

## SCHEDULE OF AUDIT FINDINGS AND RESPONSES

### **1. The Board for Volunteer Fire Fighters and Reserve Officers does not have adequate controls over its cash receipting and pension tracking system.**

#### ***Background***

The Board is responsible for administering the Volunteer Fire Fighters' and Reserve Officers' Relief and Pension Act. Its primary business is collecting pension contributions and distributing pension benefits to members.

The Board uses a database to track its pension and disability claims and payments. The database contains approximately 76,000 volunteer fire fighters' and reserve officers' individual records. These records contain members' personal information, annual pension and disability fees paid, service credit information and benefit payments.

The Board's database does not directly communicate with the statewide financial accounting system, Agency Financial Reporting System (AFRS), or the state's payroll system, Human Resource Management System (HRMS), so data is manually entered by the Board's staff.

During fiscal year 2013 the Board collected approximately \$1.1 million in pension and disability fees and made disbursements of more than \$12.7 million to pensioners and beneficiaries.

#### ***Description of Condition***

We reviewed the Board's cash receipting procedures, database management and pension disbursement processes.

The following control weaknesses were identified:

##### Cash Receipting

- There is not adequate separation of duties between receipting, depositing, and approving for three employees.
- Staff can make adjustments to receipts after a receipt has been issued without an independent review.
- Individual receipts posted to the database do not agree with deposit amounts posted in AFRS.

##### Pension System Tracking Database

- Key data fields are not restricted to ensure data is not deleted.

- An independent person does not approve or monitor additions, edits, or deletions to the database.
- There is an audit trail showing entries or corrections to the database. However, it is not utilized by Board management.

#### Pension Disbursements

- HRMS does not have the ability to set up a secondary approval level. Payment continues until the Board has identified the member as deceased.
- The Board does not reconcile disbursements posted in the database to HRMS to ensure only approved pension benefits are paid.

### *Cause of Condition*

The Board did not fully understand the prior audit recommendations regarding cash receipting and the pension tracking system. The Board prioritized adding new steps to the process and policies rather than changing the internal control environment. Additionally, the Board has insufficient staff to ensure that policies and procedures are always followed and monitored.

### *Effect of Condition*

The lack of segregation of duties, monitoring and reconciliations increases the risk that benefits collected could be misappropriated and that misappropriation would not be identified quickly.

### *Recommendation*

We recommend that the Board:

- Establish adequate segregation of duties over the receipting and depositing process.
- Ensure adjustments to receipts are independently reviewed.
- Reconcile receipts in the database to deposit amounts in AFRS.
- Establish written policies and procedures over the pension system tracking database that include restrictions for certain data fields.
- Ensure entries and changes made to data within the database are monitored. We further recommend that an independent person review changes made in the database such as additions, edits or deletions.

- Establish controls, such as an audit trail, to ensure that changes cannot be made to key data fields in the database, specifically after a receipt has been issued.
- Establish controls requiring prior approval before setting up a new employee's pension in the system.
- Perform reconciliations of disbursements posted in the database to the Human Resource Management System (HRMS).

### ***Board's Response***

*The Board appreciates the hard work provided by the Auditor's Office and understands the concerns raised regarding cash receipting and the pension tracking system. We do not concur with the overall finding that The Board for Volunteer Firefighters and Reserve Officers does not have adequate controls over its cash receipting and pension tracking system. There are a few bulleted items that we agree with, however.*

*We acknowledge we that we received a similar finding several years ago, and we have since implemented numerous checks and balances to improve our internal controls and believe that our controls, at minimum, meet those outlined in the State Administrative & Accounting Manual (SAAM). Where we couldn't segregate duties further due to our small size and limited staff, we implemented new policies and procedures to adopt preventative and detective activities to ensure that we have adequate controls over cash receipting and the pension tracking system.*

- ***There is not adequate separation of duties between receipting, depositing, and approving for three employees.***

*Duties are as segregated as reasonably as possible in a small three person office. In accordance with SAAM Sections 85.250.10.b, 85.20.10.c, and 20.258.30.b, the agency maintains a daily cash receipt record that reflects all daily receipts by account and source. The money received is counted and reconciled daily with cash receipt records and local account deposit slips. Each day, the mail is opened by two employees, one of which is usually the Executive Secretary. Mail is never opened unless it can be done in the presence of at least two employees. All money received is logged and totaled in the presence of both employees before being receipted by another employee. Although the deposit is prepared by the receipting employee, all work is reviewed by a non-receipting employee to verify that there are no differences between the intake mail log, the receipts, and the deposit. Any differences are investigated and resolved. Additionally, each day's log, CJ Report, and local deposit slip is reviewed and approved by the Executive Secretary. So, although duties are not as segregated as they are in larger agencies, more active oversight is provided by management.*

- ***Staff can make adjustments to receipts after a receipt has been issued without an independent review.***

*Staff can only void receipts after a receipt has been entered and voiding a receipt is a checked field within the receipt. All original data is retained within the database and both the original and duplicate receipts are kept. If the staff altered a receipt, it would also change the CJ Report generated and the receipts, the CJ, the deposit, and the mail log would not balance. These items are reviewed, reconciled, and approved on a daily basis by the Executive Secretary. As per SAAM Section 20.25.10, the Board has a daily detective activity process in place to provide control in this area.*

- ***Individual receipts posted to the database do not agree with deposit amounts posted in AFRS.***

*As stated above, the Board staff reconciles individual receipts posted to the database with actual bank deposits and amounts posted in AFRS each day. We are unclear as to why the SAO noted a difference and will be meeting with them to review their generated reports and try to determine whether or not a condition exists.*

- ***Key data fields are not restricted to ensure data is not deleted and an independent person does not approve or monitor additions, edits, or deletions to the database.***

*We concur that most data fields in the database are not restricted to ensure that data is not deleted. However, there is an audit trail showing entries, corrections, and deletions to the database. We have already addressed the concerns regarding receipting. Regarding pension records, all records are reviewed by independent employees, the retirees, the five member local boards of trustees, the five member state board, and the Executive Secretary to ensure accuracy before any payments are made.*

- ***There is an audit trail showing entries to the database. However, it is not utilized by Board management.***

*We concur with this statement. The tracking reports ceased to work. The Board management has since brought in an IT contractor to correct the issues and will now monitor the reports.*

- ***HRMS does not have the ability to set up a secondary approval level. Payroll continues until the Board has identified the member as deceased.***

*HRMS is a Department of Enterprise Services (DES) controlled and developed system. The Board concurs that HRMS does not have the ability to set up a secondary approval level. However, the Board has absolutely no control over, nor any ability to correct this problem.*

*The Board regularly checks the social security numbers of all benefit recipients against the Social Security Administration to identify any that have recently passed away so that payments can be stopped. These checks are performed by independent employees and the Executive Secretary monitors to ensure that pensions cease for deceased members as soon as they are identified.*

- ***The Board does not reconcile disbursements posted in the database to HRMS to ensure only approved pension benefits are paid.***

*The Board will review this bullet point more in depth to see if there is a change that could be reasonably, and safely, made to the database to address this audit concern. The pension tracking database was developed to track pension service records, not pension payments or disbursements. So, it is currently not possible to reconcile disbursements posted in the database to HRMS. The Board cannot reconcile something that is not tracked, nor was the database ever developed to track it. Section 20.05.20 of the SAAM states that “Management should build control activities into business processes and systems as the processes and systems are being designed”. Since the pension tracking system was built in the 1990’s and HRMS was implemented just a few years ago, this was not something that could have been anticipated at the database’s development.*

*According to SAAM, “Control activities can be preventative or detective: Preventive Activities are designed to deter the occurrence of an undesirable event...Detective Activities are designed to identify undesirable events that do occur.” Internal control activities can be in the form of policies, procedures, sequences or combinations of procedures, physical arrangements, or a separation of duties. Internal control activities do not have to be in the form of segregation of duties and can take other forms. The Schedule of Audit Findings states that “the Board prioritized adding new steps to the process and policies” instead of segregating duties further. In a small three person office, segregating duties any further would impede productivity. For example, giving only one staff member the ability to release a batch would segregate duties, but it would also mean that any time the staff member is absent, no bills or benefits could be paid. Section 20.25.20 states that “for any given risk, there may be multiple appropriate control activities that can be put into place...”. So, in areas where the Board could not create a larger separation of duties, it created a combination of preventive and detective activities to ensure an adequate level of control activities. These activities included authorization, review and approval, verification, reconciliation, physical security, education, training, and coaching. Segregation of duties is one type of a control activity, but it is not the only one that SAAM recognizes.*

*SAAM further states that the agency should “provide reasonable assurance that an organization will accomplish its objectives” (20.20.20.b). 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” (20.20.20.b). “Management defines the level of risk that the organization is willing to accept and strives to maintain risks within those levels” (20.20.20.c). “It is recognized that some small to medium sized operations may not be able to institute internal control procedures on the same level as larger, more complex agencies” (20.20.60.e). “Control activities, no matter how well designed and executed, can provide only reasonable assurance regarding achievement of objectives” (20.20.70.b).*

*Our agency has taken reasonable measures, given the level of risk, to institute internal control procedures to mitigate risks. The Board recognizes the limitations of its small staff and has tried, and will continue to try to ensure that it has adequate controls over its cash receipting and pension tracking system. We concur that the 20+ year old tracking system is not optimal, that HRMS does not have secondary approval requirements, and we cannot create enough separation of duties in AFRS. However, we believe that we have adequate controls over our cash receipting and pension tracking. Where we cannot have a great enough separation of duties, we have tried to implement other control activities to prevent and detect fraud. We appreciate the State Auditor’s concerns and diligence in its review, and we look forward to working with the SAO to further review some of the conditions above and try to find solutions where needed.*

### ***Auditor’s Remarks***

We appreciate the Board’s response and recognize that the Board is improving its internal controls; however, we continue to reaffirm our audit finding regarding cash receipting and pension tracking. We agree with the Board’s statement that they have a limited number of staff and are making attempts to mitigate the risks associated with a lack of segregation of duties.

We agree with the Board’s position that a new tracking system for pensions is desirable. The current access database allows for many internal control weaknesses at the Board.

We wish to thank the Board’s staff and management for their cooperation and assistance during our audit. We look forward to working with the Board on this issue and will follow up on it during the next audit.

### ***Applicable Laws and Regulations***

RCW 41.24.290, State board for volunteer fire fighters and reserve officers – Powers and duties, states in part:

The state board shall . . . Maintain such records as may be necessary and proper for the proper maintenance and operation of the principal fund, including records of the names of every person enrolled under this chapter . . . .

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

Section 20.15.30.a *Who is responsible for internal control?*

The agency head or authorized designee is ultimately responsible for identifying risks and establishing, maintaining, and reviewing the agency's system of internal control. If the agency head delegates this responsibility, the designated person should have sufficient authority to carry out these responsibilities. Normally, this person is a senior agency manager who does not serve in the internal audit function.

Section 20.15.40.c *Control Activities*

Control activities help ensure risk responses are effectively carried out and include policies and procedures, manual and automated tools, approvals, authorizations, verifications, reconciliations, security over assets, and segregation of duties. These activities occur across an agency, at all levels and in all functions, and are designed to help prevent or reduce the risk that agency objectives will not be achieved. Managers set up control activities to provide reasonable assurance that the agency and business unit objectives are met. An example of a control activity is something as simple as listing tasks assigned to staff members and then periodically checking the list to verify that assignments are completed on time. Refer to Section 20.25 for further discussion of control activities.

Section 20.15.40.e *Monitoring*

Things change and, by monitoring the risks and the effectiveness of control measures on a regular basis, an agency can react dynamically to changing conditions.

Monitoring evaluates the effectiveness of an agency's internal controls and is designed to ensure that internal controls continue to operate effectively. Monitoring is effective when it leads to the identification and correction of control weaknesses before they materially affect the achievement of the agency's objectives. An agency's internal control is most effective when there is proper monitoring, results are prioritized and communicated, and weaknesses are corrected and followed up on as necessary.

There are two types of monitoring: ongoing and periodic. Ongoing monitoring occurs in the course of operations. It includes tasks such as supervisory reviews of reconciliations, reports, and processes. Periodic monitoring includes tasks such as periodic internal audit sampling and annual reviews of high-risk business processes. Internal control deficiencies uncovered by monitoring should be reported to higher levels of management.

#### Section 85.20.10.b *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 or electronic daily transaction register.

#### Section 85.20.10.c *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.