance.

Auditor's Remarks

We appreciate the Department of Transportation's efforts in addressing this finding and will review the agency's progress toward improving internal controls during our next regular audit.

Legal Criteria

National Marine Engineers Beneficial Association (MEBA) contract for 1997 to 1999 and 1999 to 2001 (still in effect).

Section 12(e) states:

Payment will be made for travel and mileage actually performed from the terminal closest to the employee's residence to the temporary relieving terminal or from the normal relieving terminal to the temporary relieving terminal, whichever is less.

Section 12(g) states:

Engineer Officers on assignments of more than thirty (30) days scheduled duration for other than routine annual maintenance at Eagle Harbor or other shipyards shall be entitled to travel pay and mileage in accordance with subsection (e) herein above.

Section 12(d) states:

Regular employees permanently assigned to the San Juan Islands – Anacortes – Sidney B.C. routes or the Port Townsend – Keystone route will be paid the mileage and travel time indicated in Schedule A for one round trip per week when working, from the terminal nearest the employees residence.

02-16 The Department of Social and Health Services, Division of Child Support did not have adequate supporting documentation for printing and payroll costs.

Background

The Division of Child Support provides services to establish paternity, enforce support obligations, and locate parents owing child support. These activities are partially funded by the federal Child Support Enforcement program (CFDA 93.563). The Division is responsible for disbursing child support received from non-custodial parents to custodial parents.

For fiscal year 2002, the Division charged \$61,252,787 to its federal grant. Among the expenditures charged are costs for printing services and personnel. For fiscal year 2002, the Division spent \$66 million from state and federal funds for salaries and benefits to administer the program. Annually, the Division requests and receives over \$1.5 million in printing and related services from the Washington State Department of Printing. These services may include:

- Printing child support checks.
- Providing envelopes for mailing child support checks.
- Labor costs for stuffing child support checks into envelopes.
- Postage for mailing child support checks.
- Providing miscellaneous paper and other printing services.

State agencies are required to order all printing services through the State Printer.

Description of Condition

a. Printing costs

We found that payments made to the State Printer did not have adequate support documentation. Billing invoices did not include the necessary detail of goods, services and other miscellaneous charges, nor did they provide a detailed unit description, number of units provided, or a unit cost to crosscheck the items ordered/received and their related total charges. The invoices identified only a general category (i.e., material, labor, postage, etc.) and its corresponding total charge.

We tested a March 2002 payment of \$95,489 for 51 separate billing invoices received from the State Printer and found that none of the invoices had adequate detail to identify whether total charges were correct. Sixty-six percent of this payment was charged to the federal Child Support Enforcement grant and the remainder was paid with state funds.

b. Payroll time and effort

In our fiscal year 2001 audit, we found \$194,097 in salaries and benefits for non-Division employees who did not complete required time sheets or use any other allowable method for supporting time charged to the federal program. This condition was reported in Finding No. 01-15 of our fiscal year 2001 State of Washington Single Audit Report.

We reviewed the Division's corrective action taken during fiscal year 2002 and noted that it had reversed many of the charges made to the federal grant for non-Division employees. However,

we found \$38,086 in payroll costs for 17 employees who did not prepare time records that supported the amount charged to the federal grant.

Cause of Condition

The Division does not gather sufficient evidence to determine whether charges for goods and services provided are accurate and the State Printer does not provide the required itemized statement of charges. In regard to the unsupported payroll costs, when the Division attempted to reverse the costs of the non-Division employees charged to the grant, it used an incomplete estimate, which was ultimately less than the actual costs charged.

Effect of Condition

Printing costs

Accepting and paying for generalized and nonspecific charges increases the risk that management will not detect inappropriate or unintentional charges in a timely manner, if at all. In addition, the invoices presented by the State Printer do not provide sufficient information for the Division to reconcile the accuracy of goods and services provided to their related charges. As a result, the agency cannot determine if billings are accurate. In regard to the payment of \$95,489, we obtained additional evidence of support directly from the State Printer, and we will not question the costs.

Time and effort reporting

Without proper time and effort records, we are unable to substantiate the accuracy of the payroll costs charged to federal funds for this program. As a result, we are questioning \$38,086 in overcharges to the federal Child Support Enforcement program. Additionally, these unallowable costs affected the state's matching share and resulted in the reporting of incorrect expenditure amounts to the grantor.

Recommendations

We recommend that the Division establish and follow policies and procedures that require the receipt of adequate and appropriate support documentation from all vendors, including the State Printer, prior to making payment.

We recommend the Division continue to strengthen its corrective action regarding federal charges for payroll costs.

Department's Response

The Department concurs with the audit finding.

Printing Costs:

Since the time of the Auditor's initial review, the Division obtained Job Cost Sheets from the State Printer for 32 of the 51 invoices referenced above. These Job Cost Sheets were not available at the time of the auditor's initial testing of the State Printing payment batches for

March 2002. In a second review by the auditors of the State Printer March 2002 batch, the auditors approved the use of the Job Cost Sheets as adequate payment documentation. In the cases where Job Cost Sheets did not apply, the purchase orders from the State Printer were used to verify the invoices. These include printer paper orders where the paper is acquired by the State Printer through a bid process. The Division now requires Job Cost Sheets and/or State Printer purchase orders for all State Printer invoice billings.

The Accounts Payable desk manual will be revised to include procedures for correctly handling the nondescript invoices and what is the acceptable form of invoice to document what has been received for payment.

Payroll Costs:

A Corrective Action Plan has been developed and implementation has begun. As part of the Corrective Action Plan, the Division of Child Support (DCS) will review federal regulations regarding staff charges, establish time and effort documentation where necessary.

Auditor's Remarks

We appreciate the Department's prompt response to this issue. We will review the corrective action taken during our next audit.

Applicable Laws and Regulations

The Washington Office of Financial Management *State Administrative and Accounting Manual* addresses basic principles of internal control as follows:

SAAM 85.32.10 states in part:

It is the responsibility of the agency head, or authorized designee, to certify that all expenditures/expenses and disbursements are proper and correct. Agencies are responsible for processing payments to authorized vendors, contractors and others providing goods and services to the agency. Agencies are to establish and implement procedures following generally accepted accounting principles.

SAAM 85.32.10 states in part:

Prior to payment authorization, agencies are to verify that the goods and services received comply with the specifications indicated on the purchase documents.”

SAAM 85.32.40.c states in part:

Audit disbursement documents for the following:

- Quantities indicated on the invoice agree with those documented as received on the receiving report.
- Unit prices on the invoice agree with those indicated on the disbursement document.

- Extensions and footings are correct.

The U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, Attachment A, Section C.1 states, in part:

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

- b. Be allocable to Federal awards under the provisions of this Circular....
- 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.
- e. Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit....
- j. Be adequately documented.

U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, Attachment B, Section 11.h, states:

- (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.

02-17 Seattle Community Colleges is not enforcing its leave policy for administrative employees.

Description of Condition

In reviewing annual leave for managerial and professional employees, we noted the following instances of non-compliance with College policy:

- Sixty-two employees were found to have accrued annual leave balances in excess of 288 hours (the amount allowed by the policy) as of December 31. The excess leave balances were not zeroed-out and no requests for deferment of the leave were found in personnel files of those employees we made inquiries about. According to Human Resources personnel, only a few supervisors ever submit requests for deferment of an employee's excess leave balance. College policy requires leave balances to be zeroed out unless management has approved deferment of the leave. Accrued leave balances ranged up to 823.40 hours.
- Two employees were compensated for accrued annual leave balances totaling 429.96 and 405.37 hours, respectively, when they retired. Policy allows managerial and professional employees to be compensated for only 352 hours of accumulated leave upon retirement or termination.

Cause of Condition

Human Resources personnel stated that the policy limiting accumulated annual leave to 288 hours as of December 31 is not enforced. The leave reporting system is not set up to automatically eliminate excess leave balances as of this date for managerial and professional personnel.

Effect of Condition

Earned benefits are either lost at termination or a large amount of leave must be taken in a short time span, which could affect College operations.

Recommendations

We recommend the Colleges enforce the administrative employees leave policy.

Colleges' Response

As a result of the audit finding indicating our non-compliance with District Policy 479 (Leave – Administrative Employees) and related procedure, the following actions have been taken:

- *On November 26, 2002, a memorandum from the Chancellor was sent to all exempt employees notifying them that the District will fully comply with the provisions of the District leave procedure, effective this calendar year.*

- *On November 27, 2002, notifications were sent to individual employees whose annual leave balances are in excess of 288 hours. Employees were also notified about the process to follow to request to defer excess leave before December 31.*
- *An Exempt Employee Request to Defer Excess Annual Leave form has been developed and posted to the Public Folders for district-wide use.*
- *In conjunction with CIS, a program is being developed to electronically extinguish excess leave hours (above 288) by December 31 ending dates.*

Auditor's Concluding Remarks

We appreciate the Colleges' commitment to resolving this issue. We will review the condition during our next audit.

Applicable Laws and Regulations

As authorized by Revised Code of Washington 43.01.042, Seattle Community Colleges established Policy 479 governing leave for managerial and professional staff. The procedures implementing this policy state in part:

479.10.05

All accrued vacation should be used within one (1) year. As of December 31st of any year, exempt employees' leave balances should be at or below 288 hours. Hours above 288 as of December 31st will be extinguished.

479.10.06

If an employee is unable to timely take paid vacation because of operational needs, the employee's supervisor may submit a letter to the appointing authority requesting an extension of the vacation accrual and the justification for the request. The appointing authority may grant such an extension not to exceed six (6) additional months from the date of maximum benefit accrual (December 31). Any further extension may only be granted by the Chancellor or designee.

479.10.07

Upon termination or retirement from the District, unused, accrued vacation will be paid up to a maximum of 352 hours, and/or at the discretion of the appointing authority, be required for use prior to the last day of employment.

02-18 The Department of Health should improve monitoring of subrecipients and ensure compliance of vendors for the HIV Care Formula Grants program.

Background

The objective of the HIV Care Formula Grants program (CFDA 93.917) is to assist states in developing or enhancing access to high-quality, community-based care for low-income individuals with human immunodeficiency virus (HIV) and their families. Comprehensive care includes primary medical care; access to U.S. Food and Drug Administration-approved drug therapies; support services that enable individuals to access and remain in primary care; and related services that promote health and enhance the quality of life.

States may provide some or all services directly, or may enter into agreements with local HIV care consortia, associations of public and non-profit health care and support service providers, and community-based organizations that plan, develop, and deliver services to individuals with HIV.

Description of Condition

In fiscal year 2002, the Department spent more than \$11 million under the HIV Care Formula Grants program. To carry out certain aspects of the program, the Department contracted with 14 lead agencies appointed by members of the Ryan White Care Consortia. Approximately \$2.6 million was awarded to these subrecipients.

During our audit, we reviewed the Department's system for monitoring activities of its subrecipients and the method of paying subrecipient claims. Of the 14 consortia lead agencies, we found that eight agencies do not submit supporting documentation with their reimbursement claims. When the Department does not receive supporting documentation with a claim, it cannot ensure that expenditures were made for allowable purposes and in compliance with federal cost principles. We also reviewed the Department's procedures for reviewing financial documentation when it performs on-site visits of the eight agencies, which would provide a compensating control, but found that it does not review that information. For the remaining six subrecipients, we found that each had submitted adequate supporting documentation.

Under its Early Intervention Program, the Department contracted with a vendor to provide medical insurance for eligible clients. The maximum compensation to the vendor under the contract for July 2001 through March 2003 is \$2.6 million. As part of the contract, the Department reimburses the vendor for administrative costs, which were budgeted at \$185,469 for the time period mentioned above. The contract stipulates that the vendor must provide the following documentation to the Department: a categorical budget, a list of all employees whose salaries are charged to the program, an accounting of travel costs and a list of equipment purchased, including why the equipment was purchased. We found that the vendor is not submitting this information to the Department and the Department is not taking action to ensure compliance with this requirement.

Cause of Condition

Seven of the eight consortium lead agents mentioned above are local governments and the remaining agent is a not-for-profit agency. The Department does not require local governments to submit supporting documentation, partly because the local governments receive an independent audit of their federal awards by our Office. The Department believed that receiving a copy of the audit report would satisfy its fiscal monitoring responsibilities. The Department removed the requirement to submit supporting documentation for the not-for-profit agency because it had a favorable history of compliance. In regard to the vendor contract, the Department stated staff turnover in positions responsible for monitoring contracts caused the condition.

Effect of Condition

Given the lack of documentation to support reimbursement claims and a lack of fiscal monitoring, the Department cannot ensure that eight of its 14 subrecipients have spent grant funds for allowable purposes.

Recommendations

We recommend the Department review financial documentation as part of its subrecipient monitoring program. Alternatively, the Department can require all subrecipients to submit supporting documentation with their reimbursement claims. We also recommend the Department ensure that all vendors comply with the provisions of their contracts.

Department's Response

We concur with the finding by the State Auditor's Office. The Department of Health (DOH) will develop procedures to improve monitoring of both local government and non-governmental subrecipients. The DOH will take the actions necessary to ensure that vendors for the HIV Care Formula Grants program comply with the provisions of their contracts.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding. We also appreciate the cooperation extended to us throughout the audit by Department staff. We will review the status of corrective action during our next audit.

Applicable Laws and Regulations

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: ...

- (2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.

- (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....

U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Section .210(f), states:

Compliance responsibility for vendors. In most cases, the auditee's compliance responsibility for vendors is only to ensure that the procurement, receipt, and payment for goods and services comply with laws, regulations, and the provisions of contracts or grant agreements. Program compliance requirements normally do not pass through to vendors. However, the auditee is responsible for ensuring compliance for vendor transactions which are structured such that the vendor is responsible for program compliance or the vendor's records must be reviewed to determine program compliance. Also, when these vendor transactions relate to a major program, the scope of the audit shall include determining whether these transactions are in compliance with laws, regulations, and the provisions of contracts or grant agreements.

Safeguarding of Assets (Please see Other Areas on page 16.)

02-19 The Department of Transportation's Washington State Ferries Division lacks adequate internal controls over ferry vessel equipment and items that are small and susceptible to misappropriation.

Background

The Washington State Ferries Division maintains equipment and supplies to support its vessel fleet, including:

- Vessel equipment such as generators, auxiliary engines, propellers, pumps and motors, and inflatable boats with outboard motors.
- Small and attractive assets including hand tools, cell phones, hand-held computers, video cassette recorders and televisions.

The Ferry Division has three warehouses, eight shops, and 27 vessels where the items are stored. These warehouses are located in South Seattle, the Eagle Harbor vessel repair facility on Bainbridge Island, and Todd Shipyards at Harbor Island.

Description of Condition

Vessel equipment:

- We visited the Ferry System warehouses and selected 27 items for audit that appeared to be valuable, including some that were highly susceptible to loss or misuse. These are new items that are awaiting placement on a vessel or items that have been removed from a vessel. On the average, the items we reviewed had been sitting in inventory about two years. None of those items had been tagged for inventory purposes, although 13 were recorded in an inventory system. Fourteen, or 52 percent of the items, were neither tagged nor recorded in any Department inventory system, making them more susceptible to loss or misappropriation without detection in a timely manner, if at all. We estimate an average value for each of the 14 items at \$172,000.

Small and attractive items:

- We reviewed internal controls over small and attractive assets and found that although the Department had done work to identify those items most susceptible to loss or misuse, it had not completed logging them into the inventory system. As of the end of our fieldwork, the Ferry Division had recorded 42 small and attractive items in its inventory system. Inquiries with Department staff confirmed that this is likely a small percentage of the total that should be tracked by the Ferry Division.

Cause of Condition

We recognize that Ferry Division management has made many improvements over the past year to better track consumable inventory. However, management has not made these same improvements in controls over asset inventory.

Effect of Condition

Where accountability is lacking over equipment or small and attractive assets, the risk is greatly increased that they will be misappropriated or used for personal benefit without detection in a timely manner, if at all.

Recommendation

We recommend the Ferry Division:

- Record individual vessel equipment and small and attractive items in the appropriate inventory system. Each asset should be identified by a unique tag number along with other pertinent information such as location, serial number and cost.
- Perform periodic physical counts of these items, and compare that count to the inventory system records, to provide a means to adequately control these assets.

Agency's Response

Thank you for the opportunity to respond to the draft audit findings that focused on a number of Washington State Ferries activities during fiscal year 2002, including ticket sales and revenue collection, inventory control and travel. We appreciate the fact that the State Auditor has acknowledged our continued efforts in tracking consumables, improving the sales activity area (including cash counts) and reducing cash collections at terminals. WSDOT is committed to the safeguarding of public assets under our control and maintaining the highest level of integrity and accountability.

WSDOT will provide our corrective action plan to the Washington State Office of Financial Management within the allotted 30-day time frame after your organization issues the final Statewide Accountability Report for FY02.

We would also like to note that even though your Audit Team expressed concern over the Department's payments to UIW/Bechtel on the Tacoma Narrows Bridge project, we did in fact go beyond the attestation report in confirming the supporting justifications for the payment. Our activities included holding discussions with the external auditing firm, the financial representative for Bechtel and our own managers involved in the project regarding the products/services delivered over the years. These issues are very important to us and we had already scheduled an appropriate audit level of review before your office also raised the issue.

We value your office's contributions and assistance.

Auditor's Concluding Remarks

We appreciate the Department of Transportation's efforts to address this finding and will review the agency's progress toward improving internal controls during our next regular audit.

Legal Criteria

RCW 43.19.1917 – Records of equipment owned by state...

“All state agencies...shall maintain a perpetual record of ownership of state owned equipment, which shall be available for the inspection and check of those officers who are charged by law with the responsibility for auditing the records and accounts of the state organizations owning the equipment...”

All state agencies...shall account to the office of financial management...and maintain such records as the office of financial management deems necessary for proper accountability therefore...”

Office of Financial Management's, *State Administrative and Accounting Manual*, Section 30.40.10 defines small & attractive assets as those with a cost of less than \$5,000.

Section 30.40.20 states in part:

“The agency should implement specific measures to control small and attractive assets in order to minimize identified risks.”

02-20 The Department of Social and Health Services, Mental Health Division does not have sufficient internal controls over drugs in Western State Hospital pharmacies to prevent and/or detect misappropriation or loss.

Background

Western State Hospital is a 950-bed psychiatric hospital operated by the Mental Health Division of the Department of Social and Health Services. The Hospital's pharmacy and its services are an essential part of patient treatment programs. The pharmacy distributes about 14,000 doses of medication each weekday. The Hospital spends over \$5 million annually on drugs, including narcotics, for which there are federal and state regulations mandating strict controls.

The main pharmacy receives deliveries of all pharmaceuticals and distributes them to the Hospital's 30 wards and three satellite pharmacies. In addition to filling medication orders and supplying the wards with a stock of medications, the satellite pharmacies store drugs that are returned from the wards. Automated drug distribution devices are used to store drugs and fill orders for newly admitted patients and prescription changes on weekends and holidays. Two of these drug distribution devices serve the entire Hospital.

The main pharmacy prepares a seven-day supply of medication for each patient. Pharmacy couriers deliver the medications to each ward on a regular schedule. The couriers are responsible for filling each patient's medication drawer with the correct medications and for picking up medications that have been discontinued by the physician.

During the fiscal year 2001 audit, we reviewed the Hospital's internal controls over pharmaceutical inventory, including purchasing, receiving, storage, and distribution, and found many internal control deficiencies. We reported these conditions in Finding No. 4 in the Statewide Accountability Report.

Description of Condition and Cause

During the fiscal year 2002 audit, we reviewed the Hospital's progress and determined that, although controls have improved, significant internal control weaknesses still exist for pharmaceutical inventory.

Automated Drug Distribution Devices

The Hospital has never:

- Taken inventory of the contents of these machines.
- Assigned keys to these devices to specific individuals. One key code may allow more than one individual access to the machines. This is a violation of State Board of Pharmacy regulations.

Management reports that controls over the automated drug distribution devices have not been instituted as the Hospital is awaiting installation of newer devices now being mandated by the State Board of Pharmacy. The current older generation devices are now located on two

admission wards. By January 31, 2003 management anticipates the four admission wards will have the new automated drug distribution devices that have been approved by the State Board of Pharmacy. Additionally, Management reports that it plans to install these devices on all wards by 2004, pending funding approval from the Legislature.

Accountability of Drugs

The Hospital has not established:

- Proper procedures for inventory of “working stock” (controlled substances kept apart from the regular inventory of narcotics). The Hospital counts main pharmacy working stock annually but keeps no record of drugs added to or taken from this inventory during the year. Therefore, it cannot complete any reconciliation between counted drugs and recorded drugs. All these factors create a high risk of loss or misappropriation.
- Accountability over non-narcotic drugs returned to the satellite pharmacies from wards.
- Adequate controls over drop boxes, used for the transfer of drugs from wards to the pharmacies. It is estimated that three to five nurses in each ward may have access to the ward drop box. There are no special coded keys for each nurse.

Hospital management stated limited staff, employee absences, and limited technology capabilities prevent the pharmacy from accounting for non-narcotic drugs returned from the wards. Management believes that the installation of the automated drug distribution devices on all wards in 2004 will improve accountability over non-narcotic drugs and will eliminate the need for drop boxes.

Hospital managers have no plans to institute improved controls over “working stock”, as they believe current controls are in compliance with the State Board of Pharmacy regulations. Management stated it relies on the integrity of Hospital employees and on the limited Hospital technology as sufficient compensating controls for safeguarding these narcotics.

Non-Narcotic Prescription Refills

The Hospital processes medication refills daily. During the fiscal year 2001 audit, we found wide variations in the number of non-narcotic refills from day to day. At that time, management stated the number of non-narcotic refills appeared to have been high at times but they had been unable to determine the cause. In addition, nursing staff was often unable to explain the reason for the refills.

We found this condition remains and the Hospital is still unable to determine the reasons for the large variations in medication refills. Management reports it continues to gather data to ascertain the cause but believes the installation of the new automated drug distribution devices will aid in improving accountability of non-narcotic drugs and lead to a substantial reduction in the number of refills.

Effect of Condition

The risk remains that loss or misappropriation of both narcotic and non-narcotic drugs could occur and not be detected in a timely manner, if at all.

Recommendations

We recommend that Western State Hospital:

- Account for all medications that are returned to the pharmacies.
- Conduct periodic inventories of all automated drug distribution devices and assign unique codes to all individuals who have access to the automated drug distribution devices.
- Institute monitoring procedures that encompass all aspects of inventory control, including “working stock” and drop boxes.
- Determine the causes for non-narcotic prescription refills and establish controls to provide reasonable assurance that diversion or misuse of these medications is prevented or detected.
- Set up controls to deter loss and misappropriation during the interim period while more permanent controls are being established.

Department’s Response

The Department partially concurs with this finding.

Automated Drug Distribution Devices

WSH concurs with this condition. The two currently used devices will be replaced with four automated med-stations (Pyxis med-stations) by the end of January 2003. The med-station devices will electronically track the drug inventory and distribution activities. Each licensed staff member who is authorized to use the med-station device will be required to sign-on using a unique password specific to each licensed staff and also be required to provide its respective “bio-ID” (fingerprint). The med-station device will record who accessed the machine, the date and time, strength and quantity of each medication requisitioned, as well as the patient's name. The devices will also provide critical medical information specific for each patient. Additionally, when a controlled substance is requisitioned, the user will have to verify the physical count of the medication for each occurrence. Discrepancies will automatically flag both the med-station device and a console in the main pharmacy electronically. The supervising nurse for the shift will be required to resolve the discrepancies at the time they are discovered.

WSH is seeking Legislative funding to install a new med station on each ward by July 2004.

Accountability of Drugs

Working stock:

WSH does not concur with this condition.

WSH is currently in compliance with State Board of Pharmacy law and pharmacy standards regarding “working stock” processes and procedures. “Working stock” is kept in locked cabinets and is only accessible by licensed Pharmacists. With regard to the State Auditor’s recommendation, WSH does not have the resources and/or updated technology to currently meet the requirements. However, WSH has requested Legislative funding for automated devices, which will electronically monitor the activities regarding “working stock”. This problem will be eliminated once funding is approved and installation is completed.

Due to lack of resources and insufficient technology, drop boxes are currently used. These boxes are locked and accessible by individuals who have access keys. Only one nurse on each ward has access to that ward’s box. Similar to the installation of the new devices for “working stock” drugs, the installation of these machines will eliminate the need for “drop boxes”.

Drug Returns:

WSH does not concur with this condition.

Each weekday more than 1,000 tablets/capsules are returned to the main and satellite pharmacies. The most common reasons for returns include discharge of a patient, discontinuation of a medication, change in dosage, placement of patient on authorized leave, dosage refused by patients, etc. If the returned medication is in useable condition, it is returned to the shelves for redistribution. However, because of limited resources and technology, WSH does not have the capacity to track these returns on an ongoing basis.

Automated med-station devices will solve this issue. Medications in the med-station devices will not be labeled for individual patient use; rather it will be in a controlled inventory sorted by drug type. Each dose of medication added or removed by a nurse will be electronically increased or decreased from the inventory. Medications, which have been discontinued or changed per Physician order, will still be in the med-station inventory and will not be required to be transported back to the main and satellite pharmacies.

Non-Narcotic Prescription Refills

WSH does not concur with this condition.

There are several reasons for these refills to be requested in large variations. Reasons include dropped tablets and patients who spit out the dose and require re-administration of the medication. Another reason for refills is the large volume of internal patient transfers within WSH. A patient transferring from one ward, who receives their 7-day refill on one day, to another ward, who gets their 7-day refill on a different day, may require additional medication to get them through to the transition to a new delivery day.

Through data gathering, the Pharmacy Department recently determined that the Pharmacy 7-day refill delivery schedule for the wards was causing some “early refills” requests. After some internal pharmacy system configuration of the timing of delivery of the refills, the problem has been eliminated. The Pharmacy and Nursing Departments also gathered data and evaluated the types of medications that are most commonly requested for an “early refill.” Through a collaboration effort, they found that antipsychotics and anticonvulsants were the medications

most often requested. These do not represent the type of medications that are most likely to be diverted and refills are more likely due to reasons mentioned above.

Overall, the number of refill requests has decreased by 15% over the past year by streamlining the process, educating nursing staff and adjusting the refill delivery schedule. Efforts continue to retrieve additional data from nursing staff on the wards for further efficiencies. Additional improvements will be implemented after further data is collected and analyzed.

When automated med-station devices are funded and installed on all wards, patient-specific refills will be eliminated and each dose removed will be recorded electronically.

Auditor's Concluding Remarks

We appreciate both the work that the hospital has done thus far in improving its internal control weaknesses and the plans to install med-station devices to strengthen the control weaknesses that remain. However, due to the potential for loss and misappropriation of narcotics and other prescription drugs, we believe these internal control weaknesses should be addressed immediately.

Accountability and management oversight weaknesses make this highly attractive inventory a target for misappropriation and increase the public health risk that misappropriated prescription drugs may be dispensed by persons who are not licensed to do so and used by persons who are not under a doctor's orders. These activities can expose the state to potential liability. Additionally, the controls as they exist would not alert management to overstocked drugs, expired drugs and the possibility of diversion; therefore, the hospital may be purchasing more medications than it needs for patient care.

These issues, especially in view of the quantity of drugs that are returned daily to satellite pharmacies, should prompt the hospital to further strengthen existing procedures until more permanent controls are placed eighteen months from now.

Applicable Laws and Regulations

The Office of Financial Management *State Administrative and Accounting Manual* addresses basic principles of internal control as follows:

Section 20.20.20.d states in part:

Each agency is to adopt methods to assess risk and review control activities...

Section 20.20.60.d states in part:

Management systems and internal activities need to be monitored to assess the quality of their performance over time. Assessment is accomplished through ongoing monitoring activities, separate evaluation, or a combination of the two.

Section 20.20.60.d also pertains to communications relating to internal controls and states in part:

Pertinent information must be identified, captured, and communicated in a form and time frame that enable people to carry out their responsibilities.

Washington Administrative Code 246-869-120, paragraph 6, which relates to automated drug distribution devices, states in part:

At the time of removal of any drug or medicine from the device, the device shall automatically make a written record showing...the identification of the nurse removing the drug or medicine from the device....

On June 3, 2002, the State Board of Pharmacy notified the Hospital that it considered the Hospital to be out of compliance with the above WAC and set a deadline of six months to correct the situation.

Federal Compliance (Please see the description of this area on page 18.)

02-21 The Employment Security Department did not comply with regulations for allocating payroll costs for four Department of Labor federal programs.

Background

The Employment Security Department administers several programs that are partially funded by the U.S. Department of Labor. A significant amount of the Department's expenditures for salaries and benefits is charged to the federal portion of these programs. In general, federal regulations require that employees whose activities are split between a federal program and other work must charge their time to each activity based on actual time worked. Charges to federal grants for salaries and benefits initially may be based on estimates, but must be reasonable and must be adjusted quarterly after comparing the estimates to actual activity reports. Alternative time distribution systems that do not use reports of actual time worked must have federal approval before they are put into use.

Description of Condition

We reviewed time reports for Department employees in several offices and programs and found a pattern of daily time distributions being charged directly to the federal programs with the same percentage allocations every pay period, rather than for actual time worked. The Department stated it has established these percentages based on historical estimates, but we found no current documents to demonstrate the Department's analysis of activities and determination of reasonable estimates. In addition, the Department did not reconcile or adjust any of the historical estimates to actual work on a quarterly basis, nor did it obtain the required grantor approval for the use of an alternate method. This is a repeat of a condition reported in the State of Washington Single Audit Report in fiscal years 2000 and 2001.

Cause of Condition

The Department stated it is difficult to allocate time properly for certain staff positions because employees in these positions work on or support a great number of programs or projects and cannot efficiently track their time. Managers stated they have been unable to devise a method of accounting for federal costs that will not be too cumbersome for the type of employee activity we reviewed. They believe the estimates are reasonable over time, but acknowledge they have no documentation to support this analysis.

The Department has made improvement in preparing time records for some federal programs, but it was not able to fully implement corrective action during our audit period.

Effect of Condition

Because the time distribution method used is not in compliance with federal requirements, we question the following amounts for fiscal year 2002:

Federal Program	CFDA Number	Questioned Costs
Unemployment Insurance	17.225	\$32,080
Employment Service	17.207	89,069
Workforce Investment Act Adult Program	17.258	105,125
Workforce Investment Act – Dislocated Workers	17.260	48,403
Total		\$274,677

Recommendations

We recommend the Department reimburse the appropriate federal programs for any costs the grantor determines to be unallowable. We also recommend the Department ensure employees accurately report their time. We further recommend the Department consult with the grantor to determine a reasonable and acceptable way to account for payroll costs charged to federal funds.

Department’s Response

The auditor has questioned the time charges of several employees because of the appearance of repetition. In the case of many of the employees, they provide services that may be repetitive in nature. Also, several of the employees through the performance of their duties benefit multiple programs with a single activity. The department, by having these employees charge their time to several programs, is attempting to ensure that charges to federal programs are fair and equitable. To support this, we are providing explanatory information as to the job duties of employees whose time was questioned as well as the rationale for this methodology. They are grouped by agency division and position for clarity.

WorkSource Operations Division (WSOD)

Administrative Support Functions:

Divisional Administrative Assistant

This employee supported the Division’s Assistant Commissioner in his meetings and day to day work dealing with the operations and policy implementation of programs and services delivered in the agency’s field offices. These programs and services included Employment Services, Reemployment Strategies Workgroup, Unemployment Insurance Services, Training/Labor Disputes, Claimant Placement Program, Facilities, and Employer Outreach. This employee provided support as liaison to the four Regions reporting to the Assistant Commissioner. Also, as a member of the WSOD Leadership Team, the Administrative Assistant participated in strategic planning and other developmental activities in management meetings. She also provided support to the division by ordering office supplies and furniture and processing travel, conference and training requests. This work was relevant to the programs to which her salary was charged.

Secretary Administrative – West Region

This employee works as part of the West region office team that provides administrative oversight and management support to local area operations. We believe that because the position supports a variety of programs, the funding sources used were the most appropriate for charging her time and were reflective of the work she performed.

The very nature of these duties supports all funding sources administered within the region. As such, this employee's time charging is an attempt to fairly charge those programs benefiting from the services she provides.

Secretary Senior – WorkSource Everett

This employee's duties are as administrative support. Therefore, most of her responsibilities/duties involve working with personnel, time sheets, inventory, and supplies. In addition she handles phone calls and in-person inquiries relating to filing for UI. She also directs UI claimants to the TeleCenters. This employee also provides services supporting all aspects of employment services at this location. Her time charges are accurate and reflective of the benefiting programs.

WorkSource Specialists:

WorkSource Specialist 4 – Mount Vernon Office

The time charges posted by this employee are based on actual hours worked. Most of his hours worked were focused on managing his caseload by providing some core but primarily intensive services. The funding source used to account for this employee's time was the appropriate one. During this period the employee managed a caseload of Dislocated Workers including clients eligible for Trade Act and North America Free Trade Agreement (NAFTA), addressing a wide array of client needs.

WorkSource Specialist 4 – Columbia Gorge Office

This employee is currently a WorkFirst counselor located at our local WorkSource office in White Salmon. She also has knowledge of the Unemployment Insurance (UI) program. As a result, staff refer UI claimants to her as well as clients with Employment Service questions. She has been instructed to charge the UI program only for time spent on providing UI services. She occasionally conducts Job Search Interviews, which are also appropriately charged to the UI program.

This employee has also been instructed to charge the Employment Services program for services provided to non-WorkFirst clients. We believe the employee has been instructed to appropriately charge her time to the programs for which the work was performed. She has never been instructed to charge her time on any basis other than the work performed.

3. WorkSource Specialist 4 – Spokane

The duties assigned to this employee were appropriate for the codes he was provided and to which he charged his time. These duties included:

Power User/Trainer for SKIES (System Knowledge Information Exchange System). System implementation required the local area to have a power user to provide reports from the agency's Data Warehouse. In addition, he was responsible for gathering reporting requirements and documenting those needs, producing reports and/or files and checking reports for accuracy. Developing and maintaining communication with other power users of the WorkSource partnerships throughout the state; share lessons learned, queries developed, and best practices. Providing SKIES training, implementation and staff assistance.

These activities have been appropriately charged to the Employment Service program in support of the WorkSource System and Labor Exchange. This was a full-time position with reporting responsibilities to both the Spokane Area Workforce Development Council (WDC) and the Employment Security Department as SKIES was the system to be used by both parties.

Labor Market and Economic Analysis (LMEA)

Data Compiler

Work performed by this employee involved collecting data on employment and wages from agricultural employers in the state of Washington. The Employment Service program has always funded this work, as one of the purposes of this funding is the development of Labor Market Information. Agriculture is a very important industry in Washington State and there needs to be data available on employment and wages for agriculture just as there are for nonagricultural industries. The legislature directed Employment Security to "Produce agricultural labor market information and economic analysis needed to facilitate the efficient and effective mating of the local supply and demand of agricultural labor critical to an effective agricultural labor exchange in Washington State." The reference for this is RCW 50.38.060(5). Unfortunately the legislature did not provide adequate funding for the collection of this data so the agency had to combine funding from more than one source to collect this data.

Employment and Training Division

Program Assistant

This employee is the lead support staff and supervises administrative staff for Workforce Investment Act operations. In this capacity, her work is directed to a number of federal grants. The majority of her time is for the Workforce Investment Act (WIA) program. She also worked on Welfare-to-Work, Trade Act (coordinating conferences and meetings and formatting grants), and rapid response in support of the Dislocated Worker program (processing Worker Adjustment and Retraining Notices).

The employee indicated that to the best of her knowledge, her time charges were accurate and appropriately directed to the cost objective. At no time did she charge grants that she did not work on.

ES Program Coordinator 3

This employee works in the Dislocated Worker Rapid Response program of WIA. Her major allocation of time worked is for rapid response. Her activities are working on the “red flag” report of statewide plant closures. She also addresses questions from the public and state government about this program. The employee stated that the time charged to rapid response is accurate and represents her work on the program.

The employee also worked on WIA administration during this period. She works with WIA program issues with her supervisor, including coordinating WIA and UI related issues. She stated that a small amount of her time is related to the Trade Act, primarily related to its role in the “red flag” report. This includes responding to concerns from participants and the public.

The employee stated that to the best of her knowledge the time shown on her timesheets for this period are accurate. She stated that at no time did she charge grants that she did not work on.

Secretary Administrative

This employee was a member of the WIA administrative support staff. She stated that her work during this period was mainly directed to WIA administration. She also stated that a minor amount of time was directed to Welfare-to-Work about three to four hours per pay period.

The employee stated that to the best of her knowledge, the charges are appropriate for the cost objective and they are accurate. At no time was work charged to grants that she did not work on.

ES Program Coordinator 3

The employee stated that the majority of his time was spent working on Workforce Investment Act administration. He co-managed WIA 10% projects such as “Industries of the Future”, including the Request for Proposal process. He also spent some of his time working on NAFTA funded projects where he wrote a grant and produced quarterly reports. He also performed analysis of data and prepared information for presentations.

He stated that he made time available to ensure both NAFTA and WIA were charged. The employee stated that his time was directed to the appropriate cost objectives. At no time was work charged to grants that were not worked on.

Auditor’s Concluding Remarks

Many of the positions noted by the Department in its response would be considered an indirect cost, or a cost that benefits more than one cost objective and cannot be readily identified with a particular final cost objective without effort disproportionate to the results achieved. As a result, the salaries and benefits for these positions should be recovered through the Department’s indirect cost rate instead of being charged directly to the grant.

We appreciate the Department’s efforts to work with our Office and the U.S. Department of Labor to resolve the issues identified in the finding. We also appreciate the cooperation extended to us throughout the audit by Department staff. We will review the status of corrective action during our next audit.

Applicable Laws and Regulations

U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, Attachment B, Section 11(h), states:

- (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.

U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, Attachment E, Section A(1) and Section C(1)(b), states:

Indirect costs are those that have been incurred for common or joint purposes. These costs benefit more than one cost objective and cannot be readily identified with a particular final cost objective without effort disproportionate to the results achieved. After direct costs have been determined and assigned directly to Federal awards and other activities as appropriate, indirect costs are those remaining to be allocated to benefited cost objectives. A cost may not be allocated to a Federal award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to a Federal award as a direct cost....

Where a governmental unit's department or agency has several major functions which benefit from its indirect costs in varying degrees, the allocation of indirect costs may require the accumulation of such costs into separate cost groupings which then are allocated individually to benefited functions by means of a base which best measures the relative degree of benefit. The indirect costs allocated to each function are then distributed to individual awards and other activities included in that function by means of an indirect cost rate(s).

02-22 The Department of Community, Trade and Economic Development did not prepare and submit required financial reports for the Low Income Home Energy Assistance program.

Description of Condition

The Department of Community, Trade and Economic Development administers the Low Income Home Energy Assistance program (CFDA 93.568). During our audit, we found that the Department did not prepare and submit annual financial status reports for federal fiscal years 2000 and 2001 as required by the U.S. Department of Health and Human Services (HHS). These reports provide information about program expenditures, amounts obligated, and the balance of the award.

Cause of Condition

The Department was unaware of a change in the grant terms and conditions that required the financial status reports. This change was effective with the federal fiscal year that ended September 30, 2000.

Effect of Condition

The Department spent \$23 million in fiscal year 2000 and \$34.6 million in fiscal year 2001. Without accurate financial information, HHS may not be able to make informed decisions regarding program operations. Further, failure to comply with federal requirements may affect future federal funding.

Recommendations

The Department informed us that it has prepared the required financial status reports for federal fiscal years 2000 and 2001 and submitted them to HHS. We recommend the Department prepare future financial reports within the timeline prescribed by the grantor.

Department's Response

*We **concur** with the determination that the department did not prepare and submit annual financial status reports for federal fiscal years 2000 and 2001 for the Low Income Home Energy Assistance program (LIHEAP), as required by the U.S. Department of Health and Human Services (HHS).*

The Department immediately submitted the required financial reports as soon as it was brought to our attention that the reports were overlooked. Until 2000, the LIHEAP program did not require annual financial reports. This new requirement was included in the 2000 award documents and was overlooked by program and fiscal staff. Staff vacancies and changes during the past two years in program and fiscal also contributed to this oversight. Upon contacting the Federal fiscal contact, we were informed that several states overlooked this reporting change and had not submitted their reports in a timely manner and they consider this a period of transition. Officials at HHS indicate that they would consider this a management item. Therefore, we do not believe this warrants a finding.

CTED's processes will be enhanced to address this issue in two parts:

As each new federal award is received by CTED programs, divisions will be asked to submit a Federal Award Cover Sheet, highlighting requirements that are included in that award's terms and conditions. Match requirements, reporting requirements, and other fiscal related processes will be highlighted by the Division responsible for the federal award. The cover sheet will be submitted to the CTED accounting services office, along with a copy of the grant award.

The CTED accounting services office will use the information provided by the Division to prepare a Federal Assistance Grant Profile for each award as it is received from the Division. The profile will accompany the fiscal year closing reconciliation for each federal program, when submitted to the analyst's supervisor for approval. The fiscal year closing reconciliation will be reviewed and approved by the Grants and Loan Team Manager, or designee. This process enhancement will be included in the fiscal year closing instructions.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolve the issue identified in the finding. We also appreciate the cooperation extended to us throughout the audit by Department staff.

Applicable Laws and Regulations

The U.S Office of Management and Budget Circular A-133 Compliance Supplement, page 4-93.568.6, section L.1.a states:

SF-269A, Financial Status Report (short form) – Applicable beginning with Federal fiscal years ending on or after September 30, 2000.

02-23 The State of Washington Military Department did not comply with federal requirements for time and effort reporting, prevailing wages and suspension and debarment.

Background

Under the National Guard Military Operations and Maintenance program (CFDA 12.401), the Department of Defense enters into cooperative agreements with states to provide federal support for services provided by state military departments for leases, real property maintenance and repair, operations and maintenance and minor construction costs. For state fiscal year 2002, the State of Washington Military Department spent \$11,012,356 in federal funds for these purposes.

Description of Condition

During our audit, we found the following internal control weaknesses and instances of noncompliance:

a. Time and effort reporting

For all payroll costs charged directly to federal awards, Federal Office of Management and Budget regulations (Circular A-87, Attachment B, Section 11(h)) require employees to document their time and effort spent on each federal activity monthly. However, if an employee works on only one federal activity, semi-annual certifications signed by the employee or a supervisor also meet federal requirements.

During our review of payroll charges, we noted that the Department did not require salaried employees who worked solely on the Operations and Maintenance grant to prepare semi-annual certifications. In addition, we found one employee who worked on multiple activities who was not keeping monthly time and effort records. The salary and benefits charged to the federal award for this employee were \$51,527.

b. Federal prevailing wages

In general, construction projects funded by federal assistance that exceed \$2,000 are subject to the federal Davis-Bacon Act, which requires contractors and subcontractors to pay their laborers federal prevailing wages. The state of Washington has also established prevailing wage rates and procedures for construction projects funded with state money.

When reviewing the Department's internal controls over payment of prevailing wages, we found that it was not informing contractors of the federal prevailing wage requirements nor requiring that the contractors submit weekly, certified payroll reports as required. For state fiscal year 2002, the Department spent approximately \$3.1 million for construction projects subject to the Davis-Bacon Act. However, it should be noted that the contractors were using state prevailing wage rates, which are comparable to, and in some cases higher, than federal rates.

c. Suspension and debarment

Recipients of federal assistance are required to obtain a certification from potential contractors that would receive in excess of \$100,000 in compensation that states they have not been suspended or debarred from participating in federal programs. When reviewing the Department's internal controls over contracting, we found that it did review the federal list of suspended and debarred parties before awarding contracts, but was not obtaining suspension and debarment certifications for its construction-related contracts as required. For fiscal year 2002, the Department spent approximately \$2.8 million for construction projects that were subject to the suspension and debarment requirement.

Cause of Condition

The Department was unaware of the federal requirements over time and effort. However, it should be noted that during our audit, the Department developed new policies and procedures to comply with this requirement. In regard to federal prevailing wages, the Department stated that it believed that because it initially paid construction costs with state funds and was subsequently reimbursed by the federal government, it only had to comply with state prevailing wage regulations. For suspension and debarment, the Department relied on standard contract language prepared by another state agency that did not contain the required certification.

Effect of Condition

a. Time and effort reporting

Without proper time and effort records, we are unable to substantiate the accuracy of the payroll costs charged to this program. As a result, we are questioning \$51,527 charged to the grant. For the salaried employees who did not prepare a semi-annual certification, we were able to review alternative evidence that supported their effort.

b. Federal prevailing wages

If contractors and subcontractors do not obtain a federal wage register that establishes the prevailing wages for their projects, there is risk that the laborers and mechanics will not be paid the proper wages.

c. Suspension and debarment

If the Department does not obtain suspension and debarment certifications, it may be liable for amounts paid to subrecipients and vendors who have been suspended or debarred from receiving federal funds.

Recommendations

We recommend the Department:

- Maintain time and effort records that comply with federal regulations and consult with the federal grantor to determine whether questioned costs should be repaid.

- Update all construction contracts to include the appropriate provisions of the Davis-Bacon Act and develop procedures to obtain certified payroll reports from contractors.
- Obtain suspension and debarment certifications for all current contractors and update all contract language to incorporate this certificate.

Department's Response

Davis Bacon – WMD is reviewing the Davis Bacon requirements with the National Guard Bureau. WMD will comply with all Davis Bacon requirements. WMD will include the necessary requirements in contract terms and conditions that are processed directly by WMD (delegated) and will work with General Administration (GA) to include the requirements in the terms and conditions of contracts processed by them (non-delegated). As was noted in the audit, contractors are using state prevailing wage rates that are comparable to and in most cases higher than federal prevailing rates.

Suspension Debarment – The contract language relied on by WMD was from GA and did not contain the required certification. Contract language for both delegated and non-delegated projects has been changed to incorporate suspension and debarment language in the terms and conditions. A certificate has also been developed and provided to contractors so that they can file the necessary certification to WMD.

Time and Effort – A new policy and procedure has been drafted to comply with these requirements. All employees funded solely by one grant will be required to provide certification that they only worked on that grant. The employees that are funded by state and federal funds, but there is no matching requirement, will be required to provide monthly time sheets. The time sheets will be recorded in the Time Management System (TMS). The \$51,527 questioned in the audit is substantiated through an agreement in the Master Cooperative Agreement that allowed for a 90% federal and 10% state effort based on historical work performed by the telecommunication specialist. This employee is now completing monthly time sheets.

Auditor Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding. We also appreciate the cooperation extended to us throughout the audit by Department staff. We will review the status of corrective action during our next audit.

Applicable Laws and Regulations

U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, Attachment B, Section 11(h), states in part:

- (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.

29 CFR 5.5(a) states in part:

The Agency head shall cause or require the contracting officer to insert in full in any contract in excess of \$2,000 which is entered into for the actual construction, alteration and/or repair, including painting and decorating, of a public building or public work, or building or work financed in whole or in part from Federal funds ... the following clauses.... (1) Minimum wages. (i) All laborers and mechanics employed or working upon the site of the work ...will be paid unconditionally and not less often than once a week, and without subsequent deduction or rebate on any account ... the full amount of wages and bona fide fringe benefits (or cash equivalents thereof) due at time of payment computed at rates not less than those contained in the wage determination of the Secretary of Labor which is attached hereto and made a part hereof, regardless of any contractual relationship which may be alleged to exist between the contractor and such laborers and mechanics....

29 CFR 3.3(b) states,in part:

Each contractor or subcontractor engaged in the construction, prosecution, completion, or repair of any public building or public work, or building or work financed in whole or in part by loans or grants from the United States, shall furnish each week a statement with respect to the wages paid each of its employees engaged on work covered by this part 3 and part 5 of this chapter during the preceding weekly payroll period.

32 CFR 25.510(b) states:

Certification by participants in lower tier covered transactions. (1) Each participant shall require participants in lower tier covered transactions to include the certification in appendix B [*not included in this finding*] to this part for it and its principals in any proposal submitted in connection with such lower tier covered transactions.

02-24 The Department of Social and Health Services, Economic Services Administration, did not comply with federal cost principles for charging terminal leave payments.

Description of Condition

In February 2002, the U.S Department of Health and Human Services (HHS) informed the state of Washington that its practice of treating terminal leave as a direct cost was not in compliance with federal cost principles. Terminal leave payments are lump-sum payments of unused sick and annual leave to employees upon their separation from state service. Federal regulations require these payments to be allocated as a general administrative expense to all activities of the governmental unit, rather than being charged as a direct cost to a particular federal award.

During our audit of the Washington State Department of Social and Health Services, we found payments of terminal leave were charged directly to the federal Child Care and Development Fund (CFDA 93.575).

Cause of Condition

The Department was aware it needed to adjust its current policy of charging terminal leave to comply with federal requirements, but was unable to revise its policy during our audit period and it did not adjust its expenditures charged to the federal grant to correct this error for state fiscal year 2002.

Effect of Condition

We are questioning \$37,673 of terminal leave paid to childcare licensors and Department headquarters policy staff. These payments were charged directly to the Childcare and Development Fund, which is unallowable.

Recommendation

We agree with the federal grantor's recommendation that the Department change its current policy to comply with the federal requirements.

Department's Response

The Department concurs with this finding.

As of the end of fiscal year 2002, the division had not completed its corrective action to ensure compliance with the federal requirements. Since then, necessary steps have been taken and implemented to ensure that fiscal year 2003 is in compliance. With regard to the questioned costs in the amount of \$37,673, the division will reallocate the terminal leave payments according to the required methodology.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding. We also appreciate the cooperation extended to us throughout the audit by Department staff. We will review the status of corrective action during our next audit.

Applicable Laws and Regulations

U.S. Office of Management and Budget (OMB) Circular A-87, Attachment B, Paragraph 11(d)(3) states:

Payments for unused leave when an employee retires or terminates employment are allowable in the year of payment provided they are allocated as a general administrative expense to all activities of the governmental unit or component.

Follow-Up to FY 2001 Statewide Audit Areas

During our last audit period, we examined three areas on a statewide basis. Following is a discussion of the results of those audits, the overall recommendations we made at that time, and the current status of those recommendations.

Claims and Benefits

The results of our fiscal year 2001 audit work found the state lacks a centralized process to determine whether individuals are eligible for benefits or whether they are receiving benefits through some programs that would make them ineligible for others. The audit also found that individuals are not always required to provide information, such as personal identification numbers, that would assist in determining eligibility.

We provided the following recommendations:

- The state should develop a centralized process to determine if individuals are eligible to receive benefits and to cross match income data to other state agency benefit payment systems. This could include creating a single identification number for each individual receiving benefits that can be cross-matched to state records and to data files of the Internal Revenue Service and border states.
- The state should revise the laws so that individuals will be required to provide information that will allow their income to be verified.

For our audit of Fiscal Year 2002, we again included claims and benefits as a statewide area. As can be seen in the details of our findings, our concerns were reaffirmed during our audits last year. We have restated our recommendations.

Imaging

In our previous audit, we found weaknesses in the process of making and storing electronic images to replace original paper documents. These weaknesses included inappropriate access to the copied data; inadequate controls over completeness and validity of the data; lack of offsite storage; inadequate physical security over data; and noncompliance with state law (RCW 40.14.060) regarding obtaining proper approval of electronic copying procedures before destruction of paper documents.

We recommended:

- A legal review be performed of the laws and requirements on the retention of public records to ensure state agencies are not violating state law when developing and using electronic copying systems.
- The State Record Committee modify the General Records Retention Schedule to more clearly communicate the responsibilities of state agencies when destroying paper copies of documents copied electronically.

We did not specifically include imaging as a statewide issue this year. However, during the course of our regular audit work, we have continued to find many of the same types of weaknesses as those we identified last year. We reaffirm our previous recommendations.

Internal Audits

State law RCW 43.88.160(4) requires each agency to have an internal audit function to safeguard agency assets, check the accuracy and reliability of accounting data, promote operational efficiency and encourage adherence to agency policies and procedures. During fiscal year 2001, we surveyed 160 state agencies and higher education institutions to determine which agencies have internal audit programs. Only 70 of the agencies responded and of those agencies that responded, only 21 stated that they have an internal auditor program; eight of the remaining 49 stated they have internal auditing committees or boards that perform some internal audit functions. Some agencies stated they lacked funding for an internal auditor.

We recommended that either adequate funding be provided to allow agencies to come into compliance or the state law requiring an internal audit function be modified.

We did not specifically include internal audits as a statewide issue this year but will return to the subject in a future audit period.

State Employees Combined Fund Drive Local Account

We do not audit the State Employees Combined Fund Drive Account, which is managed by the Department of Personnel. This account contains money that state employees designate for specific charities. It comes from state employees' voluntary payroll deductions and some direct donations and is distributed to the charities by the Department.

Although state employees operate this fund as part of their job responsibilities and the fund is included in the state's financial statements, we have received legal advice that it is not a public fund subject to audit by our Office. The Department again reported to us that the Legislature has made no provisions requiring an audit of this fund. As a result, this fund has not been audited since its inception in 1985. Approximately \$51 million has flowed through the fund since it began.

We reaffirm our previous recommendation that the Legislature decide who should audit the State Employee Combined Fund Drive Account and direct that the audit take place. This audit should examine whether proper internal control procedures are in place to ensure accountability over public money and whether all contributions are going to the charities designated. It also should include any other procedures deemed necessary by the auditor.

Schedule of Findings Reported in Previous Statewide Accountability Reports

Finding Number	Finding Caption	Status
2001		
01-01	The Washington State Health Care Authority does not have adequate policies and procedures to ensure that all who are receiving health insurance subsidies are eligible to do so.	Partially resolved. Fiscal year 2002 finding.
01-02	Internal controls over child support checks returned to the Department of Social and Health Services, Division of Child Support, Cash Management Office are inadequate and do not provide proper safeguards.	Resolved.
01-03	The Department of Social and Health Services, Division of Vocational Rehabilitation, does not have adequate internal controls over the processing of expenditures for client services.	Unresolved. Fiscal year 2002 finding.
01-04	The Department of Social and Health Services does not have sufficient internal controls over drugs in the pharmacies at Western State Hospital to prevent and/or detect misappropriation or loss.	Partially resolved. Fiscal year 2002 finding.
01-05	The Department of Labor and Industries has not established adequate internal control over employer accounts.	Resolved.
01-06	The Washington State Historical Society has not established adequate internal controls over cash receipting.	This is a two-year audit and was not audited during fiscal year 2002.
01-07	The Washington State Historical Society has not completed an inventory of historical artifacts.	This is a two-year audit and was not audited during fiscal year 2002.
01-08	The Washington Horse Racing Commission did not collect satellite fees totaling \$954,600 from its licensees during calendar years 1999, 2000 and 2001.	This is a two-year audit and was not audited during fiscal year 2002.
01-09	The Washington Horse Racing Commission held a meeting that did not comply with the Open Public Meetings Act.	This is a two-year audit and was not audited during fiscal year 2002.
01-10	The Department of Transportation's Washington State Ferries Division does not have adequate controls over sales and revenue collection.	Unresolved. Fiscal year 2002 finding.
01-11	Some restricted funds administered by the Department of Natural	Partially

Finding Number	Finding Caption	Status
	Resources were charged more than their share of overhead costs.	resolved. Fiscal year 2002 finding.
01-12	The Liquor Control Board does not have adequate internal controls over revenue collected in its state liquor stores.	Resolved.
01-13	The Vancouver Regional Office of the Department of Fish and Wildlife does not have adequate controls over cash receipts.	Resolved.
2000		
00-5	The Department of Personnel has not established effective internal control policies and procedures.	Resolved.
00-9	The Office of the Superintendent of Public Instruction (OSPI) does not have adequate internal controls over receivables.	Resolved.
00-10	The Office of the Superintendent of Public Instruction did not comply with state laws and regulations requiring control over fixed assets.	Resolved.
00-17	The Washington State Patrol does not have adequate controls over cash receipts.	Resolved.
00-20	The Board of Volunteer Firefighters and Reserve Officers employee was beneficially interested and participated in a contract between the Board and the employee's spouse, which is a conflict of interest.	Resolved.
00-21	The Board of Volunteer Firefighters and Reserve Officers does not have adequate controls over its cash receipting and pension system database.	Resolved.

Schedule of Findings Reported in Previous State of Washington Single Audit Reports

Finding Number	Finding Caption	CFDA Number	Status
2001			
01-01	Western Washington University did not comply with federal regulations regarding the use of federal program income from four U.S. Department of Education Grants.	84.264A, 84.264B 84.315C, 84.129T	Resolved.
01-02	Public Funds were misappropriated and payroll documents falsified at the University of Washington's Diabetes Endocrinology Research Center.	93.847	Resolved.
01-03	The Department of Community, Trade and Economic Development did not submit accurate federal financial reports for the STOP Violence Against Women Program.	16.588	Resolved.
01-04	The Employment Security Department did not comply with regulations for allowable and allocable costs for six of its federal programs.	17.002, 17.207 17.225, 17.245 17.255, 17.257	Partially resolved. Fiscal year 2002 finding.
01-05	The Employment Security Department is not complying with client eligibility requirements for the Unemployment Insurance Program.	17.225	Resolved.
01-06	The Employment Security Department did not comply with cash management regulations for three federal programs.	17.207, 17.225 17.245	Resolved.
01-07	The Employment Security Department did not comply with performance reporting requirements for the Trade Adjustment Assistance program.	17.245	Resolved.
01-08	The Department of Health has not established adequate internal controls over eligibility for the Special Supplemental Nutrition Program for Women, Infants, and Children to ensure compliance with program requirements.	10.557	Resolved.
01-09	The Department of Health did not comply with special provisions regarding duplicate and dual payments for the Special Supplemental Nutrition Program for Women, Infants, and Children.	10.557	Resolved.
01-10	The Department of Health did not comply with special regulations regarding management evaluations of its subrecipients for the Special Supplemental Nutrition Program for Women, Infants, and Children.	10.557	Resolved.
01-11	The Department of Health overstated expenditures on the Schedule of Expenditures of Federal Awards for the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC).	10.557	Resolved.
01-12	The Department of Social and Health Services' Medical Assistance Administration (MAA) has not established sufficient internal controls to ensure compliance with Medicaid provisions regarding licensing and other	93.778	Partially resolved. Fiscal year 2002 finding.

Finding Number	Finding Caption	CFDA Number	Status
	eligibility criteria for its health care providers.		
01-13	The Department of Social and Health Services' Medical Assistance Administration (MAA) has not established sufficient internal controls to ensure compliance with Medicaid provisions regarding recipient eligibility for health care services.	93.778	Partially resolved. Fiscal year 2002 finding.
01-14	The Department of Social and Health Services' Division of Alcohol and Substance Abuse (DASA) has not established sufficient internal controls over the federal Substance Abuse Prevention and Treatment Block Grant to ensure compliance with program requirements.	93.959	Resolved.
01-15	The Department of Social and Health Services' Division of Child Support did not comply with regulations for allowable and allocable costs in the Child Support Enforcement program.	93.563	Partially resolved. Fiscal year 2002 finding.
01-16	The Department of Social and Health Services' Vocational Rehabilitation Program did not comply with federal regulations regarding client eligibility and allowable costs.	84.126	Resolved.
01-17	Programs within the Departments of Social and Health Services and Ecology - The State of Washington is not complying with subrecipient monitoring requirements for some of the federal programs it administers.	66.458, 66.605 93.563, 93.778	Resolved.
01-18	Programs within the Departments of Community, Trade and Economic Development, Ecology, Fish and Wildlife and Social and Health Services - The State of Washington is not complying with suspension and debarment requirements for some of the federal programs it administers.	15.608, 66.458 81.042, 93.563 93.566, 93.658 93.778	Resolved.
01-19	Seven of the state's colleges and universities are not complying with federal law for the return of student financial aid. - Washington State University (all other schools completed corrective actions as described in the FY 2001 State of Washington Corrective Action Plan)	84.007, 84.032 84.038, 84.063 84.268	Resolved.
2000			
00-1	Department of Social and Health Services Division of Alcohol and Substance Abuse (DASA) has not established sufficient internal controls over the federal Substance Abuse Prevention and Treatment Block Grant to ensure compliance with program requirements.	93.959	Resolved.
00-2	Department of Social and Health Services - Division of Child Support (DCS) did not comply with regulations for allowable and allocable costs in the Child Support Enforcement program.	93.563	Partially resolved. Fiscal year 2002 finding.
00-3	Department of Social and Health Services - Division of Child Support (DCS) did not report its total federal Child Support Enforcement program expenditures for the State of Washington Schedule of Expenditures of Federal Awards.	93.563	Resolved.
00-4	Department of Social and Health Services - DSHS does	93.596	Unresolved.

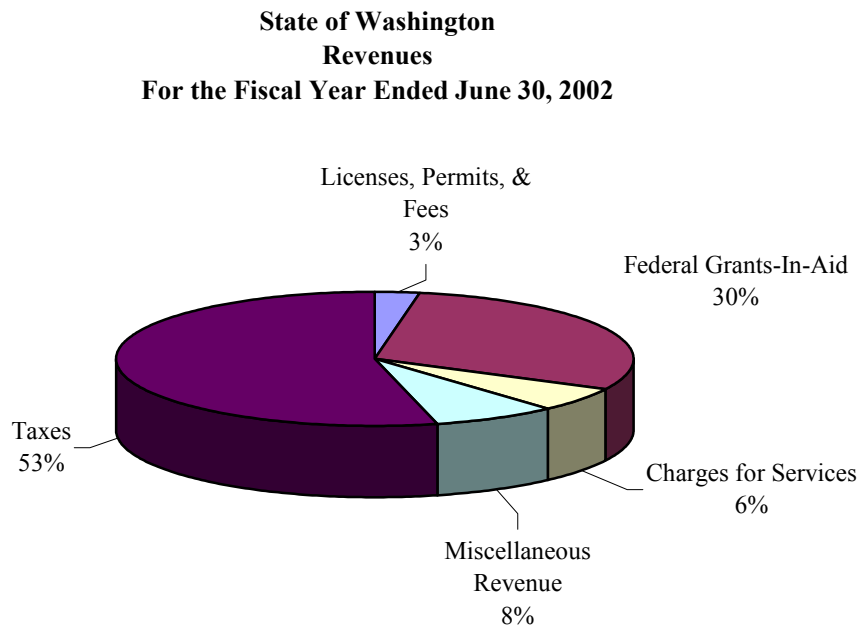
Finding Number	Finding Caption	CFDA Number	Status
	not have adequate controls in place to prevent overpayments of Child Care program expenditures.		Repeat finding in fiscal year 2002.
00-6	Employment Security Department did not comply with regulations for allowable and allocable costs for the Unemployment Insurance, Wagner-Peyser and WorkFirst programs.	17.207, 17.225 93.558	Unresolved for CFDA No. 17.225. Repeat finding in fiscal year 2002. 17.207 and 93.558 resolved.
00-10	Peninsula College charged unallowable costs to a federal program.	17.207, 17.225 93.558	Resolved.
00-12	Programs within the Departments of Ecology and Social and Health Services - The State of Washington is not complying with subrecipient monitoring requirements for some of the federal programs it administers.	66.001, 66.458 93.563, 93.778 93.959	Resolved.

State of Washington Statistical Information

The State Auditor's Office uses statistical information in planning our audits of the state of Washington. The analysis may include a review of revenues for unusual or unexpected fluctuations or to identify a new revenue source. Analytical procedures also may include a review of expenditures to identify unusual or significant increases in program expenditures or to determine if there are payments to vendors, providers or contractors that could be questionable.

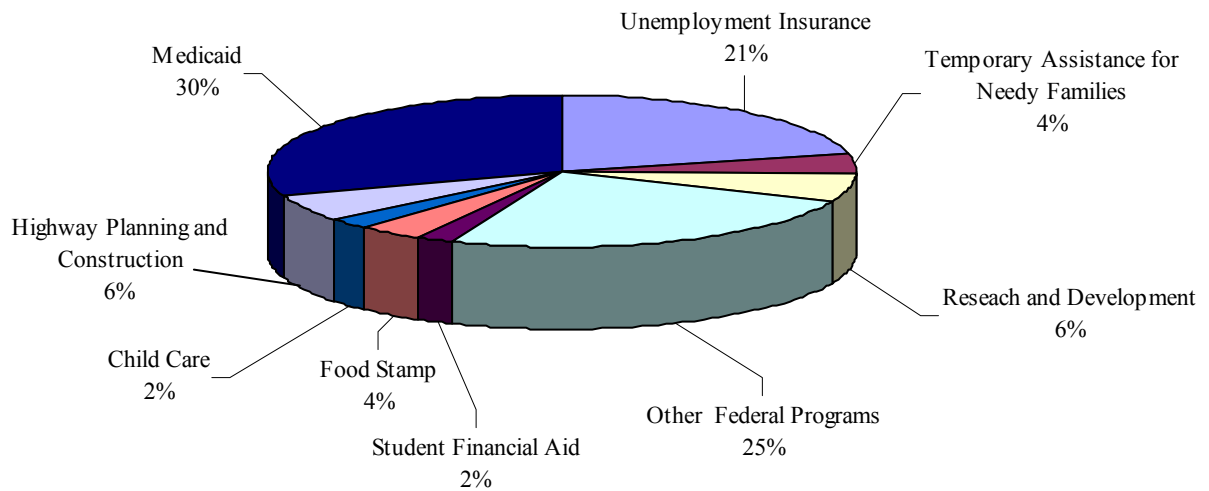
The following provides summary information on the revenues, federal dollars received and expenditures the state incurs as well as on audit costs in relation to total expenditures.

Revenues – The state of Washington's revenues for all government funds (the largest group of funds the state has established) totaled \$22,059,240,265 for fiscal year 2002. As shown below, those revenues included taxes, charges for services and federal grants. The majority of the revenue is generated by taxes. The main tax sources are retail sales tax, business and occupation taxes, property taxes and motor fuel taxes. Our approach is to focus on those revenues subject to risk of fraud or noncompliance with state law. We review the internal controls and processes to ensure that the money collected is deposited.



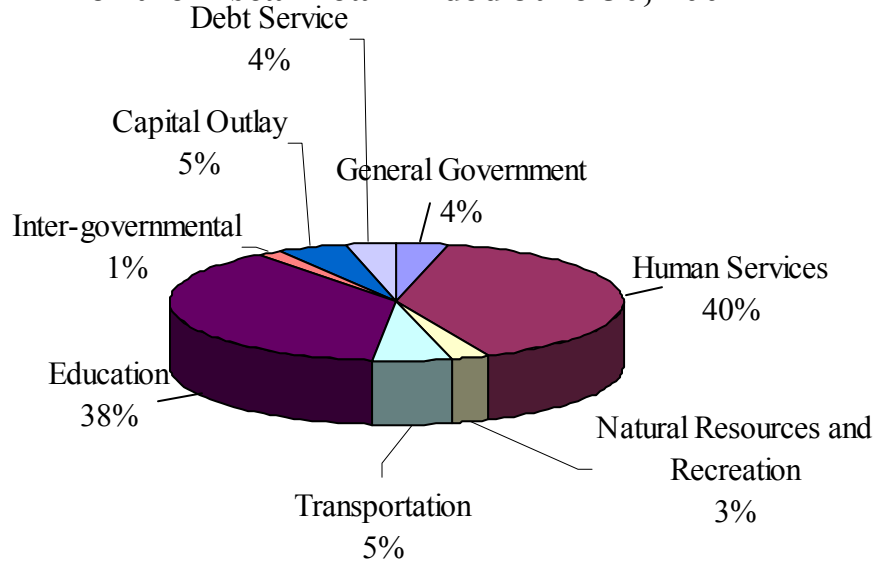
Federal Funding – The state of Washington received \$9.2 billion in federal money in fiscal year 2002, with \$2.8 billion of it going to the Medicaid program to provide health care for the state's low-income residents. The state is required to match the Medicaid program with state funds. Other major federal programs include student financial aid, highway planning and construction, and unemployment insurance. We audit these funds under special requirements of the federal government and the results are reported in our State of Washington Single Audit Report.

**State of Washington
Federal Funding
For the Fiscal Year Ended June 30, 2002**



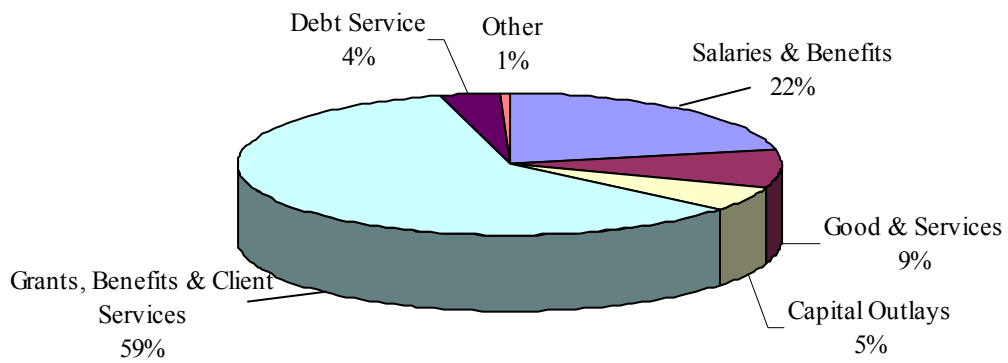
Expenditures – For the fiscal year, expenditures for the state of Washington totaled \$23.5 billion for all governmental fund types. Forty percent of the dollars are spent for human services, 38 percent on education and the remaining 22 percent in other areas.

**State of Washington
Expenditures
For the Fiscal Year Ended June 30, 2002**



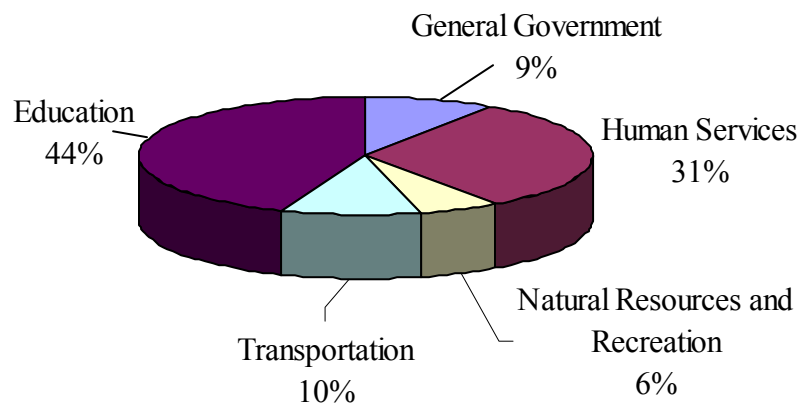
Expenditures by Object – Fifty-nine percent of expenditures for the fiscal year ended June 30, 2002 was for grants, benefits, and client services, including K-12 basic education grants. Twenty-two percent was for salaries and benefits and nine percent for goods and services. The remaining 10 percent was spent on other miscellaneous expenses.

**State of Washington
Expenditures by Object
For the Fiscal Year Ended June 30, 2002**



State Employees – The number of state employees is measured in a unit known as an FTE, which is the equivalent of one full calendar year of paid employment to one person. A FTE is not the number of employees on the payroll, nor is it the number of positions in state government. In analyzing the 106,333 FTEs employed by state agencies, 75 percent are in education and human services areas. The remaining 25 percent are in general government, natural resources and recreation, and transportation.

**State of Washington
FTE's
For the Fiscal Year Ended June 30, 2002**



Audit Costs – Over the past five years, our audit costs have increased \$1,026,173, while state expenditures have increased \$9 billion. The audit cost as a percentage of expenditures continues to decrease. The State Auditor’s Office continues to find more efficient ways to audit.

	1997	2002	Change	Change in \$
Number of state audits completed	113	96	-17	
Total state expenditures subject to audit	\$24,397,663,566	\$33,498,499,813	37%	\$9,100,836,247
Total state audit costs	\$6,076,404	\$7,102,577	17%	\$1,026,173
Audit costs as a percentage of expenditures	0.025%	0.021%	-0.004%	

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