



Washington State Auditor's Office

2004 Statewide Accountability Report



Washington _____
State Auditor

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**STATE AUDITOR’S OFFICE
STATE OF WASHINGTON ACCOUNTABILITY REPORT
FISCAL YEAR 2004
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Financial Accountability Roles and Responsibilities

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

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

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

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

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

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

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

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

State Treasurer

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

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

State Auditor

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

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

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

The State Auditor's Office does not have the authority to do performance audits, unless expressly directed to do so by the Legislature.

Joint Legislative Audit and Review Committee (JLARC)

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

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

State Employees

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

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

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

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

Our Audit Approach

State Auditor's Office Audits

The Washington State Auditor's Office regularly audits approximately 175 state agencies ranging in size from the Department of Social and Health Services to the Asparagus Commission. All public colleges and universities in Washington are considered state agencies, and we also audit them. The results of our higher education audit work will be reported later this year.

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

For state agencies, the Office performs audits on:

- Areas that pose the highest risk for misappropriation, misuse or loss of public funds or for noncompliance with state laws and regulations. *This report includes the results of such audits.*
- The State of Washington's General Purpose Financial Statements. The most recent Comprehensive Annual Financial Report, which includes these statements, was issued by the Office of Financial Management in December 2004 and is available at <http://www.ofm.wa.gov/cafr/2004/cafr04toc.htm>
- More than \$9 billion in federal funds received by the state. The current State of Washington Single Audit Report will be issued by the Office of Financial Management in the spring of 2004 and will be available at <http://www.sao.wa.gov/reports/SingleAudit/Index.htm>
- Local funds kept by agencies that are not in the care or custody of the Office of State Treasurer. Our latest Local Funds Report was issued in December 2003 and is available at <http://www.sao.wa.gov/Reports/LocalFunds/Index.htm>

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 State Auditor's Office has many competing responsibilities when conducting audits. Our high-risk approach helps to ensure our efforts are properly balanced in order to fulfill these

responsibilities. We look at areas that are the most important to the citizens of Washington, our audit clients, the Legislature, and other policymakers.

Key components of our audits are the recommendations we make on how agencies can best safeguard public assets. This can include everything from improved cash-handling procedures to tagging items in 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 described 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 help us assess risk and accountability. Once we download an audit client's financial transactions, we have software applications that can help us find transactions that are most likely to be fraudulent or out of compliance with laws and regulations. These techniques often help us audit expenditures, but they can be used for any type of financial transaction.
- We use analytical procedures to identify account balances that differ from an informed expectation. We often use these procedures to audit revenue streams, looking for activity that could point to a loss or misuse of public assets. These techniques tend to be very efficient and provide strong indicators that additional work may be needed to determine whether loss or misappropriation has occurred.
- We perform surprise cash counts, which are a powerful tool for assessing the effectiveness of controls over money collected at a given location and for finding indications that loss or misappropriation may have occurred.
- We audit computer applications looking for security over access and other safeguards. These audits are of enormous value in pointing out conditions that could allow misappropriation or loss to occur without detection by management or conditions that could allow destruction of data. Recommendations from these audits have helped state agencies tighten controls over access to computer systems. These audits also have helped our auditors identify areas in which assets are most at risk.

Usually we audit several areas on a statewide basis each year, using a consistent approach when looking at areas we believe present a statewide risk of error or misuse or of noncompliance with state laws and regulations. At each agency, we also audit other areas we believe to be high risk. The results of these audits of statewide and agency-specific risks are included in this report.

Comprehensive Annual Financial Report (CAFR)

The State Auditor's Office performs an annual audit of the statewide combined financial statements as required by state law (RCW 43.09.310). These financial statements are included in the Comprehensive Annual Financial Report (CAFR) prepared by, and available from, the Office of Financial Management. This report is designed to present the financial position and the

results of operations of the state of Washington. The Office of Financial Management prepared the first CAFR in 1982 and released the fiscal year 2004 report in December of 2004. 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, 2004, total state revenues were approximately \$40 billion and total state expenditures/expenses were approximately \$34 billion. Most of this difference was caused by investment gains that resulted in pension fund revenues exceeding expenses by more than \$5 billion.

For the last 17 years, the state has received a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association. This award recognizes conformance with the highest standards for preparation of state and local government financial reports.

Our audit of the financial statements is conducted in accordance with governmental auditing standards generally accepted in the United States of America. These standards require us to plan and perform audits to obtain reasonable assurance about whether financial statements are free of significant misstatement. An audit includes examining evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluation of the overall financial statement presentation.

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 for the state of Washington. That audit is performed in accordance with U.S. Office of Management and Budget Circular A-133 and is referred to as the State of Washington Single Audit. 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.

In the last five years we have reported 74 findings related to federal grants. Federal findings are reported for those cases where we find improvement is needed over internal controls; instances of significant noncompliance with federal regulations; and certain expenditures should be questioned and possibly repaid. 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.

The state received more than \$10 billion in federal funds in 2003. Once received by the state, a significant amount of this federal assistance is awarded to local governments and non-profit organizations. Every local government and non-profit that spends over \$300,000 in federal awards in a year must receive a federal audit. Starting in 2004, this threshold will increase to \$500,000 to alleviate the burden and cost of audits for smaller entities. Our Office played a key role in getting this threshold increased.

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 36 frauds totaling approximately \$700,000 in losses each year. In the past 18 years, we have investigated over 640 frauds totaling more than \$12.5 million in losses. During 2004, we reported on almost \$332,000 in fraud in state agencies and local governments.

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

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

Following are the state government fraud statistics for January 1, 2004, through December 31, 2004. Total fraud losses in state government were \$86,150 during this period. The average loss was \$7,832.

Category	Total Fraud Cases	Detection by Entity	Detection by SAO	Detection by Others
State Agencies	3	1	1	1
Colleges and Universities	8	7		1
Total Fraud Cases	11	8	1	2
Percent of Fraud Cases	100%	73%	9%	18%

More information on our Fraud Program is available on our web site:
<http://www.sao.wa.gov/Reports/FraudReports/FraudPage.asp>

Whistleblower Program

The State Employee Whistleblower Program, administered by our Office, provides state employees with a confidential means to report actions that can impair the integrity of 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 fiscal year 2004, the Whistleblower Program opened 48 cases. We substantiated 29.6 percent of the assertions filed.

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

Statewide Technology Audit Team

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

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

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

Application Controls

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

General Controls

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

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

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

Audit Approach

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

Computer Assisted Audit Techniques

The Statewide Technology Audit Team assists our other auditors by obtaining information from agency computer systems that are used in our audits of individual agencies. The Team assists

the other audit teams in performing computer-assisted audit techniques related to the statewide issues audits, agency legal compliance audits, local government audits, the financial statement audit and the State of Washington Single Audit. Some of the specific tests included are:

- Payments to ineligible or ghost clients.
- Payments for non-allowable costs and incorrect amounts.
- Payments to false or ineligible 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.
- Adherence to Civil Service regulations, such as status and double-fills.
- Timeliness of payments.

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 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.

Current Audit Challenges

Our use of computer-assisted auditing techniques (CAATS) has significantly improved audit efficiency and effectiveness. With CAATS, we are able to quickly select and review questionable transactions such as possible duplicate payments or payments to false vendors. We also can compare data among state agencies and among state and federal records to help identify clients who may be ineligible for payments received. However, a number of agencies continue to resist our efforts to obtain electronic records.

- In some cases, we encounter lengthy delays in agencies' responses to our requests for data. Other times, agencies have required us to undergo lengthy request processes, sign detailed confidentiality agreements, and, in some instances, pay for the information.

Agencies have used confidentiality issues related to clients' personal information or the cost of providing the information as reasons for denying our requests or delaying their responses. We continue to point out that our employees are required to maintain confidentiality regarding all audit procedures and results during the course of an audit and are aware of the on-going need for confidentiality regarding personal data, in accordance with the Governor's Executive Order 00-03, Public Records Privacy Protections.

In addition, charging us for information is counter-productive because the charges are added on to the audit bill. No private entity engaging a firm to audit the entity's records would charge that auditor to obtain those records.

- As a result of the refusal by the Health Care Authority, the Department of Personnel, and higher education agencies to provide us with information we requested, we were unable to perform cost-effective audit procedures to determine the validity of:
 - Electronic funds transfers of state employee payroll.
 - Payments for Medicaid recipients enrolled in the Basic Health Plus Program.

These issues could be easily resolved with a reminder from the Governor to agency heads that agency records, with few exceptions, are public information and that, since the State Auditor's Office has the authority and responsibility to audit these records, agencies are expected to provide unhindered and timely access. State agencies should be reminded that the purpose of Executive Order 00-03 is to prevent confidential information from being released, not to prevent our Office from obtaining documents needed for auditing purposes.

In addition to refusing to provide electronic records, agencies are using other methods to cause delays in our audits or to require us to spend unnecessary audit resources to accomplish our audit objectives and to meet state and federal auditing requirements.

- Some agencies require all meetings with line staff members to take place only within the presence of management. Line staff may be less than candid about issues with internal controls or financial systems if management is in the room.

- Some agencies ask us to justify why we want information. In some cases, they have denied us the information, if they are not satisfied with our responses.
- Some agencies indicate they are too busy to be audited and ask for a delay. We do not always have that option. Federal regulations require some audits to be completed within a specific time frame. Additionally, regular and timely audits are designed to ensure internal controls are in place to protect public resources.
- Some agencies insist that, prior to the start of any audit, we must hold entrance conferences involving a significant number of their staff members who sometimes cannot schedule meetings until weeks later. In addition to the use of the agency's time in such a pursuit, the auditor spends administrative resources, all of which are then charged to the agency. In addition, our audit process is delayed, causing additional strain on the agency's resources as the auditor tries to finish planned procedures in the remaining time.
- One agency required us to schedule all meetings through a single office. In one instance, a review of one of the Department's systems, the person to whom we were directed did not respond to our meeting request for three weeks. When we made another attempt to schedule the meeting, the person assigned the task to another individual, who then tried to schedule the meeting on a date that was three weeks away. The original entrance conference for this work took place in July, and the audit should have been completed by the end of August. However, at the beginning of October, we were still trying, in the agency's complicated process, to arrange a meeting to determine with whom we would need to meet to set up other meetings for the actual audit work. Ultimately, we ran out of time to perform the audit procedures and had to reschedule the work for fiscal year 2005.
- In order to facilitate following up on prior year findings related to systems reviews, we send a matrix listing the weaknesses or instances of noncompliance and ask each agency to report on the status of the corrective action. For any corrected items, we ask the liaison to tell us who could verify the status. Rather than completing the matrix, one department required some of our auditors to attend a meeting on the issue. This took an additional four hours of audit time, which we charged to the agency. At the meeting, we were told that nothing had been corrected.

The Medical Assistance Administration at the Department of Social and Health Services used most of the above techniques to prevent our completion of the audit of Medicaid. As a result, we disclaimed on total Medicaid expenditures of \$6.1 billion for fiscal year 2004. This means that we were unable to determine if Medicaid payments were for allowable purposes and for eligible persons. Our Special Report on Medicaid for fiscal year 2004 provides details of these problems and can be found at http://www.sao.wa.gov/Reports/Accountability/2004_Medicaid.pdf. The Medicaid special report should be considered an integral part of this State Accountability Report.

Statewide Audit Areas

Introduction

We identified two high-risk areas for statewide reviews during our fiscal year 2004 audit:

- Claims and benefits
- Client service contracts

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

Because of the numerous claims and benefits issues identified in our previous audits, we included this as a statewide audit area for the fourth year in a row.

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 internal controls and compliance and found that the state overpaid claimants, providers and other recipients due to a variety of factors. In addition, because we were unable to obtain all of the necessary information to determine if Medicaid payments were for allowable purposes and eligible persons, we disclaimed on the fiscal year 2004 Medicaid costs of \$6.1 billion. Our Special Report on Medicaid is an integral part of this report and can be found at http://www.sao.wa.gov/Reports/Accountability/2004_Medicaid.pdf.

As before, 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 payments are supported by adequate documentation.
- Attempt recovery of all identified unallowable payments.

The nine findings for this statewide area begin on page 25.

Client Service Contracts

State law defines client service contracts as services an agency provides directly to its clients, such as medical services, training programs, and residential care. The clients are members of the public who require assistance in meeting some basic needs.

Following concerns about possible misuse of public funds at some nonprofit organizations, the Legislature called for a study of state contracting for social services. The task force conducting the study recommended the publication of client service guidelines, a responsibility the Office of Financial Management completed in January 2002. Effective January 1, 2003, the Legislature made use of these guidelines mandatory for all state agencies. The guidelines include procedures for writing, procuring and monitoring client service contracts.

Client service contracting procedures require considerably fewer procurement steps than do contracts for personal services. We have identified a risk that agencies might classify personal service contracts as client service contracts to avoid the more stringent procurement requirements. Fiscal year 2004 was the first complete fiscal year during which use of the client service contracting guidelines was mandatory. Therefore, we selected these contracts to be a statewide issue for the year.

We found in general that agencies are complying with the client service contracting guidelines. We identified only two findings for this statewide area; these begin on page 64.

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 other types of contracting and purchasing; accounting systems; cash receipts and receivables; and other asset safeguards.

Federal Compliance

For the fiscal year ended June 30, 2004, the state spent more than \$10 billion in federal funds. The largest single grantor was the U.S. Department of Health and Human Services, which provides funding for programs such as Medicaid, Child Care, Temporary Assistance for Needy Families, and Research and Development at public universities. Another large federal granting agency is the U.S. Department of Education, which provides many programs for public schools and grants and loans for college students.

We completed a review of internal controls and compliance with grant requirements for 24 federal programs for the fiscal year 2004 State of Washington Single Audit. The federal grant findings we identified are included in this report, as they also relate to legal compliance and high risk.

Based on the final fiscal year expenditure amounts that we recently received, we identified an additional three federal programs that must be reviewed before our audit of fiscal year 2004 federal programs is complete. If necessary, at the completion of that work, we will issue a supplemental State Accountability Report. All federal findings will also be presented in a separate single audit report and issued to the federal government in the spring of 2004.

When evaluating the state's compliance with federal regulations, we are required by federal audit regulations to report known and likely questioned costs exceeding \$10,000 in compliance areas. 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.
- Costs that appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

As noted above, the \$10,000 reporting threshold is mandated by federal regulations. We believe this amount is appropriate for local governments such as cities, counties and schools that receive much less in federal funds than the state. However, for programs such as Medicaid, which spends \$3 billion in federal funds annually, this threshold is too low. We have recommended to the U.S. Office of Management and Budget that it increase the threshold for states that administer large federal programs.

Listed below are the 27 federal programs we audited for fiscal year 2004:

Federal Program	Federal Expenditures
Medicaid	\$3,115,970,028
Unemployment Insurance	\$1,821,771,912
Research & Development	\$673,083,145
Temporary Assistance for Needy Families	\$295,705,817
Childcare Cluster	\$202,822,325
Child Nutrition Cluster	\$175,211,958
Special Education Cluster	\$169,870,677
Jobs and Growth Tax Relief Reconciliation Act of 2003	\$98,215,418
Vocational Rehabilitation	\$45,762,829
Social Service Block Grant	\$45,643,710
Improving Teacher Quality State Grants	\$45,128,571
Low-Income Home Energy Assistance	\$38,279,533
State Children's Health Insurance Program	\$36,064,451
Trade Adjustment Assistance - Workers	\$30,964,797
Centers for Disease Control	\$29,581,447
Aging Cluster	\$18,427,878
Food Commodities (Non Cash)	\$16,034,343
State Domestic Preparedness Equipment Support Program	\$13,114,108
Gaining Early Awareness & Readiness for Undergrad Program	\$13,009,333
TRIO Cluster	\$11,211,365
Byrne Formula Grant	\$9,974,864
Mental Health Block Grant	\$8,697,249
Education Technology State Grants	\$8,521,710
Community Services Block Grant	\$8,041,902
Americorps	\$7,838,553
Juvenile Accountability Incentive Block Grant	\$4,227,101
Family Planning - Services	\$3,269,898
Total Federal Expenditures	\$6,946,444,922

Internal Controls

Internal controls are broadly defined as processes 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.

Internal controls are policies and procedures that provide reasonable assurance that management's specific objectives will be achieved; they are comprised of the following:

- Control environment, or management's overall attitude toward the importance of controls.
- Risk assessment, or management's process to identify and analyze relevant risks to public resources.
- Control activities, or management's procedures to ensure reports are reviewed for accuracy, completeness and authorization; physical controls are in place over cash receipts and equipment; contractor performance is monitored; and duties are segregated for those who handle assets.
- Information and communication, or management's methods to identify and communicate on a timely basis information employees need to perform their duties.
- Monitoring, or management's evaluation of whether controls are operating as intended and whether they are achieving objectives.

One significant method agencies can use to strengthen controls is to have an internal audit function, as described in a state law passed in 1993. It requires the Office of Financial Management (OFM) to:

... develop and maintain a system of internal controls and internal audits comprising methods and procedures to be adopted by each agency ... Each agency head or authorized designee shall be assigned the responsibility and authority for establishing and maintaining internal audits following the standards of internal auditing of the institute of internal auditors

OFM has provided internal control and auditing policies in Section 20.10 of its *State Accounting and Administrative Manual*. These policies assign to agency heads or authorized designees the responsibility and authority for deciding whether an agency should establish an internal audit program.

In this time of scarce state resources, internal controls are often the first activities to be cut back. For several years, we have recommended to agency managers that they carefully consider 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. It can cost a great deal more to try to recover those improper payments than to provide proper verifications before determining an applicant is eligible for funds.

We have also recommended that OFM, which has oversight of state government budgeting and accounting, analyze our Schedule of Audit Findings for areas in which additional guidance or training relating to internal controls may be helpful to agencies.

Almost every agency audit we performed this year included some review of the applicable controls and a determination as to whether these controls were adequate and were operating effectively. For the most part, we found this to be the case. However, many of our findings relate in some way to weaknesses in controls.

Last year we reported 60 findings; this year we are reporting 63 findings, including the 22 findings in the Special Report on Medicaid. Of these 63 findings, 42, or 67 percent, concern issues at the Department of Social and Health Services: the 22 related to Medicaid and another 20 related to state and federal legal compliance in other parts of the agency. Our Special Report on Medicaid for Fiscal Year 2004 can be found at http://www.sao.wa.gov/Reports/Accountability/2004_Medicaid.pdf. The Medicaid special report and its 22 findings should be considered an integral part of this State Accountability Report.

We attribute this continuing increase in findings in part to cuts in internal controls. We are repeating our previous recommendations and further recommending that agencies with no internal audit programs consider carefully whether such a program would be beneficial in the long run.

Internal control findings are interspersed in their appropriate areas in the findings section.

Recommendations to the Legislature

Claims and Benefits

In three previous State Accountability Reports, 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. 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.

Previously we have recommended 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.

We continue to strongly recommend that the Legislature consider a process providing for state identification numbers for those receiving state assistance.

State Grants

We noted in last year's State Accountability Report that there are currently little or no state criteria available for agencies authorized to award grants composed solely of state funds. Therefore, agencies use whatever procedures and forms they feel are appropriate, with no overall assurance that the grants are being adequately procured and monitored.

Recently the Office of Financial Management (OFM) developed a definition of "state grant", along with brief descriptions of some state grant characteristics, procedures, and best practices. Currently this is still in a draft format to allow agencies to evaluate whether the definition and descriptions are adequate. No related regulations have been added to OFM's *State Administrative and Accounting Manual*.

Other weaknesses in this area include:

- There is no available coding in the state's accounting system that allows an agency to identify easily the total amount of state grants it provides.

- OFM states it does not have any authority over state grants and, therefore, will be providing this information, including the definition, only as guidance.

We recommend the Legislature consider whether OFM should have more authority in this area and, if so, provide it with the resources it needs to establish additional controls over procuring, monitoring and accounting for state grants.

Child Care Background Checks

In previous audit reports, we recommended the Legislature consider whether the process the Department of Social and Health Services uses to provide background checks for its applicants for child-care licenses should be strengthened. During 2004, the Legislature began a series of on-going study sessions and hearings related to this issue. It is our understanding that this process has not yet been completed. We continue to believe that fingerprint-based background checks would better identify disqualifying convictions and actions and therefore would be a stronger control than the current process.

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Agency Findings

Claims and Benefits

04-01 The Department of Retirement Systems is holding approximately \$1.1 million in accounts for beneficiaries of members who have been deceased for up to 40 years. The Department did not obtain member death information necessary to distribute the money to beneficiaries within deadlines set by the Internal Revenue Service.

Background

The Department administers seven retirement systems for eligible public employees in the state. Each year, the Department collects \$675 million in employer and member contributions and pays \$1.9 billion in benefits to retirees. Currently, approximately 286,000 active members and 142,000 inactive members are in the system.

The Internal Revenue Service (IRS) requires qualified retirement plans to distribute money to beneficiaries within certain timeframes. If a member dies before receiving his or her pension, the Department must return member contributions plus interest to the member's beneficiary by December 31 of the fifth year following the member's death, unless certain exceptions apply.

Description of Condition

We reviewed member accounts with balances of more than \$50 and found that 1,193 of these members had been deceased for more than five years. Of those, the Department had recorded death dates for 432 (36 percent) of them. Our investigation revealed an additional 761 members (64 percent) who had been deceased for more than five years.

<u>Number of Years Member Deceased</u>	<u>Number of Members</u>	<u>Account Balance</u>
Between 30 and 40 years	23	\$ 5,622
Between 20 and 30 years	86	67,118
Between 10 and 20 years	265	421,545
Between 5 and 10 years	<u>387</u>	<u>653,856</u>
Total	761	\$1,148,141

We asked the Department why it did not pursue a data match with the Social Security Administration so it could receive timely information about member deaths. It indicated that it had other methods of detection, such as sending annual statements and other notices to deceased members' addresses and reading obituaries in major newspapers. Since the Department's detection methods only found 36 percent of its deceased members, we conclude these methods are not effective.

The Department obtained legal advice that was shared with our Office. The advice states the IRS expects that reasonable efforts will be made by the Department to locate beneficiaries. We agree with this legal advice, but do not see that reasonable efforts were made when the Department failed to obtain death date information for 64 percent of its deceased members. This information is necessary to avoid missing the statutory five-year deadline imposed by the IRS.

Cause of Condition

The Department did not obtain death information for members who were not receiving a pension payment.

Effect of Condition

When the Department does not obtain member death information, it is not in compliance with the Internal Revenue Service Code.

Recommendation

We recommend that the Department obtain death data for all members to ensure that beneficiaries receive payment within the statutory deadline if they can be located.

Department's Response

The Department of Retirement Systems strongly disagrees with this finding regarding our efforts to obtain death information and locate and make payment to beneficiaries of deceased members. Our success in this area clearly demonstrates a commitment to fulfilling our fiduciary responsibility. Since 2001, we have paid more than \$27 million to 15,985 inactive members or beneficiaries and initiated payment of ongoing retirement benefits to an additional 689.

The audit results, as compared with our research

As the auditor would not share the results of audit tests before delivering this finding, we have only had time to perform a limited review of the 761 accounts referenced above. We have already found that in approximately 40 percent of these accounts, the member designated their spouse as the account beneficiary. IRS rules exempt spouses from the five-year payout rule the auditor has cited. Instead, the spousal beneficiary is not required to begin receiving payment until the end of the year in which the member would have turned 70 ½. An additional 19 accounts in the auditor's total have been identified as having no benefit owing. Together, these accounts represent \$445,824 of the auditor's \$1.1 million total.

Though the auditor infers DRS was unaware deaths had occurred, in more than 400 of these cases we were in fact aware of the possibility of a member's death through our national locator service. We do not risk disenfranchising a member by acting solely on this information. Instead, we work to confirm a date of death before entering it into our system and preparing the necessary paperwork. The auditor looked only at our computer records to decide whether DRS had been notified of a death. This is not a valid or complete test.

The auditor concludes DRS' efforts in identifying deaths are not effective, as "it did not detect 64 percent of the members in its database who were deceased." This number is misleading in that it is only calculated as a percentage of unpaid accounts. The percentage does not consider the number of deaths DRS has identified and made final payment on or the number of accounts transitioned to a survivor benefit. Our statistics show that since 2000 we have made 1,424 final beneficiary payments and transitioned 3,720 ongoing payments to survivors. Additionally, 9,142 retirements have been stopped due to death with no continuing benefit and 226 benefits were stopped due to the death of the beneficiary.

DRS complies with all retirement plan regulations

DRS consistently follows all applicable Internal Revenue Service regulations regarding the distribution of money to beneficiaries. To ensure compliance, we regularly consult with special assistant attorneys general who are experts on federal tax laws and requirements for pension plans.

In this finding, the auditor discounted a recent expert opinion that DRS' efforts meet compliance standards. Since the exit conference, the Senior Assistant Attorney General who represents DRS contacted the Internal Revenue Service and reconfirmed that DRS is in compliance with IRS requirements.

It is our understanding that the auditor drew conclusions about DRS' compliance with the internal revenue code without contacting the IRS or seeking the advice of expert tax counsel.

How DRS locates inactive members and beneficiaries

In our efforts to obtain death information, we contract with national services that regularly perform searches on our behalf, pulling information from billions of linked records, including those of the Social Security Administration. While searching for inactive members and beneficiaries, we continue to safeguard their monies and credit interest to each account, just as we do for contributing members, until they are paid.

We use both technology and traditional methods to search records, yet even the most vigorous efforts occasionally yield incomplete results. We believe our efforts to identify the deaths of members not currently receiving a benefit are effective. However, we investigate additional options for obtaining the information on an ongoing basis.

In summary

The Department of Retirement Systems is a highly regarded administrator of the retirement plans of nearly half a million people in Washington state. We are committed to our mission of administering Washington's public retirement plans with the highest degree of integrity, efficiency, fairness and financial responsibility.

Our efforts are consistent with those used by other retirement systems and meet all regulatory requirements. Our efforts are not only adequate, but vigilant. We maintain this finding is unwarranted.

Auditor's Remarks

Our Office shared all audit results and related data with the Department as soon as it was reviewed at all approval levels, including our legal counsel. Due to the timing of the audit, this data was not shared with the Department until the day of our exit conference. The Department was given seven working days to respond, which is what our Office allows for all agencies that receive findings.

It is true that the Internal Revenue Service code allows the beneficiary spouse to delay distribution until the deceased member would have turned 70½. However, this exception applies only if the beneficiary **chooses** to exercise this option. Since the Department had not confirmed the death dates of 761 members, as it mentions in its response, it is unlikely that it knows whether a beneficiary will exercise this option.

The 19 accounts identified in the Department's response as having no benefit owing did owe benefits during the audit period. In January and February of 2005, six months after the end of the audit period, withdrawals and transfers resulted in accounts with no balances.

We reviewed reports produced by the Department's national locator service. We found the Department knew of possible deaths in 421 cases. In 15 cases, the information was not received by the Department until December 2004, five months after the end of the audit period. In the remaining 406 cases, the Department received the information from the service in June and July of 2003. However, only 17 deaths (4 percent) were confirmed between the one-year period of June 2003 and June 2004. We do not believe that it is reasonable that the Department has been able to confirm only 17 of 406 possible deaths in one year.

Since the Department just began using the service to obtain death dates in May 2003, many of the deaths occurred several years ago. When the Department does not confirm death dates in a timely manner, it makes it difficult for it to be in compliance with statutory deadlines.

Our 64 percent statistic was determined by comparing the number of deceased individuals in the Department's database to the number of members who were deceased according to the Social Security Administration. Our test was performed as of December 31, 2003. We found 1,193 members who were deceased, but the Department had confirmed only 432 of them. Since the remaining 761 members died up to 40 years ago, we believe that either the methods used by the Department to detect deceased members is not effective or that the Department is aware of possible deaths and is not following up on them in a timely manner.

As mentioned in the finding, our Office carefully considered the legal advice provided by the Department's legal counsel. The advice indicates that a reasonable effort is to be made to distribute account balances to beneficiaries. We do not agree with the assumptions provided to the legal counsel by the Department that indicated the Department had failed to make distributions to only a relatively small number of beneficiaries. We do not believe that \$1.1 million owed to 761 beneficiaries is a small number.

We did not consult tax experts because we are not concerned that the IRS will financially penalize the Department or disqualify any of its retirement plans. Instead, we concluded that the Department is not making the effort that is required to ensure that beneficiaries receive money

due to them within the statutory deadline. This does not have tax implications and does not require tax advice.

This issue was initially raised during our last audit of the Department. At that time, we contacted the IRS to obtain an interpretation of its regulations. An IRS representative who is an expert in this area told us that the Department would be required to obtain death dates in a timely manner in order to make distributions within the mandated time frame. We contacted the IRS again this year and confirmed the advice provided last year was still accurate. In addition, we confirmed that a spouse beneficiary is required to choose an option to delay the distribution past the five-year deadline.

We will follow up on this issue during our next audit.

Applicable Laws and Regulations

Internal Revenue Service Publication 575 states in part:

Distributions after the employee's death. If the employee was receiving periodic distributions before his or her death, any payments not made as of the time of death must be distributed at least as rapidly as under the distribution method being used at the date of death.

If the employee dies before the required beginning date, the entire account must be distributed under one of the following rules.

- Rule 1. The distribution must be completed by December 31 of the fifth year following the year of the employee's death.
- Rule 2. The distribution must be made in annual amounts over the life or life expectancy of the designated beneficiary.

04-02 The Department of Social and Health Services, Economic Services Administration, should improve compliance with eligibility requirements for the Temporary Assistance for Needy Families Program.

Background

The Department of Social and Health Services, Economic Services Administration, administers the federal Temporary Assistance for 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. For assistance payments to clients, the Program spent \$137,463,116 in federal funds and \$143,727,390 in state funds during fiscal year 2004.

The program is designed 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 includes a child under 18 living with the parent(s); in addition, the family must qualify as needy under a state's criteria. The state also has specified that, with certain exceptions, applicants must provide Social Security numbers in order to receive Program benefits.

During the fiscal year 2002 and 2003 audits, we identified weaknesses related to compliance with eligibility requirements and reported them in the Statewide Accountability Report and in the State of Washington Single Audit Report.

Description of Condition

During our current audit of the Program, we selected clients who received benefits from July 1, 2003, through June 30, 2004. We again found instances of noncompliance with eligibility requirements in the following areas:

- a. We reviewed the validity of Social Security numbers for active Program recipients and found six recipients who had Social Security numbers that were not issued by the Social Security Administration and were therefore invalid. Total Program payments to these ineligible recipients amounted to an estimated \$12,850. Including prior year payments, the total is an estimated \$33,001.
- b. We also reviewed the validity of Social Security numbers of active recipients who provided the Department with Social Security numbers of persons reported to the Social Security Administration as deceased. We found eight such instances. Total Program payments to these ineligible recipients amounted to an estimated \$18,253. Including prior year payments, the total is an estimated \$39,985.
- c. We also found nine instances in which invalid numbers appeared to have been entered because of Departmental error, rather than because of inaccurate information provided by clients. Program payments in these instances totaled an estimated \$8,257. Including prior year payments, the total is an estimated \$16,812.

- d. During our review we found one recipient who received benefits from two different Departmental assistance units for four months due to a child custody arrangement. The unallowable part of these double payments totaled \$1,480.

Cause of Condition

The Department identified several reasons that may have caused these conditions, including worker error and a client's use of a first or surname at the Department that was different from the one the client submitted to the Social Security Administration.

Effect of Condition

Clients who may not be eligible are receiving both state and federal benefits. 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. We estimate that, for the \$40,840 identified above, \$19,965 was charged to the federal program and \$20,875 was charged to state funds. Federal regulations require the auditor to question and report unallowable costs greater than \$10,000. Accordingly, we are questioning these amounts.

Recommendation

We recommend the Department:

- a. Periodically compare information provided by recipients with applicable records maintained with other state agencies and investigate any discrepancies.
- b. Require employees to follow state regulations regarding Social Security numbers and investigate and resolve invalid numbers.
- c. Require employees to follow state regulations regarding sharing child custody to prevent any double payments.

Department's Response

The Department concurs with the finding. The Economic Services Administration (ESA) has recently made changes to the electronic interface between the Department and the Social Security Administration (SSA) that will provide a broader search of the SSA databases and provide more opportunities to match the Social Security Numbers (SSN) sent from the Department. Additionally, changes planned to the current State On-line Query interface with SSA will greatly enhance the ability to identify accurate SSNs. Before ESA can implement the proposed changes, the SSA must approve the changes. Assuming SSA approval of these changes, the Department estimates the implementation by December, 2005.

On-going staff training to address this issue and future system enhancements will be provided.

Auditor's Concluding Remarks

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

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

Subpart A, Section 105 of the Circular states in part:

. . . a questioned cost means a cost that is questioned by the auditor because of a finding:

(1) Which resulted from a violation or possible violation of a provision of law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds ;

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

(3) Where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

Subpart E, Section 510 of the Circular states includes the following as audit findings the auditor shall report in a schedule of findings and questioned costs:

(a) (3) Known questioned costs which are greater than \$10,000 for a type of compliance requirement for a major program.

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.

Washington Administrative Code 388-454-0005 states in part:

- (2) If a child lives with more than one relative or parent because the relatives share custody of the child:
 - a) We include the child in the assistance unit (AU) of the parent or relative that the child lives with for the majority of the time; or
 - b) If relatives share physical custody of the child in equal amounts, we include the child in the AU of the parent or relative that first applies for assistance for the child.

04-03 The Department of Employment Security paid at least \$142,847 in unemployment insurance benefits to claimants who were not eligible. The Department also overpaid and underpaid eligible claimants by \$18,873 and \$5,150, respectively. In addition, we estimated that payments totaling more than \$185,000 were made to claimants during their first week of unemployment, which is prohibited by state law.

Background

The Department pays more than \$1.7 billion a year in benefits to unemployed workers.

Description of Condition

During our audit, we reviewed unemployment insurance benefit payments and found that at least \$142,847 in benefits was paid to claimants who were not eligible for benefits due to invalid Social Security numbers or because they already were receiving benefits for an on-the-job injury.

We found:

- Thirty-eight claimants received unemployment and workers' compensation benefits for the same time period. This is a violation of state law. These payments totaled \$125,566.
- Eight claimants used Social Security numbers of deceased individuals to receive benefits. These claimants are not eligible according to the Department's benefit eligibility policies. These claimants were paid a total of \$16,912. Seven of the eight claimants were reported to the Department by our Office in February 2004 as part of last year's audit. We verified that the Department discontinued making payments to these individuals after we noted the condition.
- One claimant used an invalid Social Security number to receive benefits. This claimant is not eligible according to the Department's benefit eligibility policies. Payments made to this individual totaled \$369.

In addition to the overpayments described above, we found that the Department paid several claimants during their first week of unemployment, which is prohibited by state law. When we examined this area, we produced a report that compared the weeks of unemployment to the benefit payment weeks and found 1,532 matches. We selected 60 of the 1,532 claimants and found 18 (30 percent) were paid during the first week of unemployment. Since the amount paid totaled \$462,616 over a nine-month period, we estimate that the amount would have been approximately \$616,821 for a 12-month period. Therefore, we estimate that \$185,046 (30 percent of \$616,812) was paid to claimants during their first week of unemployment.

These issues were reported to the Department as a finding during last year's audit.

Our review also revealed 9 claimants whose benefits were not properly reduced by their retirement pension benefits, as required by state law. Six claimants were overpaid by \$18,873 and three claimants were underpaid by \$5,150.

We found significant decreases in overpayments of unemployment benefits since our last audit in the following areas:

- Claimants that received benefits while incarcerated decreased from 15 claimants to zero claimants.
- Duplicate benefit payments decreased from 13 to zero.

Cause of Condition

The Department performs a cross-match of claimants' Social Security numbers with data from the Social Security Administration, but does not have procedures to identify deceased claimants and claimants receiving industrial insurance benefits.

The General Unemployment Insurance Development Effort system is the Department's unemployment insurance benefit payment system. An error in the system caused several claimants to be paid for their first week of unemployment, which is prohibited by law. This error has caused claimant overpayments since the system went on line in 1997. Management has been aware of this error since 1997, but considers the overpayments administrative errors and has not billed claimants for the overpayments.

We also found human errors in the calculation of the reductions to unemployment insurance benefit due to pension benefits. We also noted the Department does not consistently obtain direct verification with the retirement plan administrator as required by Washington Administrative Code. Instead, it relies on the claimant to provide information related to the share of the employee contribution to the retirement plan.

During the 2003 legislative session, state law was changed to require that interest penalties collected by the Department from delinquent claimants be used first "... to fully fund either social security number cross-match audits or other more effective activities that ensure that individuals are entitled to all amounts of benefits that they are paid . . ." For the 2003-2005 biennium, the Legislature appropriated \$6.7 million from this fund to community and technical colleges, which made this money unavailable for the Department to fully correct the issues identified during our last audit.

Effect of Condition

Without adequate internal controls over the disbursement of unemployment insurance benefits, the Department cannot ensure that benefits are being paid to eligible claimants for the correct amounts.

Recommendation

We recommend the Department:

- Improve its effort to cross-match its Social Security data with data from the Social Security Administration to identify claimants with invalid Social Security numbers and claimants using Social Security numbers belonging to deceased individuals.
- Consider sharing or obtaining data from the Department of Labor and Industries to match Social Security numbers on claimants receiving industrial insurance benefits.
- Improve the benefit payment system to prohibit payments during the claimant's first week of employment.
- Establish and follow procedures to ensure that all pension benefit reductions are accurately calculated and that the Department obtains written certifications from the administrator of the pension plan.

Department's Response

We appreciate the work performed by the State Auditor's Office on our Unemployment Insurance (UI) benefit payment processes. As usual, the audit has identified things that we can do to improve the UI program. Our agency currently performs extensive cross matches, data mining and other fraud prevention and detection efforts for the UI program. Our Office of Special Investigations and their fraud prevention and detection efforts continue to be recognized as a leader in the nation, by the USDOL and other states.

In response to the issues identified by the auditor the agency has taken the following actions:

Payments totaling an estimated \$185,000 were made to claimants during the first week of unemployment, which is prohibited by state law.

This finding is based on SAO's projections of the results of sampled transactions. We are uncomfortable with the validity of a projection because of the numerous changes that occurred in the UI program during the time of the audit. During that time, we triggered off of Extended Benefits, the Temporary Emergency Unemployment Compensation program ended and we implemented numerous changes to the UI program as mandated by Second Engrossed Senate Bill (SESB) 6097.

GUIDE staff have not yet implemented program changes to prevent the waiting week from moving to the first compensable week of the claim when the first weeks of the claim are paid out of order and a claim recalculation occurs. Since mid July 2003, the primary focus has been implementation of the far-reaching effects of UI legislative revisions. These changes required the use of the majority of GUIDE resources as well as common programming code. It was not possible to work both of these high priority items at the same time. The final implementation of benefit related legislative revisions are scheduled for the end of this year. Attention can then be refocused on the waiting week issue. Preliminary system requirements/design for this effort was completed in June 2004.

Eight claimants received benefits using the Social Security Numbers (SSN) of deceased individuals. The claimants were paid \$16,912. In addition, one claimant received benefits using an invalid Social Security Number. The claimant was paid \$369.

Eight of the nine cases of claimants using the SSN of a deceased person or an invalid SSN were brought to our attention during last year's audit. These eight were adjudicated prior to the exit interview with the State Auditor's Office in February 2004. We do not believe that these claims should be included again this year, because they were addressed during last year's audit. Also, the Department is currently in the process of establishing an overpayment for the remaining claimant who used the Social Security Number of a deceased individual.

Thirty-eight claimants received both unemployment and workers compensation benefits for the same time period. This is a violation of state law. These payments totaled \$125,566.

We agree with the audit finding concerning 38 claimants receiving both unemployment and workers compensation benefits for similar time periods. The UI Division has submitted a service request to implement a weekly Unemployment Insurance/Labor and Industries (L&I) crossmatch designed to immediately identify those claimants who have filed for and are receiving both UI and workers compensation benefits simultaneously. The Total Temporary Disability (TTD) unit will work the GUIDE-generated report and establish procedures to severely limit both overpayment and fraud activity. The service request will be given top priority once the work related to implementation of SESB 6097 is completed, so we anticipate the weekly crossmatch to begin soon. We also intend to work with the Department of Labor and Industries to improve coordination and communication when back pay awards of workers compensation benefits occur.

Nine claimants did not have their benefits properly reduced by their retirement pensions. Six were overpaid a total of \$18,874 and three were underpaid a total of \$5,251.

The audit report lists issues with nine pensions - six overpayments and three underpayments. UI Policy staff carefully researched each claim. All cases of over and under payment are being forwarded to the appropriate TeleCenter for action with the exception of cases where there was nondisclosure of pensions by claimants. Those files are being forwarded to the Office of Special Investigations for potential fraud determinations. Also, training on pensions and pension deductions will be reviewed and amended as needed to insure that staff are properly calculating and deducting pensions.

Auditor's Concluding Remarks

We appreciate the Department's efforts in addressing this finding.

The method we used to estimate the total payments made to claimants during the first week of unemployment is an accepted and proven audit practice. Therefore, we reaffirm our estimate of \$185,046.

The Department is correct that eight overpayments to individuals using Social Security numbers of deceased individuals or invalid Social Security numbers were identified and reported to the Department during the prior audit. However, overpayments continued to be made to these

claimants during this year's audit period. Federal regulations require our Office to report overpayments of this magnitude.

We will review the agency's progress during our next regular audit.

Applicable Laws and Regulations

RCW 50.04.323 (1) states in part:

The amount of benefits payable to an individual for any week which begins . . . in a period with respect to which such individual is receiving a governmental or other pension, retirement or retired pay, annuity, or any other similar periodic payment which is based on the previous work of such individual shall be reduced (but not below zero) by an amount equal to the amount of such pension, retirement or retired pay, annuity, or other payment, which is reasonably attributable to such week.

RCW 50.04.323 (1)(b) states in part:

The amount of such a reduction shall take into account contributions made by the individual for the pension, retirement or retired pay, annuity, or other similar periodic payment, in accordance with regulations prescribed by the commissioner.

RCW 50.20.010 (1) states in part:

An unemployed individual shall be eligible to receive waiting period credit or benefits with respect to any week in his or her eligibility period only if the commissioner finds that: . . . (c) He or she is able to work, and is available for work in any trade, occupation, profession, or business for which he or she is reasonably fitted [and] (d) He or she has been unemployed for a waiting period of one week.

RCW 50.20.085 states:

An individual is disqualified from benefits with respect to any day or days for which he or she is receiving, has received, or will receive compensation under RCW 51.32.060 or 51.32.090.

RCW 51.32.060 is the state law providing compensation for permanent total disability in the case of an industrial accident, which is referred to as workers' compensation pensions.

RCW 51.32.090 is the state law providing compensation for temporary total disability in the case of an industrial accident, which is referred to as workers' compensation time loss.

WAC 192-110-005 (3) states in part:

The first week you are eligible for benefits is your waiting week. You will not be paid for this week . . .

WAC 192-16-030 states in part:

The deductible pension amount shall be determined as of the last pay period in the individual's base year for which contributions were made.

Unemployment Insurance Procedures Manual, Section 5100.00, General Information -- Initial Claim, states in part:

Without a social security number (SSN), a claim for unemployment insurance cannot be completed. A correct SSN is essential to establish an unemployment insurance claim. During the initial claim process, verification of identity will occur . . . SSNs that have never been issued, belong to another individual or belong to a deceased person will be flagged

Section 20.20.20.a of the Office of Financial Management's State Administrative and Accounting Manual states in part:

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

04-04 The Department of Social and Health Services, Division of Child Care and Early Learning, does not have adequate internal controls over support for payments made to child care providers.

Background

The Department of Social and Health Services administers child care programs that pay child care centers and licensed family home child care providers for child care services for eligible families. The Department either pays the providers directly or pays clients directly, with the expectation that the clients will then use the funds for child care services. The Department has assigned responsibility for the Program to the Economic Services Administration, Division of Child Care and Early Learning. Payments are made from various funding sources, including several federal programs.

During our fiscal year 2003 audit, we found that the Division did not require adequate supporting documentation in the form of attendance records from all of its providers. The Division requires that child care centers have the parent or custodian sign the child in and out of care and note the time of arrival and departure. This is not required for family home child care providers. In addition, the attendance records that were available were not always adequate.

Program payments to vendors and clients are made from both state and federal funds. During fiscal year 2004, total payments for the Division of Child Care and Early Learning program were approximately \$255 million.

Description of Condition

We found the Division continues to allow providers to use inadequate alternative records as support for payments issued. These records do not require the parent or custodian to sign the child in and out of care each day and note the time the child arrived and departed. Therefore, this issue has not been resolved. In addition, the Division did not monitor its providers to determine if they had any attendance records to support their billings.

The Division stated that in October 2004, the Department began requiring that children be signed in and out of the family home facilities and that adequate attendance records are maintained. We will review this during the fiscal year 2005 audit and make a determination at that time as to whether these controls were appropriately implemented and are now adequate.

Cause of Condition

The Division had been working on establishing the attendance record requirement for several years and only recently was able to put it in place. The Division stopped any on-site monitoring this year because of reduced staff.

Effect of Condition

The Department cannot be assured it is paying child care providers only for the hours that children are actually in care. The Department has established total overpayments to child care

providers in the amount of approximately \$2.2 million. We question these overpayments, which were made from various funding sources, including several federal programs.

Recommendation

We recommend the Department:

- Require all child care providers to use a standard attendance record issued by the Department.
- Require all child care providers to have the parent or custodian of each child sign the standard attendance record when the child arrives and departs from care, noting the arrival and departure times.
- Monitor providers to ensure that attendance records support the payments made.

Department's Response

The Department partially concurs with this finding.

The Division of Child Care and Early Learning (DCCEL) concurs that there are not adequate internal controls over support for payments made to licensed family home providers. DCCEL is not currently funded to conduct comprehensive subsidy monitoring activities. However, DCCEL is coordinating quality assurance activities with the Community Services Division to ensure supervisory reviews of child care subsidy cases; Payment Review Program to identify and collect overpayments through the use of algorithms; and Division of Fraud Investigations to ensure in-home child care is occurring in the child's home. DCCEL has also coordinated quality assurance activities with the Division of Employment and Assistance Programs to monitor subsidy payments to a targeted group of family child care homes and the Operations Review and Consultation to monitor subsidy payments to a targeted child care centers.

We believe the Department will do a better job if the e-Child Care program is implemented. Currently, the Social Service Payment System allows duplicate authorizations, the age rate categories and age of the child are not included in the payment calculation, and there is no reconciliation between the original authorization and attendance detail. The proposed e-Child Care program is designed to resolve these problems, and many others, through the use of a newly designed electronic tracking and case management system.

The Department questions the accuracy of the \$2.2 million in overpayments mentioned in this report. This amount listed may include overpayments from former years or overpayments that have been established but not yet paid by the end of the last fiscal year.

On October 1, 2004, the Washington Administrative Code was changed to require parents to sign their children in and out of care. DCCEL developed a standard form that can be used for attendance keeping and the sign-in and –out process. However, we have not made the use of this particular form mandatory. Our position is that the key elements must be in place on any

attendance form used. That includes the date, child's name, time in, time out, and parent's signature.

Auditor's Concluding Remarks

We reaffirm our finding. During fiscal year 2004 the Division continued to allow providers to use inadequate alternative records as support for payments. In addition, the Division did not monitor to ensure that available documents supported payments made to providers. We appreciate that DCCEL is working to develop a standard form and restate our recommendation that this form be required.

The Department provided us with a report that established its total overpayments to child care providers in the amount of \$2.2 million as of June 30, 2004. We agree this may include amounts established in previous years. However, the Department was unable to separate the portion of that amount that related only to fiscal year 2004.

Applicable Laws and Regulations

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

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

The same section of the circular states in part:

4.a.. Applicable credits refer to those receipts or reductions of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are:...rebates or allowances, recoveries or indemnities on losses,...charges. To the extent that such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate.

04-05 The Department of Social and Health Services, Economic Services Administration wrote-off child care overpayments to providers without adequate support and inappropriately decreased amounts owed to the Department by child care providers.

Background

The Department of Social and Health Services administers the federally funded Seasonal Child Care Program, which pays day-care centers and in-home providers for child care services for eligible families. The Department has assigned responsibility for the Program to the Economic Services Administration, Division of Child Care and Early Learning. Program payments are made through the Social Services Payment System from federal funds in the Child Care Development Fund-Discretionary.

During fiscal year 2003, we reviewed the Department's Division of Fraud Investigations' findings related to the Mattawa child care investigation. Based on the work we performed and review of the Division's findings, we issued special investigation report, No. 6370, on May 28, 2003. In this report we communicated that some providers of family child care homes in Mattawa, Washington, made significant misstatements about their identities and/or failed to supply adequate attendance documentation to support billings submitted to the Department.

At that time, we recommended the Department:

- Seek recovery of improper payments from the providers who gave false information and forward these cases to the Grant County Prosecuting Attorney's Office for any further action deemed appropriate under the circumstances. Any compromise or settlement of this claim must be approved in writing by the Attorney General and the State Auditor, as directed in RCW 43.09.330. These payments totaled \$839,071.
- Seek recovery of all child care payments from providers who did not supply adequate supporting attendance records.
- Work with the U.S. Department of Health and Human Services to determine the amount of questioned costs to be returned by the Department to the federal grantor.

During the fiscal year 2004 audit, our objective was to determine the status of the Department's recovery process.

Description of Condition

State regulations require providers to maintain support for billings on the premises. The Division of Fraud Investigations served subpoenas on all of the Mattawa providers more than two years ago, at which time all attendance records were to be turned over to the investigators. The Division found some instances of apparent identity theft and significant instances of inadequate documentation to support billings. Seven cases were closed administratively without further action. During our audit, more than two years after the Division began its investigation, there were still eight cases which the Department had not analyzed for the establishment of

overpayments. For the others, the Department used a variety of procedures when it began overpayment proceedings.

Overpayment Reductions

Division of Child Care and Early Learning

Some instances of inadequate documentation were referred directly to the Division of Child Care and Early Learning for resolution. The Division sent letters to the providers explaining that the attendance records provided by them as a result of the subpoenas were incomplete and that providers could send in additional proof of the children's attendance. The Division provided detailed information regarding the additional information needed to clear the overpayments. Each letter specifically stated all three of the following items for the unsupported payments:

- The month and the year of the provider's invoice.
- The children's names included on the invoice.
- The amount the Department may have overpaid.

Instead of relying on the attendance records obtained from the subpoenas, the Division provided a complete list of all information a provider would need to create an attendance record to "support" the payments the Division had made. The Division sent these letters long after the subpoenas were served. It then accepted as adequate proof of attendance any records the providers sent as a result of those letters.

Attendance records provided long after the subpoena was issued may not be originals and do not provide adequate evidence that a service was provided.

We noted one case in which a provider originally owed \$17,334; after additional attendance records were received, the amount owed to the Department was reduced by \$16,714 to \$620.

Moses Lake Community Service Office

The Division of Fraud Investigations sent some cases directly to the Moses Lake Community Service Office to determine the amount of overpayments owed to the Department. Because attendance records are the supporting documents confirming whether a service was performed, the Office compared the payments the providers received with the attendance records that were obtained from the subpoenas.

As a result of this lengthy process, the Office determined that \$384,449 was owed to the Department from 13 of the cases. However, the Division of Child Care and Early Learning then performed its own procedures for eight of the providers as described above, and asked providers for additional records. The Division's reassessment based on the additional records received lowered the total overpayment for these cases to \$59,776, a reduction of \$324,673.

We reviewed notes for one of these cases and found the Department told the provider that, based on her additional documentation, her overpayment had been decreased to \$1,707.50 from the original \$34,407.56 assessment made at the Community Services Office. The provider then stated that she would review the adjusted overpayment to see if she had paper work for the remaining children on the revised overpayment. This example demonstrates the ease with which a provider could create fictitious attendance records or alter records.

Overpayment Write-offs

The Division of Fraud Investigations originally determined that the Department paid \$839,071 to 12 providers who supplied identity misstatements. The Office of Financial Recovery wrote off the debt for two of the providers in the total amount of \$371,174 because the Department was unable to locate them.

Overpayment Collections

The Department has collected a total of \$2,618 from five providers.

Cause of Condition

The Division accepted unreliable attendance documentation that may have been produced long after-the-fact because it believes that care was provided to the children. Established overpayments have not been collected in part because the Department continues to request documents and reduce overpayment amounts.

Effect of Condition

The Department has reduced the amount of overpayments to date by \$904,947. Of the remaining amount, it has collected only \$2,618. The table below demonstrates the status by the end of our audit:

Analysis by:	Original Amount	After Revisions	Payments Made
Fraud Investigations	\$ 839,554	\$ 371,174	\$ 483
Community Service Office	384,449	59,776	650
Child Care and Early Learning	<u>86,991</u>	<u>55,228</u>	<u>1,485</u>
Total	\$1,310,994	\$ 486,178	\$ 2,618

Recommendation

We recommend the Department:

- Seek recovery of all child care payments from providers who did not have adequate supporting attendance records at the time of the subpoenas.
- Enhance collection procedures and consider the use of collection agencies to recover overpayments.

- Transmit to prosecutors any information submitted by providers who were found by the Division of Fraud Investigations to have misstated their identities.
- Work with the U.S. Department of Health and Human Services to determine the amount of uncollectible overpayments which need to be returned by the Department to the federal grantor.

Department's Response

The Department does not concur with this finding. Economic Services Administration does not "write-off" or "inappropriately decrease" any child care overpayments. All providers who receive a Vendor Overpayment Notice have rights to due process. This includes the opportunity to provide additional information. In this situation, the Division of Child Care and Early Learning (DCCEL) gathered information to determine a more complete picture of the amount owed prior to establishing the overpayment amounts. The Department usually conducts a pre-hearing conference with a provider after the Vendor Overpayment Notice is written and the provider requests an administrative hearing. An Administrative Law Judge is also able to reduce the amount owed at the time of the hearing based on additional information. The Department seeks recovery of child care payments only when there is no documentation to support subsidy billing.

On October 1, 2004, DCCEL adopted revised Washington Administrative Code (WAC) requiring parents to sign children in and out of care on a daily basis. These attendance records are now required documentation for amounts claimed and paid to providers. Prior to October 1, 2004, any record that showed the child was in care was accepted as proof of attendance. For example, attendance records from the provider, the food program, Seasonal Child Care Contractors, and parent affidavits were all accepted as appropriate documentation.

Auditor's Concluding Remarks

State regulations (WAC 388-155-460) state, in part, that the licensee must maintain attendance records on the premises and complete them daily, including arrival and departure times. They further state that attendance records and invoices for state-paid children are to be maintained for at least five years. The Department's Division of Fraud Investigations issued subpoenas in 2002. The subpoenas required the providers to produce copies immediately of any and all children's attendance records. Attendance records that appear long after a subpoena was issued do not provide adequate evidence that a service was provided. We reaffirm our finding.

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.

The Office of Financial Management's State Administrative and Accounting Manual, Section 85.54.50.b states:

Written procedures are to be developed and followed to ensure that past due receivables are followed up promptly and in a manner that is cost-effective for the overall collection program. These procedures are to provide for the full range of collection procedures to be used as appropriate, including issuance of statements and dunning letters, phone and personal interviews, filing of suits and liens, referral to private collection agencies or letter services, etc. Agencies that do not have special statutory collection authority, or specialized collection operations are encouraged to use collection agencies after receivables become 90 days past due.

04-06 The Department of Social and Health Services, Division of Child Care and Early Learning, does not ensure that all recovered overpayments are credited to the appropriate funding source.

Background

The Department of Social and Health Services administers child care programs that pay child care centers and licensed family home child care providers for child care services for eligible families. The Department either pays the providers directly or pays clients directly, with the expectation that the clients will then use the funds for child care services. Program payments are made from both state and federal funds. The Department has assigned responsibility for the Program to the Economic Services Administration, Division of Child Care and Early Learning.

Child care overpayments are primarily identified by case workers during eligibility update reviews. The field offices report identified overpayments to the Department's Office of Financial Recovery. The Department has also recently started using computerized processes to identify overpayments.

Client overpayments as of June 30, 2004, were approximately \$6,388,000. Overpayments identified in a current fiscal year may not be recovered until a future fiscal year.

During the fiscal year 2003 audit, we found that the Department did not ensure that all funds recovered from client overpayments were returned to the proper funding source. The Department stated that approximately \$136,000 was recovered from client overpayments. However, the Department was not able to determine how much of this amount was initially paid with federal and state funds and to which funding source funds should be returned. We reported this weakness in the Statewide Accountability Report and in the State of Washington Single Audit Report. The Department did not concur with this finding and stated it codes the recovery to the original line of coding used for the expenditure. It explained that our Office did not understand the process it uses.

Description of Condition

During our fiscal year 2004 audit we found the Department still does not ensure all funds recovered from client overpayments are returned to the proper funding source.

We attempted to verify that recoveries were coded to the original line of coding used for the payment, as the Department stated. We selected a recovery and asked the Department to show us how it had been credited to the proper source of funding. The Department was not able to demonstrate that the individual recovery was recorded anywhere in its accounting records, much less in the proper funding source.

The Department stated that generic coding is used to account for the client recoveries. We tested one of the generic codes used and found that the funding source changed multiple times throughout the audit period.

As discussed earlier, last year the Department stated it received approximately \$136,000 in client recoveries. This year we were told that, prior to February 2004, the Department could not

identify client recoveries separately from vendor recoveries. During the last five months of the fiscal year, February 2004 through June 2004, the Department was able to make this distinction and recovered \$112,000 in client overpayments. However, as with last year, the Department is still not able to determine how much of this amount collected was initially paid with federal and state funds and to which funding source funds should be returned.

Cause of Condition

The computer system used for client overpayments is inadequate for tracking the original funding sources, and the Department has not developed an alternative method of determining to which funding sources client overpayments should be returned.

Effect of Condition

The Department may not be returning recoveries of federal funds to the proper funding sources as required by federal regulations. Payments originally made with federal program funds may be returned and credited to entirely different federal programs or to state funds.

Recommendation

We recommend the Department develop an adequate method of ensuring that all funds recovered are returned to their proper sources.

Department's Response

The Department concurs with this finding. We recognize the need to improve our process and have placed additional effort in this area. The Department's Financial Services Administration is in the process of modifying the Client Receivable System to include the detailed coding structure and historical data needed to ensure that recovered client overpayments are credited to the appropriate funding source. We expect testing to begin in April 2005 with implementation by the end of June 2005.

Auditor's Concluding Remark

We appreciate the Department's prompt and thorough response and its commitment to resolving these issues.

Applicable Laws and Regulations

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

- 4.a. Applicable credits refer to those receipts or reductions of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are . . . rebates or allowances, recoveries or indemnities on losses, . . . charges. To the extent that such credits accruing to or received by the governmental unit relate to allowable

costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate.

04-07 The Department of Social and Health Services, Division of Child Care and Early Learning, does not adequately perform background checks.

Background

The Department of Social and Health Services administers the Child Care program, which pays child care centers and licensed family home child care providers for services provided to eligible families. The Department has assigned responsibility for the Program to the Economic Services Administration, Division of Child Care and Early Learning. The Division develops the policies and procedures used to license child care providers.

Potential providers and anyone 16 years of age or older who will have unsupervised or regular access to the children in care must complete a Background Check Authorization Form. This includes assistants, volunteers and members of the applicant's household. The form is used to check whether these individuals have criminal backgrounds that would disqualify them from becoming licensed child care providers, associates, or volunteers. Applicants are not licensed if household members and others with access to the children are found to have disqualifying criminal backgrounds.

On the form, the person is required to document current name, date of birth and other names by which they have been known. A Social Security number is optional.

These forms are sent to the Department's Background Check Central Unit. The Unit enters the data provided into the Department database, which draws information from the Washington State Patrol's criminal history database and from the Department.

The Patrol's database includes only Washington arrests; therefore, a search of this database does not provide criminal background information in other states. Individuals can be included in the Patrol's database for several reasons:

- When someone is arrested in Washington State, the arrest cards (including fingerprints) are sent to the Patrol. The Patrol enters this data into the criminal history database. Once final disposition of the case is made, it is entered into the System.
- Fingerprints of all Washington State criminal justice employee applicants are entered into the criminal history database.
- Convicted sex/kidnap offenders are required to register with the sheriff in the county of residence. The requirement to register includes offenders who move into Washington from another state. The county sheriff sends these fingerprints and photographs to be entered by the Patrol into the criminal history database.
- The Patrol allows individuals meeting certain criteria to provide their own personal identification fingerprint cards to the Patrol for inclusion in the database.

If a person reports residency in the state for more than three years, the background search does not require a fingerprint check. The Background Unit conducts the search in the Patrol's

criminal history database by using the exact name and exact date of birth as given by the applicant. Other elements can match, such as Social Security numbers; however, the primary search is based on name and date of birth. Matches, if any, produce a Report of Arrest and Prosecution sheet that shows the criminal history record for this person. Sometimes this sheet includes a Washington State Department of Corrections number that the Background Unit will research. If the Background Unit finds that the person did not commit a crime in Washington State, yet has a Corrections number, it may indicate that the person has been imprisoned or is under Correction's supervision in this state for a crime committed in another state.

If a person reports residency in Washington State for less than three years, state law gives the Department authority to require a fingerprint-based background check. The Background Unit forwards these fingerprints to the Washington State Patrol. The Patrol performs a statewide search by comparing the fingerprints on the fingerprint card to the fingerprints in the Identification System. The fingerprints are forwarded electronically, by the Patrol, to the Federal Bureau of Investigation for a nationwide search. The FBI forwards its search results electronically to the Patrol, which then switches them to the Background Unit. The statewide search results are mailed by the Patrol to the Background Unit. The Patrol and FBI search results are entered into the Department's Background Check Central Unit database as received. The results are mailed to the Division licensors.

We issued special investigation report, No. 6370, on May 28, 2003. In this report, we communicated inadequacies in the background check process performed by the Department. In our fiscal year 2003 State Accountability Report, we reported that the weaknesses continued.

Description of Condition

This year we followed-up on the weaknesses noted previously and found the Department continues to conduct inadequate background checks, as follows:

- It does not require licensors to see the individuals in person and at the same time compare their information from the Department Background Check Authorization Form to any piece of original identifying information. The Division's Policy Directive allows potential providers to provide a photocopy of photo identification issued by a government entity and does not ask for any identifying information from the other individuals who will have unsupervised or regular access to the children in care.
- It does not require applicants to provide documentation of the length of their state residency.

Cause of Condition

The Department stated they do not have enough funds to correct the deficiencies in their background checks.

Effect of Condition

The Department could license and pay child care providers who do not meet licensing standards or who have associates or household members who do not meet the standards of adequate background checks. A person could provide any name or date of birth on the Background Check Authorization Form. In such a case, the background check would be performed on a name and date of birth that may be false or stolen. In our May 2003 special investigation, we reported an instance in which the Department licensed and paid a provider who was using an assumed name. In addition, an applicant could falsely state residency of more than three years to avoid the fingerprinting process and nationwide search.

Recommendation

We recommend the Department:

- Require licensors to perform a visual confirmation of the person and original photo identification for each person who will have unsupervised or regular access to the children in care. This includes the applicant, assistants, volunteers and members of the applicant's household. The information written on the Background Authorization Form should be compared to the other original documentation supporting the identity of the applicant. This review would provide some assurance that the Department is performing a background check on the person completing the form.
- Require applicants to provide documentation of the length of their state residency.
- Conduct nationwide checks on all applicants who cannot adequately document they have lived in the state at least three years.

Department's Response

The Department does not concur with this finding. The Department does not concur that the Division of Child Care and Early Learning (DCCEL) licensors are conducting inadequate background checks. State law does not require nationwide background checks to be performed on persons who report they have lived in the state for more than three years. The Department does not have the ability to verify length of state residency, and the State Auditor's report does not recommend a resolution of this condition. Nationwide background checks on all child care license applicants would be very time consuming and costly. In addition, changing the current background check policy would involve not just DCCEL, but many other state agencies as well.

RCW 74.15.030(2)(b) states:

... In order to determine the suitability of applicants for an agency license, licensees, their employees, and other persons who have unsupervised access to children in care, and who have not resided in the state of Washington during the three-year period before being authorized to care for children shall be fingerprinted. The fingerprints shall be forwarded to the Washington state patrol and federal bureau of investigation for a criminal history records check.

Licensing staff do conduct a visual comparison of the applicant/licensee and their original photo identification. It is not feasible for all staff of the facility who will have access to the children (all staff and volunteers of the facility) have a visual comparison completed, due to the sheer numbers involved and large turnover of staff.

It is impossible for the Department to obtain proof of residency.

Auditor's Concluding Remarks

We reaffirm our belief that the Department does not perform adequate procedures to ensure the child care providers with whom it contracts and the providers' associates do not have disqualifying criminal backgrounds. During 2004, the Legislature began a study of the background check process.

The Department could accept various documents for proof of length of residency, such as voter registration cards, drivers' licenses, and tax returns.

Applicable Laws and Regulations

The Office of Financial Management *State Administrative and Accounting Manual*, Section 85.32.10, states in part:

. . . At a minimum, agencies are . . . to establish and implement the following:

1. Controls to ensure that all expenditures/expenses and disbursements are for lawful and proper purposes . . .

Revised Code of Washington 74.15.030 states in part:

The secretary shall have the power and it shall be the secretary's duty:

(2) In consultation with the children's services advisory committee, and with the advice and assistance of persons representative of the various type agencies to be licensed, to adopt and publish minimum requirements for licensing applicable to each of the various categories of agencies to be licensed.

The minimum requirements shall be limited to:

(b) The character, suitability and competence of an agency and other persons associated with an agency directly responsible for the care and treatment of children, expectant mothers or developmentally disabled persons....In order to determine the suitability of applicants for an agency license, licensees, their employees, and other persons who have unsupervised access to children in care, and who have not resided in the state of Washington during the three-year period before being authorized to care for children shall be fingerprinted.

Washington Administrative Code 388-155-070(c) states in part:

Submit to the department a completed and signed family child care home license application form, including the following attachments:

- (ii) A completed criminal history and background inquiry form for each person sixteen years of age or older who will have unsupervised or regular access to the children in care. This includes you, any other applicants, assistants, volunteers and members of your household . . .
- (iii) Fingerprint cards if residing in Washington state for less than three years
.....

04-08 The Department of Social and Health Services, Economic Services Administration, did not properly monitor its contract with a non-profit organization that billed for services it did not provide.

Background

The Department of Social and Health Services, Economic Services Administration's Basic Food, Education, and Outreach Program contracts with non-profit organizations to educate potential applicants about food stamps and to assist them in completing applications. The Program receives funds from the federal State Administrative Matching Grants for the Food Stamp Program (CFDA 10.561).

To bill the Department for its services, a contractor enters information about the clients it contacted in person into the Department's on-line Food Stamp Education Reporting System. The client contact data must contain, at a minimum, each client's name and Social Security number or birth date. The contract states a contractor is to bill \$59 for the visit if the consultation occurred in the contractor's office or \$75 if it occurred at the client's home.

Description of Condition

During our 2004 audit, the Department's Division of Fraud Investigations learned from a former employee of a non-profit organization receiving funds from this Program that the organization was billing the Department for services not provided. This organization had received federal fiscal year contracts for 2003 and 2004 of approximately \$1.5 and \$1.1 million, respectively.

The Division received information that the organization may have submitted excessive monthly billings when a director instructed the former employee to add names and Social Security numbers of people with whom the organization did not have face-to-face consultations.

The Division stated it served a search warrant on the non-profit organization to obtain information necessary to determine the validity of the information. Investigators inquired of 64 selected clients listed on the billings and found that 60 of them stated they never had received such consultations. Program staff members then performed their own review and found 197 of the 222 clients they contacted reported the same lack of consultation.

We reviewed the Division's and the Program's preliminary work and found there was sufficient information to merit additional work by the State Auditor's Office. We performed the review to determine the internal control weaknesses that allowed this condition to occur without detection for a long period of time and to verify the amount of the loss.

Cause of Condition

The Program did not monitor to ensure that services billed had been performed. For instance, it did not require any supporting documentation, such as documents signed by clients acknowledging that the non-profit had consulted with them about the Program.

Further, during an internal review of the contract, the Department found that agreements outside of the contract were made with the contractor. These agreements included the Department's

willingness to accept consultations by telephone or postcard rather than in person. However, the Division of Fraud Investigations found clients inappropriately added to the billings by the non-profit were not contacted in any form.

Effect of Condition

The Department paid approximately \$1.1 million to this non-profit for services it claimed to have provided to clients from June 2002 through September 2003, the 16-month period the Division of Fraud Investigations reviewed. Federal funds provided 50 percent of the total, with the remaining amount supplied by state and local funds.

We question the \$1.1 million due to the lack of supporting documentation, the Department's inadequate monitoring, and the high rate of falsified billing records and misappropriation of public funds identified by the Division.

Recommendation

To improve its internal controls, we recommend the Program:

- Verify with clients, on a routine basis, that services have been received.
- Require contractors to provide supporting documentation for client consultations. This could include a document signed by the client and by the contractor's employee performing the consultation. At a minimum, this document should include the client's name, address, and telephone number.
- Ensure contractors follow the terms of contracts as written; if changes are required, they should be included in written amendments.

We also recommend the State Attorney General's Office and the Pierce County Prosecuting Attorney review this matter for any action deemed appropriate.

We further recommend the Department consult with the grantor, the federal Department of Agriculture, to determine the amount it may have to return to the federal government as a result of these questioned costs.

Department's Response

The Department partially concurs with the finding.

* *The Economic Services Administration (ESA) does not concur with the State Auditor's Office findings that verbal agreements were made with South Sound Outreach Services (SSOS) to accept consultations by telephone or postcard under the Basic Food Education and Outreach contract. The contract specifically states "in person contacts" and meetings were held with the lead agencies (July 2002, January 2003, May 2003, and November 2003) that included discussions of the contents of the Basic Food Education and Outreach state plan and the*

contract. A letter was also sent to South Sound Outreach Services on March 7, 2002, emphasizing that all innovative services must have prior written authorization.

* *ESA does not concur with the State Auditor's Office questioning of the entire \$1.1 million contract with SSOS for June 2002 to September 2003 for services SSOS claimed to provide to clients. The contract with SSOS included a requirement to oversee their seven other subcontractors of education and outreach services, in addition to education and outreach services SSOS provided directly to clients. The Department believes the total alleged fraudulent payment amounts were limited to \$215,218 State and Federal funds paid to SSOS for services directly delivered by SSOS.*

Each subcontractor independently entered client contact information into the Basic Food Education and Outreach online reporting to the Department. No fraud or billing irregularities have been found with any of the seven other subcontractor's reporting or billing. Of the total \$1.1 million in question spanning from June 2002 to September 2003, the alleged fraudulent payment amounts were limited to \$215,218 State and Federal funds paid to SSOS for services directly delivered by SSOS. Of this amount \$42,664 was state funding and \$172,554 was federal funding provided by United States Department of Agriculture through Food and Nutrition Services. SSOS contributed \$129,890 in local private matching funds for this contract period and this amount should not be included in the questioned costs.

* *The Department partially concurs with the State Auditor's Office findings on inadequate monitoring of a non-profit organization under the Basic Food Education and Outreach program.*

At the time of the initial allegations in October 2003, ESA was completing a thorough review of the monthly billing invoices and back up online documentation. We acknowledge, however, that our monitoring did not contain controls capable of discovering the alleged fraud perpetrated by SSOS.

In December 2003, ESA implemented changes to internal processes to reasonably ensure that SSOS is in compliance with applicable laws, regulations, and provisions stated in the audit finding. Additionally, the Basic Food Education and Outreach Program also implemented changes to their monitoring processes, to include random client contacts for all other contracts.

Upon receipt of information from a former SSOS employee that ESA was being billed for clients that were not being seen, ESA strengthened its payment review process for SSOS billings. ESA specifically reviewed SSOS client contacts submitted via the electronic reporting system and only approved payment for those clients who provided verbal or signed confirmation of services.

Auditor's Concluding Remarks

The Administration states it does not concur with our findings that verbal agreements were made with the non-profit organization to accept consultations by telephone or postcard under the Basic Food Education and Outreach contract. We are aware that once the Administration found these types of consultations, the practice stopped. However, these consultations were performed outside of contract terms. The Administration did not determine the number of questionable consultations, and funds paid for these types of consultations have not been recouped.

The Administration does not concur with our questioning the \$1.1 million because the non-profit organization had subcontractors who also provided education and outreach services with these funds. However, our review of the weaknesses that led to the specific over-billing described in the finding showed the Department was not adequately monitoring the overall activities of the non-profit organization. As a result, we determined it necessary to question all the costs.”

We appreciate the Administration’s work to resolve the contract monitoring process. We look forward to reviewing this area in the fiscal year 2005 audit.

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 . . .

Subpart A, Section .105 of Circular A-133 further states in part:

Questioned cost means a cost that is questioned by the auditor because of an audit finding . . . (2) Where the costs, at the time of the audit, are not supported by adequate documentation . . .

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

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

- a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.
- b. Be authorized or not prohibited under State or local laws or regulations.

The Office of Financial Management *State Administrative and Accounting Manual*, Section 85.32.10, states in part:

. . . At a minimum, agencies are . . . to establish and implement the following:

1. Controls to ensure that all expenditures/expenses and disbursements are for lawful and proper purposes

The Department's Administrative Policy 13.11, General Contract Monitoring, states its purpose is to provide Department staff with general contract monitoring guidance that can reasonably ensure:

- (1) The department receives goods and services that are paid through the contracting process.
- (2) The contractor meets the scope of work and specifications identified in the contract.

04-09 The Department of Social and Health Services, Children's Administration, paid through the Social Services Payment System for services performed after a client's date of death.

Background

The Department of Social and Health Services, Children's Administration administers child welfare and licensing services through 45 local offices in six geographic regions. The Administration is responsible for the investigation of child abuse and neglect complaints, child protection, family preservation, family reconciliation, foster care, group care, independent living, and adoption services for children up to 18 years of age.

The Administration can make adoption support payments to adoptive parents when the children being adopted require special assistance beyond the family's financial resources. One source of such funds is the federal Adoption Assistance Program (CFDA 93.659).

Description of Condition

We reviewed amounts paid through the Social Services Payment System for the period July 1, 2003, through December 31, 2003, for services provided after a client's death. We found 79 clients for whom these types of payments appeared to have been made. Services funded through this System with Medicaid dollars were addressed in finding M04-04 in the Special Medicaid Report we issued on December 30, 2004. For services other than Medicaid, we found five instances in which payments were made for care provided after a client's date of death.

We shared our detailed results with the Department and requested any evidence it had that the payments to these providers were allowable. Because the Department did not respond, we selected one of the potential exceptions for further examination.

The selection we made for further testing was a payment to adoptive parents who continued to receive monthly adoption support funds, even though records in the Department's Automated Client Eligibility System showed the child had died in mid-2001.

The Department's Adoption Support Program Manager researched the issue and reported to us that adoption support payments in this case were suspended in February 2004 because the family moved, leaving no forwarding address. On June 24, 2004, the file stated that warrants from October 2003 through January 2004 were returned to the Department as undeliverable. The case, however, was still open, as the Program did not know the client was deceased. Between the child's date of death and the date of our inquiries, the Department paid the adoptive parents a total of \$16,549 for 32 months of service.

Cause of Condition

The Department is largely dependent on the provider or family members to voluntarily report a client's death. Lack of timely notification or no notification leads to cases where claims are paid after the recipient has died.

Effect of Condition

The Department's inability to identify deceased clients in a timely manner allows payments for deceased clients to continue without timely detection. This leaves the Department susceptible to error or misappropriation. We question the \$16,549 paid inappropriately. The Department believes federal and state funds each paid 50 percent of this amount.

Recommendation

We recommend the Department:

- Consider establishing procedures with the Department of Health and with providers that will provide notification of clients' deaths in a timely manner.
- Request that the Division of Fraud Investigations review these payments to determine what further action the Department should take, including setting up an overpayment for collection.
- Ensure the checks returned as undeliverable are properly cancelled.

Department's Response

The Department concurs with this finding. The Department regrets the information developed in response to the auditor's request was not presented in time for the auditor's review and will work to improve timely responses to auditor requests for information.

Children's Administration (CA) staff has initiated contact with the Department of Health to develop a process that provides DSHS with a list of deceased persons in Washington State on a monthly or quarterly basis. The Administration will also develop and implement procedures for timely provider notification of deceased clients.

CA submitted the overpayment request to the Office of Financial Recovery (OFR) on November 19, 2004. Per telephone discussion with OFR staff, the person who received the adoption support checks will be legally served this month. CA will refer this case to the Division of Fraud Investigations for follow-up and has asked OFR to share the overpayment file with the Division of Fraud Investigations.

CA will implement a standardized policy for the handling of undeliverable checks and ensure compliance with existing department policies on cancellation of checks.

Auditor's Concluding Remarks

Since we received the response above, the Department communicated to us that it determined the majority of the checks written after the date of death were cashed. The Department is now determining what further steps it needs to take. We appreciate the Department's prompt and thorough response and its commitment to resolving these issues.

Applicable Laws and Regulations

The Office of Financial Management *State Administrative and 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. 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

Client Service Contracts

04-10 The Department of Social and Health Services, Mental Health Division, did not comply with state and federal regulations when contracting for services paid with federal Community Mental Health Services Block Grant funds.

Background

The Department of Social and Health Services, Mental Health Division, administers the federal Community Mental Health Services Block Grant (CFDA 93.958), received from the federal Department of Health and Human Services. This Program provides funds to states and territories to help them provide comprehensive, community-based mental health services for adults with serious mental illness and children with serious emotional disturbances. These services may include direct services to clients or other professional/technical services. The Division contracts with service providers and professional and technical contractors to provide Program services.

In fiscal year 2004, the Department spent \$8,697,249 in this Program

Federal regulations applicable to the awarding of federal funds to states require the states to follow their own laws and regulations when spending these funds.

Description of Condition

The Division is not in compliance with state regulations regarding contract procurement and therefore is not in compliance with federal regulations. During our review, we found:

- We reviewed four contracts charged to the Program that were classified as personal service contracts in the accounting records. We found two of these were awarded as client service contracts. Based on the Statement of Work within each contract, we determined the services provided under these contracts should have been classified and procured as personal service contracts. In addition, the classification justification for one of the contracts related to a prior year's contract that did not provide the same services.
- We also reviewed contract files to ensure the contracts were executed and approved by both the contractor and the Division prior to the start date of the contract. We identified nine contracts that were not properly executed and approved prior to the start date of the contracts or the performance of work. The lag times between the start dates and the execution and approval dates ranged from several days to several months.

Cause of Condition

Confusion within the Division regarding the difference between the definition of personal services and client services contracts caused the misclassification.

In addition, the Division contracting staff is not always notified until after work has begun of the need for a potential personal or client service contract.

Effect of Condition

The Department cannot ensure the state's resources were used in the most economical manner possible because contracts awarded as client services are not subject to the specific competitive procurement and filing requirements that affect personal services contracts.

We question the \$810,862.50 in federal Community Mental Health Service Block Grant funds paid for these contracts in fiscal year 2004.

Recommendation

We recommend the Department review its client service contracts to ensure they meet the definition provided by the Office of Financial Management and, for any that do not, follow appropriate procurement criteria in the future.

We also recommend the Department ensure contracts are properly executed and approved prior to the start date of the contract.

Department's Response

The Department concurs with this finding.

The Mental Health Division (MHD) Chief of Finance has instructed staff to carefully review all contracted services to ensure division contracts are correctly classified and procured.

MHD contract staff will improve tracking of contracts sent for contractor signature and return to the MHD to enable the execution of contracts prior to the start date. The division will issue verbal direction immediately and written instructions by March 15, 2005, to all staff involved in contracts management of the importance of executing contracts prior to the start dates of service.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding and will review these areas in our fiscal year 2005 audit.

Applicable Laws and Regulations

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

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

- c. Be authorized or not prohibited under State or local laws or regulations

. . . .

RCW 39.29.006 states in part:

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

(8) "Personal service contract" means an agreement, or any amendment thereto, with a consultant for the rendering of personal services to the state which is consistent with RCW 41.06.380.

The Office of Financial Management's *State Administrative and Accounting Manual*, Section 15.10.10 states:

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

Section 15.10.15 states in part:

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

Section 15.10.45 states in part:

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

Section 16.10.15 states in part:

Client Services – Services provided directly to agency clients including, but not limited to, medical and dental services, employment and training programs, residential care, and subsidized housing. Clients are considered to be those individuals who the agency has statutory responsibility to serve, protect, or oversee. Clients are members of the public, external to state government, who have social, physical, medical, economic, or educational needs. Clients are not providers of services, state employees, or business organizations.

Section 20.20.20 states in part:

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

Department of Social and Health Services, Mental Health Division, Policies and Procedures, Policy Statement No. 6.02, states in part:

Contracts must be submitted to the MHD Contract Manager at least thirty days prior to execution. No contracts will be approved after work has begun.

04-11 The Office of Superintendent of Public Instruction did not comply with state and federal requirements when contracting for services paid with federal Title I funds.

Background

Since 2002, the Office of Superintendent of Public Instruction has been contracting with School Improvement Facilitators to work with school districts and individual school staff, parents and community members to:

- Identify schools strengths and areas of need.
- Develop school improvement plans.
- Develop performance agreements between the individual schools, school districts and the Office.

The Office selects those schools needing support in improving student learning and then contracts with facilitators to help plan improvements. Originally, 25 schools were involved in the three-year process. Each year, schools have been added to the project, bringing the current total to 67 schools involved in various stages. Federal funds are provided to the state through Title I (CFDA 84.010) to assist schools that have not met "adequate yearly progress" for two consecutive school years, as set out in the federal No Child Left Behind Act.

In fiscal year 2004, the Office contracted with and paid 49 Facilitators a total of \$2,128,600. Similar contracts totaled \$761,000 in fiscal year 2002, \$1,117,500 in fiscal year 2003, and \$2,006,000 to date in fiscal year 2005. All individual contracts were for amounts of more than \$20,000.

State regulations define client services as those services provided directly to those individuals the contracting agency has statutory responsibility to serve, protect, or oversee. Client service contracts are agreements with firms or individuals to provide direct services to clients of the agency. Agencies may select client service contractors by using the most appropriate procurement methods, such as competitive, non-competitive (direct award) or sole source methods.

Personal services consist of professional or technical expertise provided by a consultant to accomplish a specific study, project, task, or other work statement. Personal service contracts are agreements with consultants to provide these personal services to state agencies, businesses, providers, other contractors, etc. These contracts are subject to specific competitive procurement and filing requirements. In addition, federal regulations require state grant recipients to follow state laws and regulations as a condition of receiving federal reimbursements.

Description of Condition

The Facilitator contracts do not meet the definition of client service contracts, as the facilitators do not provide direct services to individuals. Although the contracts more nearly meet the definition of personal services than the definition of client services, the Office classified and procured them as client service contracts. This classification was based on the belief that

principals and teachers are clients of the Office and that these contracts provided direct services to them.

Before the contracts were first procured in 2001, the Office of Financial Management, without reviewing the actual contracts, verbally concurred with the Office's classification of these contracts. Rather than soliciting competitive bids, as required for contracts over \$20,000, the Office of Superintendent of Public Instruction set the price it would pay and then awarded contracts to private individuals and Educational Service Districts. It did not file the required personal service contract information with the Office of Financial Management.

In addition, the contracts provide that, for the work of a minimum number of days, the contractor is to receive established monthly budgeted payments based on the contract total divided by the number of months in the contract period. We found no evidence that, before payment, the Office performed any comparisons between the amounts contractors billed and the minimum number of days of work the contracts required. Instead, the Office relied on contractor filing of quarterly performance reports to support the monthly payments. Quarterly reports do not provide timely support for monthly payments and do not qualify as sufficient evidence to tie performance to the contracted minimum number of days of work.

Cause of Condition

- The Office relied on verbal guidance from the Office of Financial Management regarding the proper treatment of the contracts. It did not review its approach to ensure it complied with the *Guide to Personal Service Contracting Rules and Best Practices*, which the Office of Financial Management adopted in 2002 and which the Legislature made mandatory as of January 1, 2003.
- Contract language is vague regarding the minimum performance required and how that will be reported to the Office. The contracts specify a minimum number of "days" but do not specify what constitutes a day.

Effect of Condition

Although these contracts did not go through the formal bidding process required for personal services contracts, the Office did provide evidence that the contractor selection process met a number of steps required for competitive procurement; therefore, some assurance is provided that the state's resources were used in the most economical manner possible.

With inadequate monitoring, the Office may be providing payments when the contractor provided little or no service in that particular month. However, we did find evidence that services were provided over a period of time.

Based upon sufficient evidence provided to us to support the selection process, the recognition that conflicting guidance was provided, and the evidence that the Office did receive the contracted services, we are not questioning the costs for these contracts.

Recommendation

We recommend the Office:

- Review its client service contracts to ensure they meet the definition provided by the Office of Financial Management and, for any that do not, procure them following the correct criteria in the future.
- Ensure it has received the appropriate services prior to payment and prior to requests for federal reimbursement.

Agency's Response

The Office of Superintendent of Public Instruction (OSPI) partially concurs with this finding. Each element of the finding will be addressed separately.

- *OSPI concurs with the State Auditor that the School Improvement Facilitator (SIF) contracts were classified and procured as 'client' services after relying on conversations with the Office of Financial Management (OFM) regarding the proper treatment of the classification of the contracts.*
- *OSPI does not concur that its only clients are students, as inferred in the finding by the indication we improperly classified the SIF contracts due to the belief that teachers and principals are clients of the office. In most cases OSPI does not directly serve students but provides direct services to school administrators, parents, and teachers in developing the necessary skills to serve K-12 students. Under RCW 28A.300.040, OSPI has supervision over all matters pertaining to the public schools of the state.*

OSPI will be having further discussions with the Attorney General's Office regarding this issue.

- *OSPI does not concur with the State Auditor that the SIF contracts need to be competitively bid.*

Chapter 39.29 RCW sets out a general policy of open competition for all personal service contracts entered into by state agencies, unless specifically exempted. Chapter 39.29.040(4) states, in part:

"Contracts awarded for services to be performed for a standard fee, when the standard fee is established by the contracting agency or any other governmental entity and a like contract is available to all qualified applicants."

The only available source for interpretation is the OFM Guide to Personal Services Contracting, Section 4.9.4. Focusing on the plain language of the statute, as further interpreted by OFM's personal service contracting guide, OSPI, and our Assistant Attorney General, we believe that when applied to our SIF contracts it clearly exempts these contracts from the requirements of Chapter 39.29 because the agency (1)

established a standard fee of \$30,000 per School Improvement Facilitator per eligible school for performance of the work; and (2) made the contract available to all qualified SIF applicants. In this case, the other procurement requirements in RCW 39.29 would not apply to the SIF contracts.

We would emphasize there was no attempt on the part of OSPI to classify the contracts as ‘client service’ to avoid any formal competitive solicitation. Rather, the agency followed a higher standard than required under ‘client services’ or the exceptions available to them under 39.29.040(4). After establishing a standard fee based on a fair and defensible market rate for attracting experienced educators which was made available to all qualified SIF applicants, OSPI went out for an informal competitive solicitation to ensure facilitators would be highly skilled and experienced educators with prior success in improving schools.

- *OSPI concurs with the State Auditor that the SIF contract language was vague regarding how many hours constitutes a day. We further concur that for the first two months of each quarter payments made to the SIF contractors lacked proper monitoring and inadequate supporting documentation to ensure services were received prior to payment.*

Our agency has taken immediate action in establishing a clear definition of how many hours constitute a day. More significantly OSPI is currently working on bolstering supporting documentation for all invoices to ensure it has received the appropriate services prior to any payment being made.

- *We do not agree with the State Auditor’s interpretation of the criteria set forth in Office of Management and Budget (OMB) Circular A-87 Section C. Basic Guidelines; 1.c. and 1.j.*

Section 1.c. sets forth language that for costs to be allowable under Federal awards they must, “Be authorized or not prohibited under State or local laws or regulations.” This merely requires that in order for the expenditure to be allowable under federal law, the actual expenditure that occurs must also be for a purpose allowed under state law, or for a purpose not prohibited by state law. Based on this definition, SIF contractor expenditures met the criteria as state law allows for expenditures for contractors to aid schools in school improvement efforts as long as the costs are supported. Further, all SIF contractor expenditures met the federal and state objective of this program which was to improve the teaching and learning of children at risk of not meeting challenging academic standards.

Section 1.j. sets forth language that costs must be adequately supported. As noted above, all costs were supported by quarterly progress reports.

In closing, we appreciate the work your office does and the recommendations of your staff will be very helpful to ensure we are compliant with all aspects of contracting in the future.

Auditor's Concluding Remarks

The Office of Financial Management advised us that the advice it gave to the Office of the Superintendent of Public Instruction was based upon an incomplete review of these contracts. It now indicates that the types of services provided by the contracts are personal, rather than client, services.

The contracts were not based upon a standard fee that would exempt them from competitive bidding. The cost of the contracts varied from \$10,000 to \$32,000, and these amounts were unrelated to contract duration.

The Office of Financial Management's *Guide to Personal Service Contracting* states it is always advisable to use competitive procurement for personal services, since this will favor increased participation by quality professional consultants with a submission of a best offer. It also states that competitive procurement can foster innovative approaches, reduce the accusations of favoritism and provide a more defensible position if contract problems arise.

Fiscal monitoring should be part of an overall monitoring plan to provide assurance that billings relate to the contract terms and that there is sufficient documentation to demonstrate satisfactory delivery of agreed-upon services. Reliance on quarterly reports, which could be received a significant amount of time after payment, is not timely or sufficient monitoring for monthly payments.

We appreciate the cooperation extended to us throughout the audit by Department staff.

Applicable Laws and Regulations

Contracts

RCW 39.29.006 states in part:

(7) "Personal service" means professional or technical expertise provided by a consultant to accomplish a specific study, project, task, or other work statement. This term does not include purchased services as defined under subsection (9) of this section. This term does include client services.

(8) "Personal service contract" means an agreement, or any amendment thereto, with a consultant for the rendering of personal services to the state which is consistent with RCW 41.06.380.

Section 15.10.10 of the Office of Financial Management's *State Administrative and Accounting Manual* states:

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

Section 15.10.15 of the Manual states in part:

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

RCW 39.29.006 (2) states:

"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.

Section 16.10.15 of the Manual expands on this definition:

Client Services - Services provided directly to agency clients including, but not limited to, medical and dental services, employment and training programs, residential care, and subsidized housing. Clients are considered to be those individuals who the agency has statutory responsibility to serve, protect, or oversee. Clients are members of the public, external to state government, who have social, physical, medical, economic, or educational needs. Clients are not providers of services, state employees, or business organizations.

The Office of Financial Management's *Guide to Client Service Contracting* states in part on page 2:

Clients are those individuals the agency has statutory responsibility to serve, protect or oversee. Clients are members of the public, external to state government, who have social, physical, medical, economic, or educational needs. These individuals may require government assistance to meet their needs. For example:

- Clients of the Office of Superintendent of Public Instruction include K-12 public school students, and students at the institutions of higher education are their clients.

RCW 39.29.011 states in part:

- All personal service contracts shall be entered into pursuant to competitive solicitation, except for: . . .
(4) Contracts between a consultant and an agency of less than twenty thousand dollars

RCW 39.29.055 (1) states in part:

Personal service contracts subject to competitive solicitation shall be (a) filed with the office of financial management and made available for public inspection

Allowable costs

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

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

d. Be authorized or not prohibited under State or local laws or regulations . . .

j. Be adequately documented.

Section 85.32.20 of the *State Administrative and Accounting Manual* states:

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

The Office of Financial Management's *Guide to Personal Service Contracting*, Chapter 8-3 and its *Guide to Client Service Contracting*, Chapter 5, page 39 both require contract managers, before authorizing payments, to carefully review contractors' invoices to ensure there is adequate evidence services have been delivered as required.

Item 19 of the General Terms and Conditions section of the School Improvement Facilitators contracts states in part:

Payments. No payments in advance or in anticipation of services or supplies to be provided under this contract shall be made by the Superintendent. All payments to the Contractor are conditioned upon (1) Contractor's submission of a properly executed and supported voucher for payment, including such supporting documentation of performance and supporting documentation of costs incurred or paid, or both as is otherwise provided for in the body of this contract

Other Contracting and Purchasing

04-12 The Department of Community, Trade and Economic Development, Office of International Trade, did not comply with state procurement regulations in a purchase of office furniture.

Description of Condition

The Department of Community, Trade and Economic Development, Office of International Trade purchased \$25,475 in office furniture without going through the Department's established procurement system. We found no documentation a bid process was followed, nor was the purchase made through Correctional Industries or through any state convenience contract. The purchase circumvented both Department rules and the state competitive procurement regulations. The Department made payment without an approved purchase request, without an approved field order, and without documentation that the goods were received. The furniture was placed into a suite of rooms at the Office's Seattle location.

Cause of Condition

Management overrode normal procedures to purchase the furniture.

Effect of Condition

The Department did not give other vendors an opportunity to participate in bidding and may not have obtained the best price for the furniture.

Recommendation

We recommend the Department ensure management understands procurement rules and regulations and the necessity for following them.

Department's Response

We agree with the finding. The employee responsible for this transaction has not been in a position to originate purchases for the agency since February 20, 2004. The Administrative Service Division will again distribute applicable statutes, General Administration competitive procurement regulations and Department purchasing guidelines to all employees involved in the procurement process. The Division's Assistant Directors will re-emphasize the importance of compliance with these regulations and guidelines to their employees. This will be completed by January 31, 2005.

Auditor's Concluding Remarks

We appreciate the Department's efforts in addressing this finding and will review its work to resolve this issue during our next regular audit.

Applicable Laws and Regulations

RCW 43.19.190 states in part:

The director of general administration, through the state purchasing and material control director, shall: . . .

(3) Have authority to delegate to state agencies authorization to purchase or sell, which authorization shall specify restrictions as to dollar amount or to specific types of material, equipment, services, and supplies. Acceptance of the purchasing authorization by a state agency does not relieve the state agency from conformance with other sections of RCW 43.19.190 through 43.19.1939, or from policies established by the director.

RCW 43.19.1906 states in part:

Insofar as practicable, all purchases and sales shall be based on competitive bids
. . .

A record of competition for all such purchases from three thousand dollars to thirty five thousand dollars, or subsequent limits as calculated by the office of financial management, shall be documented for audit purposes.

The Department's Approved Purchasing Policy, dated November 12, 1999, states:

A. CTED Purchasing Guidelines

1. All CTED purchasing will be conducted under the supervision of the Purchasing Officer assigned to the Office and Information Services Unit of Administrative Services.
2. All CTED purchasing must be in accordance with the General Authorities delegated by the Office of State Procurement (OSP) and within the limits established by the General Authorities or Specific Authorities granted to the agency.
3. General Authorities allow CTED to conduct purchases of \$10,000 or less, with some limitations.

B. CTED Purchasing Procedures

1. Divisions, in consultation with the Purchasing Office, determine their needs and, if necessary, perform the sole source or competition process.
2. The division prepares a Purchase Request (PR) form, including the Record of Competition, if required, and forwards the signed PR and all supporting documentation to the Purchasing Office.

5. Based on the PR, the Purchasing Officer will issue a Washington State Field Order to the vendor . . .

d. After the ordered items are received, the receiving location will forward the receiving report copy of the Field Order and the packing slip and/or invoice to the Purchasing Office.

e. The Purchasing Office will update the purchasing database and forward the receiving documentation to Accounting Services for payment of the invoice.

04-13 The Department of Labor and Industries did not provide evidence that it complied with state bid laws when purchasing information technology services totaling more than \$7.2 million.

Background

During the audit period, the Department contracted with information technology specialists for computer services. The contracts and amendments included in our review ranged from \$60,000 to \$1,912,500. Contractors provide the following types of services:

- System design and support
- Systems analysis
- System conversions
- Employee training

The Department identifies information technology vendors from a pool of pre-qualified vendors selected by the Department of General Administration. It is the Department of Labor and Industries' responsibility to perform the second level of the selection process. This involves issuing a solicitation document outlining the statement of work, period of performance, deliverables, potential budget and any special terms and conditions. The vendors submit responses directly to the Department of Labor and Industries. The Department evaluates the responses based on the criteria in the solicitation document and awards the contract to the successful bidder.

Description of Condition

During our audit, we found that the Department issued 18 requests for responses from vendors for IT projects. We found that 15 of the 18 requests and subsequent contract awards were performed in accordance with state laws and regulations. However, for three requests, we were unable to determine if the Department conducted open and fair competition before awarding the contracts to vendors. These three requests received 140 responses from vendors. Of these responses, 20 were never scored and 116 were not scored in accordance with the method prescribed in the solicitation document. For 10 contracts totaling \$7,211,300, the Department could not provide all evidence of competition.

This condition was reported during our last audit.

Cause of Condition

Some Department staff believed they had the option to not score any vendors responses that they anticipated would not score well. Also, some Department staff may not be knowledgeable of all of the contracts regulations.

Effect of Condition

Since these contracts may not have been competitively bid, all interested vendors may not have had the opportunity to participate in the competition to provide these services. Additionally, the Department cannot be assured that it received the best possible price and quality of services.

Recommendation

We recommend the Department competitively bid its purchased service contracts in compliance with state bid laws.

Department's Response

L&I concurs with this finding. Our scoring of each response to these three advertisements should have been listed on a score sheet like all our other advertisements. While each response was evaluated, all their scores were not transferred to a score sheet. All qualified vendors did have the opportunity to participate and each of their responses was evaluated by a highly qualified team of Information Technology professionals. There was excellent vendor participation from 62 interested vendors. Actual expenditures in FY04 against the 10 contracts were approximately \$2.3 million.

Auditor's Concluding Remarks

We appreciate the Department's response.

During the course of our audit, the Department was unable to provide evidence to demonstrate that all responses had been evaluated.

Although the Department is correct that the expenditures related to these contracts for the last fiscal year were approximately \$2.3 million, the period of performance for most of the contracts extends beyond the current year. These contracts have a maximum value of over \$7.2 million.

We will follow up on this issue during our next audit.

Applicable Laws and Regulations

Chapter 43.105.041(a) of the Revised Code of Washington gives the Department of Information Services the authority to develop standards and procedures governing the acquisition and disposition of information technology equipment and services.

The Information Technology Investment Standards prepared by the Department of Information Services states, in part:

The requirements for competitive solicitations are listed in the chart provided in Appendix A. These requirements apply to all forms of competitive solicitations; the estimated acquisition cost is what determines which requirements must be met.

Appendix A of the Information Technology Investment Standards requires the solicitation process for IT purchases with an estimated acquisition cost of \$100,000 or more to include the following:

- State requirements in writing
- Provide protest procedures
- Provide changes to all bidders in writing
- Bidder responds in writing
- Evaluate all proposals against requirements
- Document evaluation process
- Offer vendor debriefing

04-14 The Department of Veterans Affairs paid conference meal and lodging costs that were not in compliance with state law.

Background

The State Department of Veterans Affairs was created in 1976 to assist veterans, active duty service members and their families and has an annual operating budget of approximately \$39 million. The Department operates three veterans' homes and provides support programs for veterans through seven field offices throughout the state.

The Department contracts with independent contractors and with service organizations, such as the American Legion and the Veterans of Foreign Wars, to provide service officers who counsel and represent the Department's clients who are attempting to file claims for benefits. For a number of years, the Department has periodically presented training for these service officers to update them on changes related to veterans' laws and policies. The Department paid \$28,120 for a statewide conference for 130 service officers in Fife on March 23-25, 2004.

Description of Condition

Our review of the conference expenditures disclosed the following inappropriate charges:

- The Department paid participant meal charges that exceeded the state's authorized daily meal allowance. State regulations provide for a total cost of \$47 per person for the three breakfasts and two lunches served at the conference. However, the Department paid \$76 per person for these meals. The total meal overpayment was \$3,770.
- The Department paid lodging costs of \$2,877 for 12 participants who did not live more than 50 miles from the conference site. State regulations allow lodging reimbursements only when the temporary duty station (in this case, the conference) is more than 50 miles from the participant's home or duty station, unless the state agency provides a written supervisory approval or cost analysis. The Department provided neither of these.

Our initial review of payment documentation noted incomplete support for the conference payment. We communicated this to the Department, and staff members provided additional documentation.

Cause of Condition

The Department did not have detailed procedures in place to guide managers in planning and conducting major training conferences. In addition, there was no clear process in place to ensure comprehensive management, contractual and accounting review of all invoices and required supporting documentation prior to issuing the final payment to the vendor.

Effect of Condition

The Department paid a total of \$6,647, or 24 percent of the total conference expenditures, for charges that should not have been paid by the state.

Recommendation

We recommend the Department ensure its management:

- Understands and complies with state regulations regarding payment of travel and conference costs.
- Provides and reviews adequate documentation to support such charges.

Department's Response

- ***The Department paid participant meal charges that exceeded the state's authorized daily meal allowance.***

In an attempt to maximize the amount of productive time during the training conference and the resulting value for the state, the Department did arrange to have three meals provided on site by the conference facility: lunch on March 23rd, lunch on March 24th and breakfast on March 25th. The cost of these meals exceeded the allowable per diem by \$2.50, \$5.75 and \$0.95 respectively. Both lunches were attended by 130 authorized personnel and the single breakfast was attended by 100 authorized individuals. The total impact of this arrangement was a payment of \$1,167.50 more than the authorized per diem reimbursement for these specific meals.

The Department provided Coffee and Light Refreshments during both morning and afternoon breaks on March 23rd and 24th in accordance with the requirements of Department policy and the State Administrative and Accounting Manual Section 70.10. A written request was submitted in advance of the conference and verbal approval was obtained. Unfortunately, the approval section of the letter was not actually signed by the Deputy Director until after the conference was completed. The auditor included the total for coffee and light refreshments in what they considered meal reimbursements.

Although administrative procedures were not fully complied with, the expenditures meet the requirement for qualified exception and were justified.

- ***The Department paid lodging costs of \$2,877 for 12 participants who did not live more than 50 miles from the conference site.***

The Department does not dispute the fact that written supervisory approval was not obtained in advance of the conference for the 12 individuals who resided less than 50 miles from the hotel. However, had advance approval been requested, it clearly would have been granted on the basis of the rationale specified in SAAM 10.30.30.b.1. "An overnight stay in a commercial lodging facility to avoid having a traveler drive back and forth for back-to-back late night/early morning official state business."

The Statewide Service Officer Training Conference is a critical component of the Department's effort to increase service quality, assess individual Service Officer performance and hold both the individual and their respective Veteran Service Organization (VSO) accountable for their

work. It was communicated to all attendees that the Department would conduct pre- and post-tests covering the training objectives for the conference and the Veteran Service Organizations were accountable. From the earliest planning phase of this conference, it was expected that the individual Veteran Service Organizations would conduct evening sessions with their service officers to review and reinforce the major teaching points of the day's sessions and identify questions, discussion points and objectives for the next day. All VSOs scheduled sessions outside of the conference schedule for this purpose and at least one, the American Legion, scheduled both evening and morning sessions. Service Officers for the American Legion accounted for 8 of the 12 individuals residing within a 50 mile radius. Even though these sessions were held by the VSOs, they were for the purpose of conducting official state business. For all future conferences, these sessions will be specifically included on the conference agenda.

Auditor's Concluding Remarks

We agree that approval documentation was signed after the event, rather than before, as required by state regulation, and that conference documentation was not complete to support the expenditures.

The documentation we reviewed indicated approval was given only for meals, the costs of which exceeded the approved per diem; there was no line item for coffee and light refreshments. When the Department stated that coffee and light refreshments were part of the meal costs, we asked several times for its formal policy for serving coffee and light refreshments. State regulations allow the provision of these items at meetings and formal training only if an agency has already formally adopted policies describing the approval process. The Department has not provided us with such a policy.

We agree that state regulations make exceptions for lodging in order to prevent a traveler from having to drive back and forth for back-to-back late night/early morning meetings. However, we found no support in the conference documentation of any official state business conducted in the early morning or evening hours. The conference agenda indicates a 9:00 AM beginning time and a 4:30 PM ending time; these times do not support back-to-back late night/early morning official state business. Further, the 50-mile rule was not even considered by the Department until we asked for the travel origins of the attendees to validate payment for the room charges. The Department had to research travel origins for us, since this was not part of the conference documentation.

We reaffirm our finding.

Applicable Laws and Regulations

The State of Washington Office of Financial Management's *State Administrative and Accounting Manual*, Section 10.10.05 states in part:

The following persons in the executive, legislative, or judicial branches of government must comply with the policies in this chapter:

4. Contractors, unless there are specific contractual arrangements modifying travel reimbursement.

Section 10.10.10.a. of the Manual states in part:

Agency heads, and their designees for directing travel and approving reimbursement, are to:

1. Ensure that any travel costs incurred are:
 - Directly work related,
 - Obtained at the most economical price, and
 - Both critical and necessary for state business.
2. Exercise prudent judgment in approving travel-related costs.
3. Establish an effective system for management and control over travel-related costs

The Manual's section titled "Coffee and Light Refreshments" provides the following:
70.10.10 states:

The agency must first adopt written policies.

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.

70.10.20.a. states in part:

The agency head or authorized designee may approve the serving of coffee and light refreshments in the conduct of official state business at certain agency-sponsored meetings where:

- The agency obtains a receipt for the actual costs of the coffee and/or light refreshments, and
- The agency person responsible for the meeting receives agency approval for the serving of coffee and/or light refreshments **prior** to the event.

Sections 10.30.30 of the same manual states under the heading "What Types of Lodging Costs are Reimbursable":

- a. Reimbursable lodging expenses include the basic commercial lodging cost and any applicable sales taxes and/or hotel/motel taxes on that amount. Lodging costs in excess of the allowances and the associated taxes on the excess will be paid by the traveler.
- b. Reimbursement is allowed for lodging expenses when the temporary duty station is located more than fifty (50) miles (most direct route) of the closer of either the traveler's official residence or official station.

Under one of the following conditions, reimbursement for lodging expenses is allowed when the temporary duty station is located within fifty (50) miles (most direct route) of the closer of either the traveler's official residence or official station:

1. An overnight stay in a commercial lodging facility to avoid having a traveler drive back and forth for back-to-back late night/early morning official state business.
2. When the health and safety of travelers is of concern as provided for in Subsection 10.10.35.
3. When an agency can demonstrate that staying overnight is more economical to the state.

Agencies may request an exception to this regulation for other conditions from the Director of OFM.

Written supervisory approval for the first and third conditions and cost analysis documentation for the third condition is to be attached to the traveler's Travel Expense Voucher. Approval and documentation requirements for use of the second condition are contained in Subsection 10.10.35.

Section 10.90.10 of the same manual lists travel rate reimbursements and indicates that the meal reimbursement for Fife (Pierce County) is \$9 for breakfast and \$10 for lunch.

04-15 The Department of Transportation's Washington State Ferries Division made travel payments to employees in excess of written contract amounts.

Background

The Department's Ferries Division pays employees for travel time to work under circumstances negotiated in union contracts. We audited travel payments for the four licensed employees governed by a contract between the Ferries Division and the National Marine Engineers Beneficial Association (MEBA), the union representing some Ferries Division workers. We reviewed payments made from July 2003 through June 2004 to the four employees working under the MEBA contract for travel time after their normal workday.

Description of Condition

We found the Ferries Division paid these four crew members for travel in excess of written contract amounts. For ferries serving the San Juan Islands, the MEBA contract authorizes payment of one round trip per week from the employee's home terminal to the vessel's normal relieving terminal.

However, for those who work on the ferry vessel that has the San Juan inter-island route, the Ferries Division has been allowing three and a half hours of travel pay daily for round trips between Friday Harbor and Anacortes. The Ferries Division has designated Anacortes as the normal relieving terminal for this vessel. Crew changes for this vessel normally occur at Friday Harbor. Employees assigned to other ferry vessels are not compensated for daily travel to and from the destination where crew changes normally occur. For the four employees included in our review, \$54,059 was paid in excess of written contract limits.

This condition was reported in our last audit.

Cause of Condition

The Ferries Division has made these payments for several years and does not believe it would be legal to discontinue this practice. Division management stated that they have been unable to reach agreement with the union and cannot make contract amendments to the terms of the contract without negotiating them with the union.

Effect of Condition

Employees are being paid in excess of written contract limits for travel.

Recommendation

We recommend that the Ferries Division pursue a modification to the written union contract to reflect actual travel payment practices.

Department's Response

While the auditor has a constructive recommendation, it's important to understand that employees and management may agree to minor changes in labor contracts prior to formal contract re-negotiations. Further, it is management's opinion that the payments described in this finding are required pending formal contract negotiations, because they are based on established practice. Past practice often serves as a basis of rules governing matters not included in written labor contracts, and the agency is legally bound to interpret and apply those principles in determining rights and benefits under our existing written contracts. The State Auditor's Office is recommending that the Department work with labor representatives to formalize this understanding in writing as part of the current bargaining agreement. The Department will consider this recommendation and take appropriate action.

Auditor's Concluding Remarks

We appreciate Secretary Douglas MacDonald's and executive management's willingness to consider this recommendation. We will review the Department's progress during our next audit.

Applicable Laws and Regulations

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

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.

04-16 The Department of Social and Health Services, Mental Health Division, did not comply with state and federal regulations when it inappropriately paid fixed administrative expenditures in advance of services for the Community Mental Health Services Block Grant.

Background

The Department of Social and Health Services, Mental Health Division, administers the federal Community Mental Health Services Block Grant (CFDA 93.958), received from the federal Department of Health and Human Services. This Program provides funds to states and territories to help them provide comprehensive, community-based mental health services for adults with serious mental illness and children with serious emotional disturbances. These services may include direct services to clients or other professional/technical services. The Division contracts with service providers and professional and technical contractors to provide Program services. In fiscal year 2004, the Department spent \$8,697,249 in this Program.

The Division contracted with a vendor to provide training to its clients. Authorized funds for this contract in the amount of \$112,000 were to be provided entirely by federal funds from the federal Block Grant. Actual expenditures under this contract were \$88,900 from November 2003 through March 2004.

According to the contract, the vendor was to provide Consumer-to-Provider training, job development and recruitment, and consultation and support. The Division was to compensate the vendor for fixed administration costs, student enrollment through the course of the training, and the completion of interval and final reports.

The General Terms and Conditions of the contract stated that the Division would not make payments in advance of the delivery of services by the contractor. The Statement of Work in the contract provided for an advance payment by the Division. However, state and federal regulations do not allow advance payments.

Description of Condition

The vendor submitted an invoice and was inappropriately paid an advance of \$72,000 for fixed administrative expenditures. This payment was for administrative expenditures for the grant period October 2003 through September 2004. In March 2004, the Consumer-to-Provider training program was terminated due to insufficient applications to support the program.

Cause of Condition

The Division was unaware the contract Statement of Work with regard to advance payments was in conflict with the General Terms and Conditions of the contract and with state and federal regulations.

Effect of Condition

We question the \$72,000 in federal funds the Division paid the vendor in advance for services that were never completed.

Recommendation

We recommend the Division comply with state and federal regulations and pay only for allowable services that have been provided.

Department's Response

The Department concurs with this finding

The Mental Health Division will develop and implement policies and procedures, along with a mechanism for oversight, required to comply with state and federal regulations and preclude advance payment of administrative expenditures.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding and will review these areas in our fiscal year 2005 audit.

Applicable Laws and Regulations

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

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

- e. Be authorized or not prohibited under State or local laws or regulations
.....

Federal regulations provide an exemption for certain grant programs, including this Block Grant, from federal cost principles, including Circular A-87 mentioned above, provided the state adopts its own cost principles consistent with that circular. The State of Washington has not adopted such principles; therefore, Circular A-87 is the benchmark for regulations related to allocability of costs to federal programs. Attachment A, Section C.3 of the Circular requires allocable costs to be chargeable or assignable in accordance with the relative benefits received.

Washington State Constitution, Article VIII, Section 5, Credit Not To Be Loaned, states:

The credit of the state shall not, in any manner be given or loaned to, or in aid of, any individual, association, company or corporation.

The Office of Financial Management *State Administrative and 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. 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

The contract General Terms and Conditions and Statement of Work states in part:

. . . the Contractor shall manage the contract budget in such a way that will guarantee sufficient funds to cover the period of performance . . .

. . . DSHS shall not make any payments in advance or anticipation of the delivery of services to be provided pursuant to this Contract

Accounting Systems

04-17 The Department of Social and Health Services does not have adequate internal controls over the processing of expenditures through the Agency Financial Reporting System.

Background

The Agency Financial Reporting System is the state of Washington's official accounting system. State agencies are required to enter their financial data, including accounts payable, into this System. The System has security features that, when used effectively, can reduce the risk of error or fraud in financial transactions.

Designated security administrators in each agency are responsible for determining the level of access granted to individuals within the agency and for removing access when appropriate. Access controls are available with the System to preclude any one person from having total control over a particular type of transaction.

During our previous audit, we identified and reported internal control weaknesses related to access to the System.

Description of Condition

This year we followed-up on last year's finding to determine if improvements over access had been made. We reviewed the types of System access the Department has granted to employees with accounts payable functions and found the Department still does not take advantage of the System's internal control features that allow for an adequate segregation of duties. The Department has not established and followed written policies and procedures that would require an adequate separation of duties and timely access changes in any of its offices with an accounts payable function. Access to the accounts payable function is not secure, as described below.

- a. We found that 663 Department employees have the capability to enter and approve payment batches, with no management review required. (Last year the number of these employees was 632.) All of these employees can process a fictitious payment without oversight or approval by anyone.
- b. In addition, all 663 employees are capable of processing payments to unauthorized vendors by using certain designated codes. These employees have the ability to generate a warrant to anyone they choose. For the period July 1, 2003, through January 31, 2004, payments processed through these codes amounted to \$17,399,607.
- c. We noted that 605 of the 663 employees also have the access needed to recall certain batch types for error correction. An employee could recall and change his or her batch as well as recall and change another employee's batch.

- d. The Department's System security administrators rely on management in the hundreds of Departmental offices to notify them of requests for access, changes in access, and terminations of access. Currently, this communication is not successful. We identified 9 terminated employees who still had access to the accounts payable function. We found one employee who has been working for the State Auditor's Office since April 2004 but who still had access until November 2004.

Former employees working for other state agencies would have an especially easy opportunity to access the Department's accounts payable and prepare or alter transactions.

- e. The Department does not require that an employee independent of the process reconcile output data to the data that should have been entered into the System.

All of these conditions were also reported in last year's State Accountability Report.

Cause of Condition

The Department stated in its response last year that it does not concur with our concerns or recommendations, except for condition d. It believes it has adequate compensating controls for the other weaknesses we found. We analyzed the response in last year's State Accountability Report and concluded that the controls it described did not adequately alleviate the risks.

Effect of Condition

These control weaknesses increase to a high degree the risk that error or misappropriation could occur and not be detected by management in a timely manner, if at all.

Recommendation

We recommend the Department develop and follow written policies and procedures for its accounts payable function that would ensure:

- An adequate separation of duties for those involved in making payments in the System.
- Timely changes to and removals from System access when appropriate.

Department's Response

The Department partially concurs with this finding. As the Department responded last year, the finding is based solely on the review of system security accesses and there was no review of compensating internal controls the Department has in place. This is a general fault within the Agency Financial Reporting System itself.

The finding asserts inadequate internal controls based solely on the Department's decision to not implement segregation of duties based on system access. The Department believes exhaustive compensating controls are employed to provide sufficient internal control over the

processing of expenditures. No audit testing of these compensating controls was conducted and no evidence has been presented to assert or document the generally accepted compensating controls in place are insufficient.

Auditor's Concluding Remarks

As stated in last year's concluding remarks, we did evaluate what the Department believes to be adequate compensating controls. We concluded then and still believe that the Department does not have adequate controls to compensate for its lack of system segregation. We analyzed the Department's compensating controls as follows:

1. The Department stated it has employees who make payments and those who only use the system to make accounting adjustments. This, in the Department's opinion, is a compensating control because it limits the number of individuals who can make payments.

However, the system does not have controls that would allow for this type of separation of duties. If an individual has access to enter and approve a journal voucher for accounting adjustments, that same individual also has access to create and release a payment. The only difference between a journal voucher entry and a payment entry is the AFRS transaction code that is used. There are no restrictions on transaction codes used by individuals with AFRS access.

2. The Department stated that all transactions are required to have review and approval prior to input into the system.

This is insufficient because nothing prevents someone from bypassing procedures and simply entering and approving a fraudulent payment, without any prior review.

3. The Department stated it reviews transaction registers, which are the records of payments.

After-the-fact reviews are helpful but not as strong a control as separation of the entry and approval process. Small agencies may have no choice but to perform after-the-fact reviews because there is insufficient staff to properly segregate entry and release system access. However, with approximately 18,000 employees, the Department is Washington's largest state agency and pays out millions of dollars a day. It is usually more difficult, more expensive, and less successful to recover a payment already made than it is to prevent that payment in the first place. This control is not sufficient for the Department.

4. The Department stated that payment distribution is segregated from those who have incompatible system access.

In such a large agency with so many payments, it is unlikely an inappropriate payment would be caught simply because someone else mails the payment. In addition, the Department pays many vendors by electronic fund transfers. In that process, there are no payments to be distributed. The risk exists that someone with incompatible access could

create a fraudulent payment and electronically deposit the payment into a personal bank account.

The Department's decision to disregard available system access controls puts the agency employees at risk and increases its audit costs. The fewer payment controls an agency establishes, the greater the risk of misappropriation or error and the greater amount of testing an auditor must perform. We reaffirm our finding.

Applicable Laws and Regulations

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

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

Section 20.20.70.a states in part:

Control activities are the policies and procedures that help ensure management directives are carried out.

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.

04-18 The Department of Social and Health Services does not have adequate internal controls over the Social Service Payment System.

Background

The Department of Social and Health Services developed the Social Service Payment System in the late 1970s to:

- Authorize the delivery and/or purchase of social services for clients.
- Collect social services client data required for state and federal reporting.
- Initiate the payment process for purchased services.

The System is used by approximately 3,500 social workers across the state to authorize payments and collect information about services provided to more than 210,000 clients. The system authorizes payments in excess of \$1 billion annually to more than 109,000 service providers.

The System is the largest cross-divisional services-based system in the Department and supports payments and management information authorized by Children's Administration, Aging and Disability Services Administration, and Economic Services Administration. The System runs on a UNISYS mainframe computer system and interfaces with a number of other department systems.

Description of Condition

We reviewed controls over electronic access to the Social Service Payment System. We also followed up on weaknesses in application controls that we communicated to management at the end of our last audit. Application controls are those that ensure the accuracy, integrity and completeness of the input, processing, and output of transactions.

During our current review of electronic access to the Social Service Payment System on the UNISYS mainframe, we found the following weaknesses:

- UNISYS does not record the creator or modifier of each transaction. The Department cannot determine accountability for transactions created or updated within the mainframe.
- The Department does not have adequate controls over electronic access to the Social Service Payment System.
 - UNISYS is not capable of generating a list of operator identification (ID) and the associated user name. Because of this weakness, the Department maintains a separate database of user names, operator IDs, and access rights as a compensating control. However, our tests indicate that the database is not a complete and accurate record of users of the Social Service Payment System.

- The Department uses "generic" (shared) Social Service Payment System operator IDs and passwords to allow inquiry-only access to the System databases; this significantly increases the possibility of unauthorized access to confidential information.
- Six individuals have more than one operator ID. Assigning duplicate operator IDs allows users additional access that is not required for performance of their assigned duties.
- System passwords are a minimum of four characters with a maximum of eight characters. The Information Services Board's *Information Technology Security Standards* define "hardened" passwords as having a minimum of eight characters.
- The Department is not using a "lock-out" mechanism to deter access to the System. Lock-out mechanisms limit the number of unsuccessful attempts to log-in to a computer system. Without a limit on authentication attempts, unauthorized users have a much greater chance of cracking passwords.
- The Department does not have adequate controls in place to limit users establishing providers (vendors) in the System to the electronic access necessary to perform their assigned duties. A service provider must be established in the provider file in order to receive payment for services. The provider file input function was recently centralized to limit access to individuals in the Provider File Unit at headquarters. However, 32 operator IDs with access to provider file input are still assigned to individuals outside the Provider File Unit.
- Thirteen operator IDs have provider file input access rights and access rights that authorize payments to providers. The Department's policy is that no worker may have access to both authorization input and provider file input. Operator IDs that have provider file input access rights and authorization input access rights would be able to establish a provider and then authorize payment to that provider.

We found that many of the previous weaknesses in application controls still remain.

- The Department is not performing reconciliations of Social Service Payment System records.
 - The System does not contain transactions or other information on payments that required manual intervention or adjustment. This results in inaccurate and incomplete payment information in the System payment history and summary reports.
 - Not all input forms are accounted for through the daily reconciliation process. Therefore, payment authorizations can be created or changed without supporting documentation.

- Expenditures authorized through the System are not reconciled to financial records in the state's Agency Financial Reporting System.
- The Department does not have adequate controls over authentication of users with access to the system.
 - The Social Service Payment System does not require users to change the operator ID password periodically; this increases the opportunity for inappropriate access to the System.
 - Authorization of payments requires an additional identifier called a worker ID. Worker IDs are not password-protected. A person with input access to the System can use another individual's worker ID to create or change a payment authorization.
 - When a worker initiates or changes a payment authorization, the System does not require the worker to enter his or her own worker ID. If someone uses the worker ID of another individual, there is no audit trail to establish accountability.
 - There is no read-only access to the computer input screen that is used to add, delete, and view worker IDs. All individuals with access to this screen can add and delete worker IDs.
- The Department does not have adequate controls over Social Service Payment System computer programs.
 - The software that controls the changes to the System computer programs does not adequately maintain a record of the changes. Accountability cannot be assigned for program changes.
 - Department personnel can re-point Executive Control Language. This could result in unauthorized computer programs being run.
- Authorization for payment can be made for service providers designated as closed, deceased, or otherwise restricted. This could lead to payments to providers who should no longer be receiving them.
- The information displayed on System user screens is not appropriate to meet Health Insurance Portability and Accountability Act (HIPAA) privacy requirements.
- The Department exceeds the allowable error rate on information returns (1099-MISC) filed with the Internal Revenue Service; this may result in monetary penalties.

Cause of Condition

The Social Service Payment System is a 25 year old legacy system with 300,000 lines of code in Cobol programming language. It is limited by its original design with minimal security and lack

of Unisys software to track transactions created or updated within the mainframe. The system is inadequate and unable to perform higher level functions that today's technology requires.

Effect of Condition

These control weaknesses increase to a high degree the risk that error or misappropriation could occur and not be detected by management in a timely manner, if at all.

Recommendation

We recommend the Department establish and follow adequate internal controls over the Social Service Payment System.

Department's Response

The Department concurs with the finding. As was noted in the State Auditor's Office findings, the Social Services Payment System (SSPS) was developed in the late 1970's using a Unisys mainframe operating system. This system was state of the art at that time. Twenty five years later, expectations and features in systems have changed dramatically. The Unisys system has not allowed for many of the new specifications and features that are needed to meet today's secure payment system environment requirements. Recommended changes to the Unisys system would require software applications that are not available on today's market or would not function to provide the results desired by the State Auditor's Office. The Department has made several attempts to obtain the necessary funding through the Legislature to replace the aging and limited Unisys system without success.

The Department believes we have made and are making good faith efforts to resolve and correct the weaknesses in the SSPS system as defined by the State Auditor's Office. Many issues identified in the audit have been acted upon. For more difficult issues, solutions or alternatives have been investigated and are being put into practice as current work assignments progress. The most notable change will be a rewrite of the SSPS front-end system, WebConnect. Design changes in WebConnect will allow for implementation of many of the security and access features and controls listed by the State Auditor's office. Additional changes will take more time to enact: new development of programs, or the purchase and installation of commercial software as it becomes available on the market. The SSPS system presents many challenges in finding solutions to meet current day expectation however; the Department is making every effort to follow the recommendations as set forth by the State Auditor's Office.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding and will review these areas in our fiscal year 2005 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 in part:

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

The Washington State Department of Social and Health Services' *Information Technology Security Policy Manual*, Chapter 4: Access Security, Identification, & Authorization, states in part:

4.2.2 AUTHENTICATION REQUIREMENTS

Policy Statement 4.2.2

Adequate controls must be in place to authenticate users accessing department computers, networks, and applications; see DSHS IT Security References R4.2.2 Authentication Requirements, for further detail.

Standards

- S1.** Users and other entities such as applications or servers must be authenticated using such methods as login IDs and passwords, digital certificates, smart cards, or tokens.

4.2.3 USER IDS

4.2.3.1 General User ID Requirements

Policy Statement 4.2.3.1

Each system or application must have established procedures to ensure that each user ID is uniquely associated with a user. . . .

Standards

- S1.** Electronic access to confidential information will always be protected, at a minimum, by a unique user ID, and a password that is constructed and protected as required by section 4.2.4 Use and Construction of Passwords.
- S2.** Assigning duplicate user IDs or sharing user IDs is prohibited, except that generic user IDs with limited access privileges may be used for:
 - Maintenance, troubleshooting, or system monitoring;
 - Training;
 - Shared workstations in secured areas, where no classified data is accessible unless all users have identical access needs; or
 - Program batch runs.
- S3.** Users shall not be assigned or be allowed to use bogus user IDs (a user ID created under a fictitious name). This does not prohibit the use of test user IDs

4.2.4.1 General Password Requirements

Policy Statement 4.2.4.1

Users and system administrators must be informed of the importance of constructing safe passwords and protecting them from unauthorized disclosure; see DSHS IT Security References R4.2.2 Authentication Requirements.

Standards . . .

- S4.** Change passwords at least every 120 days or more often when required by the system. Where the feature is available, system administrators must configure systems to prompt users to change their passwords when they have expired. . . .
- S11.** Where possible, password rules must be systematically enforced, including configuring systems so that:
 - a. Entry of passwords on the screen is not viewable (i.e. a character such as the * is used to hide the actual keyed entry.)
 - b. Passwords are encrypted during storage and transmission using at least 128-bit encryption.
 - c. A “lock-out” mechanism is activated after a maximum of up to five unsuccessful authentication attempts.

The Washington State Department of Social and Health Services’ *Information Technology Security Policy Manual*, Chapter 6: System Design, Development, Maintenance, and Operations, states in part:

6.2.1 SECURITY REQUIREMENTS DURING DESIGN AND DEVELOPMENT

Policy Statement 6.2.1

IT security must be an integral part of the system development or acquisition process. See DSHS IT Security Procedures P6.2.1 Internet Based Applications, for details.

NOTE: Failure to address and specify security requirements early in a project increases the likelihood that security will prove to be inadequate or that additional costs will be incurred.

Standards

- S1.** Staff will:
 - a. Identify the category of data (see Chapter 3, Classifying and Protecting Data and IT Resources) to be processed or accessed by the system.
 - b. Ensure that appropriate IT security measures are included in the design of the system from the beginning of the project, and
 - c. That plans for securing the system are included in the system’s documentation.

- S2.** Where audit trails recording access to information are required, managers or developers must design applications such that the audit trails will be secure, and easily maintained and reconstructed.

6.2.3 APPLICATION ACCESS AND PRIVILEGES

Policy Statement 6.2.3

Access privileges for each employee must be controlled to ensure that the employee can only access those applications and processes needed in the performance of his or her duties.

Standards

- S1.** Operations Managers must require all applications on DSHS mainframe or client server systems to be regulated by standard access control systems software such as RACE, SIMAN and Security Option 1 for the UNISYS, or SAM for Windows.

NOTE: Access control systems software can be:

- a. A feature of an operating system
 - b. An add-on access control package
 - c. A front-end or firewall that performs access control
- S2.** A user's session must initially be controlled by access control systems software, and, if defined permissions allow it, control will then be passed to separate application software.
- S3.** Managers of mainframe operations must ensure that operators are limited to only those system options for which they have privileges.
- S4.** Managers of mainframe operations must separate work duties and responsibilities of employees in the data control center, including input/output processing, production control, and operations.
- S5.** No modifications by operations staff to production data, production programs, or the operating system are permitted.
- S6.** Only authorized maintenance personnel may access the production library. Controls must be in place to prevent unauthorized use or removal of tape files, diskettes, and other media.

6.2.4 MODIFYING MAINFRAMED PRODUCTION SYSTEMS

Policy Statement 6.2.4

Managers of operations must employ a formal change control procedure to ensure only authorized changes are made to computer production processing at DSHS.

Standards

- S1.** Establish and document a system change control procedure.

- S2.** Requests for changes to production programs or systems shall be in writing. This may be done by e-mail so long as the recipient of the request confirms its authenticity, e.g. by phone.
- S3.** Provide operations staff with adequate training and operating documentation before a system is moved into production processing.

Policy Statement 6.2.5

Managers of IT operations must require logs to be maintained for DSHS production application systems.

Standards

- S1.** All computer systems running DSHS production application systems must include logs which record:
 - a. Changes to critical application system files
 - b. Additions and changes to the privileges of users
 - c. System start-ups and shutdowns
 - d. Attempted system access violations
- S2.** It must be possible to reconstruct activities from operation logs
....

04-19 The Department of Labor and Industries' Pension Payment System lacks adequate internal controls to ensure that public resources are safeguarded.

Background

The Pension Payment System is a computer-based benefit payment system that is maintained by the Department of Labor and Industries. The system was designed to track and process pension payments to permanently disabled workers. The system processes more than \$447 million in benefits a year.

Description of Condition

During our audit, we reviewed the Pension Payment System. We noted the following weaknesses:

- The Department did not retain the reports designed to identify pensioners who are receiving Social Security benefits without a reduction to their pension benefits. We were unable to confirm that these reports had been generated or reviewed to ensure pensioners were not overpaid.
- We found seven instances (28 percent) of 25 pensioners reviewed whose pension benefits were not reduced due to Social Security benefits. For one of these pensioners, we estimate the Department overpaid \$35,843 in benefits.
- Changes to pension benefit amounts are not reviewed.
- Changes to pensioner data are not adequately reviewed to verify the changes are appropriate and correct.
- No procedure or data match is in place to identify pensioners who have remarried and may no longer be eligible for pension benefits.
- The system does not calculate pension benefits. Staff manually calculates the benefit payment, which increases the risk that errors may occur resulting in over- or under-payments of benefits.
- The system does not recognize when a pensioner has been paid partial disability benefits nor does it prompt staff to deduct these payments from the pension. This could result in an overpayment of benefits.
- No system is in place to automatically track identified overpayments to pensioners. The Department tracks these overpayments manually.
- No controls are in place to ensure that one-time payments under \$50,000 are independently reviewed.

- An adequate independent review is not performed when staff creates new pensioner records, benefits and entitlements.
- The Pension Benefits Manager has access to create new pension benefits without an independent review.
- The information technology staff share logon IDs. This does not allow the system to identify and provide accountability for those making changes to data.
- System security is not adequate.

Cause of Condition

The pension payment system is an old system that was designed without consideration of internal controls.

Effect of Condition

These system weaknesses increase the risk that payments can be made to people who are no longer eligible for benefits. Additionally, they increase the risk that inappropriate payments due to error or misappropriation could occur.

Recommendation

We recommend the Department strengthen its internal controls over the pension system.

Department's Response

The Department does not agree with this finding. While the processing of payments and adjustments in the pension system includes several manual procedures and calculations, the Department has compensating controls in place to maintain the quality and accuracy of the benefits paid and reserve amounts established. Many of our efforts to minimize the system's risks were developed in collaboration with prior State Auditor reviews and staff. For example, one weakness pointed out by the auditor states that "an adequate independent review is not performed when staff creates new pensioner records, benefits and entitlements." As the result of prior audits and L&I's desire for quality control, a second pension benefits specialist reviews all of the calculations and documentation for every 20th new pension established.

In addition, some of the weaknesses pointed out by the audit are addressed by reports that have been used by pension benefits staff for several years. Until now, the Department has not added data elements to some reports or maintained copies of others for review by the auditor because the issue was not identified by the SAO. This issue is apparent in the first weakness described in the finding.

This audit of the pension benefit system was a review of the system application. Some of the concerns expressed by the auditor relate to workload levels – the pension benefit program is staffed by five specialists providing benefits to 22,000 recipients. For example, the second

weakness noted, that seven instances of 25 pensioners reviewed did not have benefits reduced due to Social Security entitlements, may relate more to workloads than to shortcomings in the system or its compensating controls. Department records indicate benefits should have been reduced in only three of the 25 for periods more than 60 days ago.

Finally, the Department does not agree with the weakness concerning information technology staff sharing logon IDs. These shared, role-based IDs and specific practices, restrictions, and access controls were developed in 1995 to comply with a SAO request that ongoing programmer access to production data be removed. The model used by L&I is accepted by professional information security organizations as sound and valid.

The Department does view the SAO's objective review and noted concerns as important to improving the quality and integrity of the pension benefit program. For this reason, we are taking several steps to address the weaknesses outlined. These include adding additional elements to our existing audit control reports to identify and randomly sample pension amounts that have changed; assigning development of a procedure or data match to identify remarried pensioners to our Fraud Detection and Compliance Program; and retaining various reports to be available for SAO review after staff have taken appropriate action.

Auditor's Concluding Remarks

We reaffirm our finding.

We have reviewed internal controls designed by the Department to compensate for the system weaknesses and found them to be inadequate to mitigate the risk of misappropriation or errors. We are not familiar with the prior recommendation referenced in the Department's response. We reviewed several years of work done by our Office and could not find any reference to this issue.

The Department indicates we did not inform them of reports that were to be retained. It is the Department's responsibility to follow records retention requirements. State regulations require that the reports referred to in the Department's response be kept.

Although the Department states only three of the 25 pensioners did not have their benefits reduced within 60 days, it agrees that seven pensioners were overpaid. Since the information necessary to reduce the benefits was available for all seven pensioners, we believe the reductions should have been made, regardless of workload issues. Further, our sample size of 25 revealed a 28 percent error rate. Projecting this error rate into the population of pensioners results in a much higher estimate of pensioners who are being overpaid. We recognize that heavy workloads may have contributed to this high error rate. However, it is management's responsibility to address workload issues.

The State Auditor's Office does not consider the practice of sharing logon IDs a sound and valid practice. This situation allows a user to check out a shared logon IDs and make changes to programs and/or data. Although the system history file recognizes that a change was made, it does not identify which program or data was changed. If a misappropriation were to occur using a shared logon ID, neither the Department nor our Office would be able to detect which user made the change.

We appreciate the Department's efforts to address weaknesses reported in this finding.

Applicable Laws and Regulations

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

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

04-20 The Department of Labor and Industries does not perform a periodic reconciliation between its unique payment systems and the financial system.

Background

The Department has three large unique computer systems used to pay workers' compensation benefits. These systems operate independently of each other and independent of other state financial systems. They are:

Pension Payment System (PPS)

Benefit Payment System (BPS)

Medical Information Payment System (MIPS)

Description of Condition

We compared six months of activity between the Department's overall financial system and each of the systems identified above and found the following differences:

	Financial System	Unique System	Difference
PPS	\$ 221,196,093	\$ 223,492,001	\$ 2,295,908
BPS	\$ 268,941,045	\$ 271,771,468	\$ 2,830,423
MIPS	\$ 228,164,559	\$ 228,571,985	\$ 407,426

The Department has several other unique systems not mentioned in this finding that also are not reconciled to the financial system.

This condition was reported to the Department during our last audit.

Cause of Condition

The Department stated it does not have enough staff to perform the reconciliations in a consistent and timely manner. We do not know what caused these differences.

Effect of Condition

When the Department does not perform reconciliations between its unique systems and the financial system, it does not have assurance that the amounts reported in any of the systems are accurate and free of errors or irregularities. Maintaining accurate information in its financial system is important to legislators, Department staff and others in policy-making and budget-setting positions.

Recommendation

We recommend that the Department perform periodic reconciliations between its unique systems and the financial system and make appropriate adjustments to the system(s) if discrepancies are detected.

Department's Response

The Department concurs with this finding and has taken the following corrective action:

The agency has reallocated staff resources to help determine what is needed to perform the reconciliations, to develop the reconciliation procedures and to perform the reconciliations. The results of this analyses may require business system changes or report development and additional resources may need to be identified.

While the reconciliation processes are being fully developed, we will begin reconciliations of the majority of the transactions processed by our unique systems to our General Ledger.

Auditor's Concluding Remarks

We appreciate the steps the Department is taking to resolve this issue. We will review its progress during our next audit.

Applicable Laws and Regulations

Section 20.20.20.a of the State Administrative and Accounting Manual states in part:

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

04-21 The Department of Health does not have adequate internal controls to ensure the integrity of licensing revenue received and processed by its computer system.

Background

The Department of Health is responsible for issuing, re-certifying, and reinstating approximately 135 different types of medical provider licenses. It uses a purchased, off-the-shelf licensing application for this purpose. During fiscal year 2004, the system processed approximately \$23 million in licensing fees received at its customer service center.

Description of Condition

We found that the system lacks internal procedures to reconcile license revenue processed by the system to license revenue collected at the customer service center. In addition, no comprehensive manual process is in place to match revenue collected to licenses issued.

Cause of Condition

The computer system was purchased by the Department in 1989 and is now outdated. The original vendor is out of business and the system no longer can be updated.

Effect of Condition

The agency cannot ensure that all revenue collected at the customer service center has actually been processed by the system, nor can it ensure that fees were properly paid for all licenses issued.

Recommendation

We recommend the Department develop manual procedures to compensate for the weaknesses in system controls until a new system is in place. These manual procedures should account for revenue received and licenses issued on a daily or weekly basis.

Department's Response

We generally concur with the finding by the State Auditor's Office and agree that the ASI licensing system lacks the ability to reconcile revenue received to licenses issued. DOH is seeking a replacement system to manage licensing activities. The agency will also evaluate the cost effectiveness of additional interim internal controls that could be employed until a new system is established.

Normally, incoming payments for license fees are directly received by the agency's revenue office and processed through its automated revenue system independent of the ASI system. In accordance with state regulations, all cash receipts are deposited with the State Treasurer within 24 hours

When the revenue system records receipts, it also credits the appropriate individual accounts for each licensing program. In the majority of transactions, the revenue system performs an

automatic upload to the ASI system matching the license record with the appropriate transaction data. In some cases, manual entries are necessitated by the need to resolve issues with licensing transaction data. Manual entries are not immediate and account for timing differences between receipt of licensing fees and updating of licensing information in the ASI system. Short-term reconciliations of our revenue and ASI systems are made difficult as a result.

We wish to emphasize that the only revenues received directly by the customer service center are fees paid at the licensing counter from walk-in customers, and constitute less than five percent of total licensing revenues. The customer service center maintains a log and receipt book for all licensing transactions. Cash reconciliations are performed daily and all receipts are sent directly to the revenue office for processing.

The Auditor's Office finding states the agency cannot ensure that all revenue collected at the customer service center has actually been processed by the system. Although this may be true for the ASI system, it is not applicable to our revenue collection system in general. Our agency recently performed an internal review of the revenue processed by both the ASI and revenue systems over a twelve month period, which confirmed consistency between total license fees collected and the number and type of licenses processed.

We recognize that the licensing system should contain edits that would prohibit a license transaction from occurring without a corresponding revenue transaction. The current ASI system is no longer supported by the original vendor, making further modification of this system impractical. Therefore, the agency has made the procurement of a new licensing system that will contain appropriate financial controls a top priority.

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 the Department staff.

Applicable Laws and Regulations

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

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

Section 20.20.70.a states in part:

Control activities are the policies and procedures that help ensure management directives are carried out.

Segregation of duties - Duties are divided, or segregated, among different people to reduce the risk of error or inappropriate actions.

04-22 The Capital Asset Management System maintained by the Office of Financial Management lacks adequate controls to ensure that assets are properly safeguarded.

Background

The Capital Asset Management System (CAMS) is a computer-based capital asset accounting system that is maintained by the Office of Financial Management (OFM) and used by several state agencies. CAMS is designed to keep track of and provide accountability for equipment and other assets. The system also is used in the preparation of management reports and state financial statements. Approximately 85 state agencies use CAMS to account for \$3.5 billion in assets.

OFM is responsible for establishing accounting and reporting requirements for all state agencies. Agencies are required to use CAMS unless they obtain a written waiver from OFM, which allows the agency to maintain fixed asset information on systems other than CAMS.

Description of Condition

During the course of our audit, we reviewed the CAMS system. We noted the following internal control weaknesses:

1. Assets can be deleted from CAMS by users with system access to purge. The history of these deletions is not kept in the system. It is not possible for management or the auditor to determine whether items were deleted from the system and subsequently misappropriated. OFM states that since a paper copy is produced, the system does not need to keep a trail of the activity. We disagree. Further, OFM stated a misappropriation would not go undetected since CAMS and the financial system must be reconciled at year-end. They indicated that, "an individual would require access and update capabilities to CAMS to delete the asset and to AFRS to adjust the AFRS control accounts, and would further need to intercept and conceal the CAMS Daily and Monthly Activity Reports." This is not true, since most agencies, including OFM, calculate the net between the two systems and add or subtract the difference from the financial system to force them to agree. This is usually done by someone who has no access to CAMS.
2. The system does not identify the user who made changes to the system, including corrections, additions and deletions. It is not possible for management or the auditor to determine who made which entries into the system. OFM states a paper copy of a report showing the user identification of the individual who entered transactions is sufficient. We disagree. If the paper copy is misplaced or destroyed, management and the auditor would not be able to determine who made which entries into the system during a fraud investigation.
3. The system does not require the user to enter an acquisition cost in the total amount field. OFM does not want to make this a required field since it believes that the system is used to track some assets for physical location reasons only, not for financial reasons. OFM's *State Accounting and Administrative Manual* requires certain fields for inventoriable assets, regardless of whether they are being tracked for financial reasons or physical

reasons. The acquisition cost is a required field. Therefore, OFM is violating policy it has set for the state by not entering acquisition costs for all assets on CAMS. OFM again believes that the agency control for capitalized values in CAMS is the required reconciliation with AFRS. However, as mentioned above, the practice of identifying the difference between CAMS and AFRS and entering it into the financial system does not provide any control over the accuracy of this data.

4. Before the system was recently modified, it allowed the user to enter the date of acquisition as the current or any past date. In response to last year's finding, OFM modified the system to accept an acquisition date of anything after the year 1850. Ensuring that purchases are posted within 150 years of the purchase date does not add anything of value to this system. Management should ensure the system allows purchases to be posted within a reasonable amount of time, such as one month, and should establish a process to validate purchases that do not meet that time frame.
5. Users are assigned security access to the system, but the system allows them to have all levels of security up to the level assigned. For example, if an individual is assigned a security level of 10, he or she has the access needed to inquire, browse, request reports and add asset records. Individuals with a security level of 16 have the same access as those with a level 10 access and the access needed to dispose of and delete asset records. This deficiency does not allow agencies to properly separate duties. OFM states it will rely on agencies to segregate duties properly. However, this system's weakness does not give agencies the option to segregate duties. If an individual is given the access to purge assets, the access to add or modify asset data cannot be prohibited through the system's access security.

These conditions were reported during our last audit.

Cause of Condition

The Office stated it does not have the funding to correct all of the noted weaknesses within CAMS.

Effect of Condition

These system weaknesses increase the risk that assets could be lost, stolen or misplaced without detection.

Recommendation

We recommend OFM modify the system to resolve the existing weaknesses or consider developing a new system with stronger internal controls.

Office's Response

OFM would like to reiterate our position that user agency policies and procedures provide compensating controls to minimize the risk of misappropriation of state assets. However, as

resources allow, OFM will continue to make minor cost effective changes to CAMS to address potential system weaknesses.

Auditor's Concluding Remarks

We believe that the system used to track \$3.5 billion in state owned assets should have adequate system internal controls, rather than relying on each of the 85 state agencies to set up additional procedures to compensate for the system's weaknesses.

In some cases, such as user access security, compensating controls cannot be put in place by user agencies since the system doesn't allow agency management to assign access that results in segregation of duties.

We reaffirm our finding and will review any changes to the system in our next audit.

Applicable Laws and Regulations

Section 43.88.160 (1) of the Revised Code of Washington states, in part, that the Office of Financial Management:

... shall devise and supervise a modern and complete accounting system for each agency to the end that all revenues, expenditures, receipts, disbursements, resources, and obligations of the state shall be properly and systematically accounted for. ... Any agency maintaining its own accounting and reporting system shall comply with the updated accounting procedures manual and the rules of the director adopted under this chapter. An agency may receive a waiver from complying with this requirement if the waiver is approved by the director.

Section 30.40.30 of the State Administrative and Accounting Manual states in part:

Agencies are to use the Capital Asset Management System (CAMS) operated by the OFM Accounting Division for all assets that meet the state's capitalization policy. Agencies may use an alternate in-house system provided written approval of OFM Accounting Division is obtained prior to initiating acquisition or development of the system.

Section 30.20.10.d states in part:

Donated Assets – Use the fair market value at the time of acquisition plus all appropriate ancillary costs. If the fair market value is not practicably determinable due to lack of sufficient records, use the estimated cost.

Section 90.20.70.b (13) states:

Reconcile Capital Assets. Reconcile the balances in GL Code Series 2XXX "Capital Assets" in AFRS with the balances for capital assets with a unit cost of \$5,000 or more in the Capital Asset Management System (CAMS) or other authorized capital asset subsidiary system. An adjusting entry is required when

the subsidiary system and AFRS are out of balance. Separately record additions, deletions, and adjustments to capital assets occurring during the year. **Adjusting entries to capital assets are not to be netted.**

Section 85.60.60 states, in part:

Quarterly, all agencies are to reconcile their authorized capital asset management system with the balances in GL Code Series 2XXX "Capital Assets" to ensure the accuracy of the balances in the general ledger. As a result of this reconciliation, prior period adjustments may be required.

Section 30.20.20 states, in part:

Although small and attractive assets do not meet the state's capitalization policy above, they are considered capital assets for purposes of marking and identifying capital assets (refer to Section 30.30), inventory records requirements (refer to Section 30.40), and physical inventory counts (refer to Section 30.45).

Section 30.40.30 states, in part:

Agencies are to maintain capital asset inventory systems that include records for all inventoriable assets.

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

Agency capital asset inventory systems should contain, at a minimum, the following data elements, . . . Cost – The total cost (value) assigned to the asset.

Inventory Controls

04-23 The Department of Corrections does not have sufficient internal controls over its pharmacy inventory to prevent or detect misappropriation or loss.

Background

The Department of Corrections operates pharmacies at its eight largest institutions. These pharmacies also serve the needs of inmates in the other correctional and pre-release facilities.

Three types of medications are available at the pharmacies:

- Over-the-counter medicine can be obtained without a prescription. Examples are aspirin and antacids.
- Non-scheduled prescription drugs, also known as non-scheduled substances, must be prescribed by a doctor or other health care professional with authority to prescribe medications. These drugs do not tend to cause physical or psychological dependency. Examples are antibiotics and blood pressure medications.
- Scheduled drugs, also known as scheduled substances, must be dispensed only by prescription and are heavily controlled by federal and state laws and Board of Pharmacy rules. For instance, these drugs must be securely locked, logged in detail by location and usage, and continuously inventoried. Examples are brand-names such as Vicodin and Percocet.

Description of Condition

We reviewed the agency's internal controls over pharmaceutical inventory including purchasing, receiving, storage and distribution at five correction centers. We found the following weaknesses in internal controls:

Location Condition	Airway Height Corrections Center	Clallam Bay Corrections Center	Monroe Corrections Complex	McNeil Island Corrections Center	Washington State Penitentiary
a. Lack of inventory controls over non-scheduled drugs.	X	X	X	X	X
b. No/incomplete/non-current policies and procedures.	X	X	X		
c. Inadequate controls over non-scheduled drugs held for destruction.		X	X	X	X

d. Inadequate controls over scheduled drugs returned to pharmacies.		X	X	X	
e. Access to rooms, cabinets or drawers containing scheduled drugs not adequately secured.			X	X	
f. Drug ordering and receiving functions not separated.				X	
g. Inadequate control of Drug Enforcement Agency documentation.				X	

To help identify any potential loss, we had planned to analyze inventory records for non-scheduled drugs to determine if the amount on hand appeared reasonable. However, because the institutions had no records indicating the amounts dispensed for each drug, we were unable to perform such a review.

Cause of Condition

The Department has not provided any centralized guidance or oversight to ensure the adequacy of controls and compliance with state and federal regulations. Pharmacies have been allowed to operate independently, with supervising pharmacists establishing their own policies, procedures and methods of doing business.

In addition, the institutions do not always realize that drugs are part of the Department's consumable inventories and should be subject to at least the same inventory controls as food, clothing, and other items. The Office of Financial Management has not made it clear in its inventory requirements that drug supplies are particularly high-risk items requiring firm controls.

Effect of Condition

The Department does not know if all medications are accounted for. Inadequate controls over medications increase the risk of loss or misappropriation and the risk that losses may not be detected in a timely manner, if at all.

Recommendation

We recommend that the Department of Corrections:

- a. Institute an inventory system that ensures accountability for non-scheduled substances and detects losses.
- b. Develop agency-wide operating policies and procedures for its pharmacies to ensure consistency in controls and compliance with state and federal regulations.

- c. Establish adequate controls over non-scheduled medications being held for destruction.
- d. Require that scheduled medications being returned to the pharmacy be adequately tracked.
- e. Require rooms, cabinets or drawers containing scheduled medications to be locked except when in use.
- f. Require adequate separation of duties in the ordering and receiving of drugs. At least two people should be involved in the receiving process, which should include a comparison to the original order.
- g. Require the maintenance of adequate controls over federally-required ordering forms for scheduled drugs.

Department's Response

The Department corrected five of the seven conditions noted in this finding immediately upon being notified that the conditions existed, and reported to the State Auditor's Office that corrective action had been completed. The remaining two conditions are being addressed as follows:

1. Condition a, Lack of Inventory Controls Over Non-Scheduled Drugs:

The Department maintains excellent physical controls over pharmacy inventories, including locating pharmacies inside the secure perimeter of each facility, keeping pharmacies locked at all times, allowing only pharmacy staff to have keys, and restricting pharmacy access to only pharmacy staff and escorted, authorized visitors. Pharmacy staff are professionally licensed, well educated and highly trained. These controls significantly reduce the risk of loss or misappropriation of drugs.

The specific issue of concern to the State Auditor's Office is that the Department does not maintain perpetual inventory records for over-the-counter medications (such as aspirin) and non-scheduled prescription drugs (such as antibiotics). Instead, the Department maintains a periodic inventory, which involves physically counting inventory at fiscal year end and adjusting the accounting records to reflect the inventory valuation. According to the State of Washington Office of Financial Management's State Administrative and Accounting Manual, both methods are acceptable inventory methods.

The State Auditor's Office has verbally recommended the Department implement a perpetual inventory system that tracks all over-the-counter and non-scheduled prescription drug use by the individual tablet or dose as a better method to account for pharmacy inventory.

The Department acknowledges and appreciates SAO's concerns about accountability for pharmacy inventory. Pharmacists have always maintained perpetual inventory records for scheduled drugs, and are now maintaining perpetual inventory records for certain over-the-counter and non-scheduled prescription drugs considered by the pharmacists to be high risk.

The Department is currently researching the feasibility of implementing a cost-effective perpetual inventory system for all over-the counter medications and non-scheduled prescription drugs. Should funding be provided and should a system be available, the Department will pilot the system at several test sites as soon as practicable.

2. *Condition b., No/Incomplete/Non-Current Policies and Procedures:*

The Department has recently hired a Pharmacy Director who is updating and standardizing policies and procedures for all pharmacies.

Auditor's Concluding Remarks

We commend the Department for its prompt corrective action on most of the issues in this finding and will review its corrective actions during our next regular audit. Regarding inventory controls, the periodic inventory method permitted by the Office of Financial Management must be considered the absolute minimum control level. The Department maintains its food and some of its other consumables on perpetual inventory systems. We believe that comparable controls over drugs are warranted.

Applicable Laws and Regulations

The State of Washington Office of Financial Management's *State Administrative and Accounting Manual* addresses basic principles of internal controls:

Section 35.10.10 states in part:

- The purpose of an inventory system is: 1) to provide control and accountability over inventories.

Section 35.10.25 states the agency responsibilities include:

- Developing and implementing policies and procedures to safeguard, control, and account for inventories.

Section 20.20.20.d states:

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

Section 20.20.60.d states:

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 20.20.70.a states:

Segregation of duties – Duties are divided, or segregated, among different people to reduce the risk of error or inappropriate actions.

Code of Federal Regulations, Title 21, Section 1301.75 b (8) (d) states:

Accessibility to storage areas. The scheduled substances storage areas shall be accessible only to an absolute minimum number of specifically authorized employees.

Code of Federal Regulations, Title 21, Section 1305.13 (a) states:

The purchaser shall retain Copy 3 of each order form which has been filled. He/She shall also retain in his files all copies of each unaccepted or defective order form and each statement attached thereto.

Code of Federal Regulations, Title 21, Section 1305.12 (b) states:

Whenever any used or unused order forms are stolen or lost (otherwise than in the course of transmission) by any purchaser or supplier, he/she shall immediately upon discovery of such theft or loss, report the same to the Special Agent in Charge of the Drug Enforcement Administration in the Divisional Office responsible for the area in which the registrant is located, stating the serial number of each form stolen or lost.

04-24 The Department of Labor and Industries destroyed inventory records prior to the approved destruction date.

Background

State law requires governmental entities to promote and support the orderly and efficient management of their records. Records retention and disposition schedules are vital to every records management program. The purpose of these schedules is to ensure that records are retained for as long as they are needed for administrative, fiscal, legal and historical/research purposes. Minimum records retention periods are determined by careful study and analysis of records by the agencies' appointed records officer to determine their potential value for these purposes.

State guidelines require that agencies conduct physical inventories of all inventoriable assets every other year. This inventory should be performed by staff having no direct responsibility for assets subject to the count. After the inventory is completed, the agency inventory officer conducts the reconciliation process. After the inventory is reconciled, the agency inventory officer certifies the reconciliation with a statement and signature that it is correct and reports this to their supervisor. The certification, together with the reconciliation and the inventory listing, serves as the support for the inventory balance and for accounting adjustments. These documents must be retained by the agency for a minimum of six years.

Description of Condition

During the course of our audit, we discovered that 46 out of 152 inventory reports (30 percent) supporting the Department's May 2003 physical inventory had been destroyed. These reports were used by staff performing the physical inventory to note changes or discrepancies in information. The certification forms signed by both the inventory takers and the asset custodians were the only records retained. Documents supporting the physical inventory must be retained for a minimum of six years.

Cause of Condition

The Department's officials believed that signed certification forms were sufficient to satisfy records retention requirements.

Effect of Condition

Destroying inventory records before the approved destruction date creates the potential for the misappropriation of public assets. Without copies of the inventory reports, we are unable to ensure that the physical inventory was performed as required and that all discrepancies were properly reconciled.

Recommendation

We recommend the Department comply with approved records retention schedules.

Department's Response

The Department concurs with this finding. The Department will ensure that all of the inventory listings for official physical inventories are kept according to approved record retention schedules and the requirements of the State Administrative and Accounting Manual. We will include in the upcoming official physical inventory instructions to retain the inventory reports for six years. We will also indicate for each asset record in the asset accounting system the date the asset was last officially inventoried.

Auditor's Concluding Remarks

We appreciate the steps the Department is taking to resolve this issue. We will review its progress during our next audit.

Applicable Laws and Regulations

Chapter 40.14.060 of the Revised Code of Washington states:

- (1) Any destruction of official public records shall be pursuant to a schedule approved under RCW 40.14.050. Official public records shall not be destroyed unless:
 - (a) Except as provided under RCW 40.14.070(2)(b), the records are six or more years old;
 - (b) The department of origin of the records has made a satisfactory showing to the state records committee that the retention of the records for a minimum of six years is both unnecessary and uneconomical, particularly if lesser federal retention periods for records generated by the state under federal programs have been established; or
 - (c) The originals of official public records less than six years old have been copied or reproduced by any photographic or other process approved by the state archivist which accurately reproduces or forms a durable medium for so reproducing the original.
- (2) Any lesser term of retention than six years must have the additional approval of the director of financial management, the state auditor and the attorney general, except when records have federal retention guidelines the state records committee may adjust the retention period accordingly. An automatic reduction of retention periods from seven to six years for official public records on record retention schedules existing on June 10, 1982, shall not be made, but the same shall be reviewed individually by the state records committee for approval or disapproval of the change to a retention period of six years.

Recommendations for the destruction or disposition of office files and memoranda shall be submitted to the records committee upon approved forms prepared by the records officer of the agency concerned and the archivist. The committee shall determine the period of time that any office file or memorandum shall be preserved and may authorize the division of archives and records management to arrange for its destruction or disposition.

Section 30.45.10 of the State Administrative and Accounting Manual states that agencies must:

Conduct physical inventories at least once every other fiscal year for all inventoriable assets.

Section 30.45.50 states:

The certification, together with the reconciliation and the inventory listing, serves as the support for the inventory balance and for accounting adjustments, if any, and must be retained by the agency. The agency should retain this documentation in accordance with the approved agency records retention schedules.

Cash Receipts and Receivables

04-25 More than \$9 million in employer industrial insurance premium payments recorded as being received by the Department of Labor and Industries between July 2003 and December 2003 were not reflected as being deposited in the state's financial system. Contributing factors to this difference could be employee misappropriation, inaccurate reports or timing differences.

Background

The Department collects industrial insurance premiums totaling more than \$1.5 billion per year from more than 166,000 businesses in Washington 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 the audit, we noted weaknesses in how employer premiums were receipted. We noted the same weaknesses in our audits of the Department operations in 2002 and 2003 and reported differences of \$4.7 million and \$5.8 million, respectively, which could not be resolved. The increase in identified differences each year is partially attributable to the increases to premium rates.

We attempted to reconcile the premiums posted to employer accounts to amounts deposited in the bank. We found that the employer account system reflected payments of \$9 million more than what was recorded as deposited in the state's financial system. 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, errors exist in the employer account reports, 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 \$697,322,883 per the employer account system and \$688,267,030 per bank deposit records.

We reviewed the internal controls over cash receipts and found:

- The Department does not perform an adequate daily reconciliation between cash deposited and the records of the day's transactions. Cashiers balance amounts to be deposited to the payments recorded in employer accounts daily, using a report produced by the employer accounts system. However, the amount the report indicates is to be deposited can be manually reduced by a cashier by hand-writing an adjustment of any amount on the report and then subtracting it from the amount to be deposited. Appropriate reductions include any non-sufficient funds checks and timing differences. However, since management does not review the adjustments and their validity, this weakness creates an opportunity for misappropriation.

- 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. The Department indicated that it would segregate these duties in January 2005. We will confirm that this segregation of duties has taken place during the next audit.

Cause of Condition

The employer accounts system was not designed to fully support reconciliation to the financial system. Further, the Department did not believe that the lack of segregation of duties compromised the integrity of the cash receipts information.

Effect of Condition

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

Recommendation

We recommend the Department:

- Reconcile payments posted to independent systems, including the employer accounts system, to amounts deposited.
- Establish and follow internal controls designed to safeguard cash receipts. This should include modifying the inadequate daily reconciliation process and either segregating duties in the cashier's office or compensating for the weaknesses it creates.
- Determine what accounts for the \$9 million discrepancy.

Department's Response

The Department concurs with this finding and has taken the following corrective actions:

We concur that posting of payment to employer accounts by the cashier's office is at risk due to a lack of segregation of duties. We are developing a plan to improve the internal controls for the posting of payments and adjustments to employer accounts. Any changes in duties in the cashier's office will be implemented by the end of February 2005.

The Department has reallocated staff to reconcile the Employer Account System to the agency financial system records on an ongoing basis. To date, we have reconciled the December 2003 financial reports and have identified the differences to be the premium transactions that were processed outside of the transactions in the control of the cashier's office. These include warrant issues, warrant cancellations, interfund and intrafund transfers, and interagency payments. We will evaluate the feasibility of developing comprehensive employer account system reports that encompasses both the

cashier and non-cashier transactions. We will now focus our attention to reconciling fiscal year 2005 and developing procedures and reports to continue the monthly reconciliation into the future.

Auditor's Concluding Remarks

We appreciate the steps the Department is taking to resolve this issue. We will review its progress during our next audit.

Applicable Laws and Regulations

Section 85.50.40.a of the Office of Financial Management's *State Administrative and Accounting Manual* 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.

Section 20.20.30.a states in part:

The agency director has the ultimate responsibility for establishing, maintaining, and reviewing the system of internal control in the agency.

Section 85.54.60.c, states that:

Any adjustment increasing or decreasing the amount of receivables carried on the books of an agency is to be supported by a revised billing document, a credit memorandum, or other appropriate documentation. Written procedures are to be developed and followed to ensure that only authorized adjustments are recorded.

04-26 The Department of Transportation's Washington State Ferries Division does not have adequate controls over ticket sales and revenue collection.

Background

We have reported inadequate controls over revenue collection at the Washington State Ferries Division in reports dating back to 1986. The Washington State Ferries Division uses point-of-sale and automated revenue control systems to track money collected at ferry terminals. The Ferries Division has approximately 190 full-time and part-time ticket sellers at 14 terminals. Approximately \$123 million was collected during fiscal year 2004. Independent contractors at terminals in the San Juan Islands and in British Columbia collected an additional \$2.9 million. While the Ferries Division has continued to work to strengthen internal controls over recorded sales by analyzing revenue trends and monitoring ticket sellers' activity, additional controls are needed to ensure all sales are recorded. Neither our Office nor the Ferries Division can estimate how much is lost due to unrecorded sales.

In 2004, a Ferries Division investigation concluded that four ticket sellers at the Colman Dock terminal had misappropriated funds from unrecorded and voided sales after the suspicious activity was reported by four customers. Two customers reported they received unusual looking, hand-written receipts. One customer did not receive appropriate change and did not receive a receipt. One customer received a receipt that indicated he paid less than what was actually paid. The investigation used video surveillance of 25 sellers at the Colman Dock terminal during a five-day period in June 2004. The video surveillance showed that the four ticket sellers had misappropriated more than \$1,800. These incidents further demonstrate the need for strong controls.

Description of Condition

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

Controls in place to detect unrecorded sales include the electronic display of amounts due from customers and signs at each toll booth notifying customers of the telephone number to call if they do not receive a correctly printed cash receipt. However, these controls are inadequate to ensure that all money collected is actually 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 Ferries Division does not independently collect vehicle and passenger counts for comparison to revenue collected by individual ticket sellers or in total. Inadequate compensating controls are in place to provide the necessary protection for public funds.

- Frequent-user ferry coupons collected by ticket sellers in toll booths and ticket takers in the terminal traffic lanes are not adequately controlled. Historically, these coupons represent about 32 percent of the total vehicle and passenger transactions. Unless requested, customers do not receive a receipt when they pay with a frequent-user coupon. This increases the risk that a coupon could be used more than once or that a cash sale could be entered incorrectly as a coupon collection in order to misappropriate cash without detection.

Cause of Condition

The Ferries Division is replacing the current point-of-sale receipting system with a comprehensive revenue collection system in December 2005. The Division believes that the new system will have stronger controls over ticket sales and revenue collection. Management believes it would not be cost effective to modify the current point-of-sale cash receipting system since it will be discarded in December 2005.

Effect of Condition

The Ferries Division's inadequate internal controls over cash receipts increase the risk that the loss or misappropriation of public funds may occur and not be detected by management in a timely manner, if at all, and in fact, allowed misappropriations to occur.

Recommendation

We recommend that the Ferries Division develop and follow internal controls adequate to provide reasonable assurance that public funds are adequately safeguarded.

Department's Response

The Department is in the process of replacing the current point-of-sale system at the Ferries Division with an electronic fare system, which will provide additional controls over ticket sales and revenue collection. The new system is scheduled for phased implementation between September and December of 2005. Although the Department is focusing much of its effort on the new electronic fare system, the Department is also committed to improving the effectiveness of its current systems including the use of new techniques to improve internal controls within existing limitations. Our successful investigation of four ticket sellers as described above demonstrates our commitment to this end. We look forward to working with the State Auditor's Office in continuing to strengthen our internal controls.

Auditor's Concluding Remarks

We appreciate the Department's efforts to improve internal controls. We will review its progress during our next audit.

Applicable Laws and Regulations

Section 20.20.30.a of the Office of Financial Management's *State Administrative and Accounting Manual* states in part:

The agency director has the ultimate responsibility for establishing, maintaining, and reviewing the system of internal control in the agency.

04-27 The Department of Personnel has not established adequate internal controls over cash receipts for the Combined Fund Drive.

Background

The Combined Fund Drive is a state government program established as a way for state employees to contribute to charities, mainly through automated payroll deductions. The Fund Drive then distributes these donations to the charitable organizations designated by the employees. The Fund Drive, although separately located, is organized in the Department of Personnel and uses Department fiscal personnel to record and deposit contributions and distribute funds.

The Fund Drive's main activities take place each year in the autumn, when agencies solicit employees for donations and organize other types of fund-raisers. In addition to the automated deductions, the Department also receives currency and checks intermittently throughout the year, with a greatly increased volume during the autumn campaign.

These cash receipts include one-time charitable donations; money collected by state agencies at fundraisers; fees from groups participating in charity fairs; payments toward the cost of attending the Fund Drive's annual retreats; and checks from donors made payable to specific charities which the Combined Fund Drive sends on to the intended recipients.

The Department's fiscal office receives most of the cash receipts; however, the Fund Drive office also receives a small portion. Money received at the Fund Drive's office is hand-carried by a Fund Drive staff member to the Department's fiscal office for receipt, accounting and deposit. State regulations require all cash receipts to be deposited in the form received directly to the State Treasurer's office within 24 hours.

This is the first audit of the Combined Fund Drive program since its funds were made part of the state treasury in 2003. Prior to that event, the State Auditor's Office had no authority to audit the Fund Drive.

Description of Condition

We found no internal controls in place at the Department's Combined Fund Drive office to ensure the funds received there, either through the mail or over-the-counter, were properly receipted, recorded and transferred to the Department's fiscal office.

While the Department's fiscal office provided adequate controls over currency and checks received through the mail, we found it had the following systemic weaknesses in internal controls over cash receipts from over-the-counter transactions:

1. Duties were not adequately segregated. The staff members who wrote receipts for all over-the-counter transactions were the same people who prepared the deposit; thus, these staff members had complete control of over-the-counter cash receipts.
2. Generic cash receipt books, rather than official books pre-printed with the name of the Department, were used for currency transactions. To further weaken controls in this area,

the individual receipt forms from these books were often issued out of order, and some of the forms appeared altered without explanation.

3. The staff did not consistently deposit the currency associated with the receipts within 24 hours. Some currency was not deposited at all. Departmental review procedures failed to detect these exceptions to the deposit regulations.
4. Numerous changes were made to cash-receipting records, including source documents, without any written explanation or justification for the changes. Review procedures did not investigate these changes.
5. Review procedures did not ensure the check and cash composition of the deposit agreed with the mode of payment (currency or check) on all cash receipt forms issued each business day.

Cause of Condition

The Combined Fund Drive was fully incorporated into the legal responsibility of the Department only recently. The unexpected and numerous small dollar transactions that occurred during the annual campaign contributed to additional workload for the Department.

Effect of Condition

Funds could be lost or misappropriated without detection in a timely manner, if at all. For example, during March 2004, we reviewed cash receipts for the month of October 2003, one of the busiest months for the Combined Fund Drive. Out of a total of \$1,968 in currency received that month, we found \$116 from two transactions that had been received but never deposited. The Department was unaware of this loss at the time and was unable, six months later, to determine responsibility.

Recommendation

We recommend the Department take responsibility for establishing internal controls over all of the cash receipting functions in the Combined Fund Drive office.

We also recommend the Department improve its policies and procedures for over-the-counter cash receipts to ensure the fiscal office will:

1. Provide adequate segregation of duties in the processes for cash receipting and depositing.
2. Correctly and sequentially issue pre-numbered official cash receipt forms for all over-the-counter transactions, noting the mode of payment.
3. Deposit all receipts intact in the mode received within 24 hours.
4. Initial and explain all changes to cash receipt records.

5. Require adequate supervisory review of all procedures.

Department's Response

The Department generally agrees with the findings and recommendations of the State Auditor and recognizes management's responsibility to maintain and monitor the internal control structure. It is noted in the audit report that the Department "provided adequate controls over currency and checks received through the mail" and that the weaknesses were in the area of "over-the-counter transactions." In addition, the report recognizes that "the volume of unexpected small-dollar transactions that occurred during the annual campaign" was a contributing cause of the condition. The Department has formally issued a Fundraiser Cash Handling Policy and Procedure for agency use, which has already resulted in a reduced volume of "over-the-counter transactions."

The Department has also taken other actions to improve controls and will continue to in order to resolve the issues discussed in the report.

Auditor's Concluding Remarks

We appreciate the Department's positive approach and commitment to resolving the issues identified in the finding and will review its progress during our next regular audit. We also sincerely appreciate the cooperation extended to us throughout the audit by Department staff.

Applicable Laws and Regulations

The Office of Financial Management's *State Accounting and Administrative Manual*, Chapter 85.20.10, "Collection and Deposit of Cash Receipts", states in part:

Section a. Receipt Forms

Format - . . . agencies are required to develop and adopt an official receipt form that satisfies their unique requirements. The form adopted is to be pre-numbered. At a minimum, the form is to provide for the following information: date, amount, mode of payment, and identification of the agency and the preparer . . .

Use - 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. Receipts are to be issued in numeric sequence and the numeric sequence is to be strictly controlled. It is not necessary to issue **cash receipts** for remittances received through the mail. In instances where a cash receipt is not required to be issued, other internal control procedures are to be established to ensure proper accounting . . .

Section b. Record of Cash Receipts

Agencies are to maintain daily cash receipt records reflecting all daily receipts by account and source . . .

Section 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.

Section d. **Cash Over and Short**

Cash over and short is to be separately recorded in the accounting records. The agency is to make the necessary entries to properly reflect cash over and short in the General Ledger . . . The transactions affecting these balances are to be analyzed regularly and controlled to reduce the possibility of misappropriated cash.

Section e. **Deposit of Cash Receipts**

Generally, cash receipts must be deposited intact within 24 hours of receipt.

04-28 The Board for Volunteer Firefighters and Reserve Officers does not have adequate controls over its cash receipting and pension system database.

Background

The Board provides services to volunteer firefighters, emergency medical service volunteers, reserve law enforcement officers and their families. Protection is provided in the case of injury or death in the performance of duty. The Board administers a pension plan that provides benefits to any enrolled member who has served honorably as an active member for at least 10 years and who is 65 years old. Reduced pension benefit options are available to volunteers who do not meet the age requirement.

The Board has three employees: an executive secretary, a confidential secretary and a benefits specialist. The Board uses a database to track its pension and disability claims and payments. The database also contains an individual record for each volunteer firefighter and reserve officer. These individual member records include fees paid, service credit information and benefit payments.

During the two-year audit period, approximately \$1.8 million in pension and disability fees were collected by the Board and approximately \$16 million was disbursed to pensioners and their beneficiaries.

Description of Condition

Based on our review of the database and cash receipting procedures, we noted the following weaknesses:

- Duties are not properly segregated.
 - Checks and remittance forms are forwarded to the confidential secretary after the mail log is prepared.
 - The confidential secretary posts the pension and disability fees paid to the database cash receipt records and to the member accounts in the database.
 - No one independently monitors this work to ensure it is correct.
- All three employees have access to adjust all data recorded in the database. None of the data fields are restricted to certain employees. During the audit period, the Board installed tracking software on the database. However, management does not regularly monitor data changes recorded by the tracking software.
- The Board does not consistently record the amounts of the checks received through the mail on the mail log. During the audit period, we noted eight instances in which the amount entered on the mail log was taken from the remittance forms, not from the check. Therefore, the Board is unable to use the mail log to determine if all funds received were deposited.

- We were unable to reconcile deposits to the amounts posted to member records on the database since the Board does not record all disability fees to member records on the database. Due to this missing data, management also cannot perform a reconciliation between cash receipts posted to the member accounts on the database and the deposits.
- The database allows user changes that do not protect the integrity of the data. For example, receipt data can be changed after the receipt is issued and records can be deleted without approval.

Cause of Condition

Although internal controls over cash receipting and the pension system database have improved since prior audits, they are still not adequate to ensure that all cash receipts are deposited.

Effect of Condition

Inadequate internal controls and procedures, improper segregation of duties and a lack of oversight of administrative processes by management increase the risk of loss of public funds. In addition, these conditions impair the Board's ability to prevent or detect errors and irregularities in a timely manner, if at all. Without proper controls, the Board's assets and operations are not properly safeguarded.

Recommendation

We recommend that:

- Duties are segregated between handling cash, posting accounts and making deposits.
- Management regularly reviews the tracking software reports to ensure that changes to data in the database are appropriate.
- The mail log reflects the amount of each check received through the mail and that any variances are noted on the Board's copy of the remittance form.
- All fees and premiums are recorded in the member records on the database.
- Management performs a monthly reconciliation between receipts recorded on the mail log, receipts posted to the database and deposits recorded in the Agency Financial Reporting System.
- Modify the database to ensure data integrity.

Board's Response

We do not concur with this finding. We believe that, although some improvements can reasonably be made to the database and cash receipting procedures, they are not large enough weaknesses to warrant a finding. We would like to address the following specific issues:

- *Duties are as segregated as reasonably as possible in a small three person office. After the mail log is prepared, the checks and remittance forms are forwarded to the Confidential Secretary, who posts the pension and disability fees paid to the members' records. This work is independently monitored to ensure that no fraud is perpetrated and to ensure that it is correct. The following steps are taken to ensure the integrity of the data as reasonably as possible:*
 - *The Executive Secretary randomly chooses CJ reports to audit every month. She compares the intake form against the deposit slips, a database report, the receipts generated, and the AFRS DTR9001 report. The Executive Secretary does not perform a daily reconciliation because the process can take up to two hours of work time a day, depending on the number of transactions. This would cost the agency between \$8,000 and \$16,000. It would, therefore, not be cost effective to implement the reconciliation on a daily basis.*
 - *Before the Board can pay out any amount of money for a member, the local board of each department must review and approve the expenditure. When a member completes his/her service and wishes to draw a pension, the local board of trustees reviews the service records that we have and certifies their accuracy. Any error would be identified.*
 - *If the Confidential Secretary were to receipt in money and post payments to an account for herself, she would have to do this several times to equal the amount of money we would pay annually out to prevent it. Additionally, she'd have to find a five person local board of trustees to fraudulently certify her retirement papers before she could draw any money. This process provides a reasonable check and balance to ensure the integrity of the system. It would be unnecessary to check the receipts against the individual member records and would be cost prohibitive.*
 - *With only three employees, all employees must have access to record all data in the database. If all employees did not have access, the office would be unable to perform its work when employees were absent. In a large office, certain duties can be restricted to only payroll officers. There may be three payroll officers in an agency of 50, so 47 employees do not have access to those functions, segregating their duties. In our office, we have to all serve as either a primary or a back-up data entry person because of our limited staffing.*

- *After the 1998-2000 audit period, we met with Yolanda Wilson from Small Agency Client Services and it was determined that it would not have been cost effective to contract with SACS to provide receipting services for the Board.*
- *The Board agrees that there were eight instances where the staff mistakenly wrote the amount from the remittance form instead of the check. Although this represents an error rate of only .2%, the Board has implemented measures to ensure it doesn't happen in the future. It now reconciles the amount on the intake form against the deposit daily.*
- *The Board has recorded all disability fees to member records on the database since January 1, 2004. A pension payment cannot be made without a corresponding disability fee. Since our database is currently configured to be able to reflect only one type of a payment per year, we show an F for a split fee, an M for a municipality paid fee, and a D if only a disability fee was paid and no pension fee was paid. If an F or an M shows in the database, it means that both the disability fee and the pension fee were paid in a given year for an individual. It is unnecessary to spend more staff time reconciling the deposits to the amounts posted to member records when the local board of trustees must, by law, review, approve, and certify member records before drawing a pension. This check ensures that no individual can perpetrate a fraud.*
- *Receipt data can be changed after a receipt is issued. Currently, it is necessary to be able to void some data fields in the receipt table on erroneous receipts or our batches would not balance. We are working with contractors to find a solution to this issue.*

There are adequate controls in place to ensure the integrity of data. Receipts are randomly reconciled against the intake forms, the deposit, and the daily AFRS report. According to the State Administrative and Accounting Manual, 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 size 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 commiserate with the risk. No matter how well we design a control procedure, there is always a small risk that the objectives will not be achieved. It is not cost effective for the agency head, or any other member of our small staff, to spend two hours a day performing a receipt reconciliation. All departments know that they will receive a receipt for any transaction involving money and to call if they do not receive their receipt. All departments have to verify pension records to make sure that anyone

who is about to receive a pension is entitled to it. Because of the size of our operations, we are not able to institute the level of internal control desired by the auditor's office given the cost to do so.

With the risks that management has identified, procedures to minimize the risk have been implemented on a level commiserate with our size and given considerations of costs, benefits, and risks and we, therefore, disagree with the auditor's finding.

Auditor's Concluding Remarks

We believe internal controls could be strengthened within the current staffing level. For example, the Board should use the remittance forms instead of the checks to post accounts as paid. This would result in a segregation of duties between handling cash and posting accounts.

Since verification of the mail logs to cash journals and to the accounts posted on the database is inadequate, Board management would not be able to detect any misappropriation in a timely manner. Local boards are knowledgeable of valid pensions originating from their location, but they would not have the information necessary to determine if funds at the state board level had been misappropriated.

We are familiar with the separate pension and disability systems. Disability payments, when received without a pension payment are, in fact, recorded in the database. We do not recommend that all disability payments be entered into the database, but that reconciliation be performed between the deposit, receipts issued and the premiums posted to pension and disability member records. Without the sum of total disability payments received, it is not possible to perform the reconciliation to verify that all money received was deposited.

We reaffirm our finding. We look forward to working with the Board during the next audit period to resolve these issues.

Applicable Laws and Regulations

Chapter 41.24.290 of the Revised Code of Washington State board for volunteer fire fighters and reserve officers—Powers and duties, states in part:

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

Chapter 43.88.1609(4a) of the Revised Code of Washington requires the Office of Financial Management (OFM) to develop and maintain a system of internal controls that will safeguard state assets and encourage adherence to prescribed policies for accounting and financial controls.

To comply with this law, OFM has developed the State Administrative and Accounting Manual, which prescribes the following:

Section 85.20.10.b:

Agencies are to maintain daily cash receipt records reflecting all daily receipts by account and source

Section 85.20.10.c:

On a daily basis, collections are to be counted and reconciled with cash receipt records

Section 20.20.60.d:

Control Activities – Control activities are the internal policies and procedures that help ensure management directives are carried out. They help ensure necessary actions are taken to address risks to achieving the entity's objectives . . . They include a range of activities as diverse as approvals, authorizations, verifications, reconciliation . . . and segregation of duties.

Section 20.20.70.a:

Control activities are actions taken to minimize risk . . . Control activities and procedures should be considered to ensure the organization is in compliance with the *State Accounting and Administrative Manual*, the Revised Code of Washington, . . . and other applicable regulatory policies.

Information processing – A variety of control activities should be performed to check the accuracy and completeness of information as well as the authorization of transactions. Development of new systems, and changes to existing ones should be controlled. Additionally, access to programs and data should be restricted.

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.

Safeguarding Other Assets

04-29 The Department of Community, Trade and Economic Development's Housing Division is not complying with state regulations for managing past-due loans.

Background

The Legislature established the Housing Trust Fund in state law to account for the revenue and expenditures necessary to assist low- and very low-income citizens in meeting basic housing needs. Revenue sources may include legislative appropriations, private contributions, loan repayments, and other sources such as federal funds. The Department awards these funds as contracted loans or grants to eligible organizations such as local governments, local housing authorities, and non-profit organizations. During fiscal year 2004, the Department awarded \$23,736,252 from the Trust Fund in loans and grants. The Department stated it has awarded \$366,178,111 in loans and grants over the life of the Fund, with \$277,546,775 remaining in loan balances.

The process of analyzing receivable accounts and determining uncollectible amounts is called aging the receivables. State regulations require agencies with more than \$50,000 in past due receivables to age their receivables at least monthly, followed by management review of the reports.

Description of Condition

At the time of our audit, we found the Housing Division was not complying with state regulations for the aging of receivable accounts and the collection of overdue receivables and did not properly account for delinquent loans. Specifically, it did not:

- Establish and follow written procedures ensuring the aging of accounts and the collection of past-due accounts.
- Prepare monthly aging reports for management review.

These conditions were previously reported in the fiscal year 2003 State Accountability Report, finding 03-32.

Cause of Condition

The Housing Division stated it performed reviews of delinquent loans on-line during fiscal year 2004, but it did not document the practice or the subsequent management review. The database, although improved from the previous year, did not provide a way to document this review. Staff had hoped it would.

The Division chooses loan restructuring and deferral of past due accounts rather than determining that loans are uncollectible.

Effect of Condition

Department management had no documented opportunity to analyze and evaluate collection procedures and determine if further steps should be taken to safeguard state assets.

Recommendation

We recommend the Department:

- Establish and follow adequate written procedures ensuring the aging of accounts and collection of past-due accounts.
- Prepare monthly aging reports for management review and document the review.

Department's Response

We partially disagree with the finding. In accordance with The Office of Financial Management's State Administrative and Accounting Manual Section 85.54.50.b, the Housing Division is effectively managing projects that are delinquent in loan payments. Housing Division management has been and is fully aware of all delinquent loan issues. Management is aggressively working with each delinquent loan contractor to preserve the existing low-income housing and resolve any loan issues. The reviews were not documented on an aging report and the monthly aging reports were not saved. The Housing Division will print a monthly hard copy of aging reports for the Assistant Director's review beginning December 2004, and the reports will be filed for documentation purposes. The Housing Division will revise written procedures to further define the aging of accounts and the collection of past due accounts by March 31, 2005.

Auditor's Concluding Remarks

We appreciate the Department's efforts in addressing this finding and will review its work to resolve this issue during our next regular audit.

Applicable Laws and Regulations

The Office of Financial Management's *State Administrative and Accounting Manual*, Section 85.54.50.a states:

Agencies with more than \$50,000 in past due receivables are to prepare aging reports at least monthly. Aging reports are required to be reviewed by management and such review documented on the report.

Section 85.54.50.b states:

Written procedures are to be developed and followed to ensure that past due receivables are followed up promptly and in a manner that is cost-effective for the overall collection program. These procedures are to provide for the full range of collection procedures to be used as appropriate, including issuance of statements

and dunning letters, phone and personal interviews, filing of suits and liens, referral to private collection agencies or letter services, etc. Agencies that do not have special statutory collection authority, or specialized collection operations are encouraged to use collection agencies after receivables become 90 days past due.

04-30 The Department of Social and Health Services, Division of Developmental Disabilities, should establish adequate internal controls to ensure that vehicles used to transport clients of supported living services are properly insured.

Background

The Department of Social and Health Services, Division of Developmental Disabilities, contracts with individuals and agencies to provide supported living services to some of its clients. Supported living services allow clients to live independently while receiving assistance in performing their daily activities, such as paying bills or preparing meals. Support may vary from a few hours per month to 24 hours a day of one-on-one assistance. The Department reimburses the contractors for expenses associated with these services. With some exceptions, clients are expected to pay for their own rent, utilities and food.

State regulations address the service provider's involvement with a client's transportation needs. Services are to include transportation to emergency medical care, medical appointments, and therapy. Also, within available resources, the provider must assist with transportation to and from work, school, and leisure activities. Any vehicle the service provider uses to transport clients must be in safe operating condition and properly insured for its usage.

Many times the service provider's employees supply transportation for clients in their personal vehicles. In our previous audit, we issued a management letter to the Department expressing our concern that a service provider allowed its employees to transport clients in vehicles that were not properly insured for that purpose. We recommended the Department ensure that providers of supported living services be properly insured for the vehicles used to transport clients.

Description of Condition

The Department still has not established sufficient controls to ensure supported living clients are transported only in vehicles that are properly insured. During our current audit, we learned the Department contracts with 11 service provider evaluators who complete forms that include evaluations of whether each vehicle used to transport clients is in safe condition and has the required insurance. However, the Department has not yet established minimum requirements specifically for vehicle insurance, nor has it described for evaluators how they are to perform this particular part of the evaluation.

We contacted each of the evaluators to determine what they rely on as adequate evidence that insurance is appropriate for vehicles used to transport clients. Responses demonstrated a lack of consistency between the evaluators when conducting this portion of their evaluations. Some evaluators review only records of vehicles owned or leased by the providers, while others attempt to validate that all vehicles, including employee vehicles used to transport clients, are insured properly. Most evaluators appear unclear as to what specific items they are to be reviewing.

Cause of Condition

The Department does not believe it is at a high risk of liability in the event of an injury to a client being driven in an underinsured private vehicle.

Effect of Condition

A potential financial liability to the state has not been fully addressed by the Department.

Recommendation

We recommend the Department establish the following internal controls in this area:

- Clearly define its expectations for properly insured vehicles used to transport clients.
- Add language to the service provider contracts that specifically addresses required vehicle coverage for employee-owned vehicles used to transport clients or that prohibits employees from using their own vehicles for such purposes.
- Clearly describe to its evaluators which vehicles will be evaluated when determining and documenting whether providers are meeting the requirement for proper insurance.

Department's Response

The Department partially concurs with this finding. Currently the Department verifies availability of business auto insurance for agency-owned vehicles. This verification is obtained as part of the certification evaluation process.

The Department conducted a survey of the Division of Developmental Disability (DDD) Certified Community Residential Service Providers in late 2003 regarding insurance coverage for vehicles used to transport clients. About 20 percent of the providers responded to the survey. The survey indicated that a majority of the agencies who responded have "vehicles for hire" coverage in their general liability. This insurance acts as a secondary insurance coverage beyond the employee's primary insurance.

The survey indicated that when employees inform their insurance companies that they are using their personal vehicles to transport clients, the employee's insurance premium is increased. The Department believes employees cannot personally afford this increase in insurance costs and therefore the agencies would need to pay the additional cost of insurance for their employees. The agencies in turn would request funding from the Department to pay the additional employee insurance cost.

*The survey also indicated that some agencies allow clients to be transported **only** in agency owned vehicles. If all DD Residential Services agencies were to use only agency owned vehicles to transport clients, there would be a requirement to purchase a large number of vehicles. The cost of purchasing vehicles is typically not built into an agency's reimbursement rate; therefore, the Department would receive a large number of requests for additional reimbursement.*

For the reasons stated above, there would be a fiscal impact of a Department requirement that:

- *the residential agency staff carry additional coverage for transporting clients or,*

- *the agency carry auto liability insurance to cover their employees who transport clients in their privately owned vehicles, or*
- *the agency use only agency owned vehicles to transport clients.*

The Department must evaluate this fiscal impact and request funding for these costs prior to including the recommended requirements in agency contracts.

Auditor's Concluding Remarks

We appreciate the Department's plan to address this finding. We will review the Department's progress during the fiscal year 2005 audit.

Applicable Laws and Regulations

Washington Administrative Code 388-820-720 states:

- (1) The service provider must provide transportation or ensure that clients have a way to get to:
 - (a) Emergency medical care;
 - (b) Medical appointments; and
 - (c) Therapies.
- (2) Within available resources, the service provider must provide necessary assistance with transportation to and from:
 - (a) Work, school or other publicly funded services;
 - (b) Leisure or recreation activities;
 - (c) Client-requested activities; and
 - (d) ISP- or IISP-related activities.
- (3) A vehicle that the service provider uses to transport clients must be:
 - (a) In safe operating condition; and
 - (b) Properly insured for its usage.

Federal Compliance

04-31 The Department of Social and Health Services, Economic Services Administration, does not enter accurate information in its Random Moment Time Sample to ensure administrative costs are properly charged to federal and state funds.

Background

The Department of Social and Health Services uses 12 cost allocation methods in its federally approved Public Assistance Cost Allocation Plan. Staff effort is allocated to several programs based on a variety of methods. We reviewed the Random Moment Time Sample method during our fiscal year 2004 audit of cost allocation at the Department.

This method estimates the allocation of the social workers' time to federal or state programs that benefit from this staff effort. The U.S. Department of Health and Human Services prefers this method when staff members perform many different activities on a variety of programs over a short period of time. The Department has a specific policies and procedures manual explaining how to use the method that is included in the Public Assistance Cost Allocation Plan.

The method requires the use of valid statistical data to ensure a proper allocation of administration costs to the various programs. The plan must be followed to make certain a valid statistical sample is used and the proper results are entered into the allocation program. If the data is invalid, the accuracy of the allocation of administrative costs to various federal and state programs cannot be assured.

During the monthly process, coordinators are to distribute and gather applicable survey documents. Selected workers are to complete the surveys with information describing the services they are performing at the survey times. When this data is entered in the system, it is used to distribute administrative costs to federal and state programs for the month.

The Department uses this method for both the Economic Services Administration and Children's Administration. During our audit, we concentrated on the Economic Services Administration's system. The Administration uses the system to allocate employees' time to several programs, including Temporary Aid to Needy Families, Refugee Cash Medical, Childcare and Development Fund, Social Service Block Grant, Medicaid, and Food Stamps.

Description of Condition

We found that the data collected for the system was not accurate. Many survey documents were not completed accurately according to instructions, invalidating the data. Other survey documents were not retained to serve as support for the charges. We reviewed 1,109 of 4,466 survey documents completed during a three-month period and found 503 exceptions, a 45 percent error rate; of these, 356, or 32 percent, affected federal funds.

Cause of Condition

Coordinators and staff members selected to complete the survey documents have not received adequate training. In addition, these individuals often do not know about the manual that explains how to complete the documents properly. Further, when an error is made, management does not always explain the error to the staff member so it will not reoccur. In some cases, the Community Services Office administrator does not monitor this process.

Effect of Condition

Several federal programs in the Administration rely on the system for the allocation of administrative charges:

Federal Program and CFDA Number	Federal Portion	State Portion	Total fiscal year 2004 Administrative Costs
TANF (93.558)	26,676,581	36,907,772	63,584,353
Refugee Cash Medical (93.566)	1,791,777	0	1,791,777
CCDF (93.596)	6,248,951	6,248,952	12,497,904
SSBG (93.667)	4,475,373	10,879,180	15,354,552
Medicaid (93.778)	32,640,285	32,383,915	65,024,200
Food Stamps (10.561)	29,483,273	29,483,273	58,966,546
STATE ONLY	0	8,018,554	8,018,554
Report Total	101,316,240	123,921,645	225,237,885

Since the Department cannot be sure that administrative costs are being charged accurately to these programs, we are questioning the \$225,237,885 in costs shown above.

Recommendation

We recommend that the Department provide training to the coordinators and staff who may be selected as part of the statistical sample used to determine administrative expenditures for the above programs. In addition, we recommend the manual that includes the policies and procedures be available to these employees. We further recommend that Community Service Office administrators monitor the process.

Department's Response

The Department partially concurs with the finding.

- A. *The State Auditor's report for the Economic Services Administration (ESA), Random Moment Time Sample (RMTS) process states the survey documents were not completed accurately. However, it does not give specific information to adequately identify and address the issues. In our review of the copies of the RMTS documents sent to the Division of Management and Operations Support from five offices for the State Auditor to review, not filling in the time or signing the documents were the main*

items we found to be in error. While staff may not have followed all instructions for completing the documents this does not invalidate the task reported. An example would be not completing the assigned time. If staff completed the document at the assigned time they may not have seen the need to fill in the time, but rather thought they needed to fill this in only when there were completing the document later than the assigned time.

- B. The expenditures are incorrectly questioned. Even if the questioned RMTS documents were excluded from consideration, there would be no impact to our actual expenditures. Excluding the questioned RMTS documents would result in the minor shifting of expenditures from one federal funding source to another.*
- C. The Department concurs with the recommendations the auditor provided concerning the RMTS process. ESA will provide additional training to staff to ensure staff understands the entire RMTS process. This training will include providing the policies and procedures manual to all employees involved in the RMTS process. Also, Community Service Office Administrators will be informed of their requirement to monitor the RMTS process.*

Auditor's Concluding Remarks

We reaffirm our finding. The Random Moment Time Sample method requires the use of valid statistical data to ensure a proper allocation of administration costs to various federal programs. Many survey documents were not accurately completed. If the preparer does not sign or note the time completed, the Department has no assurance the correct person completed the information at the proper time. This situation invalidates the data, leading to an invalid statistical sample and possible invalid federal program charges.

When this occurs, the risk is high that one federal program may pay for expenditures that should have been allocated to a different federal program. In such a case, the costs would not be allowable for the paying program. We agree this would not change the total expenditures for the Department; however, it could significantly change the federal agency reimbursing for the costs. The issues of allowability and allocability for specific programs are highly significant to federal funding sources.

We appreciate that the Department concurs with our recommendations and plans to establish a training program and additional monitoring for this cost allocation process.

Applicable Laws and Regulations

Title 45 Code of Federal Regulations, Subtitle A (10-1-03 Edition), Section 95.507 - Plan Requirements, sub-section (b.8) states in part:

. . . an adequate accounting and statistical system exists to support claims that will be made under the cost allocation plan

Section 95.517 - Claims for Federal Financial Participation, sub-section (a) states in part:

A State must claim FFP for costs associated with a program only in accordance with its approved cost allocation plan

Section 95.519 - Cost Disallowance states in part:

If costs under a Public Assistance program are not claimed in accordance with the approved cost allocation plan (except as otherwise provided in Sec. 95.517), or if the State failed to submit an amended cost allocation plan as required by Sec. 95.509, the costs improperly claimed will be disallowed.

. . . (b) If the issue affects the programs of more than one Operating Division, or Federal department or the State, the Director, DCA, after consulting with the Operating Divisions, shall determine the amount inappropriately claimed under each program. The Director, DCA will notify the State of this determination, of the dollar affect of the determination on the claims made under each program, and will inform the State of its opportunity for appeal of the determination under 45 CFR part 16. The State will subsequently be notified by the appropriate Operating Division as to the disposition of the funds in question.

Section 74.53 - Retention and access requirements for records, sub-section (b and c) states in part:

Financial records, supporting documents, statistical records, and all other records pertinent to an award shall be retained for a period of three years from the date of submission of the final expenditure report or, for awards that are renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report.

The U.S. Office of Management and Budget's Circular A-87, Attachment B, (11.h) - Support of Salaries and Wages, states:

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

(a) Substitute systems which use sampling methods (primarily for Aid to Families with Dependent Children (AFDC), Medicaid, and other public assistance programs) must meet acceptable statistical sampling standards including:

(i) The sampling universe must include all of the employees whose salaries and wages are to be allocated based on sample results except as provided in subsection (c);

(ii) The entire time period involved must be covered by the sample; and

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

The Implementation Guide for Circular A-87, ASMB C-10, (<http://www.hhs.gov/grantsnet/state/asmbc10.pdf>), issued on April 8, 1997 by the U.S. Department of Health and Human Services, subsection 3-21, states in part:

... a statistical reporting system (e.g. random moment sampling) should be considered for employees working in dynamic situations (performing many different types of activities on a variety of programs over a short period of time).

04-32 The Department of Social and Health Services did not comply with federal requirements for an independent peer review of the Community Mental Health Services Block Grant.

Background

The Department of Social and Health Services, Health and Rehabilitative Services Administration, administers the federal Community Mental Health Services Block Grant (CFDA 93.958), received from the federal Department of Health and Human Services. This Program provides funds to states and territories to help them provide comprehensive, community-based mental health services for adults with serious mental illness and children with serious emotional disturbances.

In fiscal year 2004, the Department spent \$8,697,249 in this Program. Approximately 95 percent of this amount was awarded to Regional Support Networks and other contractors who administer the Program throughout the state.

Special terms and conditions of the federal grant require a state to provide an independent peer review of the Program to assess the quality, appropriateness, and effectiveness of treatment services provided to individuals. At least 5 percent of the entities providing services must be reviewed annually and they must be representative of the entities providing the services.

Description of Condition

We found the Administration is not complying with the requirement for an independent peer review of the Program.

Cause of Condition

The Administration stated it received verbal guidance from the Community Mental Health Services Division of the Department of Health and Human Services that the independent peer review requirement is not an effective or efficient method of reviewing the program. Therefore, the Community Mental Health Services Division is not requiring states to follow this requirement. However, the requirement remains in effect in the federal regulations and is still included in the federal guidance provided to auditors.

Recommendation

We recommend the Department comply with the requirements for an independent peer review or petition the federal grantor to change its regulation.

Department's Response

The Department concurs with this finding. The Mental Health Division has petitioned for the federal grantor to change its regulation.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding and will review these areas in our fiscal year 2005 audit.

Applicable Laws and Regulations

Title V of the Public Health Service Act [42 U.S.C. 300x-1 et seq.] Section 1943 states in part:

(a) The State will – (1)

(A) for the fiscal year for which the grant involved is provided, provide for independent peer review to assess the quality, appropriateness, and efficacy of treatment services provided in the State to individuals under the program involved: and

(B) ensure that, in the conduct of such peer review, not fewer than 5 percent of the entities providing services in the State under such program are reviewed (which 5 percent is representative of the total population of such entities);

. . . .

04-33 The Department of Community, Trade and Economic Development did not comply with federal requirements for suspension and debarment.

Background

The Department of Community, Trade and Economic Development administers the federal Home Investment Partnership Program (CFDA 14.239), also referred to as the HOME program. The objectives of the HOME program are to:

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

The Department reported total HOME expenditures of \$12,810,816 for fiscal year 2004. Approximately 90 percent of these expenditures were awards passed through to subgrantees, such as local governments and non-profit organizations.

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

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

Description of Condition

The Department is not in compliance with federal suspension and debarment requirements. The Department chose the option to include a descriptive clause or condition in the contracts for two sections of the HOME program: Tenant Based Rental Assistance and Housing Repairs and Rehabilitation Program. The Department failed to include a notification that the subgrantees also have responsibilities regarding suspension and debarment when they make further awards. We estimate the payments related to these two sections of HOME during fiscal year 2004 totaled \$4.5 million. This condition was previously reported in the fiscal year 2003 State Accountability Report and the State of Washington Single Audit Report.

Cause of Condition

The Department believed that the requirement to pass on this information to subgrantees applied only in the case of construction contracts. In addition, employees followed Office of Financial Management preliminary guidance, rather than fully researching the new regulations.

Effect of Condition

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

Recommendation

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

Department's Response

We disagree with the finding. The Housing Division believes that it complies with the US Department of Housing and Urban Development's Title 24 of the Code of Federal Regulations, Sections 24.300, 330 and 440. The Housing Repairs and Rehabilitation Program (HRRP) in its contract Specific Terms and Conditions and General Terms and Conditions sections references compliance with Executive Order 12549, Debarment and Suspension, as well as requiring contractors to certify that neither the organization nor its principals are "... presently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from participation in this transaction by any federal department or agency." In addition, the Conditions prohibit the contractor from entering into contracts with parties that are suspended or debarred and require the Contractor to maintain records of certifications concerning debarment and suspension of construction contractors.

The Housing Division's contractors for the Tenant Based Rental Assistance program (TBRA) are responsible for the determination of low-income family eligibility to receive rental assistance and pay for the family's rent with vouchers directly to landlords. They do not deal with lower tier contractors.

Auditor's Concluding Remarks

Under a grant from the federal government to a state, the suspension and debarment requirements apply to all of the state's awards to subgrantees and, effective November 26, 2003, to contractors receiving individual state contracts for \$25,000 or more, a decrease from the prior threshold of \$100,000. In addition, the state's contract language must notify its subgrantees and contractors of their responsibilities to pass down suspension and debarment requirements to all of their sub-subgrantees and to their contractors with individual contracts of \$25,000 or more. The term "contractors" does not refer only to construction-related contracts.

We reaffirm our finding that the contract language regarding suspension and debarment in the HOME program contracts is inadequate.

Applicable Laws and Regulations

Title 45 of the Code of Federal Regulations, Section 76.300 states:

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

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

45 CFR 76.330, subpart C states:

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

- a) Comply with this subpart as a condition of participation in the transaction. You may do so using any method unless section 76.440 requires a specific method be used.
- b) Pass the requirement to comply with this subpart to each person with whom the participant enters into a covered transaction at the next lower tier.”

45 CFR 76.440 states:

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

04-34 The Department of Community, Trade and Economic Development did not comply with federal requirements for time and effort reporting.

Background

The Department of Community, Trade and Economic Development administers the Low Income Home Energy Assistance Program (CFDA 93.568), referred to as LIHEAP, and the Community Services Block Grant (CFDA 93.569). While the majority of program payments are for services, both programs also receive some funding for administration.

The goals of LIHEAP are to assist low-income households to:

- Meet the costs of heating and cooling their homes.
- Improve energy self-sufficiency.
- Reduce their vulnerability arising from energy needs.

The target population is low-income households with the highest home energy costs or needs in relation to income, taking family size into account. Other targets are low-income households with members who are vulnerable, such as the elderly, disabled, and young children. The Department reported total LIHEAP expenditures of \$38,279,533 for fiscal year 2004.

The Community Services Block Grant can be used to fund programs and other activities that:

- Assist low-income individuals and families attain self sufficiency.
- Provide emergency assistance.
- Support positive youth development.
- Promote civic engagement.
- Improve planning and coordination among multiple resources to address poverty-related conditions.

Funding is used for such services as employment, self-sufficiency, housing, education, income management, health, nutrition, transportation, and links to other resources. The Department funds 31 Community Action Agencies, which assist over 450,000 low-income individuals annually. Community Services Block Grant expenditures for fiscal year 2004 were \$6,723,564.

For payroll costs charged directly to federal awards, federal regulations require employees to document their time and effort spent on each federal activity monthly. These monthly records must reflect the actual after-the-fact distribution of the employee's activities. States may charge by budget only if they compare the budget to actual activities at least every three months and adjust requests for federal funds accordingly.

Description of Condition

During our review of payroll charges, we found 13 employees in the LIHEAP and Block Grant programs who worked on multiple activities but charged their time based on budgeted, rather than actual, amounts, without proper periodic adjustments. The total salaries and benefits charged to LIHEAP and the Community Services Block Grant based on budget are estimated to

be \$113,000; of this amount, \$41,000 is attributable to LIHEAP and \$72,000 is attributable to the Community Services Block Grant. This condition for LIHEAP was previously reported in finding 03-2 in the fiscal year 2003 State of Washington Single Audit Report.

Cause of Condition

Management believes the estimated time charged to the awards closely approximates actual hours worked.

Effect of Condition

Without proper time and effort records, the Department is unable to substantiate the accuracy of the payroll costs charged to these two programs. We are questioning the approximately \$41,000 in federal funds charged to LIHEAP and the \$72,000 charged to the Community Services Block Grant.

Recommendation

We recommend the Department maintain time and effort records that comply with federal regulations or perform at least a quarterly reconciliation of estimated to actual hours. We also recommend the Department consult with the federal grantor to determine whether any questioned costs should be repaid.

Department's Response

We agree with the finding. Until CTED has approved cost allocation plans, staff that work on more than one program will charge their time based on actual time spent on the various projects.

Management is confident that the time charged to the noted programs reflects the actual efforts expended and did not cause overcharges to any program. These changes will be completed by December 31, 2004.

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 the Department staff.

Applicable Laws and Regulations

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

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

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

- 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) 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...unless a statistical sampling system 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.
- 3) 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.

04-35 The Department of Social and Health Services, Division of Vocational Rehabilitation, did not comply with federal time and effort reporting requirements for its Rehabilitation Services grant.

Background

The Department of Social and Health Services, Division of Vocational Rehabilitation, administers the federal Rehabilitation Services-Basic Program (CFDA 84.126). This program provides vocational rehabilitation services for individuals with disabilities so that they may prepare for and engage in gainful employment. For fiscal year 2004, the Department reported total federal program expenditures of \$40,334,088, of which \$16,754,811 was for wages and benefits.

For payroll costs charged directly to federal awards, federal regulations require employees to document the time and effort spent on each federal activity monthly. These monthly records must reflect the actual distribution of the employee's activities. However, if an employee works on only one federal activity, semi-annual certifications signed by the employee or a supervisor meet federal requirements.

Description of Condition

We found the following:

- The Department charged \$114,040 in salaries and benefits to the grant for agency employees whose time was allocated to the program on a strict percentage basis rather than on actual time spent on Program activities.
- Over 300 employees worked and were charged full-time to the Program. The Department did not require these employees or their supervisors to certify their time spent working on the Program. This issue was previously reported in the State of Washington Single Audit report for fiscal year 2003.

Cause of Condition

The Department staff members responsible for the allocation of senior agency staff costs were not familiar with the federal time and effort reporting requirements.

In addition, the Division had developed but not yet put in place policies and procedures to ensure compliance with the federal requirements over time and effort reporting for employees who work 100 percent on a grant program.

Effect of Condition

Without time and effort documentation and certifications, the federal grantor cannot be assured that wages charged to its program are accurate and valid. As a result, we are questioning the \$114,040 charged to the Program by employees who spent only part of their time in those activities. However, in considering the nature of the job duties and responsibilities of each field

office, we feel the risk is low that the 300 full-time employees were performing duties other than those pertaining to the Program and therefore we do not question these costs.

Recommendation

We recommend the Division:

- For employees spending only part of their time on the Program, charge wages and benefits to the Program based on actual time and effort documentation and discontinue charging these costs on pre-set information in the payroll system.
- Require employees who work 100 percent on a single federal program, or their supervisors, to certify in writing on a semi-annual basis their time spent working on the program.

Department's Response

The Department concurs with this finding. In response to the fiscal year 2003 finding, a corrective action plan was immediately developed and implemented during the next semi-annual certification period of October 1, 2004 through March 31, 2005. The DSHS Accounting Policy Management Board issued Fiscal Policy 50.01, Federal Compliance With Time Allocation/Certification, on July 1, 2004. The Division of Vocational Rehabilitation has implemented the requirements of that policy and semi-annual certifications have been completed for salaried and part-time employees for both the current period and the audit review period. The Department will work towards compliance with federal time and effort reporting requirements.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding and will review these areas in our fiscal year 2005 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.

04-36 The Department of Social and Health Services, Juvenile Rehabilitation Administration did not comply with federal requirements for time and effort reporting for the Juvenile Accountability Incentive Block Grant Program.

Background

The Department of Social and Health Services, Juvenile Rehabilitation Administration administers the Juvenile Accountability Incentive Block Grant Program (CFDA 16.523). In fiscal year 2004, the Department spent grant funds of \$4,224,808. It awarded 75 percent of this amount as pass-through grants to 48 local governments to conduct juvenile justice activities such as hiring additional judges, prosecutors, public defenders, and probation officers; building or renovating detention facilities; or establishing drug courts.

The Department spent an additional \$627,797 for Administration salaries and benefits.

For payroll costs charged directly to federal awards, federal regulations require employees to document the time and effort spent on each federal activity monthly. These monthly reports must reflect the actual distribution of the employee's activities. However, if an employee works only on one federal activity, semiannual certifications signed by the employee or a supervisor meet federal requirements.

Description of Condition

During our review of payroll charges, we noted the Administration did not require any of the employees charged to this grant to account for their time according to federal requirements. All seven salaried employees and the two part-time employees working solely on the Program did not prepare semiannual certifications of their time. In addition, we found two employees working 50 percent of the time on the Program were charging their time based on budgeted rather than actual amounts.

Cause of Condition

The Administration was unaware of the federal requirement regarding time and effort reporting.

Effect of Condition

Without proper time and effort records, the Department cannot substantiate the accuracy of payroll costs charged to this program. We question the entire \$627,797 charged to this grant for salaries and benefits.

Recommendation

We recommend the Department maintain time and effort records that comply with federal regulations.

Department's Response

The Department concurs with this finding. The DSHS Accounting Policy Management Board issued Fiscal Policy 50.01, Federal Compliance with Time Allocation/Certification, on July 1, 2004. The Juvenile Rehabilitation Administration (JRA) has implemented the requirements of that policy and semiannual certifications have been completed for salaried and part-time employees for both the current period and the audit review period. JRA employees who work on multiple activities now keep daily timesheets on their activities.

JRA does not concur with the questioned payroll costs of \$627,797. It is the administration's position that these funds were expended appropriately within the purpose areas of the federal grant.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding and will review these areas in our fiscal year 2005 audit.

Applicable Laws and Regulations

The 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...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 or 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.

04-37 The Military Department did not comply with federal requirements for time and effort reporting in the State Domestic Preparedness Equipment Support Program.

Background

The Military Department administers the State Domestic Preparedness Equipment Support Program (CFDA 16.007 and CFDA 97.004), which receives funds from the federal Department of Homeland Security. The funds are provided to enhance the capacity of state and local first responders to respond to a terrorism incident, such as the use of chemical and biological agents or radiological, nuclear, and explosive devices. The Program receives federal funding for the purchase of specialized equipment to improve the capabilities of state and local governments to respond to such acts. The total Program expenditures for fiscal year 2004 are \$13,114,108. Included in this amount are the estimated total salaries and benefits of \$200,000.

For payroll costs charged directly to federal awards, federal regulations require employees to document their time and effort spent on each federal activity monthly. These monthly records must reflect the actual after-the-fact distribution of an employee's activities. States may charge by budget only if they compare the budget to actual activities at least every three months and adjust requests for federal funds accordingly.

Description of Condition

We found a monthly average of 16 employees working on multiple activities who were keeping monthly time and effort records based on budgeted amounts, rather than on actual amounts.

Cause of Condition

The Department was unaware of the federal requirements regarding time and effort reporting.

Effect of Condition

Without proper time and effort records, the Department is unable to substantiate the accuracy of the payroll costs it charged to this program. We are questioning the estimated \$150,000 charged to the program for the salaries and benefits of the 16 employees.

Recommendation

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

Department's Response

The Military Department concurs with the finding and has already initiated the following corrective action to address the issue.

In March 2004, during the audit period of July 1, 2003 to June 30, 2004, the Washington Military Department put in place a time and effort policy and procedure. The policy and procedure states clearly that actual time will be reported. To strengthen the implementation of the policy and procedure an additional process has been instituted that has the Payroll section forwarding any timesheet suspected of using budgeted time to the Accounting Manager. In turn the Accounting manager will bring timesheets to the attention of the Emergency Management Division (EMD) Chief of Staff. The EMD Chief of Staff is also directly monitoring timesheets. The monitoring of timesheets by the EMD Chief of Staff has already resulted in timesheets being returned to supervisors and staff to report actual time.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issue identified in the finding. We also appreciate the cooperation extended to us throughout the audit by the Department staff.

Applicable Laws and Regulations

U.S. Office of Management and Budget Circular A-87 (2004 version), *Cost Principles for State, Local and Indian Tribal Governments*, Attachment B, Section 8(h), states in part:

(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.

04-38 The Department of Social and Health Services, Economic Services Administration, does not adequately monitor other state agencies to which it provides funds from the federal Temporary Assistance to Needy Families Program.

Background

The Department of Social and Health Services, Economic Services Administration, is the administering state agency for the federal Temporary Assistance to Needy Families Program (CFDA 93.558). The Administration receives Program funds from the federal Department of Health and Human Services and, through interagency agreements, shares some of these funds with three other state agencies: the Employment Security Department, the Department of Community, Trade and Economic Development, and the State Board for Community and Technical Colleges. During fiscal year 2004, the Administration received \$295,705,817 in Program funds and distributed \$141,137,600 of these funds to the three agencies.

Description of Condition

We found the Administration does not receive supporting documents or perform adequate monitoring of the state agencies with which it shares Program funds. The agreement with Employment Security was the only one to mention monitoring activities, and it delegated these activities to the Office of Financial Management. We found no one in the Administration who was monitoring any of the agreements for allowable uses of the funds. As the administering agency, the Department is responsible for ensuring Program funds are used according to federal regulations.

Cause of Condition

The Administration stated it discussed the need for review of supporting documents with the Office of Financial Management and assumed that the Office would monitor these agreements. The Administration's understanding was that the Office would receive and review reports from the three agencies and there was no need for the Department to duplicate this effort. However, we found no one in the Office who was monitoring any of the agreements for allowable uses of the funds.

Effect of Condition

The Administration does not have assurance that Program funds were used for allowable purposes.

Recommendation

We recommend the Administration monitor state agencies receiving Program funds to assure that these agencies are using funds for allowable costs.

Department's Response

The Department partially concurs with this finding. The State Auditor's Office (SAO) audited this program and relevant contracts as recently as two years ago. The SAO had not previously found any questioned costs or issued any audit findings. In the time since SAO audited these contracts, there have been no changes in our procedures concerning these contracts.

Yearly risk assessments that were done on partner agency contracts identified these contracts as 'low risk'. This means the Division of Management and Operations Support (DMOS) reviews each billing for expenditure patterns and appropriateness of those patterns. The Department believes internal controls are in place that help insure consistent and appropriate use of Temporary Assistance to Needy Families Program (TANF) funds by DSHS partner agencies in the WorkFirst Program (WF). Reasonable, timely and thorough back-up practices assure appropriate payments are made on WorkFirst billings (as listed below). Practices within and between the four state WorkFirst partner agencies; Employment Security Department (ESD); Department of Community Trade and Economic Development (CTED); and State Board for Community and Technical Colleges (SBCTC) ensuring the provision of appropriate and accountable use of funds include:

- *A-19 assurances (vendor certification that everything in the billing is true) are signed and accompany all billings. DMOS verifies back up documents with invoice voucher A-19 and monitors for consistent expenditure patterns;*
- *Consistent and thorough documentation (by individual case numbers) exists in the shared automation system, eJAS, to which all administrating partner agencies and all contractors providing services have access and contractual obligation;*
- *Sub-cabinet meetings two and three, quarterly monitor eJAS data including WF partnership statewide performance measures from the program level rising to the Governor's performance measures;*
- *Sub-cabinet meeting three, management through weekly (now bi-weekly) oversight of the WF Partnership's programmatic and fiscal operations as implemented in the field;*
- *Partnership/program collaboration at the local office level helps insure appropriate use of funds – local Community Services Offices, local Employment Security Department Offices, local community and technical colleges, and Community Jobs contractors work together at providing services for shared clients. All WorkFirst client activity is documented in eJAS.*
- *Accountability is mentioned in all Interlocal Agreements:*
 - *CTED -- under "Inspection; Maintenance of Records" – during the agreement and for six years afterwards, the contractor's records shall "demonstrate accounting procedures, practices, and records which sufficiently and properly document the Contractor's invoices to DSHS and all expenditures"*
 - *SBCTC – under "TANF/TANF Maintenance of Effort Compliances" – SBCTC shall provide DSHS with "client and fiscal data necessary to comply with the data reporting provisions"; and, -- under "Inspection; Maintenance of Records" – during the agreement and for six years afterwards, the contractor's records shall "demonstrate accounting procedures, practices, and records which sufficiently and properly document the Contractor's invoices to DSHS and all expenditures."*

In an effort to strengthen current practices, the Department will initiate an action plan to improve documentation and monitoring of WorkFirst partners' billings.

Auditor's Concluding Remarks

We acknowledge monitoring techniques are in place for assessing the overall use of funds at the agencies in question. However, we reaffirm our finding that monitoring is inadequate to provide assurance Program funds are used for allowable purposes.

We appreciate the Department's commitment to resolving the issues identified in the finding by implementing an action plan to improve documentation and monitoring of the WorkFirst partners' billings. We will review the agency's corrective action during our next regular audit. We also appreciate the cooperation extended to us throughout the audit by Department staff.

Applicable Laws and Regulations

Title 45 of the Code of Federal Regulations, Section 92.40: Monitoring and reporting program performance, states in part:

(a) Monitoring by grantees. Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

04-39 The Department of Social and Health Services, Juvenile Rehabilitation Administration is not complying with subrecipient monitoring requirements for the Juvenile Accountability Incentive Block Grant.

Background

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

To help ensure that funds are spent appropriately, the federal government requires pass-through agencies to monitor the activities of subrecipients to provide reasonable assurances they are complying with federal requirements. Monitoring includes reviewing reports submitted by subrecipients and performing on-site reviews of subrecipients financial, operations and program records.

In fiscal year 2004, the Department spent grant funds of \$4,224,808 from the Juvenile Accountability Incentive Block Grant (CFDA 16.523). It awarded 75 percent of this amount as pass-through grants to 48 local governments to conduct juvenile justice activities such as hiring additional judges, prosecutors, public defenders, and probation officers; building or renovating detention facilities; or establishing drug courts.

Description of Condition

We reviewed the Department's system for monitoring the activities of these subrecipients and its process for paying subrecipient claims. The monthly claims from the local governments include salaries and benefits, contractual services, travel and administrative costs. We found the local governments do not submit supporting cost documentation with reimbursement claims. A review of financial documentation during on-site visits would provide a compensating control, but we found the Department does not perform such a review.

Local governments submit progress reports quarterly, and the Department withholds payment if the report is not received. While this is an important method of monitoring, it does not provide a review of financial information.

Cause of Condition

The Department said it is aware of the need to review subrecipient financial information but lacked the staff to meet this responsibility.

Effect of Condition

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

Recommendation

We recommend the Department review financial documentation supporting subrecipient reimbursement claims, either before payment or during on-site visits.

Department's Response

The Department concurs with this finding. The JAIBG Program Site Review form, which is completed during each on-site visit annually, has been revised to include a review of financial information. This review will include all support cost documentation for reimbursement claims for a specific time period. Site visits are scheduled with each site by the program administrator, or in the case of some remote sites, the Juvenile Rehabilitation Administration regional administrator for the region in which the site resides. Site visits that take precedence are those that are considered higher risk or contract terms that are soon to expire.

In addition, DSHS Administrative Policy 13.14, Identifying and Managing Federal Sub-recipient Contracts and Agreements is currently being reviewed at the executive level; we anticipate the policy will be finalized and released by March 31, 2005.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding and will review these areas in our fiscal year 2005 audit.

Applicable Laws and Regulations

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

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

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

Office of Juvenile Justice and Delinquency Prevention, Grant Award Number 2002-JB-BX-0040, states in part:

Special Conditions

11. The recipient agrees to monitor all subawards for performance and fiscal integrity, including cash match. In addition, the recipient will monitor all subrecipients to assure that required audits are performed.

04-40 The Department of Social and Health Services, Health and Rehabilitative Services Administration, does not adequately monitor its subrecipients for the Community Mental Health Services Block Grant.

Background

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

To help ensure that funds are spent appropriately, the federal government requires pass-through agencies to monitor the activities of subrecipients to provide reasonable assurances they are complying with federal requirements. Monitoring includes reviewing reports submitted by subrecipients, reviewing audit reports for the subrecipients, and performing on-site reviews of subrecipient financial, operational and program records.

The Department of Social and Health Services, Mental Health Division, administers the federal Community Mental Health Services Block Grant (CFDA 93.958). This Program provides funds to states and territories to help them provide comprehensive, community-based mental health services for adults with serious mental illness and children with serious emotional disturbances.

The Department contracts with Regional Support Networks and other contractors who administer the Program throughout the state. These subrecipients must submit plans to the Administration documenting how they will use the funds. Each month the subrecipients submit claims for reimbursement to the Department for services provided while following their plans. In fiscal year 2004, the Department spent \$8,697,249 in this Program.

Description and Effect of Condition

We reviewed the Division's process for monitoring the activities of the subrecipients and for paying their claims. We found the Division does not require them to submit supporting documentation of their costs with their reimbursement claims, although some do. The Division does not perform on-site reviews of subrecipients who don't provide supporting documentation; such reviews would provide a compensating control. Without proper documentation or on-site reviews, the Division cannot be certain its subrecipients have spent grant funds for allowable purposes.

We also found the Division has no adequate process in place to ensure it receives all required reports of independent audits of subrecipient federal funds, reviews those reports, and follows-up on any needed corrective action. Without such a process, the Division cannot ensure it or its subrecipients have complied with federal requirements for subrecipient audits.

Cause of Condition

The Division believed it did not need to monitor because its subrecipients receive audits of their federal funds performed by the State Auditor's Office. However, the federal government has made it clear that such reliance is not sufficient to meet the recipient's (in this case, the Division) responsibilities towards its subrecipients and towards the federal grantor.

Recommendation

We recommend the Division establish and follow a process to:

- Require the submission of adequate payment support by all subrecipients or perform an on-site review of this support.
- Monitor subrecipients requiring an audit in accordance with federal regulations by:
 - Establishing a record of all such audits it needs to receive and ensuring it receives them.
 - Performing a timely review of these audit reports, followed by timely management decisions on audit findings.
 - Requiring timely corrective action on audit issues.

Department's Response

The Department concurs with this finding.

The Mental Health Division (MHD) will develop a contract monitoring process for all contracts, including, but not limited to, the Mental Health Block Grant contracts. In addition MHD will implement DSHS Administrative Policy 13.14, Identifying and Managing Federal Subrecipient Contracts and Agreements scheduled for release March 31, 2005.

Auditor's Concluding Remarks

We appreciate the Department's commitment to resolving the issues identified in the finding and will review these areas in our fiscal year 2005 audit.

Applicable Laws and Regulations

The U.S. Office of Management and Budget's 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 Federal awards it makes:

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

- (4) Ensure that subrecipients expending \$300,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.
- (5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.
- (6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records

04-41 The Military Department does not have adequate internal controls to ensure compliance with regulations regarding purchases for, contracting with, and monitoring of its subrecipients in the State Domestic Preparedness Equipment Support Program.

Background

State agencies often distribute federal funds to other organizations that provide services needed to accomplish federal program objectives. These organizations are known as subrecipients, while the state agencies are called pass-through agencies. To help ensure that funds are spent appropriately, the federal government requires pass-through agencies to monitor the activities of subrecipients to provide reasonable assurance that they are complying with federal requirements. Monitoring requirements are contained in the federal Office of Management and Budget's Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*.

Monitoring may take various forms, such as reviewing reports submitted by subrecipients; regular contact with subrecipients; and performing on-site reviews of subrecipient financial and program records and operations. Factors that may affect the degree of monitoring include program complexity, amount of the award, and risks directly related to the subrecipient. Pass-through agencies must ensure they receive and review audit reports from subrecipients and follow-up on any problems identified in those reports.

The Military Department administers the State Domestic Preparedness Equipment Support Program (CFDA 16.007 and CFDA 97.004), which receives funds from the federal Department of Homeland Security. The funds are provided to enhance the capacity of state and local first responders to respond to terrorism, such as the use of chemical and biological agents or radiological, nuclear, and explosive devices. The Program receives federal funding for the purchase of specialized equipment to improve the capabilities of state and local governments to respond to such acts. Total Program expenditures for fiscal year 2004 were \$13,114,108.

In addition to its own activities, the Department contracts with all 39 counties of the state to provide funds for the purchase of specialized equipment and for training exercises, planning and administration. These counties are subrecipients of the Department and together received \$12,845,271 of the Department's federal equipment grant during fiscal year 2004.

Description of Condition

During our review, we found the Department has:

- Inadequate controls over the approval of equipment purchases made by the Department and sent to the subrecipient counties. There is no evidence that the program manager is reviewing and approving the equipment purchases.
- Inadequate information in subrecipient contracts regarding subrecipient obligations to record and track equipment purchased with federal funds.

- Inadequate procedures for monitoring the activities of its subrecipients. There is no system in place to perform periodic on-site visits of subrecipients, nor to collect, review, and follow-up on subrecipient audit reports.

Cause of Condition

The Department was unaware of the need to have adequate procedures to ensure equipment is purchased properly, subrecipient contracts include equipment controls, and subrecipient audit reports are received and reviewed. The Department stated it was aware of the need to review subrecipient financial information during on-site visits but lacked the staff to conduct such visits.

Effect of Condition

Inadequate internal controls increase the risk of loss of public funds. In addition, these conditions impair the Department's ability to prevent or detect errors and irregularities in a timely manner.

Recommendation

We recommend the Department:

- Establish and follow adequate internal controls to ensure it makes only allowable equipment purchases with grant funds.
- Devote the resources necessary to ensure it properly monitors its subrecipients. At a minimum, the Department should:
 - Communicate the federal equipment management requirements to all subrecipients.
 - Periodically check that all subrecipients have an adequate system for equipment recording, usage, inventorying and disposition.
 - Check annually to see if counties received an audit of the program, when required.

Department's Response

The Military Department concurs with the finding and has already initiated the following corrective action to address the issues.

An oversight management group has been established and has met to direct the development and implementation of sub-recipient monitoring policy and procedures. A comprehensive written agency policy and procedure will be completed by 03/31/05. Training will be provided to program staff that will be involved in monitoring sub-recipients. The progress of writing and implementing the policy and procedures will be reported to the Director of the Washington Military Department on a monthly basis until fully implemented.

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 the Department staff.

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:

A pass-through entity shall perform the following:

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 . . .

Ensure that subrecipients expending \$300,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.

Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.

The Department of Homeland Security has established the Office of Justice Programs' *Financial Guide* as the fiscal and oversight requirements for this grant program. Part II, Chapter 3 of this guide states in part:

1. Reviewing Financial Operations. Direct recipients should be familiar with, and periodically monitor, their subrecipients' financial operations, records, system, and procedures. Particular attention should be directed to the maintenance of current financial data . . .

5. Audit Requirements. Recipients must ensure that subrecipients have met the necessary audit requirements contained in this Guide (see Part III, Chapter 19: Audit Requirements).

Where the conduct of a program or one of its components is delegated to a subrecipient, the direct recipient is responsible for all aspects of the program including proper accounting and financial recordkeeping by the subrecipient. Responsibilities include the accounting of receipts and expenditures, cash management, the maintaining of adequate financial records, and the refunding of expenditures disallowed by audits.

Part III, Chapter 19 of the Guide states in part:

When subawards are made to another organization or organizations, the recipient shall require that subrecipients comply with the audit requirements set forth in this chapter.

Recipients are responsible for ensuring that subrecipient audit reports are received and for resolving any audit findings. Known or suspected violations of any law encountered during audits, including fraud, theft, embezzlement, forgery, or other serious irregularities, must be communicated to the recipient.

For subrecipients who are not required to have an audit as stipulated in OMB Circular A-133, the recipient is still responsible for monitoring the subrecipients' activities to provide reasonable assurance that the subrecipient administered Federal awards in compliance with Federal requirements

Part III, Chapter 6 of the Guide states in part:

Records for equipment, non-expendable personal property, and real property shall be retained for a period of three years from the date of the disposition or replacement or transfer at the discretion of the awarding agency. If any litigation, claim, or audit is started before the expiration of the three-year period, the records shall be retained until all litigations, claims, or audit findings involving the records have been resolved.

Schedules of Prior Year Findings

Fiscal Year 2002

Finding Number	Finding Caption	Status
2002		
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 questioned the validity of payments to claimants and service providers of approximately \$1.9 million.	Summary level only. Resolution of individual findings is listed below
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.	Resolved.
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.	Resolved.
02-09	The Department of Licensing's controls are not adequate to ensure information processed within the Unisys System is secure.	Unresolved. Management Letter re-issued for 2004.
02-16	The Department of Social and Health Services, Division of Child Support did not have adequate supporting documentation for printing and payroll costs.	Resolved.
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.	Almost completely resolved. Follow up on remaining issues will be performed in 2005.

Fiscal Year 2003

Finding Number	Finding Caption	Status
2003		
03-01	The Department of Social and Health Services, Medical Assistance Administration, did not provide the State Auditor's Office reliable records needed for audit in a timely manner.	Disclaimed program in SFY04. Did not receive records requested and/or records did not appear reliable and/or unable to obtain information independently and/or unable to interview line staff at all or without the presence of management.
03-02	The Department of Social and Health Services, Medical Assistance Administration, received federal Medicaid funds for unallowable services provided to undocumented aliens.	Unresolved. Finding and disclaimer issued for 2004.
03-03	The Department of Employment Security paid at least \$221,677 in unemployment insurance benefits to claimants who were not eligible. In addition, we estimated that payments totaling more than \$546,000 were made to claimants during the first week of unemployment, which is prohibited by state law.	Unresolved. Repeat finding for 2004.
03-04	The Department of Social and Health Services, Medical Assistance Administration, has not established sufficient internal controls to ensure that Medicaid payments are made only for persons with valid Social Security numbers and are not made on behalf of deceased individuals or persons using the Social Security numbers of deceased individuals.	Unresolved. Finding and disclaimer issued for 2004.
03-05	The Department of Social and Health Services, Economic Services Administration, should improve compliance with eligibility requirements for the Temporary Assistance to Needy Families Program.	Partially resolved. Remaining issues repeated as a finding for 2004.
03-06	The Department of Social and Health Services, Medical Assistance Administration, has not established sufficient internal controls to ensure the eligibility of families enrolled in the Medicaid Basic Health Plus program.	Disclaimer for 2004. Unable to obtain data.
03-07	The Department of Social and Health Services, Medical Assistance Administration, has not established sufficient internal controls to ensure compliance with Medicaid provisions regarding licensing and other eligibility criteria for its health care providers.	Partially resolved. Remaining issues reported as a finding for 2004.

03-08	The Department of Social and Health Services, Medical Assistance Administration, has not established sufficient internal controls to ensure that capitation rates for its managed care providers are based on accurate fee-for-service encounter data.	Unresolved. Repeat finding for 2004.
03-09	The Department of Social and Health Services, Aging and Disability Services Administration and Medical Assistance Administration, has not set up an effective system of communication that would ensure that Medicaid payments are not being made to nursing homes that are not in compliance with the federally mandated health and safety standards.	Unresolved. Finding and disclaimer issued for 2004.
03-10	The Department of Social and Health Services, Aging and Disability Services Administration, cannot determine whether nursing home payment rates properly excluded unallowable expenditures related to supplemental Medicaid payments.	Partially resolved. Remaining issues reported as a management letter for 2004.
03-11	The Department of Social and Health Services, Division of Child Care and Early Learning, does not have adequate internal controls over support for payments made to licensed family home providers and assurance that all recovered overpayments are credited to the proper funding source.	Unresolved. Repeat finding for 2004.
03-12	The Department of Social and Health Services, Division of Child Care and Early Learning, does not adequately perform background checks.	Unresolved. Repeat finding for 2004.
03-13	The Department of Fish and Wildlife spent \$5.8 million in federal funds to purchase land without the approval of the Governor and the state Legislature.	This is a multi-year audit and was not audited for fiscal year 2004.
03-14	The Department of Health has not established adequate internal controls to ensure that only appropriate refunds are processed.	Resolved.
03-15	The Department of Social and Health Services does not have adequate internal controls over the processing of expenditures through the Agency Financial Reporting System.	Unresolved. Repeat finding for 2004.
03-16	The Department of Community, Trade and Economic Development does not have adequate internal controls over the processing of expenditures through the Agency Financial Reporting System.	Resolved.
03-17	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.	Resolved.
03-18	The Department of Transportation's controls over access to applications and data files on the mainframe computer are not adequate.	Resolved.
03-19	The Department of Natural Resources does not have adequate control over access to the state's Personnel Payroll System.	Resolved.

03-20	The Department of Corrections has not established and followed adequate controls over electronic access to the Trust Accounting System.	Partially resolved. Remaining issues reported as a management letter for 2004.
03-21	The Department of Social and Health Services, Division of Child Support, has not established adequate procedures to limit access to the Financial Management Imaging System only to those who need it.	Resolved.
03-22	The Department of Transportation paid nearly \$30 million to reimburse the developer of the Tacoma Narrows Bridge Project without gaining adequate assurance that the costs met contract terms and were actually incurred.	Resolved.
03-23	The Department of Labor and Industries did not provide evidence that it complied with state bid laws when purchasing information technology services totaling more than \$14 million.	Unresolved. Repeat finding for 2004.
03-24	The Department of Community, Trade and Economic Development did not follow bidding regulations when it solicited bids for the purchase of 25 modular bunkhouses for the Monitor Park Migrant Housing Camp.	Resolved.
03-25	The Department of Community, Trade, and Economic Development Housing Division did not purchase farm worker facilities in compliance with state regulations.	Resolved.
03-26	The State Parks and Recreation Commission did not comply with state bid laws and did not adequately monitor contracts and change orders.	This is a multi-year audit and was not audited for fiscal year 2004.
03-27	The State Parks and Recreation Commission did not adequately monitor contracts with concessionaires and lessees.	This is a multi-year audit and was not audited for fiscal year 2004.
03-28	The Department of Social and Health Services, Mental Health Division, did not properly monitor its contract with a non-profit agency whose funds were used for the personal expenses of a staff member.	Partially resolved. Remaining issues reported as a management letter for 2004.
03-29	The Department of Social and Health Services, Division of Developmental Disabilities, made inappropriate payments to a for-profit agency with which it has a contract to provide services to its clients.	Resolved.
03-30	The Department of Transportation's Washington State Ferries Division is not following state purchasing guidelines when buying from vendors deemed a sole source.	Resolved.

03-31	The Department of Community, Trade, and Economic Development is not adequately administering state housing assistance funds awarded in the form of forgivable loans.	Partially resolved. Remaining issues reported as a management letter for 2004.
03-32	The Department of Community, Trade and Economic Development is not complying with state regulations for collection of overdue loan payments in several of its loan programs.	Partially resolved. Remaining issues repeated as a finding for 2004.
03-33	The Capital Asset Management System maintained by the Office of Financial Management lacks adequate controls to ensure that assets are properly safeguarded.	Unresolved. Repeat finding for 2004.
03-34	The Department of Labor and Industries removed equipment that cost more than \$133,000 from its inventory system without evidence that it had done a reasonable search for the missing items. The Department did not report these losses and additional equipment losses of \$128,000 to the State Auditor's Office as required by state law.	Resolved.
03-35	The Department of Veterans Affairs does not have sufficient internal controls over its pharmaceutical inventory to prevent or detect misappropriation or loss.	Partially resolved. Management Letter issued for unresolved issues.
03-36	The Washington Horse Racing Commission lacks adequate controls to safeguard equipment and other assets that are small and susceptible to misappropriation.	This is a multi-year audit and was not audited for fiscal year 2004.
03-37	The Washington State Historical Society has not completed an inventory of historical artifacts.	This is a multi-year audit and was not audited for fiscal year 2004.
03-38	More than \$5.8 million in employer industrial insurance premium payments recorded as being received by the Department of Labor and Industries between July 2002 and December 2002 were not reflected as being deposited in the industrial insurance accounts. The Department was unable to account for this difference.	Unresolved. Repeat finding for 2004.
03-39	The Department of Labor and Industries does not have adequate internal controls over cash receipts and disbursements in its Self Insurance section.	Resolved.
03-40	The Department of Labor and Industries does not perform a periodic reconciliation between its unique disbursement systems and the financial system.	Unresolved. Repeat finding for 2004.
03-41	The Department of Transportation's Washington State Ferries Division does not have adequate controls over ticket sales and revenue collection.	Unresolved. Repeat finding for 2004.

03-42	The Department of Transportation's Washington State Ferries Division made travel payments to employees in excess of contract amounts and lacked adequate controls over travel payments.	Unresolved. Repeat finding for 2004.
03-43	The Liquor Control Board does not have adequate internal controls over revenue collected in its state liquor stores.	Resolved.
03-44	The Department of Social and Health Services, Office of Accounting Services, does not have adequate internal controls over the Foster Care Trust Fund.	Resolved.
03-45	The Washington State Commission on African-American Affairs does not have adequate internal controls over its disbursements, which resulted in a loss of at least \$5,857.	This is a multi-year audit and was not audited for fiscal year 2004.
03-46	The Washington State Historical Society has not established adequate internal controls over its local bank account and investments.	This is a multi-year audit and was not audited for fiscal year 2004.
03-47	The Washington State Historical Society has not established adequate internal controls over cash receipts.	This is a multi-year audit and was not audited for fiscal year 2004.
03-48	The Department of Health did not comply with state law regarding yearly surveys of hospitals.	Partially resolved. The Department proposed legislation to change timeline from 1 year to 18 months.
03-49	The State Printer does not bill agencies on an actual cost basis as required by state law.	This is a multi-year audit and was not audited for fiscal year 2004.
03-50	The Department of Labor and Industries did not allocate indirect costs equitably among its programs and funds.	Partially resolved. Management Letter issued for unresolved issues.
03-51	The Department of Labor and Industries destroyed inventory records prior to the approved destruction data.	Unresolved. Repeat finding for 2004.
03-52	The Department of Social and Health Services, Medical Assistance Administration, has not established sufficient internal controls to ensure financial reports submitted to the federal government comply with Medicaid provisions.	Unresolved. Repeat finding for 2004.
03-53	The Washington Interagency Committee for Outdoor Recreation should improve its internal controls over federal reporting.	Resolved.
03-54	The Department of Social and Health Services, Medical Assistance Administration, is not complying with subrecipient monitoring requirements for the Medicaid Program.	Partially resolved. Remaining issues reported as a finding for 2004.

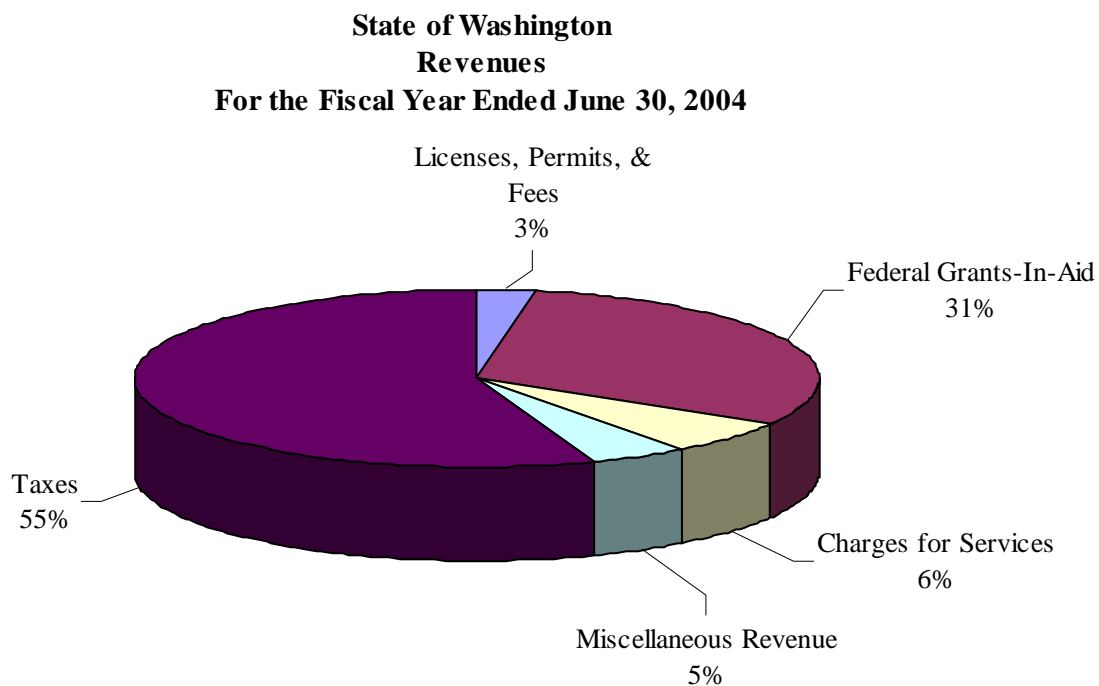
03-55	The Department of Health does not adequately monitor its subrecipients for the Breast and Cervical Cancer program.	Resolved.
03-56	The Department of Community, Trade and Economic Development did not comply with federal requirements for time and effort reporting and suspension and debarment in the Home program.	Partially resolved. Suspension and debarment is a repeat finding for 2004.
03-57	The Department of Community, Trade and Economic Development did not comply with federal requirements for time and effort reporting in the LIHEAP program.	Unresolved. Repeat finding for 2004.
03-58	The Employment Security Department did not comply with federal requirements for payroll time and effort reporting for the Unemployment Insurance program.	Resolved.
03-59	The Employment Security Department did not comply with federal requirements for payroll time and effort reporting for the Workforce Investments Act program.	Resolved.
03-60	The Department of Social and Health Services did not comply with federal time and effort reporting requirements for its Rehabilitation Services grant.	Corrective action in process. Repeat finding for 2004.

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.

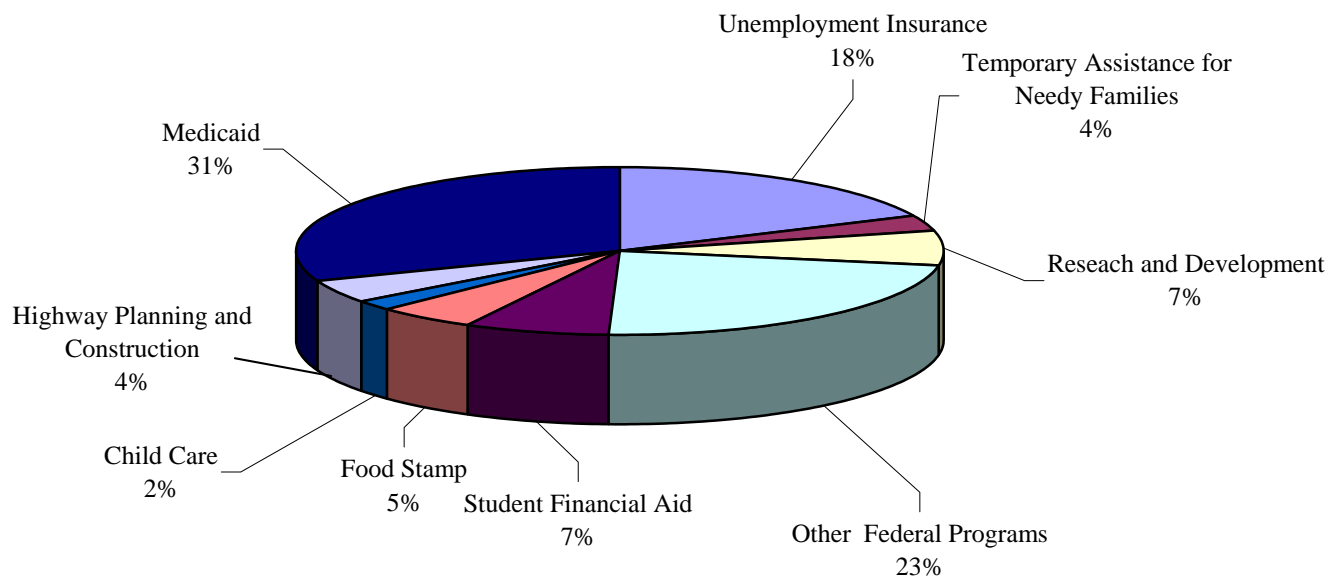
The following provides summary information on the revenues, federal dollars received and expenditures the state incurs as well as on audit costs in relation to total expenditures.

Revenues – The state of Washington's revenues for all government funds (the largest group of funds the state has established) totaled almost \$25 billion for fiscal year 2004. 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.



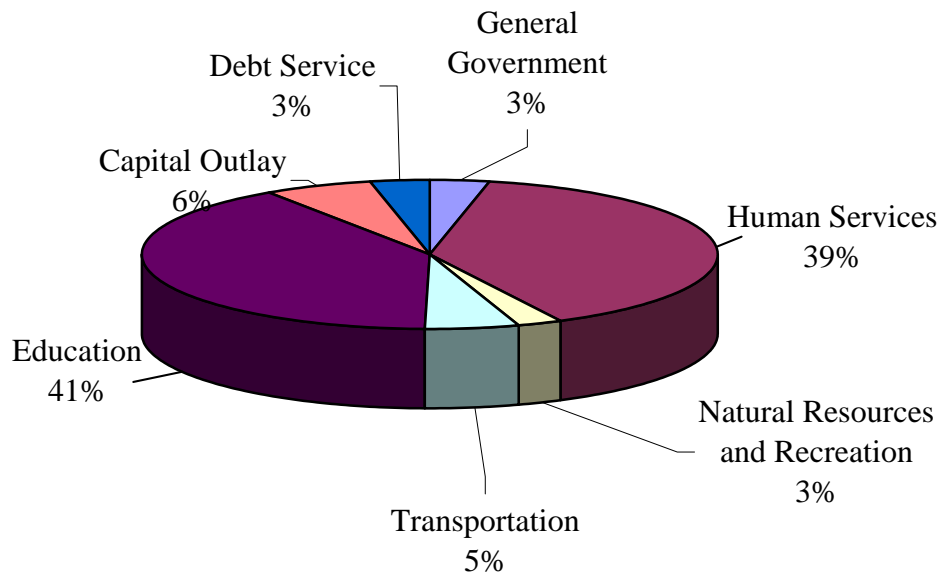
Federal Funding – The state of Washington received \$10.1 billion in federal money in fiscal year 2004, with \$3.1 billion of it going to the Medicaid program to provide health care for the state's low-income residents. The state is required to match the Medicaid program with state funds. Other major 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, 2004**



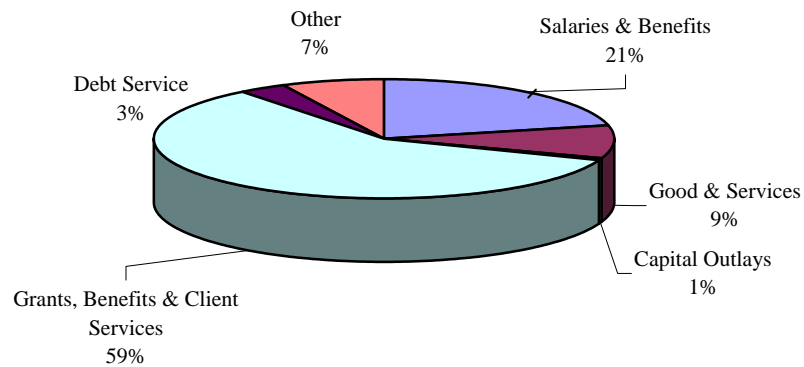
Expenditures – For the fiscal year, expenditures for the state of Washington totaled \$25.7 billion for all governmental fund types. Thirty-nine percent of the dollars were spent on human services, 41 percent on education and the remaining 20 percent in other areas.

**State of Washington
Expenditures
For the Fiscal Year Ended June 30, 2004**



Expenditures by Object – Fifty-nine percent of expenditures for the fiscal year ended June 30, 2004 was for grants, benefits, and client services, including K-12 basic education grants. Twenty-one percent was for salaries and benefits and nine percent for goods and services. The remaining 11 percent was spent on other miscellaneous expenses.

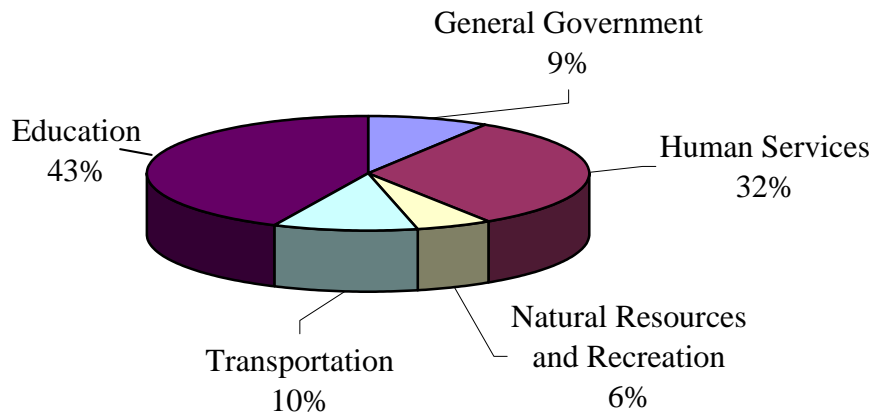
**State of Washington
Expenditures by Object
For the Fiscal Year Ended June 30, 2004**



State Employees – OFM measures the number of state employees in full time equivalent (FTE) staff years. One person working 40 hours a week for a full year is counted as one FTE staff year. Two people working half time also count as one FTE. Although the state provides funding for compensation of local school teachers, this support is in the form of payments to the school districts. Therefore, OFM does not consider K-12 teachers in statewide FTE statistics.

Our analysis indicates that 74.3 percent of the state's 103,569 FTEs are in higher education and human services. The remaining 25.7 percent are in general government, natural resources and recreation, and transportation.

**State of Washington
FTE's
For the Fiscal Year Ended June 30, 2004**



Audit Costs – Over the past seven years, our audit costs have increased \$387,844, while state expenditures have increased \$9.2 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.

	1998	2004	Change	Change in \$
Number of state audits completed	125	75	-50	
Total state expenditures subject to audit	\$25,991,432,000	\$35,259,817,545	36%	\$9,268,385,545
Total state audit costs	\$5,900,756	\$6,288,600	7%	\$387,844
Audit costs as a percentage of expenditures	0.023%	0.018%	-0.005%	

Agencies Audited for Fiscal Year 2004

Columbia River Gorge
Corrections, Department of
Ecology, Department of
Employment Security, Department of
Financial Management, Office of
Fish and Wildlife, Department of
Gambling Commission
General Administration, Department of
Governor, Office of the
Health Care Authority
Health, Department of
Home Care Quality Authority
Information Services, Department of
Joint Legislative Systems Committee
Labor and Industries, Department of
Legislative Evaluation and Accountability Program
Licensing, Department of
Liquor Control Board
Lottery Commission
Military Department
Natural Resources, Department of
Personnel, Department of
Retirement Systems, Department of
Revenue, Department of
Social and Health Services, Department of
State Investment Board
Superintendent of Public Instruction, Office of the
Trade and Economic Development, Department of
Transportation, Department of
Treasurer, Office of State
Veterans Affairs, Department of
Volunteer Firefighters and Reserve Officers, Board for
Washington State Lottery
Washington State Patrol

Findings by Agency

Agency	Beginning Pages
Community, Trade and Economic Development, Department of	74, 138, 151, 154
Corrections, Department of	114
Employment Security, Department of	34
Financial Management, Office of	110
Health, Department of	108
Labor and Industries, Department of	77, 102, 106, 119, 122
Military, Department of	164, 175
Personnel, Department of	128
Retirement Systems, Department of	25
Social and Health Services, Department of ***	30, 40, 43, 48, 51, 56, 61, 64, 87, 90, 94, 141, 144, 149, 158, 161, 167, 170, 172
Superintendent of Public Instruction, Office of	67
Transportation, Department of	85, 125
Veterans Affairs, Department of	80
Volunteer Firefighters and Reserve Officers, Board for	132

*** Our Special Report on Medicaid for Fiscal Year 2004 can be found at http://www.sao.wa.gov/Reports/Accountability/2004_Medicaid.pdf. The Medicaid special report and its 22 findings should be considered an integral part of this State Accountability Report.