

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

1. The Agency lacks adequate controls to safeguard and account for its capitalized and small-and-attractive assets.

Background

At the end of fiscal year 2013, the Agency had reported a \$215,374 balance in capitalized furniture and equipment. There were no recorded fixed asset additions or deletions in the Agency Financial Reporting System (AFRS) for the fiscal period. The Agency estimated it had not performed an inventory of capitalized or small-and-attractive assets since 2008.

Description of Condition

We found internal controls over property accountability were inadequate or nonexistent for capitalized fixed assets and small-and-attractive assets.

Capitalized Assets

We found the Agency:

- Has no written policies or procedures on recording, adjusting or inventorying capitalized assets
- Does not adequately monitor or inventory capitalized assets
- Does not record transactions in required general ledger accounts to properly record the value or depreciation of technology-based capital assets
- Does not record capital assets in an approved capital asset inventory system that includes records for all assets that can be inventoried
- Does not adequately compare to a record of inventory its capital assets with a unit cost of \$5,000 or greater, or collections with a total cost of \$5,000 or greater

Although we didn't perform a complete test of capitalized assets, we identified five capital assets valued at greater than \$5,000 that were not recorded in the accounting system. These assets consisted of four large computer servers acquired from another state agency valued at about \$7,000 each and a Cisco Unified Communications System that was part of an asset collection that exceeded the \$5,000 threshold. Agency personnel confirmed assets were not recorded in the Capital Asset Management System or an alternative in-house inventory system. Using an alternative system would require written approval by the Office of Financial Management and the Office of the Chief Information Officer.

Small-and-Attractive Assets

Small-and-attractive assets valued at \$300 or more should be recorded on the property records of an agency as inventoriable assets. We found the Agency:

- Has no written policies or procedures for identifying and controlling small-and-attractive assets
- Has no risk assessment (both financial and operational) to identify those assets that are particularly at risk or vulnerable to loss
- Has inadequate procedures in place for assigning inventory ID tags to assets identified by Agency personnel
- Does not monitor or inventory small-and-attractive assets
- Does not track small-and-attractive assets purchased through the purchase card program

We judgmentally selected for review seven assets recorded on the inventory log, totaling \$5,700, and found all assets had assigned property ID tags. We also judgmentally selected eight assets acquired with employee purchase cards, and found six assets (75 percent) did not have property ID tags.

Items found on the inventory log did not always have values or dates the asset was acquired. Agency personnel confirmed that not all of its desktop computers, notebook computers, smart phones, and scanners were accounted for on the existing inventory log.

The Agency employs 34 staff but had 27 active laptops in addition to the 69 desktop computers maintained at various museum locations. Many of the items had been purchased a number of years earlier and had low or no depreciated value. Other items, however, had been purchased less than one year before our review.

We found no compensating controls that reduce the risk associated with the internal control weaknesses identified above.

Cause of Condition

The Agency reduced personnel and underwent high staff turnover in the 2012-2013 biennium. Administrative staff outside of fiscal operations performed duties such as managing the purchase card program, identifying accountable assets, and issuing property ID tags for assets identified by Agency personnel. Tasks in the fiscal office included: establishing ACH payments to the credit card vendor, coding purchases, and appropriately recording assets. These issues contributed to the inadequate control environment.

In addition, management and employees were unaware of state regulatory requirements for both capitalized and small-and-attractive assets. The Agency does not require department heads to certify inventory. Fiscal and purchase card administrators do not monitor expenditures for capital and small-and-attractive assets.

Effect of Condition

Without adequate internal controls to ensure proper safeguarding, assets are at risk and vulnerable to misappropriation, misuse or loss, which would not be detected in a timely manner, if at all. Financial information is also inaccurately recorded for capitalized assets.

Recommendation

We recommend the Agency implement or strengthen internal controls in its property accountability operations, as follows:

- Develop written policies and procedures that describe how capital and small-and-attractive assets will be managed
- Perform a risk assessment to identify and minimize risks associated with the purchase and control of small-and-attractive assets
- Promptly post transactions affecting capitalized assets to AFRS and an approved capital asset inventory system
- Record current and prior acquisitions of small-and-attractive assets made on purchase cards in the inventory log
- Segregate duties for purchasing, approving and entering asset information in the system
- Perform timely inventories of capital and small-and-attractive assets at least every other fiscal year
- Ensure Agency management reviews and certifies the completed physical inventory
- Train inventory coordinators on inventory policies and procedures; key personnel should be aware of state regulations governing their fiscal responsibilities for asset accountability.

Agency's Response

Our agency concurs with the findings. We have updated our internal policy to meet the auditor's recommendation and have appointed inventory coordinators by realigning their responsibilities to manage fixed assets using the state Capital Asset Management System. An inventory of the Washington State History Museum facility has been nearly completed and

we will be proceeding to inventory the Research Center and State Capital Museum facilities shortly.

The main causes for this finding are twofold. First, our agency has faced a significant reduction in fiscal staffing due to the state fiscal crisis. We have two fiscal staff, while many internal controls require three or more staff to carry out. Second, during the period audited, our agency was actively implementing two new financial management systems. Policies and procedures were being created, tested, and revised during the period audited.

Auditor's Remarks

We appreciate the Agency's commitment to resolve these issues. We wish to thank the Agency's staff and management for their cooperation and assistance during our audit. We look forward to working with the Agency on this issue and will follow up on it during the next audit.

Applicable Laws and Regulations

The State of Washington Office of Financial Management's *State Administrative and Accounting Manual (SAAM)*, **Section 20.15.30.c**, states:

Agency management at all levels is responsible for internal control under their span of control. Management should make it clear that agency staff have explicit or implicit control activity duties including: delivery of services to the public; producing information for the management control system; maintaining financial information; and inspecting or maintaining physical assets. In addition, agency management should provide channels outside normal reporting lines so agency staff can report problems in operations, noncompliance with codes of conduct, violations of policy, and illegal acts.

Management is also responsible to convey the importance of internal controls to all personnel both by what they say and what they do. If management is willing to override controls, then the message that controls are not important will be conveyed to employees.

Section 30.45.10.a of the SAAM states:

Conduct physical inventories at least once every other fiscal year for all inventoriable assets except as noted below.

Section 30.40.20 of the SAAM states in part:

The agency should implement specific measures to control small and attractive assets in order to minimize identified risks. Periodically, the agency should perform a follow up risk assessment to determine if the additional controls implemented are effective in managing the identified risks.

Section 30.40.45 of the SAAM states in part:

After the physical inventory count is completed, the agency inventory officer is to conduct the reconciliation process. When all differences have been identified and explained, the inventory is considered reconciled (Refer to Subsection 85.60.60).

After the inventory is reconciled, the agency inventory officer is to certify the reconciliation with a statement and signature that it is correct and report this to the supervisor. If the certification cannot be made, the inventory officer is to disclose that fact and the supervisor is to determine the appropriate course of action.

Section 30.40.30 of the SAAM states in part:

Agencies are to maintain a capital asset inventory system that includes records for all inventoriable assets.

Agencies are to use the Capital Asset Management System (CAMS) for all assets that meet the state's capitalization policy. Agencies may use an alternate in-house system provided written approval from the Office of Financial Management, Office of the Chief Information Officer (OCIO) is obtained prior to initiating acquisition or development of the system.

For assets defined as small and attractive, agencies may use either CAMS or an alternate in-house system without OCIO approval.

Section 30.20.95 of the SAAM states:

Agencies are to reconcile the balance in GL Code Series 2XXX "Capital Assets" to the balance of the detail listing of capital assets in the agency's authorized capital asset management system. Agencies using the state's Capital Asset Management System (CAMS) have available capital asset reports for both cost and depreciation showing beginning balances, additions, deletions, and ending balances. Agencies not using CAMS are to develop similar capital asset reports.

Section 85.60.97a of the SAAM states in part:

Assets transferred between state agencies - When a capital asset is transferred from one agency to another, the receiving agency is to record the asset at the carrying value of the transferring agency.

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

2. The Agency lacks adequate internal controls over disbursements of local funds, including purchase card and procurement expenditures.

Background

During fiscal year 2013, the Agency reported approximately \$789,682 in local fund expenditures for personal service contracts, goods and services, travel, capital outlays, and other grants and benefits. The Agency has 24 purchase cards and used those cards for approximately \$150,000 in purchases during the audit period.

Description of Condition

We found ineffective or nonexistent controls in the Agency's use of purchase cards, procurement and vendor payments.

Purchase Cards

We reviewed the Agency's controls over the use of state-issued purchase cards. Department heads were allowed to request and purchase items as long as the amount did not exceed their budget or credit card limit. This environment resulted in the use of local funds to purchase small business software, an Amazon prime membership, and disproportionate IT purchases, including hard drives, laptops, iPads and cellular phones. Agency staff split purchases exceeding transaction limits; they also used state owned phones and iPads on their personal cellular plans. The Agency Purchase Card Program:

- Has no written policies or procedures for the purchase card program
- Does not have a complete list of cardholders compared to the card custodian, US Bank
- Does not periodically review and reduce card limits based on requirements
- Does not require separation of duties between the requester and approver
- Does not question the legitimacy of purchases for business purposes
- Does not require all supporting documentation for each transaction
- Does not prohibit splitting purchases to circumvent daily or monthly limits

We judgmentally selected for review 48 purchase card transactions, totaling \$24,996, and found:

- Thirty-nine purchase transactions (81 percent), totaling \$22,205, were not pre-approved
- Thirty-six purchase transactions (75 percent), totaling \$21,815, were requested and approved by the same individual
- Seventeen transactions, totaling \$1,363, were food purchases not supported by documentation in compliance with SAAM 70.15

We found no compensating controls that would reduce the risks associated with the internal control weaknesses identified above.

Procurement and Vendor Payments

The Agency had insufficient internal controls over the procurement process: it had no written policies or procedures for initiating procurements, monitoring performance or making contract payments. The Agency did not maintain adequate documentation of competitive procurement processes in accordance with superseded and current OFM guidance.

We reviewed payments made to three vendors that were considered high-risk based on amounts paid in the audit period. We found the Agency:

- Paid a vendor \$79,142 for IT services in fiscal year 2013. In 2005, an IT services contract was sent out to bid and unofficially awarded to this vendor without sufficient documentation. The vendor was paid \$466,746 from September 2007 through December 2013. Records supporting the amounts paid to this vendor between 2005 and August 2007 were not available. The Agency continues to pay this vendor for IT services without a formal contract.
- Entered into two contracts with a vendor for website design, maintenance and marketing. The vendor was paid \$36,712 in fiscal year 2013. Of this amount, \$23,175 was paid for services performed outside the contracted timeframe, without a formal contract amendment.

Cause of Condition

The Agency reduced personnel and underwent high staff turnover in the 2012-2013 biennium. Affected staff contributed to the Agency fiscal operation by performing duties such as managing the purchase card program and reconciling source documentation to financial systems. These issues contributed to the inadequate control environment. In addition, management and fiscal employees were unaware of state regulatory requirements.

Effect of Condition

There is no reasonable assurance that the Agency's financial information accurately states its financial condition. Without adequate internal controls to ensure disbursements are properly

maintained or supervised, public funds are at risk for misappropriation, misuse or loss that would not be detected in a timely manner, if at all.

Recommendation

We recommend the Agency implement or strengthen internal controls in its financial operations by developing written policies and procedures to incorporate the following:

Purchase Cards

- Implement specific policies and procedures that establish guidelines as required by state regulations, and incorporate controls to monitor expenditures
- Monitor purchase card holders and daily/monthly limits periodically
- Ensure all purchases are pre-approved, prior to payment
- Ensure purchase requests and approvals are segregated duties
- Maintain adequate documentation to support disbursements
- Prohibit split purchases to circumvent daily or monthly limits

Procurement and Vendor Payments

- Implement specific policies and procedures for initiating procurements, monitoring performance, and making payments on contracts
- Enter into formal written contracts
- Maintain contract documentation on file for the duration of the contract plus state retention requirements
- Match contract requirements to invoices before making payments to vendors.
- Monitor contract performance
- Review contract limitations for budgeted contract amounts
- Amend contracts to extend the terms of goods or services in a timely manner

Agency's Response

Our agency concurs with the finding on purchase card usage and procurement process. The agency has adopted a new purchase card policy, reduced the number of cards issued by nearly 50%, and established a more stringent internal controls process. The agency initiated contract and procurement training in August 2013 which was required for all contract

managers. The agency will evaluate ways to continue to improve contracting and procurement procedures.

The main causes for this finding are twofold. First, our agency has faced a significant reduction in fiscal staffing due to the state fiscal crisis. We have two fiscal staff, while many internal controls require three or more staff to carry out. Second, during the period audited, our agency was actively implementing two new financial management systems. Policies and procedures were being created, tested, and revised during the period audited.

Auditor's Remarks

We appreciate the Agency's commitment to resolve these issues. We wish to thank the Agency's staff and management for their cooperation and assistance during our audit. We look forward to working with the Agency on this issue and will follow up on it during the next audit.

Applicable Laws and Regulations

Overall

The State of Washington Office of Financial Management's *State Administrative and Account Manual*:

SAAM Section 20.15.20 defines internal controls as "a process, not one event, but a series of ongoing actions and activities that occur throughout each agency's operations".

SAAM, Section 20.25.30.a states in part:

An agency should establish control activities that are effective and efficient. Controls that should be considered by the agency include, but are not limited to:

- Authorization - to provide reasonable assurance that all transactions are within the limits set by policy or that exceptions to policy have been granted by the appropriate officials.
- Physical Security over Assets - to provide reasonable assurance that assets are safeguarded and protected from loss or damage due to accident, natural disaster, negligence or intentional acts of fraud, theft or abuse.
- Segregation of duties - to reduce the risk of error and fraud by requiring that more than one person is involved in completing a particular fiscal process.

- Review and approval – Control activities in this category are designed to provide reasonable assurance that transactions have been reviewed for accuracy and completeness by appropriate personnel.
- Verification – Control activities in this category include a variety of computer and manual controls designed to provide reasonable assurance that all accounting information has been correctly captured.
- Reconciliation– Control activities in this category are designed to provide reasonable assurance of the accuracy of financial records through the periodic comparison of source documents to data recorded in accounting information systems.
- Education, training and coaching– Control activities in this category reduce the risk of error and inefficiency in operations by ensuring that personnel have the proper education and training to perform their duties effectively. Education and training programs should be periodically reviewed and updated to conform to any changes in the agency environment or fiscal processing procedures.”

Purchase Cards

SAAM Section 70.10.10 states, “An agency may not provide coffee and light refreshments at meetings and formal training sessions unless the agency has formally adopted written internal policies and procedures that describe the approval process for these items.”

SAAM Section 70.10.20a states, “Per RCW 43.03.050(4), with approval of an agency head or authorized designee, an agency may serve coffee or light refreshments at a meeting where:

- The purpose of the meeting is to conduct state business or to provide formal training that benefits the state; and
- The coffee or light refreshment is an integral part of the meeting or training session; and
- The agency obtains a receipt for the actual costs of the coffee and/or light refreshments.

SAAM Section 70.15.10a states in part, “RCW 43.03.050(3) provides for reimbursement for meals, for certain business meetings (includes conferences, conventions, and formal training sessions) involving elective and appointive officials, and state employees.”

SAAM Section 70.15.30 requires that, “Agencies must document the request and approval in advance for expenditures for meals with meetings. Agencies may use a Travel Authorization (form A40-A) or agency equivalent form, an Invoice Voucher (form A19-1A), or a formally

written agency memorandum for this purpose. The documentation should provide support for the authorization, including:

- The names of the state organizations or persons attending the meeting (includes conferences, conventions, and formal training sessions), and
- The purpose or accomplishments of the meeting.”

SAAM Section 45.10.70c states that “the Agency program administrator is the person responsible for management and oversight of the purchase card program within the agency, and is responsible for the following:

- Managing the purchase card program within the agency.
- Developing and enforcing agency policies and procedures for using the purchase card, including disciplinary procedures related to unauthorized use of cards and card renewal procedures. The agency policies and procedures should meet the minimum requirements of the statewide policies and procedures contained in this chapter. State ethics laws should also be considered when developing agency policies.
- Establishing and maintaining the purchase card reporting structure/hierarchy for the agency and ensuring proper separation of duties. For example, a card user may not be the reviewer or approving official for their own transactions.
- Reviewing purchase card applications and determining who within the agency should receive a card. For agencies utilizing department cards, this also includes designating card custodians.
- Ensuring that a card user agreement form has been signed by both the card user and appropriate approving official before issuing the card, and maintaining copies of the signed agreements in the agency’s files.
- Maintaining a list of current cardholders, card custodians, and designated card users that are authorized to use cards.
- Obtaining cards from the issuing bank and distributing new and reissued cards to agency employees.
- Providing training to approving officials, cardholders, card custodians, and designated card users in the management, security, and use of the card.
- Reviewing the agency purchase card program at least annually to ensure that proper procedures are being followed.

- Ensuring card users satisfy documentation requirements for purchases.
- Closing card accounts as necessary, and collecting and destroying cards upon employee reassignment or termination.”

SAAM Section 45.10.70d states in part “The approving official is assigned to monitor, review, and approve card transactions to ensure compliance with purchase card policies and procedures, and is responsible for the following:

- Establishing authorization controls for each card, which includes limits on the types of purchases, dollar limit per transaction, billing cycle purchase limit, etc.
- Ensuring timely reconciliation of card statements, including ensuring that supporting documentation is attached.
- Monitoring card activity for unusual patterns of use or unacceptable transactions, and taking appropriate disciplinary measures with card users who misuse their purchase card.”

SAAM Section 45.10.50 states in part “Unacceptable uses include, but are not limited to:

- Splitting purchases to circumvent the daily or monthly purchase limits on a card, or to avoid competitive bidding limits or purchasing authority limits.”
- Purchases from any merchant, product, or service normally considered to be inappropriate use of state funds, including, but not limited to: Items for personal use.”

Procurement and Vendor Payments

SAAM Section 15.10.45a states, “All contracted personal services, regardless of dollar amount, require a written document specifying the agreement between the agency and the contractor. Required elements in a personal service contract are identification of the parties, scope of services, maximum compensation, payment mechanism, period of performance, and signatures of responsible parties. Numerous other terms are often included in contract documents to provide additional legal protection to the State.”

SAAM Section 15.20.40, states in part that, “Agencies are responsible to maintain adequate documentation of the competitive process to substantiate that all bidders were treated equally and fairly and that an equitable and impartial competition was conducted.

This version of Chapter 15 was superseded effective July 1, 2007 but the requirements of a written contract and documentation of the competitive process remained the same throughout all versions. The current authority over the procedures is Department of Enterprise Services (DES) and the revised SAAM reads as follows:

SAAM Section 16.20.15a requires a written contract. All client service contracts, regardless of dollar amount, require a written document specifying the agreement between the agency and the contractor.

Required elements in a client service contract are:

- Identification of all parties to the contract;
- Scope of services that clearly describes the responsibilities and obligations of the parties including for performance-based contracts, deliverables, performance measures or outcomes;
- Maximum compensation, when applicable;
- Period of performance; including start and end dates or a statement, for example, that the end date is two years from the start date;
- Payment mechanism that describes the basis on which the contractor will be paid for services whether an hourly/daily/weekly/monthly rate, by deliverable, completion of a project phase or milestone, achievement of a performance target or outcome, lump sum, etc; for performance-based contracts, payment is tied to performance; and
- Signatures of all responsible parties.

Numerous other terms are often included in the contract documents to provide additional legal protection to the State.

Amendments to client service contracts must also be in writing.

SAAM Section 16.20.30d states in part, “The contract should define the documentation required to authorize payment and to assist the contractor in invoicing correctly so that the contract manager can expedite approval of the invoice for payment.

At a minimum, invoices submitted should include the contract number or other evidence of authorization to contract, date(s) services were provided, description of services provided or any goods received, and approval for payment.”

State Government General Records Retention Schedule (SGRRS) Version 5.1 (August 2011) GS 01050 - Contracts and Agreements, Retain for 6 years after termination or expiration of instrument *then* Destroy.