



Office of the Washington State Auditor
Pat McCarthy

Accountability Audit Report

Cowlitz County

For the period January 1, 2021 through December 31, 2021

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**Office of the Washington State Auditor
Pat McCarthy**

February 9, 2023

Board of Commissioners
Cowlitz County
Kelso, Washington

Report on Accountability

Thank you for the opportunity to work with you to promote accountability, integrity and openness in government. The Office of the Washington State Auditor takes seriously our role of providing state and local governments with assurance and accountability as the independent auditor of public accounts. In this way, we strive to help government work better, cost less, deliver higher value and earn greater public trust.

Independent audits provide essential accountability and transparency for County operations. This information is valuable to management, the governing body and public stakeholders when assessing the government's stewardship of public resources.

Attached is our independent audit report on the County's compliance with applicable requirements and safeguarding of public resources for the areas we examined. We appreciate the opportunity to work with your staff and value your cooperation during the audit.

Sincerely,

Pat McCarthy, State Auditor
Olympia, WA

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AUDIT RESULTS

Results in brief

This report describes the overall results and conclusions for the areas we examined. In most of the areas we examined, County operations complied, in all material respects, with applicable state laws, regulations, and its own policies, and provided adequate controls over safeguarding of public resources.

As referenced above, we identified areas where the County could make improvements. These recommendations are included with our report as a finding.

In keeping with general auditing practices, we do not examine every transaction, activity, policy, internal control, or area. As a result, no information is provided on the areas that were not examined.

About the audit

This report contains the results of our independent accountability audit of Cowlitz County from January 1, 2021 through December 31, 2021.

Management is responsible for ensuring compliance and adequate safeguarding of public resources from fraud, loss or abuse. This includes the design, implementation and maintenance of internal controls relevant to these objectives.

This audit was conducted under the authority of RCW 43.09.260, which requires the Office of the Washington State Auditor to examine the financial affairs of all local governments. Our audit involved obtaining evidence about the County's use of public resources, compliance with state laws and regulations and its own policies and procedures, and internal controls over such matters. The procedures performed were based on our assessment of risks in the areas we examined.

Based on our risk assessment for the year ended December 31, 2021, the areas examined were those representing the highest risk of fraud, loss, abuse, or noncompliance. In addition, as part of this audit we followed up on the special investigation report issued April 1, 2021, over travel expense reimbursements. We also examined the following areas during this audit period:

- Cash receipting – timeliness and completeness of deposits and voids and adjustments at Building and Planning
- Accounts payable – general disbursements, credit cards, travel expenditures, employee reimbursements and electronic funds transfers
- Selected IT security policies, procedures, practices and controls protecting financial systems – patch management
- Payroll – gross wages, overtime and leave cash outs

- Building and Planning – use of restricted funds for fire and permit fees and software conversion for permit billing
- Accounts receivable – water and sewer billings
- Open public meetings – compliance with minutes, meetings and executive session requirements
- Financial condition – reviewing for indications of financial distress

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

Cowlitz County January 1, 2021 through December 31, 2021

2021-001 The County lacked adequate internal controls over disbursements, which resulted in losses of \$205,235 in public funds.

Background

Cowlitz County serves more than 114,000 residents in Southwest Washington. An elected, three-member Board of Commissioners governs the County, which had an annual budget of about \$261 million in fiscal year 2021. The County spends about \$73 million annually in general disbursements to vendors, including payments via electronic funds transfer (EFT) and credit card charges. The County is responsible for establishing adequate controls over disbursements to ensure payments are for valid expenses.

Description of Condition

On July 28, 2022, the County notified our Office regarding a loss of public funds, as required by state law (RCW 43.09.185). The County contracts with behavioral health organizations to provide substance abuse treatment and services for individuals involved in the criminal justice system and participating in the County Superior Court's Adult Drug Court program. The County paid two invoices totaling \$21,000 to one provider that the County later determined to be fraudulent because the provider did not perform the services for which it was billing. County staff did not adequately review the invoices to confirm the behavioral health organizations had actually provided services before paying them.

The County notified our Office of another loss of public funds on September 7, 2022. Specifically, the County reported a phishing incident where the County paid a public works project invoice totaling \$184,235 to a fraudulent bank account. After the contractor contacted the County because it did not receive payment, County staff realized the phishing scheme. The County worked with the bank and ultimately recovered the sent funds. While the County had a practice of contacting vendors over the phone to confirm requested changes, staff did not complete this verification before sending payment. Also, the County does not have formal written policies over EFTs, including the requirement to sufficiently verify all bank change requests to make sure they were made by the actual vendor.

In addition, during the County's 2018-2019 accountability audit, we reported on internal control weaknesses in a fraud investigation report related to the Coroner receiving personal reimbursements from a professional organization for travel expenses that the County had paid. In the current audit, we followed up on the corrective action taken to resolve the control weaknesses, and found the County had not established effective review and approval processes over the Coroner's credit card transactions. Our testing found the Coroner is responsible for approving his own transactions, and a person knowledgeable of the activity does not independently review them to ensure they are valid.

Cause of Condition

Although the County does have controls and processes in place that cover payments for services, EFTs, and credit cards, they have not been effective in ensuring these transactions are only paid for actual, valid County expenses. Furthermore, management has not adequately responded to prior audit recommendations.

Effect of Condition

Inadequate internal controls over the County's disbursements and a lack of proper oversight contributed to the loss of \$205,235 of public funds and increases the risk that a loss or misappropriation of public funds could occur again and not be detected by management quickly, if at all.

As noted above, the County has subsequently recovered \$184,235 of the lost funds.

Recommendation

We recommend the County strengthen its controls processes, and formally adopt policies and procedures that are effective in ensuring it only pays actual, valid County expenses. Specifically, we recommend the County:

- Implement policies and procedures to ensure contractors provide services before paying them
- Develop written policies and procedures that comply with the *Budgeting, Accounting and Reporting System* (BARS) Manual's (3.8.11.30) requirements for electronic payments. This should include requiring staff to sufficiently verify bank account changes with vendors.
- Strengthen its controls to ensure staff follow verification procedures to protect EFT transactions from internal and external threats
- Provide adequate communication and training to staff on cybersecurity risks and EFT verification requirements

- Ensure credit card charges are independently reviewed and approved by people who would be knowledgeable of the activity

County's Response

The State Auditor's Office claim that Cowlitz County suffered a loss of \$205,235 is misleading. Cowlitz County takes internal controls, transparency, and maintaining public trust very seriously. Each of the incidents below were discovered by County Staff, then self-reported to the State Auditor's Office.

Health and Human Services, July 28, 2022 loss of public funds: *When this issue was brought to the attention of management, Staff immediately began an investigation and notified the State Auditor's Office and law enforcement. Cowlitz County Health and Human Services denied reimbursement for two additional fraudulent invoices submitted, no longer contracts with this provider, and has strengthened internal controls by implementing policies and procedures that ensure contractors are not reimbursed for services that were not provided. In addition, County Staff have supported law enforcement's continued efforts, resulting in an arrest and charges filed against the provider that submitted the fraudulent data and invoices.*

Public Works, September 7, 2022 phishing scam: *When this issue was discovered, County Staff immediately notified the State Auditor's Office and law enforcement. Cowlitz County worked diligently with law enforcement and the financial institutions involved to isolate and recover the full amount of \$184,235.*

Shortly after this incident, the State Auditor's Office published its guidance and standards for public agencies, namely "Best Practices for ACH Electronic Payments" to alert agencies on the tactics of "bad actors" and reciting standards and best practices safeguards for managing public funds. This guidance manual was apparently published in response to prior incidents where public monies were forfeit and no audit findings were issued.

Cowlitz County recognizes the need to strengthen safeguards over county funds in response to ever-evolving cyber security threats. The following actions have been taken:

- *All Accounts Payable Clerks in the County were immediately notified to be on alert, sent resources on detecting wire-fraud scams, and provided example procedures to follow for verifying vendor account changes.*
- *An in-person training on fraud awareness and vendor account verification was conducted on November 1, 2022, for all Clerks.*

- *Written procedures on wire-fraud scams and verification of account changes were adopted in Public Works, the Treasurer's Office, the Auditor's Office, and the Purchasing Department.*
- *The County has implemented a new service called Account Validation with our financial institution to provide additional verification of vendor account credentials.*
- *A countywide policy on cyber awareness and EFT procedures was adopted by the Board of County Commissioners on December 13, 2022.*

In addition, the county has established and will maintain a vigorous communication and training program regarding cyber-security risks and best practices for processing electronic payments with all accounts payable users.

Coroner, 2018 – 2019 Accountability Audit: *When concerns regarding the Coroner's Office were reported, County Staff immediately notified the State Auditor's Office and law enforcement. An investigation into the allegations ensued and a report was issued by the State Auditor's Office in April 2021, two years after the complaints were reported. The fraud investigation conducted by the State Auditor's Office totaled \$21,850.40, exceeding the amount SAO claimed to be misappropriated.*

In addition, the elected Coroner attempted to repay the misappropriation, in the amount of \$12,602.71, but the County declined receipting the funds, acting on the guidance provided by the State Auditor's Office.

The Cowlitz County Prosecuting Attorney turned the case over to Clark County to ensure there was no conflict of interest and is currently waiting to hear if formal charges will be filed in this case. The County is unable to seek recovery of the \$12,602.71 in misappropriated funds or the \$21,850.40 fraud investigation costs until the case is finalized.

The County was disappointed in the Coroner, who lacked transparency when submitting expenditure reimbursements from both the County and an outside organization. It is difficult, if not impossible, for the County to know when an employee seeks payment from an outside organization when transparency is lacking. The directives of the State Auditor on "establish[ing] effective review and approval processes over the Coroner's credit card transactions" through countywide policymaking rings hollow, given county governance and administrative authority being disbursed by law amongst multiple, independently elected officials within non-charter counties. As recited within County Government 101 – Understanding County Government in Washington State, WSAC (2012) pp.19-20:

No single administrator or executive oversees a county's operations under the commission form of government.

The board of county commissioners shares administrative functions with other independently elected county officials, including a clerk, treasurer, sheriff, assessor, coroner and auditor. Other independently elected county officials and court officers include the county prosecuting attorney and the judges of district court and the county superior court...

Although the county commissioners establish the budget and act as the county legislative body, the independent role of the other county elected officers makes county government quite different from other forms of municipal government that have separate legislative and executive branches.

and in County Commissioner Guide, MRSC (2015) p.8:

While you, as county commissioner, establish the budget and act as the county legislative body, you also share administrative functions with several other independently-elected county officials, including a clerk, treasurer, sheriff, assessor, coroner (or medical examiner), and auditor (or recorder). The county prosecuting attorney and the judges of the superior and district courts are also independently-elected.

In response to this incident, the County has taken the following actions to strengthen internal controls, which may provide some measure of additional oversight and prevention in these matters:

- *Added a declaration on expense reimbursement requests that all employees must attest to, acknowledging that they have not sought reimbursement from outside sources.*
- *Adopted written policies on voucher review and approval, including the rejection of any voucher submitted to the Auditor's Office lacking appropriate review and approval.*

The County will continue to use all resources within the scope of its statutory authority to ensure that the reimbursement of travel expenses follow all policies and procedures.

Cowlitz County welcomes any assistance from the State Auditor's Office in developing the recommended countywide oversight process or for changes in laws that would deter this type of fraud by an elected official from happening in the future.

Auditor's Remarks

It is the responsibility of the County for the design and implementation of internal controls sufficient to safeguard public resources. Although, the County was fortunate to recover some of the funds involved in the losses, ultimately public funds were not safeguarded.

The responsibility of safeguarding public funds extends to all County departments, functions and officers, regardless of whether an officer or department head has been separately elected.

We appreciate that the County is working to strengthen its control processes and its cooperation during the audit.

Applicable Laws and Regulations

RCW 42.24.080 – Municipal corporations and political subdivisions – Claims against for contractual purposes – Auditing and payment – Forms – Authentication and certification.

RCW 43.09.200 – Local government accounting – Uniform system of accounting.

RCW 43.09.2855 – Local Governments – Use of credit cards.

Budgeting, Accounting and Reporting System (BARS) Manual – Accounting Principles and Controls, Internal Control, Sections 3.1.3.20 and 3.1.3.30

Budgeting, Accounting and Reporting System (BARS) Manual – Accounting, Expenditures, Purchase Cards, Section 3.8.4

Budgeting, Accounting and Reporting System (BARS) Manual – Electronic Funds Transfer (EFT) – Disbursement, Section 3.8.11

RELATED REPORTS

Financial

Our opinion on the County's financial statements and compliance with federal grant program requirements is provided in a separate report, which includes the County's financial statements. That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

Federal grant programs

We evaluated internal controls and tested compliance with the federal program requirements, as applicable, for the County's major federal programs, which are listed in the Schedule of Findings and Questioned Costs section of the separate financial statement and single audit report. That report includes federal findings regarding subrecipient monitoring. That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

INFORMATION ABOUT THE COUNTY

Cowlitz County serves approximately 114,275 citizens residing in Southwest Washington. The County is administered by an elected three-member Board of Commissioners. The County operated on an annual budget of approximately \$261 million for fiscal year 2021.

The County currently employs 520 full-time and 87 part-time workers, 324 of whom are currently members of one of nine bargaining units. The employees provide an array of services, including planning and development, water, sewer, road construction, parks and recreation, human services, public safety, civil and criminal courts and geographic information services.

Contact information related to this report

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Information current as of report publish date.

Audit history

You can find current and past audit reports for Cowlitz County at <http://portal.sao.wa.gov/ReportSearch>.

ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the Washington State Constitution and is part of the executive branch of state government. The State Auditor is elected by the people of Washington and serves four-year terms.

We work with state agencies, local governments and the public to achieve our vision of increasing trust in government by helping governments work better and deliver higher value.

In fulfilling our mission to provide citizens with independent and transparent examinations of how state and local governments use public funds, we hold ourselves to those same standards by continually improving our audit quality and operational efficiency, and by developing highly engaged and committed employees.

As an agency, the State Auditor's Office has the independence necessary to objectively perform audits, attestation engagements and investigations. Our work is designed to comply with professional standards as well as to satisfy the requirements of federal, state and local laws. The Office also has an extensive quality control program and undergoes regular external peer review to ensure our work meets the highest possible standards of accuracy, objectivity and clarity.

Our audits look at financial information and compliance with federal, state and local laws for all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits and cybersecurity audits of state agencies and local governments, as well as state whistleblower, fraud and citizen hotline investigations.

The results of our work are available to everyone through the more than 2,000 reports we publish each year on our website, www.sao.wa.gov. Additionally, we share regular news and other information via an email subscription service and social media channels.

We take our role as partners in accountability seriously. The Office provides training and technical assistance to governments both directly and through partnerships with other governmental support organizations.

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