STATE AUDITOR'S OFFICE
STATE OF WASHINGTON ACCOUNTABLITY REPORT
FISCAL YEAR 2001

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February 7, 2002

Dear Citizens, Legislators, Policymakers and other interested parties:

Welcome to the State Auditor's Office first statewide report on state government accountability.

This report looks at what we found during our audits in 2001. It also reflects a new facet to our audits: looking at some issues on a statewide, rather than agency-by-agency basis.

It also reflects the hard work of dozens of auditors who are out in the field every day finding issues and making suggestions for improvements to agencies' financial operations.

When we decide what to look at during our audits, we rely heavily on the knowledge and expertise of these auditors. They are able to identify emerging issues and to point to areas where agencies are at risk of being out of compliance. This improves the efficiency of our work, benefiting our audit clients.

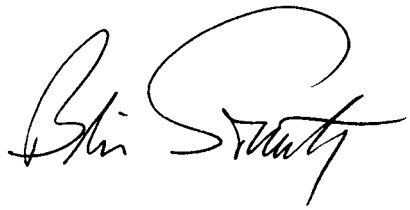
Based on our analysis, in 2001 we looked at e-commerce areas; computer security; whether people receiving benefits from the state were eligible to do so; and whether state agencies are complying with a law that instructs them to set up internal audit operations to monitor themselves.

This work will continue in 2002, as we look at the security of information technology systems; agencies' monitoring of grants; and continue our work in the claims/benefits area.

As a strong advocate for citizens who expect that their tax dollars will be safeguarded, we believe this comprehensive approach will add value to our audits for citizens, legislators, policymakers and other interested parties who want to know what their government is doing.

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

Sincerely,



BRIAN SONNTAG, CGFM
STATE AUDITOR

State Auditor's Office Mission

The State Auditor's Office independently serves the citizens of Washington by promoting accountability, fiscal integrity and openness in state and local government. Working with these governments, we strive to ensure the proper use of public resources

State Auditor's Office Audits

The Washington State Auditor's Office regularly audits 268 state agencies ranging from the largest, such as the Department of Social and Health Services, to the smallest, such as the Asparagus Commission. State agencies also include all public colleges and universities in Washington.

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

The Office performs audits on the:

- The State of Washington's General Purpose Financial Statements
- Nearly $8 billion in federal funds received by the state.
- Areas that pose the highest risk for the misappropriation, misuse or loss of public funds.
- Funds kept by agencies that are not in the care or custody of the Office of State Treasurer. These are known as local funds.

We also have responsibilities in two other areas:

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

Comprehensive Annual Financial Report (CAFR)

The State Auditor's Office performs an annual audit of the statewide combined financial statements as required by state law (RCW 43.09.310). These financial statements are included in the Comprehensive Annual Financial Report (CAFR) prepared by the Office of Financial Management. This report is designed to present the financial position and the results of operations of the state of Washington. The Office of Financial Management prepared the first CAFR in 1982. 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, 2001, total state revenues and expenditures were approximately $26 billion and $30 billion, respectively.

For the last 14 years, the state has received a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officer's Association. This award recognizes conformance with the highest standards for preparation of state and local government financial reports.

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

Statewide Single Audit

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

For the fiscal year ended June 30, 2001, the state spent nearly $8 billion in federal assistance. The largest single grantor was the Department of Health and Human Services, which provides funding for programs such as Medicaid and Temporary Assistance for Needy Families. In the last four years we have reported 40 findings related to federal grants. Historically, almost half of the federal findings have been in the area of allowable costs or cost principles. About one eighth of the federal findings were related to cash management; about one eighth were related to eligibility of recipients; and another one eighth were related to the reporting of expenditures. The remaining findings were in areas such as subrecipient monitoring, charging to grants within the period of availability and failure to meet matching requirements.

We reviewed internal controls and compliance with grant requirements for 20 programs in the fiscal year 2001 SWSA. Findings related to federal grants are not included in this report. Instead, they will be presented in a separate single audit report to be issued early in March. At this time, we anticipate the single audit report will have about 20 federal findings.

Legal Compliance Audit (State Accountability Report)

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

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

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

- Computer-assisted auditing techniques have given us a new tool to assess accountability. Once we download an audit client's financial transactions, we have software applications that can help us find transactions that are most likely to be fraudulent or out of compliance with laws and regulations. These techniques often help us audit expenditures, but they can be used for any type of financial transaction.

- We also use analytical procedures throughout an audit. The different types of analyses are too numerous to mention here. However, they typically have a common purpose: to find when account balances differ from an informed expectation. We often use these procedures to audit revenue streams to look for activity outside our expectations that can point to a loss or misuse of public assets. These techniques tend to be very efficient and provide strong indicators that additional work may be needed to determine whether loss or misappropriation has occurred.

- Surprise cash counts are a powerful tool for assessing the state of controls over money collected at a given location, and for finding indications that a fraud may have occurred.

- We audit certain computer applications for security over access, and for other safeguards. These audits are of enormous value in pointing out conditions that could allow fraud to occur without detection by management or conditions that could allow destruction of data. Recommendations from these audits over the past year have helped many state agencies tighten controls over access to computer systems. This improves their chances of preventing fraud, or detecting it in a timely manner. These audits also have helped our auditors identify areas in which assets are most at risk.

We audit several areas on a statewide basis each year. Each team that audits state agencies uses a consistent approach to look at areas we believe present a statewide risk of theft or misuse of assets or noncompliance.

Whistleblower Program

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

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 and/or actions that could pose a 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.

From July 1, 2000 through December 2001, the Whistleblower Program investigated 223 assertions of improper governmental action with a substantiation rate of 37 percent (83 assertions). As a result, the Program recommended recovery of more than $325,000.

In addition to recovery, the Whistleblower Program collaboratively worked with state agencies to develop corrective actions to prevent improper governmental actions in the future. This proactive approach results in greater public accountability, and ensures that public resources are appropriately used.

Fraud Program

As part of our efforts to ensure accountability over public dollars, the State Auditor's Office places a high priority on its fraud program.

Fraud prevention and detection are an integral part of our risk-based approach to auditing, providing meaningful information to citizens, legislators and other policymakers interested in state and local government operations.

We take great pride in the two aspects of the program:

- The Special Investigations Team, which monitors all fraud cases throughout the state. We have a team manager, two full-time fraud specialists, and 17 others who investigate frauds reported to or detected by our agency. In the past year, we have reported on $275,121 of fraud in state agencies.

- Our fraud prevention training for the financial managers of state agencies and local governments. 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 a significant amount.

We also use computer-assisted audit techniques to help us keep up with increasingly sophisticated fraud schemes, providing extra value to those we audit.

Local Fund Report

At the Legislature's request, the State Auditor's Office audits the financial activity and record-keeping practices of local funds as part of its audits of state agencies. The audit of local funds is performed at the end of each biennium and reports the results.

Local funds are those state funds not in the care and custody of the State Treasurer's Office. They primarily are used by state colleges and universities. The Legislature established some of these funds. The rest are authorized under state law (RCW 43.88.195), which authorizes the Office of Financial Management to allow agencies to establish local funds outside the State Treasury when agencies present compelling reasons to do so. As of June 30, 2001, 62 local funds reported $5.4 billion in cash and investments, compared to $4.3 billion at June 30, 1999.

The following table shows the cash and investments in local accounts by fund type.

At June 30, 2001 and June 30, 2000		
	2001	**2000**
Special Revenue Funds	$1,130,111,233	$1,071,304,650
Capital Projects Activities	6,964,419	12,868,637
Permanent Funds	1,240,728,149	1,152,128,755
Enterprise Activities	2,731,568,045	2,573,690,316
Internal Service Activities	9,757,381	9,524,950
Private Purpose Trust Activities	38,708,587	36,755,896
Cash Held for Others	240,032,485	215,040,302
TOTAL LOCAL FUNDS	**$5,397,870,300**	**$5,071,313,506**

During the 1999-2001 biennium, 33 state agencies had money in 62 separate local funds. These 33 agencies include five universities, one college and 34 community and technical colleges (For reporting purposes, the state combines the 34 community and technical colleges into one state agency). Colleges and universities spend most of their money through various local funds.

Some state agencies use one local fund while others use multiple local funds. The local fund report, available on our web site, www.sao.wa.gov, contains detailed information about all 62 local funds and the agencies that use these funds. Each state agency, including the colleges and universities, is responsible for accounting procedures and internal controls over the local fund(s) it uses.

State Employee Combined Fund Drive Local Account

The State Employees Combined Fund Drive is a local account. We do not audit the State Employee Combined Fund Drive Account, which is managed by the Department of Personnel. This account contains money that state employees designate for specific charities. It comes from state employees' voluntary payroll deductions and some direct donations and is distributed to the charities by the Department.

Although state employees operate this fund as part of their job responsibilities and the fund is included in the state's financial statements, we have received legal advice that it is not a public fund subject to audit by our Office. The Legislature made no provisions requiring an audit of this fund. As a result, this fund has not been audited since its inception in 1985. Approximately $40 million has flowed through the fund since it began.

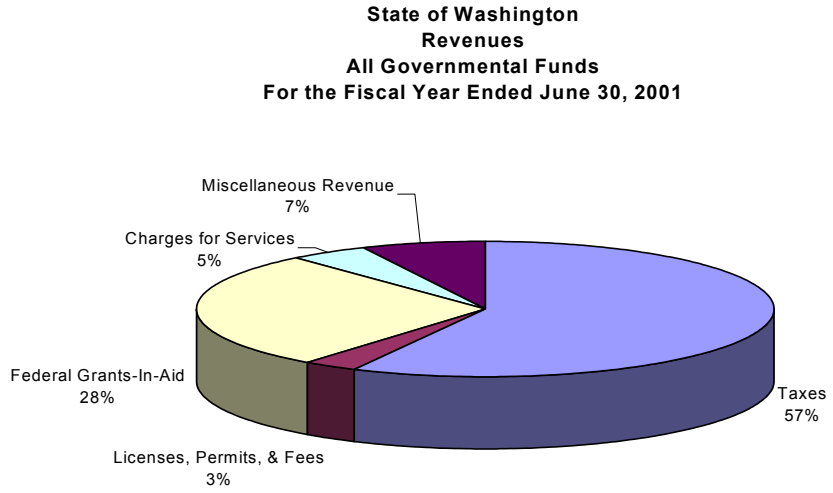
We recommend the legislature decide who should audit the State Employee Combined Fund Drive Account and direct that the audit take place. This audit should examine whether all contributions are going to the charities designated, whether proper internal control procedures are in place to ensure accountability over public money and should include any other procedures deemed necessary by the auditor.

State of Washington Statistical Information

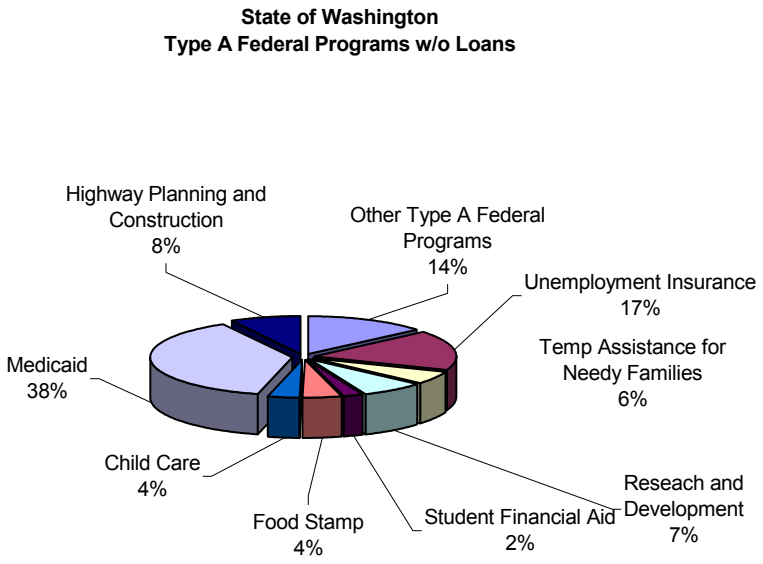
The State Auditor's Office uses statistical information in planning our audits of the state of Washington. The analysis may include a review of revenues for unusual or unexpected fluctuations or to identify a new revenue source. Analytical procedures also may include a review of expenditures to identify 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 totaled $20,690,189,182 for fiscal year 2001 (July 1, 2000 through June 30, 2001). As shown below, these revenues include 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. The remaining funding sources make up 43 percent of the revenue. 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.

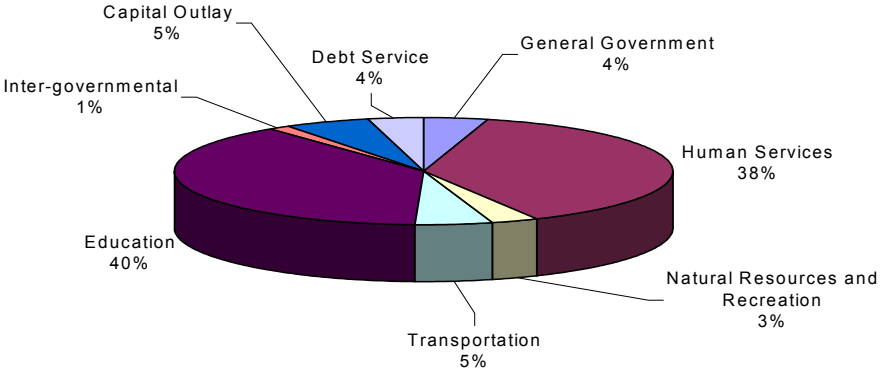


Federal Funding – The state of Washington receives over $7 billion in federal money each year, more than $2 billion of it going to the Medicaid program to provide health care for some of the state's low-income residents. The state is required to make approximately 100% match on the medicaid program with state funds. Other federal programs include student financial aid, highway planning and construction, and unemployment insurance. These funds are audited under special requirements of the federal government and the results are reported in our Statewide Single Audit Report.

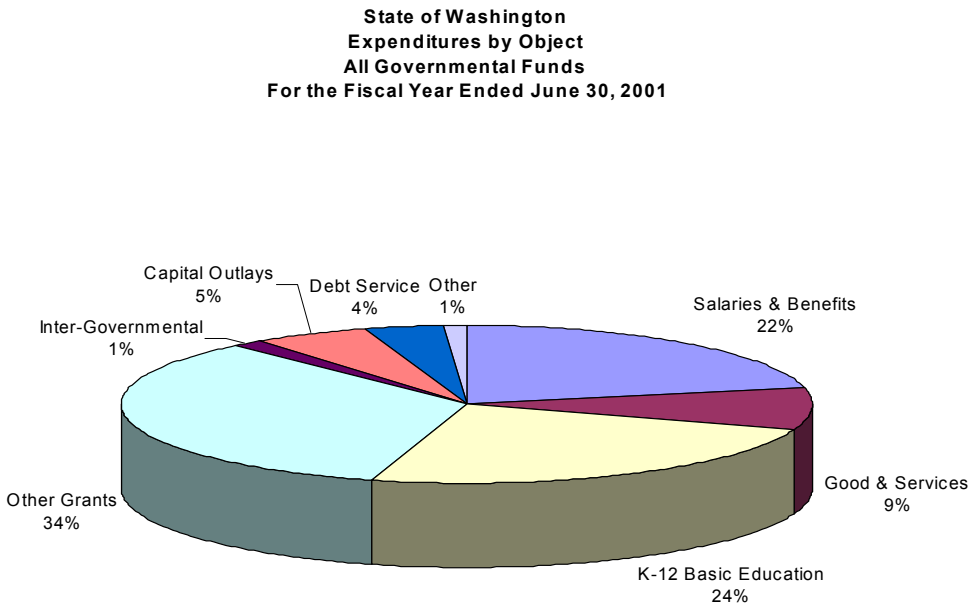


Expenditures – For the fiscal year, expenditures for the state of Washington totaled $21.8 billion for all governmental fund types. Forty percent of the dollars are spent for education, 38 percent on human services and the remaining 22 percent in other areas.

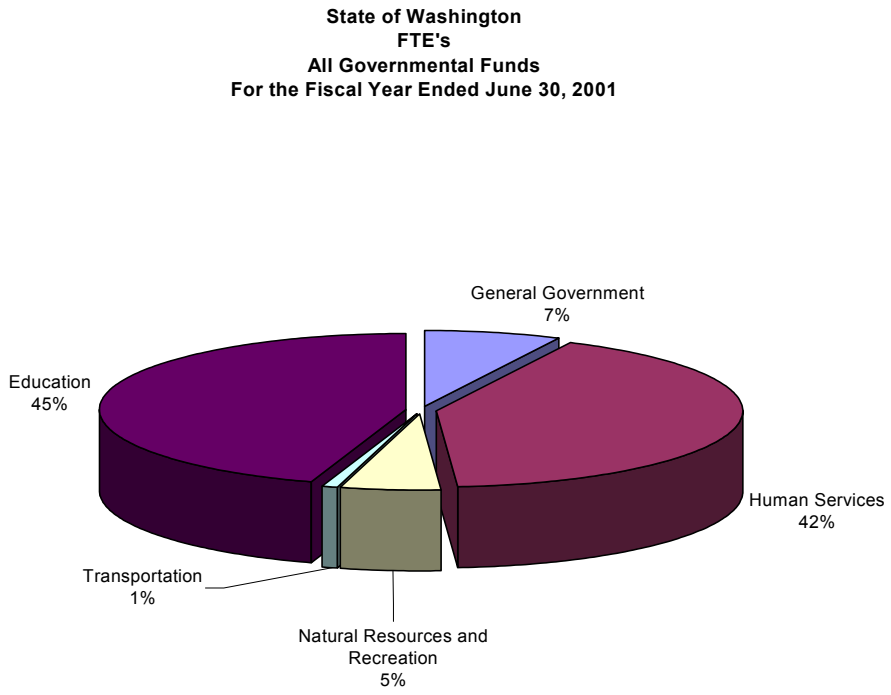
State of Washington
Expenditures
All Governmanetal Funds
For The Fiscal Year Ended June 30, 2001



Expenditures by Object – In analyzing the expenditures for all governmental fund types, 34 percent is for state grants and clients services, 24 percent for K-12 Basic Education grants, 22 percent for salaries and benefits and 9 percent for goods and services. The other 11 percent is spent on other miscellaneous expenses.



State Employees – The number of state employees is measured in a unit known as an FTE, which is the equivalent of one full calendar year of paid employment to one person. A FTE is not the number of employees on the payroll, nor is it the number of positions in state government. In analyzing the 41,094 FTEs employed in general fund state agencies, 87 percent are in education and human services areas. The remaining 13 percent are in general government, natural resources and recreation, and transportation.



Audit Costs – Over the past five years, our audit costs have increased $304,143, while state expenditures have increased $6 billion. The audit cost as a percentage of expenditures has decreased .01% in the same time period. The State Auditor's Office continues to find more efficient ways to audit.

	1996	2001	Change	Change in $
Number of state audits completed	140	104	-36	
Total state expenditures audited	$23,714,042,998	$29,671,479,439	25%	$5,957,436,441
Total state audit costs	$6,156,404	$6,460,547	5%	$304,143
Audit costs as a percentage of expenditures	0.03%	0.02%	-0.01%	

Fiscal Year 2001 Statewide Audit Areas

Claims Benefits – The state of Washington provides billions of dollars in benefits to people through many different claims benefit programs. Different eligibility requirements apply to each program. In performing this year's audit, we focused on identifying the benefit payment systems, accounting procedures and controls, eligibility requirements, the possible testing to perform in fiscal year 2002 audit and the information required from state agencies to allow us to conduct testing of claims benefit systems.

The State Auditor's Office has identified claims benefits as high risk based on what other states have found. The state of Pennsylvania paid over $3.5 million to provide Medical Assistance managed care coverage for people who were ineligible for the program because they were incarcerated or dead. The State of Oregon found that the Oregon Health Plan extended benefits to thousands of ineligible people at a cost to the state of $4.3 million.

As disclosed in our finding on Health Care Authority, we also found significant issues with policies and procedures that should ensure that all who receive health insurance subsidies are eligible. Also, the Authority does not know how much it is owed from subscribers who have been over-subsidized and has not collected those overpayments, or assessed penalties, as authorized by state law. In other programs, we questioned significant dollars that were paid to individuals and medical providers.

The results of our fiscal year 2001 audit work found the state lacks a centralized process to determine whether individuals are eligible for benefits or whether they are receiving benefits through other programs that would make them ineligible for others. The audit also found that individuals are not required to provide information, such as personal identification number that would assist in determining eligibility.

Imaging – With improvements in technology and the desire for more efficiency in state government, state agencies continue to move toward a paperless work environment. As a result, agencies are making and storing electronic images of documents, rather than storing the original paper copies on site. Some state agencies are destroying paper documents after the images are made, but before they are audited. While this may result in a more efficient work environment, it has also raised questions as to the integrity and security of the data. For example, the original data from the paper copies may not be captured completely and accurately and may not be adequately protected from damage or manipulation.

To address these concerns, we reviewed internal controls over imaged documents. We concluded that of the 65 state agencies audited in this area, 15 were making electronic copies of key documents. The other agencies were either not doing this, or were doing so only for convenience of retrieval. They were maintaining the paper document as the original source document. We found weaknesses in the process at seven agencies, including inappropriate access to the copied data, inadequate controls over completeness and validity of the data, lack of offsite storage, inadequate physical security, and noncompliance with state law (RCW 40.14.060) regarding obtaining proper approval of electronic copying procedures before destruction of paper documents.

In addition to specific recommendations at the seven agencies discussed above, we recommended to the State Record Committee that the General Records Retention Schedule be modified to more clearly communicate the responsibilities of state agencies when destroying paper copies of documents copied electronically.

Internal Audit Survey – In 1996, the Legislature passed a law (RCW 43.88.160(4)) requiring each agency to have an internal audit function to safeguard agency assets, check the accuracy and reliability of accounting data, to promote operational efficiency and encourage adherence to agency policies and procedures.

During fiscal year 2001 we surveyed 160 state agencies and higher education institutions to determine which agencies have internal audit programs, how they are set up, and what kind of work they do. We received responses from 70 (42 percent) agencies and of those agencies that responded; only 21 (30 percent) stated that they have an internal auditor program. Two agencies stated that they want to establish an internal audit program, but they have not received funding to hire an internal auditor. In addition, of the 21 agencies that have an internal auditor, only 11 (52 percent) have had their internal audit function go through a peer review. Of the 49 agencies that reported they do not have an internal audit program, eight agencies have an internal auditing committee or board that performs some internal audit function.

We recommend the following for the Statewide Areas:

- The state develop a centralized process on determining if individuals are eligible to receive benefits and a process to cross match to other state agency benefit payment systems and create a single identification on individuals receiving benefits that can be cross matched to the Internal Revenue Service and border states data files. We further recommend the laws be change to require individuals to provide information that will allow the verification of income.

- A legal review of the laws and requirements on the retention of public record to ensure state agencies' electronic copying systems are not violating state law.

- Funding be provided or the state law be modified that requires state agencies to have an internal audit function.

Fiscal Year 2002 Statewide Audit Areas

In our audit of agencies for the 2002 fiscal year, we will review:

Billings and Accounts Receivable – The cash-handling function associated with a billing and accounts receivable operation represents high risk a fraud will occur. Our audit approach will analyze the internal control structure and the accounts receivable records. We will determine if duties are appropriately segregated and/or an adequate monitoring program is in place. We will also compare accounts receivable records to subsidiary accounting records for agreement and confirm with individuals and companies large receivable balances and delinquent accounts.

Claims Benefits – The majority of state claims benefit payments are made through three state agencies: the Department of Social and Health Services, the Department of Employment Security and the Department of Labor and Industries. Previous audit findings indicate a high risk that errors will occur and benefit payments will be made to unqualified claimants, payments will be made in the wrong amounts, duplicate payments will be made, etc. We will use computer-assisted audit techniques to identify questionable transactions for examination during the audits of these departments. We will also work with boarder states to receive data files on individuals receiving benefits and match those to our benefit payments systems.

Contracting – Past experience has shown us that the contracting process is a high-risk area. We will analyze accounting records, identify contracts in effect during the audit period and apply analytical procedures to select and test those that have a high risk of noncompliance with state law and regulations.

Indirect Cost Allocations – Indirect cost allocations provide state agencies with the means to recover costs incurred for common or joint purposes while engaged in federal programs or in contracts with other state agencies. There is a risk that indirect charges made be over/understated. We will review cost allocation plans for compliance to specifications set out in the program or contract.

Internal Controls – The Office of Financial Management requires each agency director to establish and maintain an effective system of internal controls to safeguard assets, check the accuracy and reliability of accounting data, promote operational efficiency and encourage adherence to agency policies for accounting and financial control. Weaknesses in the internal control structure put agencies at risk for noncompliance with state laws and regulations, raise questions about the reliability of financial records and endanger state assets. We will review and analyze the internal controls established by agencies to determine if they are operating as designed to ensure compliance with state laws and regulations and safeguard assets.

Restricted Funds – The projected shortfall of state revenue increases the risk funds restricted for a specific purpose will be used to benefit another program outside the intended use for those funds. We will use computer-assisted audit techniques to analyze the accounting records to identify high-risk transactions that will be reviewed for compliance with state laws and regulations.

State Grants – The risks associated with state grants are noncompliance with grant terms and conditions by the recipient and a lack of adequate monitoring by the grantor agency. At the recipient level we will review grant expenditures to determine if they are in compliance with grant terms and conditions. At the grantor level we will review the grant monitoring process to determine if it is adequate to ensure compliance with the grant terms and conditions.

Schedule Of Agencies With No State Or Federal Findings

Agency	Number of Years Without Findings
Department of Agriculture	6
Attorney General's Office	4
Columbia River Gorge Commission	6
Comprehensive Annual Financial Report	15
Department of Corrections	1
Office of Financial Management	7
Fish and Wildlife Migratory Waterfowl Art Committee	5
Gambling Commission	1
Department of General Administration	4
Office of the Insurance Commissioner	6
Department of Labor and Industries	1
Department of Licensing	1
Lottery Commission	4
Office of Superintendent of Public Instruction	1
Department of Retirement Systems	6
Department of Revenue	10
State Board for Community and Technical Colleges	8
State Investment Board	10
Office of the State Treasurer	9
Department of Veteran's Affairs	1

Schedule Of Findings

Finding Number	Finding Caption
01-01	The Washington State Health Care Authority does not have adequate policies and procedures to ensure that all who are receiving health insurance subsidies are eligible to do so.
01-02	Internal controls over child support checks returned to the Department of Social and Health Services, Division of Child Support, Cash Management Office are inadequate and do not provide proper safeguards.
01-03	The Department of Social and Health Services, Division of Vocational Rehabilitation, does not have adequate internal controls over the processing of expenditures for client services.
01-04	The Department of Social and Health Services does not have sufficient internal controls over drugs in the pharmacies at Western State Hospital to prevent and/or detect misappropriation or loss.
01-05	The Department of Labor and Industries has not established adequate internal control over employer accounts.
01-06	The Washington State Historical Society has not established adequate internal controls over cash receipting.
01-07	The Washington State Historical Society has not completed an inventory of historical artifacts.
01-08	The Washington Horse Racing Commission did not collect satellite fees totaling $954,600 from its licensees during calendar years 1999, 2000 and 2001.
01-09	The Washington Horse Racing Commission held a meeting that did not comply with the Open Public Meetings Act.
01-10	The Department of Transportation's Washington State Ferries Division does not have adequate controls over sales and revenue collection.
01-11	Some restricted funds administered by the Department of Natural Resources were charged more than their share of overhead costs.
01-12	The Liquor Control Board does not have adequate internal controls over revenue collected in its state liquor stores.
01-13	The Vancouver Regional Office of the Department of Fish and Wildlife does not have adequate controls over cash receipts.

01-01 The Washington State Health Care Authority does not have adequate policies and procedures to ensure that all who are receiving health insurance subsidies are eligible to do so. Also, the Authority does not know how much it is owed from subscribers who have been over-subsidized and has not collected those overpayments, or assessed penalties, as authorized by state law.

Background

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

The amount of the subsidy is based on family size, income, age of dependents and on the cost of the subscriber's health plan. During the audit period under review, the Basic Health Plan had an average of 130,978 subscribers receiving health insurance subsidies at a benefit cost of $208 million in state funds.

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

This year, we performed follow-up work in these areas to determine whether policies and procedures had been developed and were being followed. We found that of the total number of subscribers, 95,474 accounts met the Health Care Authority's criteria for re-certification. The remaining 33,645 accounts were not considered for re-certification based on unwritten Agency policy and continued to receive the subsidy.

Of those accounts that met the criteria, less than one-fourth (16,659 subscribers) were sent a letter seeking verification of continued eligibility. Only 45.6 percent of those who were sent the letter provided documentation that supported continued eligibility. The remaining voluntarily disenrolled or were disenrolled by the Authority when they did not respond to the letter.

Description of Condition

Our fiscal year 2001 audit included a review patterned after work done in fiscal year 1997. We found:

- The Authority does not know how much it has overpaid to ineligible subscribers.

- More than 37,000 subscribers enrolled in the program did not provide information sufficient to allow the Authority to review their eligibility.

- The Authority does not perform independent income verification (i.e. Employment Security Department records, etc.,) when enrolling a new subscriber.

Our work to independently verify income levels showed that the Authority subsidized more than 7,000 accounts in which income reported by subscribers was less than the income reported by independent sources. In all 7,000 cases, the difference between the sources was greater than $3,000 for a six-month period. Our review of 29 of these accounts with the greatest disparity indicated that all 29 had income in excess of the maximum allowed by law and were not eligible to participate in the program.

We reviewed 25 accounts of subscribers with out-of-state mailing addresses and found that three were ineligible for continued enrollment. In all three cases, the Authority had been notified by the subscriber, but did not remove the subscribers from the program. When we pointed this out during the audit, the Authority removed these subscribers from the program.

The Authority does not require periodic proof of student status for dependents between the ages of 19 and 23. Dependents in this age group must show proof that they are a student in order to be eligible for the program.

Despite state law and agency regulations, the Agency in most cases has not pursued repayments and has never assessed penalties.

Cause of Condition

The overpayments and lack of collections were caused by the Authority:

- Not establishing written rules on re-certification as required by state law.

- Reconfirming eligibility of only a small percentage of subscribers' accounts each year.

- Excluding certain accounts from its automated re-certification selection process, based on unwritten agency policy.

- Computing the amount of the subsidy based on verification of only the most recent month's income versus actual annual income.

- Lacking procedures for independent verification of income and subscriber information.

- Lacking procedures for income recertification for self-employed subscribers and other non-wage sources of income, such as rental payments.

- Not identifying and pursuing overpayments in a timely manner.

- Pursuing only a limited number of overpayments.

- Not applying the penalties authorized by law and its own regulations.

Effect of Condition

In administering the Basic Health Plan, the Authority is paying health insurance premiums for subscribers who are not eligible to participate in the program. Additionally, some Basic Health subscribers are receiving subsidies in amounts greater than allowed by law. The Authority is not readily able to compute the amount of overpayments due from ineligible or over-subsidized subscribers. Overpayments are not being identified, consistently repaid, and penalties are not being assessed.

This affects the amount of money that is available to the program and prevents other eligible subscribers from receiving these health insurance benefits. Currently, there are 4,105 potential subscribers waiting for Plan openings.

Recommendations

We recommend the agency establish policies and procedures to ensure that all of those who receive the Basic Health subsidy are eligible.

We further recommend that the agency determine how much is owed to it in overpayments and penalties and attempt to collect this amount, according to agency regulations.

We further recommend that all participants are recertified on a regular and timely basis to prevent overpayments.

Department's Response

The Washington State Health Care Authority has a proud tradition of providing responsible stewardship of public funds. Recognition of that responsibility is foremost in our agency mission, and is a firm belief of every HCA employee.

Because of that strong sense of responsibility, the Authority recognizes the gravity of the findings reported by the State Auditor. The severity of the findings is somewhat surprising in light of previous audits which indicated that good progress had been made in the areas of recoupment and recertification. In many of the areas cited by the Auditor, the agency has already begun efforts to correct deficiencies. In some instances, projects are already completed.

Following our review of the Auditor's report, we realize that further efforts are needed to address other aspects of the recertification and recoupment processes. As a result, the Authority is undertaking a redirection of resources to address those issues as well. Our plan of action is outlined on the following pages.

The purpose of this response is to address the concerns expressed in the Auditor's report. We will outline what is already being done, and/or what will be done, to correct those deficiencies. We also will clarify several misperceptions in the Auditor's report.

Responses to Audit Findings

General Finding: The Authority does not have adequate policies and procedures to ensure that all who are receiving health insurance subsidies are eligible to do so. Also, the Authority does not know how much it is owed from subscribers who have been over-subsidized and has not collected those over-payments, or assessed penalties, as authorized by law.

The Authority does not have adequate policies and procedures to ensure that all who are receiving health insurance subsidies are eligible to do so.

To address this finding, the Authority has reviewed all of its current policies and procedures on recertification and recoupment to be sure that they are clear and adequate for the needs of the HCA. Changes and clarifications have been drafted and are in the process of adoption. New policies and procedures to fill in the gaps identified in the audit and in our review are being written. Where appropriate, rules will be adopted to ensure that all who are receiving health insurance subsidies are eligible to do so. A pre-proposal notice of rule-making (CR-101) was filed on December 19, 2001 beginning the formal process of adopting rules to be concluded within the next four months.

- *The Authority does not know how much it has overpaid to ineligible subscribers.*

  The Authority will review all open accounts by December 31, 2002 to verify current eligibility and determine the amount of any subsidy overpayment. Thereafter, the Authority will annually recertify all enrollees to determine continued eligibility at the enrollees' annual renewal dates. The accounts of all subscribers will be reviewed to determine whether there are ineligible enrollees. Once identified, ineligible enrollees will be subject to recoupment. The HCA will begin an aggressive campaign to recoup overpayment of subsidies.

  In order to complete the task by year's end, no later than February 28, 2002, BH will expand the number of accounts to be recertified to at least 3,000 a month. Re-directing current resources and priorities will accomplish this. Our Information Systems division has recently enhanced our ability to accomplish recoupment and collections. We are working with the Attorney General's Office to develop and implement a process for recoupment of overpayments, including a process for prosecuting those who have submitted fraudulent or intentionally misleading information.

- *More than 37,000 subscribers enrolled in the program did not provide information sufficient to allow the Authority to review their eligibility.*

  Many Basic Health enrollees either do not have or do not provide a Social Security Number when enrolling in the program. Federal law makes it unlawful for a state agency to deny "any right, benefit, or privilege provided by law" for failure to provide a

Social Security Number. (5 USC 552A, see note in Section 7(a)(1) of Pub. L. 93-579, Sec. 7.) Independent income verification data sources such as Employment Security and Internal Revenue Service reports are indexed to SSNs, so without them it will be necessary to develop alternative methods of income verification.

Until we are able to find primary data that is not indexed to SSNs, we will use other alternatives such as applying greater and more frequent income documentation requirements to those subscribers. If there are issues with the data, we will require subscribers to provide detailed information and evidence of income.

- *The Authority does not perform independent income verification (i.e. Employment Security Department records, etc.) when enrolling a new subscriber. Our work to independently verify income levels showed that the Authority subsidized more than 7,000 accounts in which income reported by subscribers was less than the income reported by independent sources. In all 7,000 cases, the difference between the sources was greater than $3,000 for a six-month period. Our review of 29 of these accounts with the greatest disparity indicated that all 29 had income in excess of the maximum allowed by law and were not eligible to participate in the program.*

  RCW 70.47.020(4), and RCW 70.47.060(9) require the use of current income at the time of enrollment. At WAC 182-25-040(2)(a), we have defined income at the time of enrollment to be "the most recent thirty days or complete calendar month as of the date of application." There currently are no independent income verification data that verify the most recent month's income. For example, data from Employment Security is at least six to nine months old. Until a source of current income data is available, the Authority will compare the enrollee's statement of current income to Employment Security data. Where there are differences, it will be the obligation of the enrollee or applicant to provide sufficient information to verify his or her current income or explain any discrepancies between what is stated on the application or recertification questionnaire and what is shown on the Employment Security data in order to be considered "eligible."

  During the audited period (July 2000 through December 2000), accounts reviewed by the audit team were compared for accuracy of income data. The audit identified 29 accounts with a significant disparity. Of these, our review shows that nearly all of these cases would be resolved by policy and procedure changes that have or will be implemented:
  8 of them disenrolled during the period the audit was conducted. These are the accounts that are most likely to be identified under new procedures.
  7 of these enrolled during the audit period and would have been reverified after 12 months of enrollment, and if a discrepancy between reported income and independent verification source was detected. The Authority will adopt a policy to reverify all accounts at least annually.
  4 of these identified accounts had been recertified during the prior 12 months based on information voluntarily provided by the enrollee. In the future, if such accounts provide new information, they will undergo further review, sufficient to serve as a full recertification.

5 of these were identified by the audit team using a Labor and Industries data match. At that time, HCA did not have access to those data. While not a sufficient tool, these data will be used in the future to aid in income verification.
5 of these accounts had been identified by the Authority for recertification, and were in the process of review.

The Authority in its review of these 29 cases also considered several elements in addition to those used by the audit team:
Allowable adjustments. In determining income levels for the purpose of determining eligibility, Basic Health allows income deductions for expenses such as childcare (WAC 182 25 017 (17)). As a result, BH income levels may not correspond exactly with those of Employment Security or Labor & Industries, which do not incorporate such deductions into their income data reports.
One-time payments. The databases provide income that may be overstated for one month due to a one-time payment. For purposes of eligibility for Basic Health, such one-time payments affect subsidies only in the month the income is received, and are not averaged over a number of months. Such one-time payments may affect eligibility, but only for the month in question.

- *We reviewed 25 accounts of subscribers with out-of-state mailing addresses and found that three were ineligible for continued enrollment. In all three cases, the Authority had been notified by the subscriber, but did not remove the subscribers from the program. When we pointed this out during the audit, the Authority removed these subscribers from the program.*

  Proof of residency at time of application and recertification has been a requirement for eligibility. The Authority recognizes its failure to strictly monitor compliance and has taken administrative measures to retrain staff and regularly audit records to assure compliance.

- *The Authority does not require periodic proof of student status for dependents between the ages of 19 and 23. Dependents in this age group must show proof that they are a student in order to be eligible for the program.*

  This has already been corrected, and a new policy has been adopted. Annual recertification for accounts with students for continued subsidy for ages 19, 20, 21 and 22 was added effective November 1, 2001.

- *Despite state law and Agency regulations, the Agency in most cases has not pursued repayments and has never assessed penalties.*

  Since 1998, Basic Health has recovered a total of $338,379.53 in overpaid subsidies. Recoupment will be increased in the future using automation and redirection of staff resources. Previously, due to resource issues, Basic Health prioritized cases with the largest subsidy overpayment to purse for recovery.
  By statute RCW 70.47.060(9), the Authority cannot collect both repayments and penalties. We are developing criteria for imposing penalties for overpayment due to

fraud or intentional misrepresentation of information, and have filed a Preproposal Statement of Inquiry (CR-101), on December 19, 2001.
The Agency has added more specific information regarding income, reporting and recoupment to the Member Handbook and member educational materials.

Action Plan

The Agency has undergone many changes over the years to ensure that subsidies are applied correctly using available resources (see Exhibit A). Following is our action plan to address the auditor's findings:

February 2002
Institute a program to aggressively recoup subsidy overpayments.
Increase recertification from 1500 to 3000 accounts per month.

Spring 2002
Develop an automated recoupment process for financial and employer sponsored accounts. These are different from individual accounts in that the program must generate the bill to the member, not the sponsor who pays their premiums.
Establish interagency agreement and process with L&I to conduct data matching.
In order to use Department of Revenue data we must obtain a UBI number for self employed members who have one. The UBI number will be a new requirement for anyone who is self-employed and will target many of these accounts when expanding recertifications to 3,000 monthly.

Summer 2002
Establish IRS bulk processing agreement (contingent upon IRS agreement). We will submit in bulk to the IRS authorization forms signed by the applicant or enrollee. This will allow the IRS to send documentation directly to Basic Health and replace the member's requirement to submit a 1040 form.
Update member materials informing applicants and members of the penalties for fraud and the program's intent to investigate, collect and possibly prosecute.
Implement fraud policy to impose penalties and allow the Agency to seek prosecution if appropriate, when overpayment is the result of fraud. This requires a WAC change, which will include criteria for imposing penalties.

January 2003
Implement a renewal policy that will require all members to re-apply and submit updated income documentation annually to verify continued eligibility. In addition, the program will conduct independent income verification on a scheduled basis to ensure accuracy of reported income. Accounts flagged through independent verification occurring prior to renewal date will be recertified. Members will continue to be required to submit a change in source of income. This policy change will require legal review and a WAC change.
Revise WAC definition of income to ensure all appropriate income is considered when determining eligibility and subsidy level.

Conclusion

We value the many useful suggestions from the State Auditor's Office over the years that have improved the Basic Health Plan. We have worked continually to provide health benefits in the most expeditious manner to the working poor in Washington. We continue to work to ensure that those residents eligible for Basic Health receive it.

History of Recertification and Recoupment

1995
RCW 70.47.060(9) revised to require recertification "on a reasonable schedule defined by the Authority."

1996
Initiated recertification test period of 60 accounts, followed by monthly caseload of 200 accounts.

1997
Expanded recertification to 500 accounts per month.
Also, the Authority hired an auditor specifically for an in-depth examination of the Basic Health program. The report produced from this review contained a number of recommendations and was shared with the Office of State Auditor. Basic Health complied fully with the recommendations in this report.

1998
July expanded recertification to 1000 accounts per month.
November expanded recertification to 1250 accounts per month.
SHB 3109, Section 1, subsection (9), allowed Basic Health to recoup subsidy overpayments or impose sanctions for members who do not correctly report income or income changes.

1999
Adopted rules for recoupment in WAC 182-25-085.
May initiated recoupment process selecting 20 accounts per month.
August 1999 signed agreement for data sharing with Department of Revenue. We were unable to initiate this match immediately due to problems regarding the data. These included: reporting of gross (not net) income, age of data income, and lack of Unified Business Identifier (UBI). Without a unified business identifier matches are not member specific and confidentiality laws would preclude sending notices based on this match.

November 2000
Added Financial Sponsor and Employer sponsored group accounts in the automated recertification process. This process had been manual and only a small number had been selected.
Automation allowed us to expand recertification to 1500 accounts per month.

January 2001
Began to verify current residency as part of the recertification process.

May 2001
Added Foster Parent accounts to recertification process, requiring enrollees to submit a current Foster Parent License.

July 2001
Increased recertification by 33%, (1500 per month to 2000 per month) and included accounts without Social Security Numbers.

August 2001
We are required to give the members due process; therefore a perjury statement was added to Basic Health application. It states: "I have read and understood the information in this application. I declare, under penalty of perjury, the information I have given in this application and attachments is true, correct, and complete to the best of my knowledge. I understand that anyone who submits false information may lose coverage, may be held financially responsible for services obtained under Basic Health or additional premium amounts due, and may face other penalties for prosecution and collection."

November 2001
Added annual recertification for accounts with student status for continued eligibility at ages 19, 20, 21 and 22.

December 2001
Stepped up member communication and education on program requirements and consequences for noncompliance. Examples are: addition to billing messages, Hot Policy Pages and member educational pieces, and addition of more specific information regarding income, reporting and recoupment to the Member Handbook.

Auditor's Remarks

We appreciate the commitment and cooperation of Health Care Authority and Basic Health personnel in responding to this finding and will review progress on corrective action during our next audit period.

Applicable Laws and Regulations

RCW 70.47.020(4) states:

> "Subsidized enrollee" means an individual, or an individual plus the individual's spouse or dependent children… (d) whose gross family income at the time of enrollment does not exceed two hundred percent of the federal poverty level as adjusted for family size and determined annually by the federal department of health and human services….

RCW 70.47.060 states:

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

RCW 70.47.060 (9) states:

> …to determine, upon application and on a reasonable schedule defined by the authority, or at the request of any enrollee, eligibility due to current gross family income for sliding scale premiums…When an enrollee fails to report income or income changes accurately, the administrator shall have the authority either to bill the enrollee for the amounts overpaid by the state or to impose civil penalties of up to two hundred percent of the amount of the subsidy overpaid due to the enrollee incorrectly reporting income. The administrator shall adopt rules to define the appropriate application of these sanctions and the processes to implement the sanctions….

WAC 182-25-010 further defines dependent:

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

WAC 182-25-030 states:

> (1) To be eligible for enrollment in BHP, an individual must be a Washington state resident…(2) Persons not meeting these criteria, as evidenced by information submitted on the application for enrollment or otherwise obtained by BHP, will not be enrolled. An enrollee who is no longer a Washington resident…will be disenrolled from the plan as provided in WAC 182-25-090….

WAC 182-25-040 (10) states:

> On a scheduled approved by the administrator, BHP will request verification of information from all or a subset of enrollees (recertification), requiring new documentation of income to determine if the enrollee has had a change in income that would result in a different subsidy level. For good cause, BHP may require recertification on a more widespread or more frequent basis….

WAC 182-25-085 states:

> (1) If the HCA determines that the enrollee has received a subsidy overpayment due to failure to report income correctly, the HCA may: (a) Bill the enrollee for the amount of subside overpaid by the state; or (b) Impose civil penalties of up to two hundred percent of the subsidy overpayment….

WAC 182-25-085(6) states:

> The HCA will take all necessary and appropriate administrative and legal actions to collect the unpaid amount of any subsidy overpayment or civil penalty….

01-02 Internal controls over child support checks returned to the Division of Child Support's Cash Management Office are inadequate and do not provide proper safeguards.

Background

The Department of Social and Health Services, Division of Child Support, is responsible for collecting child support from non-custodial parents and remitting those funds to custodial parents. During fiscal year 2001, the Division collected $605,215,474 in support payments.

The Division routinely issues checks to custodial parents and refunds to non-custodial parents. Some checks issued are undeliverable and are returned to the Division. Checks are returned by the post office as undeliverable due to an incorrect address. The Division also prints checks without addresses. All undeliverable checks are returned to the cash management section, where they are stored in the safe until staff finds a valid address.

Description of Condition

We found significant internal control weaknesses in the cash management unit:

- Checks were not logged in when they were returned.
- Checks were in an unlocked safe.
- Staff had access to checks in the safe and the ability to make changes to the related accounting records.
- An inventory of the safe contents had never been taken and the agency did not know the number and value of checks within the safe.
- A reconciliation of checks in the safe to agency records has never been performed and there was no system in place to perform such a reconciliation to ensure that all returned checks are accounted for.
- Cash management staff with the ability to clear suspense items were creating "Dummy Cases" to facilitate administrative activities. There was no appropriate monitoring of this activity.

On July 2, 2001, we inventoried the safe and established that it held checks totaling $501,050. Agency records reflected the safe contained checks totaling $547,572. We were unable to determine the reason for the $46,522 variance.

The following weaknesses were found during our reconciliation of the contents in the safe:

- Checks were not consistently stamped "canceled".

- Checks were canceled within the Support Enforcement Management System but remained in the safe. Although canceled in the system, the checks were still negotiable. One such check identified during our inventory was later cashed.

- Checks nearing the deadline for sending to the Department of Revenue as Unclaimed Property were canceled and re-issued, remaining undeliverable in the safe and circumventing the Unclaimed Propery requirement.

- In cases in which electronic fund transfers were made, checks were also produced. The checks were canceled in the system but remained negotiable and in the safe.

- Canceled checks were not shredded in a timely manner.

- Logs of shredded checks were incomplete and difficult to read.

Cause of Condition

The Division of Child Support has not established adequate policies and procedures to ensure segregation of duties and the safeguarding of negotiable items.

Effect of Condition

These weaknesses increase the risk that misappropriation or loss could occur and not be detected by management in a timely manner, if at all. In addition, the Division cannot ensure that checks were filed, delivered, or shredded appropriately.

Recommendations

We recommend:

- Management review and update policies and procedures to ensure segregation of duties over access to checks and the accounting system. These procedures should include taking an inventory of the checks and performing reconciliations.

- The practice of printing checks without addresses be re-evaluated.

- Returned checks be shredded in a timely manner.

- Checks not be produced when electronic fund transfers are made.

Department's Response

The Department concurs with this finding.

In September 2001, a team was commissioned to complete a review and analysis of the returned check workflow in the cash programs area of DCS. The team's recommendations are contained in a document dated October 19, 2001, entitled "Review of the Returned Check Process: Control

and Reconciliation". Management reviewed the document and selected the "preferred option": stop printing checks without addresses, and to image, index, then immediately shred checks returned because of incorrect addresses. This new process will significantly reduce the need for manual reconciliation by eliminating the physical documents that are vulnerable to theft. Both the Support Enforcement Management System (SEMS) and the imaging system will provide reports needed to reconcile, track and control the returned check process.

The State Auditor's Office (SAO) was provided with a copy of the proposed procedures and agreed that these would address their concerns. However, because programming changes to both SEMS and the imaging system are required to implement the changes, the new processes will not be fully in place until February 2002. Therefore, the SAO was not able to view the proposed process in practice in order to eliminate the need for this finding.

The safe that contains the returned checks has been moved into the cash operations secured area. All mail received by the cash program staff is now opened in the secured area and checks to be remailed are sealed into addressed envelopes while still in the secured area. SEMS is now updated at the same time that a check is remailed or shredded, rather than delaying the action after the SEMS update.

Currently there is no procedure to replace a cancelled electronic funds transfer (EFT) other than issuing a check to the recipient. The problem of holding returned checks created from a cancelled EFT will be eliminated when the new returned check process is fully in place. Also, a SEMS revision will be requested that will allow a cancelled EFT to be replaced with a new EFT. We anticipate that this revision will also be completed in 2002.

Auditor's Remarks

We would like to thank the Department for its response and acknowledge the commitment by Division of Child Support management and staff in correcting the conditions cited in this finding. We look forward to reviewing these improvements during our next audit.

Applicable Laws and Regulations

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

SAAM 20.20.20.a:

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

SAAM 20.20.30.a:

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

SAAM 20.20.0.c:

> The manager of each organizational unit and any other components within an agency is responsible for internal control in that unit.

SAAM 85.38.90:

> Agencies with local accounts are to develop and implement written procedures for controlling local checks. Procedures should provide for adequate internal control….

SAAM 20.20.70.a:

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

01-03 The Department of Social and Health Services, Division of Vocational Rehabilitation, does not have adequate internal controls over the processing of expenditures for client services.

Background

The Division of Vocational Rehabilitation assists people with disabilities in preparing for, obtaining or retaining employment. The Division provides vocational assessment; treatment for physical and mental disabilities that hinder employment; job preparation and training; job placement; job site analysis and rehabilitation technology; follow-up services; and employment support. Other services include help with independent living and transition from school to work. The Division also provides technical assistance and staff education for business and industry. The Division has 40 field offices statewide and placed 3,840 individuals in jobs during fiscal year 2001.

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

Description of Condition

The Division does not have adequate internal controls over expenditures processed through the Service Tracking and Reporting System. We found:

- Inadequate separation of duties:

  - Counselors could establish a client in the system, authorize and issue a purchase order, and then approve and make the payment.
  - Secretaries and counselor aides could draft and issue a purchase order and make the payment, without a counselor being involved.
  - Counselors, secretaries and counselor aides can have the payment warrant returned to them at the originating field office.

  Inadequate separation of duties can lead to inappropriate transactions.

- Payments recorded in the system are not reconciled to supporting documentation in the field offices. Without this step payment accuracy cannot be verified.

- Clients are not required to provide receipts for, certify to, or identify actual travel information to the Division.

- Occasionally, the only support for a payment is a photocopy of a vendor receipt or invoice. Photocopies can create a duplicate payment or be altered to support inappropriate payments.

- Supervisors do not adequately review payments to ensure they are appropriate.

Cause of Condition

Division field office employees have limited knowledge of what constitutes adequate internal controls and rely on the Division's procedures manual for guidance. We found that rules and procedures in the manual for processing payments are inadequate. For example, they do not require field personnel to obtain and file original vendor receipts or invoices as support for expenditures.

The Division has not adequately separated the duties of its employees through restrictive access to functions in the system, or instituted appropriate compensating controls.

Effect of Condition

Inadequate written procedures and poor separation of duties can lead to inappropriate transactions.

Recommendations

We recommend the Division develop and follow procedures that provide adequate internal controls for processing, documenting and reviewing expenditures.

We also recommend the Division separate the duties for processing payments by restricting access to payment functions in the system.

Department's Response

The Department partially concurs with this finding.

- *Inadequate separation of duties***.**

  The Department concurs with this condition. The Division of Vocational Rehabilitation is looking at ways to lower the risk to an acceptable level in regard to separation of duties when processing payments through the Service Tracking and Reporting System (STARS). This will be addressed by reviewing the system for possible enhancements, working with the field office employees to ensure that they have knowledge of internal controls and reviewing and updating the procedures in the Division's manual.

  The Division will review and update its procedures manual. Once updated, training or detailed guidance will be given to the field staff to ensure they understand the procedures and the importance of adhering to them. This must be implemented/addressed with understanding that the goal of the Division is to provide services to clients in a timely manner.

  The Division has many remote locations around the state that are staffed with very few employees (2-3). At these locations, there would need to be an exception to the standard separation of duties requirements to ensure that services to the clients are made in a timely manner. To address the locations that have minimal staff, the Division developed

policy #115 Cash Accountability. Controls that assist in negating the lack of separation of duties include on-sight review by the division's internal auditor and supervisory review of payments (see supervisory review response below for more information).

- *Payments recorded in the system are not reconciled to supporting documentation in the field offices. Without this step payment accuracy cannot be verified.*

  The Department does not concur with this condition. The division's internal auditor verifies approximately 10% of all purchases on an annual basis. These tests are performed at all field locations. The selection of transactions is randomly made by the STARS system and part of the testing performed includes reconciling supporting documentation at the field locations to that report.

  In addition to the review performed by the Division's internal auditor, the supervisors will review some of the payments to ensure that they are accurate and appropriate (see supervisory review response below for more information).

- *Clients are not required to provide receipts for, certify to, or identify actual travel information to the Division.*

  The Department does not concur with this condition. Customers are not required to provide receipts or certify the actual mileage traveled for which they are reimbursed. Instead, the customer and counselor prepare an Employment Plan prior to services being provided, which may include the identification of mileage. For example, the majority of DVR's customers who receive a mileage allowance are attending school. The mileage allowance must be paid in advance to the customer and it's based on the miles from their residence to the school times the number of days they are attending school times a mileage rate (MPG/est. cost per gal). Both parties must sign the Employment Plan.

  In addition to the signed Employment Plan, the counselors also have a 90-day review with the customer to ensure they are holding a certain grade average and they continue to have the ability to attend. If a customer needs to drop out of school, all mileage allowance checks cease.

- *Occasionally, the only support for a payment is a photocopy of a vendor receipt or invoice. Photocopies can create a duplicate payment or be altered to support inappropriate payments.*

  The Department concurs with this condition. DVR is in the process of updating procedures to instruct staff to pay only from original invoices. Testing by the State Auditors Office showed that two payments out of the 20 tested were made from photocopied documents. We would like to comment that one of the photocopies the Division made payment from was what the customer supplied us. The customer maintained the original, as we were reimbursing her for moving expenses.

- *Supervisors do not adequately review payments to ensure they are appropriate.*

  The Department concurs with this condition. The division issued an administrative policy Supervisory AFP Review #414 on July 25, 1996. The Division will review and update this document. It will also include these procedures in the Division policy manual and provide procedural training to staff.

Applicable Laws and Regulations

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

Section 85.32.10 states:

> It is the responsibility of the agency head, or authorized designee, to certify that all expenditures/expenses and disbursements are proper and correct. Agencies are responsible for processing payments to authorized vendors, contractors, and others providing goods and services to the agency. Agencies are to establish and implement procedures following generally accepted accounting principles. At a minimum, agencies are also to establish and implement the following:
>
> 1. Controls to ensure that all expenditures/expenses and disbursements are for lawful and proper purposes and recorded in a timely manner (refer to Chapter 20 of this manual for guidance related to internal control procedures),
>
> 2. Procedures to ensure prompt and accurate payment of authorized obligations, and
>
> 3. Procedures to control cash disbursements.

01-04 The Department of Social and Health Services does not have sufficient internal controls over drugs in the pharmacies at Western State Hospital to prevent and/or detect misappropriation or loss.

Background

Western State Hospital is a 1,000-bed psychiatric hospital operated by the Mental Health Division of the Department of Social and Health Services. The Hospital's pharmacy and its services are an essential part of patient treatment programs. The pharmacy distributes about 15,000 doses of medication each weekday. The Hospital spends over $5 million annually on drugs.

The main pharmacy receives deliveries of all pharmaceuticals and distributes them to the Hospital's 32 wards and three satellite pharmacies. In addition to filling medication orders and supplying the wards with a stock of medications, the satellite pharmacies store drugs that are returned from the wards. Automated drug distribution devices are used to store drugs and fill orders for newly admitted patients and prescription changes on weekends and holidays. Two of these devices serve the entire Hospital.

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

Description of Condition

We reviewed the Hospital's internal controls over pharmaceutical inventory including purchasing, receiving, storage and distribution. We found the following:

- Transfer of Narcotics from the Ward to the Pharmacy
    - There is no management oversight to ensure that narcotics are not lost or misappropriated during transport.
    - Wards do not notify the pharmacies when narcotics are to be returned via courier.
    - Inaccurate counts of narcotics by nursing and pharmacy staff at the time of delivery were noted.

- Narcotics Count
    - The Nursing Department does not monitor activities to ensure compliance with procedures related to narcotics counts.
    - Ineffective communication between upper and middle management prevents notification to individuals who are in the position to correct problems with medication variances.
    - Narcotics are left unattended in the main pharmacy for up to a day while waiting to be counted and stored.

- Purchasing, Receipt and Storage of Drugs

  - Duties are not segregated. The supply officer is responsible for ordering, receiving, storing, some distribution and the annual inventory count of drugs.
  - Management does not monitor the activities of the Supply Officer to ensure accountability over inventory.
  - The Hospital does not count the entire inventory of drugs. With the exception of narcotics, the inventories in the satellite pharmacies have never been counted. Inventories in the satellite pharmacies are sizeable and approximate in size to those in the Main Pharmacy, which are counted annually.
  - There is no accountability over the non-narcotic drugs that are returned to the satellite pharmacies from wards.

- Automated Drug Distribution Devices

  - Inventories have never been taken in these machines. We found a 15 percent error rate in our count, compared to what the machine should have held.
  - Keys to these devices are not assigned to a specific individual. One key code may allow more than one individual access to the machines. This is a violation of State Board of Pharmacy regulations.

- Main Pharmacy

  - "Working stock" (Schedule III through V narcotics returned from wards) is not counted as inventory, creating a high risk of loss or misappropriation.
  - Anyone with a right of entry to the main pharmacy may enter the storeroom and access the entire inventory of non-narcotic drugs.
  - Drop boxes are used for the transfer of drugs from wards to the pharmacies. The controls over these are inadequate. All nurses who administer medication have keys to these boxes. At any one time, seven nurses could access an individual box.

- Non Scheduled Prescription Refills

  The Hospital processes medication refills daily. There are wide variations in the number of refills from day to day. Management stated that the number of non-scheduled refills appears to be high at times and they have not been able to determine why. Nursing staff is often unable to explain the reason for the non-scheduled refills.

- Police Reports Related to Lost or Missing Drugs

  Between June 27, 2001 and October 15, 2001, the Washington State Patrol investigated several drug-related incidents at the Hospital:

  - Three suspected drug losses, one of which involved a controlled substance.
  - Two instances in which "stashes" of medications were found. Paper bags or plastic envelopes were filled with up to 65 doses of non-narcotic drugs and hidden in cabinets and drawers.

- Two instances in which drugs were thought to be missing but were actually miscounted by the Pharmacy and Nursing staffs.

According to State Patrol investigators, based on the inadequate controls in place at the Hospital, responsibility for these incidents may never be determined.

Cause of Condition

The following causes led to these conditions:

- Management states that it has staffing difficulties including recruitment and frequent employee absences and therefore has not stressed the necessity for controls.

- Management states that its controls are typical for institutional pharmacies and thus feel maintaining current procedures is adequate.

- Management states that the integrity of the staff is a sufficient compensating control in the absence of other controls.

- Western State Hospital does not devote the necessary resources to developing and following adequate written policies and procedures for inventorying, reconciliation, monitoring, and security functions.

- Nurse managers do not monitor activities to ensure that policies pertaining to narcotics counts are followed.

- Pharmacy technicians have the responsibility for delivering and distributing drugs including narcotics, with no management oversight.

- The Nursing service has not instituted compensating controls to deter the loss or misappropriation of drugs from the wards.

- Management and staff reported that nurses keep "stashes" of medications for various reasons including:

    - Limited pharmacy hours
    - The size of the Hospital campus and the distance to and limited number of automated drug distribution devices.
    - Nurses on understaffed wards may stash drugs to eliminate trips to the machines. Difficulty in recruiting nurses was cited as a factor in staffing shortages.

Effect of Condition

The Hospital's current internal control structure lends itself to misappropriation or loss of narcotics during their transport from ward to pharmacies and to loss of non-narcotic drugs from the Main Pharmacy and satellite pharmacies. Due to insufficient monitoring, lack of segregation

of duties, and poor inventory practices the risk of loss or misappropriation of drugs is high. Losses may not be detected in a timely manner, if at all.

Recommendations

We recommend that Western State Hospital:

- Establish and follow written policies and procedures for all aspects of inventory.
- Segregate the responsibilities for ordering, receiving, distribution, and inventory of drugs.
- Institute monitoring procedures that encompass all aspects of inventory control including drop boxes and automated drug devices.
- Account for all medications that are returned to the pharmacies.
- Control access to the main pharmacy.
- Assign unique codes to all individuals who have access to the automated drug distribution devices.
- Conduct periodic inventories of all pharmacies and automated drug distribution devices and "working stock".
- Determine the causes for non-scheduled prescription refills and establish controls to provide reasonable assurance that diversion or misuse of these medications is prevented or detected.

Department's Response

The Department partially concurs with this audit finding and will respond to each condition and its related element separately.

- *Transfer of Narcotics from the Ward to the Pharmacy*

    - *There is no management oversight to ensure that narcotics are not lost or misappropriated during transport.*

      The Department does not concur. Western State Hospital (WSH) has policies and procedures (Drug Use Control (DUC) policies 50:05, 70:07, WSH Pharmacy policy 020.1700) describing each step of managing controlled substances. Both Pharmacy and Nursing Staff must sign for doses received from the Pharmacy. Nursing Staff must sign for doses given to patients. Two Nursing Staff must sign doses wasted. Doses returned to the Pharmacy must be signed both Nursing and Pharmacy Staff. The auditor detected a possibility where staff bringing controlled substances back to the Pharmacy could divert the policies as stated below.

Because of the importance of this issue, the Pharmacy has formed an internal committee comprised of Pharmacists, Technicians, and Management to look at every step of the controlled substance procedure to improve processes where possible. The committee review should be completed by February 2002.

In addition to the formation of an internal review committee in Pharmacy, the Nursing Administration has completed an audit of the Controlled Substance Log Book. Preliminary results indicate overall compliance with documentation requirements. Non-compliant areas have been reported to Unit Nursing Managers for correction. Also, the Medication Administration Process has been distributed to Unit Nursing Management, and they are currently conducting a review of the process. Results are not available at this time. Both of these activities will be incorporated into our existing Nursing Performance Improvement Plan and will be conducted on a quarterly basis.

- *Wards do not notify the pharmacies when narcotics are returned via courier.*

  The Department does not concur. WSH DUC Policy 70:07 and 50:05 detail the procedure used. Both Nursing and Pharmacy staff must sign off on drugs to be returned to the pharmacy on two different forms. The auditor suggested that the wards call the pharmacy when they intend to return controlled substances. While this is a process we will consider, WSH is looking at other processes to improve the reconciliation of forms between the wards and the pharmacy.

- *Inaccurate counts of narcotics by nursing and pharmacy staff at the time of delivery were noted.*

  Partial concurrence. WSH Pharmacy and Nursing Administration learned of this problem when the auditor was testing. WSH DUC Policies 50:05 and 70:07 require accurate counting. Nursing and Pharmacy have been issued directives reminding staff of the importance of accuracy when dealing with controlled substances. Due to the magnitude of the number of controlled substances processed, staff can become casual about the procedure. For example, in a 12-month period of time there were 13,167 transactions made from Pharmacy to Nursing consisting of 316,978 tablets/capsules/vials of controlled substances. WSH should be able to correct this condition with the aforementioned steps.

- *Narcotics Count*

  - *The Nursing Department does not monitor activities to ensure compliance with procedures related to narcotics counts.*

    Concur. The Nursing Department recently implemented quarterly assessments of all wards to ensure that policies and procedures relating to controlled substances are complied with.

- *Ineffective communication between upper and middle management prevents notification to individuals who are in the position to correct problems with medication variances.*

  Concur. Staff has been re-educated about the proper procedure for reporting medication variances. When the proper procedures are followed, middle Management is advised of the problem and can investigate and take corrective action.

- *Narcotics are left unattended in the main pharmacy for up to a day while waiting to be counted and stored.*

  The Department does not concur. The Pharmacy administration disputes this finding. The finding occurred because a Staff Pharmacist who signed for controlled substances on a particular day put the wrong date on the documentation. A staffing schedule shows that the pharmacist was in the main pharmacy on the day the medications were received, but he inadvertently wrote down the next day's date. The date that he wrote down (the next day) he was not working in the main pharmacy at all and wouldn't have signed for the medications. The auditor was informed of this dating mistake. To ensure that this will not occur again, the procedure has been changed so that the Supply Officer and a Staff Pharmacist check the controlled substances received from the wholesaler at the same time, using the invoice to document what was received. Therefore, the controlled substances are not left unattended after receipt from the wholesaler.

- *Purchasing, Receipt and Storage of Drugs*

  - *Duties are not segregated. The supply officer is responsible for ordering, receiving, storing, some distribution and the annual inventory count of drugs.*

    Concur. This issue is acknowledged and will be remedied by 1/28/02. A different Pharmacy staff member will receive and store the medication orders. The Supply Officer will no longer count medications at inventory.

  - *Management does not monitor the activities of the Supply Officer to ensure accountability over inventory.*

    Partially Concur. WSH agrees we need to improve the separation of duties of the Supply Officer, we do not concur that the position is not monitored. WSH is implementing new procedures (in January 2002) in cooperation with the Business Office, where random unannounced spot audit checks over inventory will be done throughout the year. Additionally, a complete inventory in the Pharmacy warehouse will be completed in January 2002.

- *The Hospital does not count the entire inventory of drugs. With the exception of narcotics, the inventories in the satellite pharmacies have never been counted. Inventories in the satellite pharmacies are sizeable and approximate in size to those in the Main Pharmacy, which are counted annually.*

  Concur. An entire inventory of the satellite pharmacies will be completed by 6/30/02 and annually thereafter.

- *There is no accountability over the non-narcotic drugs that are returned to the satellite pharmacies from wards.*

  Partially Concur. WSH procedures allow only licensed nursing and pharmacy staff to have access to medications. All pharmaceuticals are locked in a medical or pharmacy room. WSH did an analysis in December to assess the situation and level of activity. Our assessment found that during the third quarter of 2001, 19,481 medication orders were discontinued by physicians. The majority of discontinued orders result in a 1 to 7-day supply of medications consisting of thousands of tablets and capsules being returned to the Pharmacy. They are returned to stock for reuse at a later time. In addition, other unused doses are returned to the Pharmacy four days a week when the weekly medication supply is delivered. Many of these are single tablets. On one day (12/19/01) 1,073 tablets/capsules were returned in addition to those returned with medication change orders. This analysis will help us assess staffing and technology requirements in order to provide complete inventory maintenance and accountability in the satellite pharmacies.

- *Automated Drug Distribution Devices*

  - *Inventories have never been taken in these machines. We found a 15 percent error rate in our count, compared to what the machine should have held.*

    Concur. However, in the 15% error rate, only one box of medications was short one tablet. The others counted in the error rate had one extra tablet inside, suggesting complacency by staff filling the boxes rather than loss. No boxes containing controlled substances were found to be inaccurately filled. WSH management recognizes the need to provide periodic training and remind staff of existing procedures. WSH will do so as part of employee development and to improve our pharmaceutical accounting.

  - *Keys to these devices are not assigned to a specific individual. One key code may allow more than one individual access to the machines. This is a violation of State Board of Pharmacy regulations.*

    Concur. The current automated drug distribution devices, or Documeds, are old technology, which had not been upgraded by the vendor. They have been grandfathered by the Board of Pharmacy, and WSH has not been cited by the Board for using them. However, we acknowledge that the technology is not as secure as newer technology. The auditor was aware that the manufacturer of the Documed has

not updated the technology to accommodate individual codes for each nurse. Thus, establishing individual codes will require purchase of newer drug distribution devices. Newer automated drug distribution devices such as Pyxis machines had been requested by the Director of Pharmacy to replace the Documeds but previous requests were denied because of current funding. Pyxis machines will be re-requested in FY 2003 to replace the two Documeds. Also, two additional machines will be requested to ensure that at least one is in each building so that Nursing Staff will not have to travel across campus during the night for medications.

- *Main Pharmacy*

  - *"Working stock" (Schedule III through V narcotics returned from wards) is not counted as inventory, creating a high risk of loss or misappropriation.*

    The Department partially concurs. Small quantities of Schedule III through V controlled substances are maintained in the pharmacy units for use mostly in filling small quantities of medications for patients going on leave. They are not counted but are locked and are only accessible by a pharmacist. This is standard practice in hospital pharmacies. WSH Pharmacy exceeds WAC requirements on counting Schedule III through V controlled substances, which are not in "working stock." However, the committee will evaluate the possibility of periodic inventories of these medications.

  - *Anyone with a right of entry to the main pharmacy may enter the storeroom and access the entire inventory of non-narcotic drugs.*

    Concur. A work order has been submitted to our maintenance department to construct a separate area for the Main Pharmacy warehouse. Access to this warehouse will be restricted to the Supply Officer and several Pharmacists. This will be scheduled in with ongoing FEMA and hospital repairs and should be completed by September 2002. We are looking into technology improvement in access control, such as a card swipe security device that would also provide an activity report of staff entering and exiting the Main Pharmacy warehouse.

- *Drop boxes are used for the transfer of drugs from wards to the pharmacies. The controls over these are inadequate. All nurses who administer medication have keys to these boxes. At any one time, seven nurses could access an individual box.*

  Concur. A work order was submitted to correct this problem during the audit. The carpenter shop is building new lock boxes for each individual ward and plans to have them installed by 1/31/02.

- *Non Scheduled Prescription Refills*

  The Hospital processes medication refills daily. There are wide variations in the number of refills from day to day. Management stated that the number of non-scheduled refills

appears to be high at times and they have not been able to determine why. Nursing staff is often unable to explain the reason for the non-scheduled refills.

Partially concur. We agree that many refills are processed and this can occur for a variety of reasons. In a 24-hour facility the nurse on duty may not have the documentation about a medication that isn't present. There is a medication administration record which states doses given to the patients. Nursing and Pharmacy are assessing the refill process in order to improve documentation.

- *Police Reports Related to Lost or Missing Drugs*

  Between June 27, 2001 and October 15, 2001, the Washington State Patrol investigated several drug-related incidents at the Hospital:

  - *Three suspected drug thefts, one of which involved a controlled substance.*

    Concur. It is WSH procedure to report drug thefts, this was reported to local law enforcement and the controlled substance loss was reported to the DEA.

  - *Two instances in which "stashes" of medications were found. Paper bags or plastic envelopes were filled with up to 65 doses of non-narcotic drugs and hidden in cabinets and drawers.*

    Concur. Nursing Administration will examine options to remedy this. Some options we are looking into include installing Pyxis machines on each ward so that Nursing Staff would realize that they would always have the medication they need and there would be no need to "stash" medications. It is estimated that installing a Pyxis machine on each ward will cost WSH a minimum of $73,000 per month for the lease. Another solution would be to have a 7-day week, 24-hour pharmacy so that a nurse could easily obtain a medication at any time. This would require several additional FTE's for the Pharmacy including Pharmacists and Pharmacy Technicians.

  - *Two instances in which drugs were thought to be missing but were actually miscounted by the Pharmacy and Nursing staffs.*

    Concur. Please refer to response to "Transfer of Narcotics from Ward to Pharmacy" above.

Applicable Laws and Regulations

Code of Federal Regulation, Title 21, Section 1301.75 paragraph (b) states in pertinent part:

> Controlled substances listed in Schedules II, III, IV, V shall be stored in a securely locked, substantially constructed cabinet. However, pharmacies and institutional practitioners may disperse such substances throughout the stock of noncontrolled substances in such a manner as to obstruct the theft or diversion of the controlled substances.

WAC 246-869-120, paragraph 6 states in part:

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

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

Section 35.10.55 states:

> The physical inventory, or inventory count, should be performed by persons with no direct responsibility (custody and receipt/issue authority) for the inventory. If it is not feasible to use such personnel for any part of the inventory, those parts are, at least, to be tested and verified by a person with no direct responsibility for the stock..

Section 20.20.70.a states:

> Physical controls - …inventories…should be secured physically.

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 20.20.20.d pertains to communications as it relates to internal controls and states:

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

01-05 The Department of Labor and Industries has not established adequate internal controls over employer accounts.

Description of Condition

The state industrial insurance law (Title 51 RCW) provides no-fault accident and disability coverage to workers in Washington State. This insurance covers medical expenses and pays a portion of wages lost while a worker recovers from a workplace injury. Both workers and employers pay premiums totaling approximately $1 billion per year to fund the benefits.

The Department of Labor and Industries collects industrial insurance premiums from more than 150,000 employers doing business in Washington State. Each quarter, premium assessments and the related payments are posted to each employer account. In the interim, accounts can be adjusted under certain circumstances, such as employer bankruptcy and account errors.

We reviewed the internal controls over employer account adjustments and selected 22 account adjustments to determine if they were valid and adequately supported. Our review disclosed the following weaknesses:

- Inadequate segregation of duties between handling cash, employer contact and the ability to adjust employer accounts. Department revenue officers have contact with and collect money from delinquent employers. They also have access to electronically change employer account balances without proper oversight.

- 55 percent of adjustments selected for review did not have any evidence that an independent person reviewed or approved the adjustment. These adjustments were for amounts between $550 and $6,908.

- 36 percent of adjustments selected for review were not adequately supported with an explanation to justify the adjustment.

As a result of this internal control weakness, a Department revenue officer allegedly adjusted an employer's account illegally from owing approximately $19,000 to a credit balance of approximately $2,100. The adjustment was made in an attempt to convince the employer, who is the owner of a construction company, to perform work on the revenue officer's personal property. The employer did not agree to the offer and reported the incident to the Department. The account was later corrected to reflect the appropriate balance. Therefore, no public funds were actually misappropriated. The Department contacted the Washington State Patrol and the case has been investigated. The employee is currently on administrative leave with pay. Charges were filed by the King County Prosecutor against the employee for bribery, computer trespass, and falsification of account. Per agency discussion with the Prosecutor and to protect the integrity of the criminal investigation, no further administrative action was taken pending the outcome of the criminal case. The case is scheduled for trial in April 2002.

Cause of Condition

The Department provided employer account access to the revenue officers. They were unaware that it created an internal control weakness. There is not an adequate review process to compensate for the inadequate segregation of duties.

Effect of Condition

Without proper segregation of duties between contact with employers, cash handling and employer account access, the Department cannot ensure that adjustments are valid. This weakness increases the risk of misappropriation of public funds.

Recommendations

We recommend the Department:

- Remove employer account access from all employees who have contact with employers and handle cash.

- Ensure all adjustments are adequately supported and justified.

We further recommend that the reviewer evidences adjustment approvals and that they include a review of the supporting documentation and the justification.

Department's Response

Since the Department became aware of the allegations against one of our Revenue Officers abusing his access to the various electronic systems, we conducted our own internal audit to seek solutions to mitigate a future occurrence of this situation. Our plan is to take steps such as:

- *Perform a thorough review of the access to the various electronic revenue collection systems granted to Revenue Officers to ensure only the access needed is granted.*

- *Produce a report to Employer Services and Collections management for any adjustment that brings an account's balance from a debit to a credit or if the dollar value of the account changes by an amount "to be determined".*

- *Create a management exception report that is generated monthly for any adjustment made by anyone other than the assigned person or designee.*

- *Create a "Collections Program Manager" position responsible to set policy and procedures for these activities.*

As usual, the Department will work closely with the on-site State Auditor's Office in the development of the mitigation activities.

Auditor's Remarks

We appreciate the Department's prompt and thorough response to this issue.

Applicable Laws and Regulations

The State of Washington Office of Financial Management's *State Administrative and Accounting Manual,* 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.

01-06 The Washington State Historical Society has not established adequate internal controls over cash receipting.

Description of Condition

During our review of the Washington State Historical Society's cash receipting system, we noted the following internal control weaknesses that create a potential for misappropriation of public funds.

- The Society does not use attendance reports or monitor attendance. Therefore, it is difficult to ascertain if all revenues are receipted.

- The Society does not consistently comply with their own policies regarding cash voids and error corrections. While explanations for voids and error corrections are logged, supervisors do not consistently sign the log to indicate the explanation had been reviewed and approved.

- The mail opening and check recording on the mail log are not assigned to specific people. Employees who handle cash are instructed to post checks received to the log. Therefore, it is difficult to determine if all money received through the mail is included on the log.

- Not all checks are restrictively endorsed immediately upon receipt.

- There is not adequate segregation of duties between recording cash receipts into the accounting system and access to cash receipts.

- There is not adequate segregation of duties between collecting money from the donation box and depositing the money.

- The following issues relate to facilities rentals:

    - There is not adequate segregation of duties for handling collection of facility rentals. One individual initiates the transaction, bills the client, and receives the money.
    - Facility rental agreements are not numbered.
    - Invoices for facility rental are not numbers as required by the State Office of Financial Management.

Cause of Condition

The above weaknesses were caused by a general lack of emphasis on good internal controls.

Effect of Condition

These weaknesses result in decreased accountability over cash receipts and an increased risk that cash could be misappropriated and not be detected in a timely manner, if at all.

Recommendation

We recommend that the Society:

- Establish a method to verify attendance.

- Establish and monitor policies and procedures to strengthen internal controls over cash receipting.

Society's Response

- *The Society believes it does monitor attendance but we intend to move toward a ticketing system that will correct shortcomings in this area.*

- *The Society agrees and will implement procedures to ensure that supervisors sign the log to indicate review and approval of the transaction at every occurrence.*

- *Currently, one staff person is charged with daily logging of the checks received, however, in the past some checks were forwarded to a department before logging. The Society will implement a centralized logging system where all cash receipts received are logged and then deposited. Only copies of checks will be distributed to departments as required.*

- *The Society will implement a system whereby all checks are restrictively endorsed upon receipt at all sites.*

- *This finding applies to a site where there are very few staff to segregate duties. To compensate for this internal control weakness, the Society proposes to implement a random monitoring system using management staff.*

- *This finding applies to the same site as indicated above. The Society intends to implement a system whereby two staff request the key from a manager and then together collect and count the money from the donation box.*

    - *The Society proposes to correct this weakness by implementing a centralized invoice system that segregates contract preparation and invoicing. Because of the check logging system noted above, facilities rental staff no longer will be receiving the money.*
    - *The rental agreements currently use a "reservation" number generated by the VISTA reservation system as the contract number. The contract document will be changed to indicate "Contract/Reservation" number.*
    - *The Society will implement a centralized invoicing system that will number invoices.*

Auditor's Remarks

We appreciate the Society's prompt and thorough response.

Applicable Laws and Regulations

The State of Washington Office of Financial Management's *State Administrative and Accounting Manual* covers cash handling:

Section 85.50.40.a states that:

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

Section 85.20.10.c states:

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

Section 85.54.60 states in part:

> Detailed postings of documents are to be recorded and maintained in the subsidiary ledgers for all outstanding receivables. Detailed postings are to be summarized and entered in the general ledger control account.

Section 85.54.60.a states:

> Sequentially numbered billing documents (invoices) are to be used.

01-07 The Washington State Historical Society has not completed the catalog inventory of historical artifacts.

Description of Condition

The Washington State Historical Society still does not maintain a complete inventory listing of historical artifacts. This condition has been reported as a finding since 1991. Currently, the collection is documented in varying degrees of detail and accuracy through card catalogs, donor lists and other historical records. The Society does not know the extent of unrecorded artifacts, or whether all items recorded are still in the collection. The Society is making progress in recording the artifacts into a single comprehensive system. However, completion of this task is not expected for many years.

Cause of Condition

The Society indicated that it does not have the funding to hire additional staff to complete the inventory process at a faster rate.

Effect of Condition

Weak controls put historical artifacts, held in trust by the Society, at risk. Artifacts could be stolen or misplaced and the current system is inadequate to identify the missing items.

Recommendation

We recommend the Society complete cataloging its inventory of historical artifacts as soon as possible to comply with state regulations. While we recognize the Society's funding is limited, preserving history through artifacts is essential to the Society's mission.

Society's Response

The Society agrees with the audit finding. As in previous audit finding responses, this is an exception of long-standing duration; one which was created over the course of the first ninety years of the organization's life; and which, as we believe the Office of the State Auditor would attest, is an issue that the agency has made considerable progress toward resolving from the time (approximately 1987) the management of these assets has rested with the current administration of the Society. During the biennium, the Society made substantial progress in securing the artifacts by completing the rehabilitation of the Research Center facility which houses the preponderance of the Society's collections.

Auditor's Remarks

We appreciate the Society's efforts toward completing the catalog inventory.

Applicable Laws and Regulations

RCW 27.34.070 (1) requires the Society to catalog historical artifacts:

> Each state historical society is designated a trustee for the state whose powers and duties include but are not limited to the following: (a) To collect, catalog, preserve, and interpret objects, manuscripts, sites photographs, and other materials illustrative of the cultural, artistic, and natural history of this state.

The State of Washington Office of Financial Management's *State Administrative and Accounting Manual*, section 30.40.10 states in part:

> Collections under the control of a state historical society as defined by RCW 27.34.020 are required by RCW 27.34.070 to be cataloged.

01-08 The Washington Horse Racing Commission did not collect satellite fees totaling $954,600 from its licensees during calendar years 1999, 2000 and 2001.

Description of Condition

In 1987, state law (RCW 67.16.230) was enacted allowing the Washington Horse Racing Commission to establish and collect an annual fee from racetracks with satellite wagering locations. The fee was designed to cover the Commission's costs of regulating and monitoring the satellite locations. In 1991, the Commission established this fee in Washington Administrative Code 260-75-010 at $150 per day.

The Commission has never collected this fee. We determined that the amount that could have been collected in 1999, 2000 and 2001 totaled $954,600. The Commission had the authority to defer payment of this fee if the daily revenue for racetracks with satellite locations exceeded $400,000. We determined that the Commission did not defer any payments. However, it could have deferred $646,500.

Cause of Condition

Commission officials stated that the fee was based on estimated costs that they later found were significantly in excess of actual costs associated with the Commission's oversight of satellite locations. Commission officials also believed that they could not enforce this fee since it was not reflected in the racetracks' financial projections as approved by the Commission.

Effect of Condition

By not collecting this fee, the Commission may not have recovered all of the costs of regulating the satellite locations. In addition, state law (RCW 67.16.100) requires any money collected by the Commission and not spent at the close of the biennium, to be placed in an account administered by the state Department of Agriculture to assist agricultural fairs across the state. The only exception to this law is if the Office of Financial Management grants the Commission the authority to carry over working capital into the next biennium. We determined that it had been granted this authority for the last eight bienniums.

Recommendations

We recommend that the Commission recover the fees that were not collected or retroactively defer payments, where allowable by law.

We recommended that the Commission either begin charging the fee to its licensees or that the Commission repeal the regulation requiring its collection. Effective October 18, 2001, the regulation was repealed.

Commission's Response

Thank you for the opportunity to respond to the audit finding that the Washington Horse Racing Commission (WHRC) did not collect satellite fees from licensed racing associations as authorized by RCW 67.16.230 and WAC 260-75-010.

As noted in the audit report, this fee ($150 per day per site) was designed to recoup the anticipated expenses associated with the approval and regulation of satellite wagering facilities. As originally envisioned, the fee was to be collected on those days when a racetrack's satellite wagering handle fell below $400,000 per day.

Shortly after this rule was adopted, it became apparent that the Commission had overestimated the cost of inspecting the satellite wagering facilities. Instead of having a Mutuel Inspector at each site, management found that it could oversee the wagering from the racetrack Tote Room and send Mutuel Inspectors to the satellite sites on a rotating basis.

The Commission further concluded that imposition of the satellite inspection fee would adversely impact the financial health of the horse racing industry. As you know, the industry has struggled since the Longacres Race Course closed in 1992. This was followed by the closure of Yakima Meadows in November 1998 and the bankruptcy of the Playfair racetrack in July 2001. With the only remaining "for profit" track (Emerald Downs) reporting operating losses in 2000 and 2001, the imposition of the satellite wagering fee would not be in the best interest of horse racing.

For these reasons, the Commission elected to waive collection of the satellite inspection fee. At the advice of the State Auditor, the Commission repealed the rule that authorized the collection of this fee (WAC 260-75-010).

Auditor's Remarks

We appreciate the Commission's cooperation and prompt response to this issue.

Applicable Laws and Regulations

RCW 67.16.230 authorizes the establishment of satellite location fees:

> The commission is authorized to establish and collect an annual fee for each separate satellite location. The fee to be collected from the licensee shall be set to reflect the commission's expected costs of approving, regulating, and monitoring each satellite location.

WAC 260-75-010 requires the daily fee:

> All licensees of the Washington horse racing commission that operate satellite locations ... shall pay daily a fee of one hundred fifty dollars, per site, to the commission. This fee will be used by the commission to cover the costs of administering the satellite racing program of Washington; provided that, if the daily mutuel handle of the license from all

> locations is in excess for four hundred thousand dollars, the commission may defer payment of this fee for such day.

RCW 67.16.100 (2) requires money not expended to be transferred to the fair account:

> Any moneys collected or paid to the commission under the terms of this chapter and not expended at the close of the fiscal biennium shall be paid to the state treasurer and be placed in the fair fund created in RCW 15.76.115. The commission may, with the approval of the office of financial management, retain any sum required for working capital.

RCW 15.76.115 provides the purpose of the fair account:

> Expenditures from the [fair] fund may be used only for assisting fairs in the manner provided in this chapter. Only the director of agriculture or the director's designee may authorize expenditures from this fund.

01-09 The Washington Horse Racing Commission held a meeting that did not comply with the Open Public Meetings Act.

Description of Condition

A Commission member invited the Executive Secretary of the Horse Racing Commission to a meeting on January 20, 2001. Three of the Commissioners discussed legislative issues prior to his arrival. When he arrived, the Commissioners indicated that they wanted to talk to him about his job performance. The Executive Secretary responded by stating that he believed this meeting violated the Open Public Meetings Act since three of the five Commissioners were present. The Executive Secretary immediately left and the meeting was over. No additional business was discussed.

We determined that this meeting violated the Open Public Meetings Act since a majority of the governing body members gathered with a purpose of taking action. Action, as defined by state law (RCW 42.30.070), includes deliberations, discussions, considerations, reviews and evaluations.

Cause of Condition

The Commissioners originally planned to have two Commissioners present, which would not constitute a quorum. However, a third Commissioner decided to attend. They were also not aware that a discussion constituted action, as defined by state law.

Effect of Condition

When the Commission does not adhere to the requirements of the Open Public Meetings Act, the public is denied the right to be apprised of the discussions and decisions of the Commission.

Recommendations

We recommend the Commission comply with the Open Public Meetings Act.

Commission's Response

Before any meeting with the Executive Secretary occurred, one or more Commissioners received legal advice on this matter. We were advised that as long as no official action was contemplated, we were free to discuss personnel issues with the Executive Secretary in addition to pending legislative issues affecting the agency that were, at the time, before the state Legislature. Only two of the Commissioners were prepared to discuss personnel issues. The third Commissioner did not plan to attend the meeting, but only attended at the last minute because of her interest in the legislative issues. The meeting did not last very long, I would say less than 5 minutes. After the brief meeting, two of the Commissioners had breakfast and no other additional business was discussed.

As a consequence of this meeting, we have taken steps to avoid any potential problems with the Open Public Meetings Act in the future and we will strictly adhere to those steps which are now

in place. All future meetings involving personnel will be publicized as executive sessions to discuss personnel issues, as authorized by the Open Public Meetings Act.

Auditor's Remarks

We appreciate the Commission's prompt response to this issue.

Applicable Laws and Regulations

RCW 42.30.010 states:

> The legislature finds and declares that all public commissions, boards, councils, committees, subcommittees, departments, divisions, offices, and all other public agencies of this state and subdivisions thereof exist to aid in the conduct of the people's business. It is the intent of this chapter that their actions be taken openly and that their deliberations be conducted openly. The people of this state do not yield their sovereignty to the agencies which serve them. The people, in delegating authority, do not give their public servants the right to decide what is good for the people to know and what is not good for them to know. The people insist in remaining informed so that they may retain control over the instruments they have created.

RCW 42.30.070 states in part:

> It shall not be a violation of the requirements of this chapter for a majority of the members of a governing body to travel together or gather for purposes other than a regular meeting or a special meeting as these terms are used in this chapter; PROVIDED, That they take no action as defined in this chapter.

RCW 42.30.020 (3) defines action:

> "Action" means the transaction of the official business of a public agency by a governing body including but not limited to receipt of public testimony, deliberations, discussions, considerations, reviews, evaluations, and final actions.

RCW 42.30.020 (4) defines meeting:

> "Meeting" means meetings at which action is taken.

01-10 The Department of Transportation's Washington State Ferries Division does not have adequate controls over sales and revenue collection

Background

The Washington State Ferries Division uses its point-of-sale system and automated revenue control system to track money collected at ferry terminals. Annual revenue collected through the system is approximately $97 million. Independent terminal-agent contractors in the San Juan Islands collect an additional $2.3 million. While the Ferry System has worked to strengthen internal controls over recorded sales, additional controls are needed, primarily over potential unrecorded sales.

Description of Condition

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

The Ferry System has set up some controls, including electronic displays of amounts due and signs at each booth notifying customers of the number to call if they do not receive a correctly printed receipt (see "Recent improvements by the Ferry System"). However, these controls are inadequate to ensure that all money collected is recorded in the system. On international routes, management has established additional controls to better safeguard funds. Revenues from international routes comprise a small percent of the system total.

Specifically:

- No system is in place to ensure that all sales are recorded. Money from unrecorded sales could be lost or misappropriated, without detection by management in a timely manner, if at all. The Ferry System does not reconcile vehicle and passenger counts to revenue collected by individual sellers or in total. Inadequate compensating controls are in place to provide the necessary protection for public funds.

- During times when the system is off-line, sellers are not required to issue receipts to customers.

- Frequent-user ferry coupons collected by sellers in booths and ticket takers in the terminal traffic lanes are not adequately controlled. Coupons represent 45 percent of the total vehicle and passenger transactions. The following conditions are present in this area:

    - Customers do not routinely receive a receipt when giving a frequent-user coupon to a seller. Further, the Ferry System performs only limited reconciliation of coupons collected to what is entered in the point-of-sale system. Internal audits comparing coupons collected to point-of-sale entries were performed during the year at two

terminals. However, terminal agents do not do this daily. This increases the risk that a cash sale could be entered incorrectly as a coupon collection in order to misappropriate cash without detection.

- Additionally, we could not verify that all coupons collected are invalidated, increasing the risk that a coupon could be used more than once. The only verification performed was part of the internal audit work at two terminals, mentioned above.

- Ferry System employees operate 15 ferry terminals. Additionally, independent contracted agents operate four terminals located in the San Juan Islands and one in Sidney, British Columbia, collecting $2.3 million for the past year. Our audit identified the following weaknesses at those terminals:

  - Receipting practices for inter-island fares increase the risk that public funds from ticket sales could be lost or misappropriated without detection by Ferry System management. The revenue collected for these sales is approximately $600,000 per year. These contracted agents are given a supply of pre-numbered tickets with an assigned retail price for sale at their terminal. These tickets are supposed to be presented by the passenger at the time of boarding. The agent must remit the retail value of each ticket sold to the Ferry System. We observed a contracted agent selling inter-island tickets prior to a vessel departure. Shortly thereafter, the same agent collected these tickets from the customers and did not invalidate them. This practice does not prevent the resale of the same tickets by the contracted agent and may result in unrecorded sales that would be nearly impossible to trace.

  - All contracted agents for the San Juan Island terminals are permitted to commingle personal and state funds. The Ferry System provides these agents no formal procedures for selling and redeeming tickets, recording cash receipts, safeguarding funds or making bank deposits. Only one of the contracted agents uses a state bank account for deposits.

- The current revenue control system does not provide a practical means to compare actual versus expected receipts for each terminal operated by a contracted agent. This prevents management from monitoring revenue for any departure from expectations.

Recent improvements by the Ferry System

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

<u>Revenue Variances</u>

- Variances between receipts in the point-of-sale system and the money submitted to the agent for deposit with the bank are now resolved in an average of seven days, rather than three months, as noted in previous audits.

- A monthly performance review is completed by terminal agents for each seller, including reviews of variances of collected media.

Off-Line Sales

- Off-line sales are now reviewed monthly This includes identifying risks that are present when the system is down, and follow up of activity in those areas.
- The Ferry System tested the use of pre-numbered, two-part, manual cash receipt form. This manual receipt was tested at one terminal to record sales when the point-of-sale system was off-line.

Frequent-User Coupons

- Reconciliations of coupon inventory records to stock on hand by the sellers were increased.
- The Ferry System devised a "surprise" coupon-count process and did two such counts.
- Improved procedures related to the destruction of obsolete coupons.

Management Oversight of Seller Activities

Ferry System management initiated reviews of revenue variances each month and took appropriate action when following up on these variances. On-site terminal reviews were performed and managers met to discuss improving internal controls over receipts.

Computer Inquiry Program

The Ferry System increased the use of computer-assisted analysis to reconcile revenue and inventory variances.

The above actions help to improve controls related primarily to recorded sales. Strengthened controls to prevent unrecorded sales are still needed for both on-line and off-line sales.

Cause of Condition

Ferry System management states that the existing set of compensating controls used within their physical facilities, and the need for rapid transaction time inherent in accomplishing their mission, results in the possibility that all customer fares are not properly recorded or deposited.

Effect of Condition

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

Recommendation

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

Agency's Response

Thank you for the opportunity to respond to the "draft" audit finding on the Washington State Ferry (WSF) Point of Sales activities for fiscal year 2001. The gist of the finding is that the ferry system must continue to make progress in improving its controls over the possibility of revenue losses from "unrecorded sales." We were pleased at your sense that important progress has been made, and we share your view that more work needs to be done.

The actual details of our action plan will be provided to your office when we submit our plan to the Office of Financial Management, which will be within 30 days after you issue your Statewide Audit Report for FY01.

We value your office's contributions and assistance.

Auditor's Remarks

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

01-11 Some restricted funds administered by the Department of Natural Resources were charged more than their share of overhead costs.

Background

The Department's 1999-2001 overhead costs were approximately $37.5 million. Overhead consists of those costs associated with executive management, financial management, employee services, information technology, facilities operations and Natural Resources Building rent.

Description of Condition

The Department allocates overhead costs to its administrative funds based upon an estimated number of full-time employees who directly charge each fund. The Department considers its method of allocating overhead based upon this estimate the most appropriate method available. Some of the smaller funds and accounts are administratively or legislatively capped to limit their overhead charges. Their uncharged overhead is subsequently distributed to all the remaining uncapped funds including the restricted funds.

According to the Department's overhead allocation methodology, the allocation of overhead costs should be based on actual employees who charge a given fund. In some cases, the difference between the estimate and the actual number of employees is substantial. During the 1999-2001 biennium, we found that seven restricted funds were charged approximately $2.4 million more than their share of overhead costs. During the 1997-1999 biennium, we found that four restricted funds were charged approximately $3.1 million more than their share of overhead costs. Based upon the Department's method of allocating overhead, it overcharged the following restricted funds a total of $5.5 million during the last two bienniums:

- Forest Development Account
- Aquatic Lands Enhancement Account
- Resource Management Cost Account
- Salmon Recovery Account
- Aquatic Land Dredged Material Disposal Site Account
- Forest Fire Protection Assessment Account
- Agricultural College Trust Management Account

We disclosed this issue in letters to the previous state Lands Commissioner during our last two audits.

Cause of Condition

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

Effect of Condition

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

Recommendations

We recommend the Department:

- Use restricted funds for allowable purposes as determined by the Legislature.
- Reimburse the restricted funds for unallowable overhead paid over the last two bienniums.
- Ensure that one fund does not benefit another where prohibited by state law.

Agency's Response

Due to the Management Letter of the prior audit, we have calculated the overhead allocation for all funds (excluding federal funds) for 01-03 based on the actual FTE rate for 97-99 biennium as the provisional rate used for budget purposes. After June 30, 2003, we will calculate the actual FTE for 01-03 and compare to the provisional rate used. Any discrepancy will be carried forward into the 03-05 biennium. DNR has submitted a supplemental budget item to the Legislature to cover the past two biennium undercharges to GF-S and to reimburse the restricted funds for the overhead overpayment. If the supplemental budget is not approved by the Legislature, we have no choice but to carry the amount forward into the next biennium in addition to the 01-03 amount.

Auditor's Remarks

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

Applicable Laws and Regulations

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

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

01-12 The Liquor Control Board does not have adequate internal controls over revenue collected in its state liquor stores.

Background

The Board collected approximately $421 million from sales at its liquor stores during fiscal year 2001.

The Board allows state liquor stores to retain currency received from the sale of merchandise in what the agency calls a working fund that is used to make change during the next day's transactions and to pay for routine operating expenses such as custodial services and postage. Each store manager has discretion over how much is withheld from daily deposits for these purposes.

The store manager or assistant enters the daily cash figures into the point-of-sale cash receipting system, including the amount ready for deposit with the bank and the cash left at the store. The system compares these summary figures entered by store management to the total of all receipt transactions to calculate an overage or shortage for the day. The cash withheld and the amount ready for deposit should add up to the total funds on hand in the store until the bank deposit is made. This information is displayed on a store balance report created by the receipting system. Store managers are not held accountable for what they claim to have on hand until someone independent of the store performs a surprise cash count of a working fund.

Description of Condition

During our past two audits we found several areas in which controls are weak at state liquor stores:

- Store managers do not deposit all revenue collected daily. As explained above, the Board allows its stores to retain money received from the day's sales in a working fund. Since the amount of the fund varies each day at each location, the agency is not able to properly monitor the financial operations of its stores. The use of money collected to make change or for other purposes increases the risk that it could be lost or misappropriated and not detected in a timely manner, if at all.

- Bank deposits prepared by the store managers are not independently monitored to ensure that the check and cash composition of the deposit reconciles to the mode of payment for transactions recorded in the store's point-of-sale computer system. Our audit experience in other state agencies proves that misappropriations can and do occur when management does not compare the check and cash composition of receipts to bank deposits.

- The Board's Financial Division monitors what is deposited in the bank from each store and compares this to what each store's computer records show was deposited in the bank. This may take two months to finish. This monitoring is neither timely nor complete. For example, the Financial Division cannot compare total sales to total bank deposits due to the use of the working funds and lack of monitoring check and cash composition of the daily bank deposit.

Cause of Condition

The Board does not require its stores to deposit all revenue collected intact, daily.

The Board has not authorized petty cash and change funds with established amounts. Neither of these funds should use money withheld from the store's revenues.

State liquor store management can manipulate the amount reported in the point-of-sale computer system as over or short for the day, by reentering figures into the receipting system. This renders monitoring of overages and shortages useless and hinders the Board's ability to monitor its stores' financial operations.

Effect of Condition

Inadequate internal controls increase the risk that public funds will be misappropriated or lost and impair the Board's ability to prevent or detect errors and irregularities in a timely manner, if at all.

At the end of our previous audit, we reported that these control weaknesses allowed employees to misappropriate over $35,000 from two state liquor stores.

Recommendations

We again recommend:

- The Board no longer allow stores to retain currency from daily sales.

- The Board authorize a petty cash fund for each store that needs cash for routine and minor expenses. This fund should be established and maintained at a constant amount. The Board should reimburse each fund for legitimate expenditures, back to its authorized amount, through the normal vendor payment process. Store personnel should not be allowed to make expenditures directly from store revenue.

- The Board authorize a change fund for each store. This fund should be established and maintained at a constant amount, sufficient to meet each store's need to make change for cash transactions. Store personnel should not be allowed to withhold store revenue from deposit for the purpose of increasing a store's change fund.

- Each state liquor store deposit all currency and checks received from sales intact each day.

- Someone independent of store personnel monitor to ensure that all receipts according to the point-of-sale computer system are deposited intact with the bank daily. This monitoring should be done timely.

- Improve controls in the point-of-sale computer system to prevent store management from entering or altering the amount of cash and checks on hand prior to deposit with the bank.

The computer system should calculate that automatically and be monitored against actual deposit as described above.

Board's Response

This is in response to the December 2001 repeat audit findings regarding internal controls over revenue collected in state liquor stores. I want to assure you that the repeat finding was the result of back-to-back audits and not a case of agency unresponsiveness.

The original exit interview for the FY2000 audit took place in June 2001. In response to the audit finding, Bonnie Boyle, our Administrative Director at that time, responded with a corrective action plan to develop and implement a new petty cash procedure by January 2002. Because the FY 2001 audit started in September 2001 and concluded in December 2001, the agency did not have adequate time to develop and implement a new statewide procedure before the findings of the FY 2001 audit report.

The procedure will be implemented statewide on January 14, 2002 and will improve internal controls over revenue collected in state liquor stores. The new procedure will:

- *Authorize and establish a petty cash fund for each store that needs cash for routine and minor expenses.*
- *Authorize and establish a change fund for each store.*
- *Require all state liquor stores to make daily deposits of all currency and checks received from sales intact each day. Stores are prohibited from retaining currency from daily sales.*

The reconciliation procedure for bank deposit time frames will be improved from 8 weeks to 4 weeks by: (1) expanding and automating the current download process from 3 banks to 10 banks, and (2) getting deposit information weekly from the 16 banks that currently send their detail to us monthly. This will allow faster access to data.

We believe these new procedures will improve our internal controls as recommended by your audit findings. Thank you.

Auditor's Remarks

We appreciate the Board's plan to address this finding and look forward to it taking action to resolve these control weaknesses. We will review the Board's progress during our next regular audit.

Applicable Laws and Regulations

RCW 43.01.050 states in part:

> Each state officer or other person, other than county treasurer, who is authorized by law to collect or receive moneys which are required by statute to be deposited in the state treasury shall transmit to the state treasurer each day, all such moneys collected by him on the preceding day….

01-13 The Vancouver Regional Office of the Department of Fish and Wildlife does not have adequate controls over cash receipts.

Background

The Department of Fish and Wildlife sells hunting and fishing licenses through 614 authorized private businesses called dealers, including the Department's eight license sales offices. The Department collected $34,143,579 in revenue from recreational license sales during fiscal year 2001. This revenue supports numerous fish and wildlife activities carried out by the Department.

During our previous audit, we found that at least $14,892 in public funds was misappropriated from this Regional Office. These funds came from license sales. The control weaknesses cited below allowed this to occur and go undetected by management. Regional management has made some improvements in controls over cash receipts. However, significant weaknesses remain.

Description of Condition

During the current audit, we reviewed internal controls over cash receipts at the Vancouver Regional Office on two occasions. We found significant internal control weaknesses during the first visit and therefore, performed a follow-up audit to determine the risk to public funds. The Regional Office did make some improvements in its internal controls after our first visit of the year. However, the following weaknesses remain, that could allow funds to be misappropriated without detection in a timely manner, if at all.

- All sales are not recorded on the cash register.

- Several staff members have access to the safe and the cash registers. This access should be limited.

- Duties are not properly segregated. One of the Customer Service Specialists has too much control over the cash receipting process. This individual has access to license sales, verifies the amount deposited, has access to the safe, and completes one of the three daily reconciliations of sales recorded on the cash register to cash and checks received. No one independent of the cash receipting process reviews these reconciliations. In addition this individual verifies that recorded sales agree with the bank validated deposit slip.

- Total sales recorded do not agree with total bank deposits. We identified several deposits that were short in cash and the region could not explain the differences.

- The cash/check composition recorded on the cash register does not agree with the composition recorded on the validated deposit slip. This was true for several deposits that we examined. Our audit experience in other state agencies proves that misappropriations can and do occur when management does not compare the check and cash composition of receipts to bank deposits.

- The Point-of-Sale system and hand-written receipts, as well as sales recorded on the cash register, do not match the validated deposit slip. This was true for several deposits that we examined.

- The region uses rediform receipts to track miscellaneous sales rather than official pre-numbered cash receipts with the agency's name printed on them. Rediform receipts provide no internal controls over cash receipts because they can be obtained by anyone. Once obtained, they can be provided to the customer at the time of sale, and the related funds misappropriated, without detection by management.

- The monthly reconciliation submitted to headquarters is not accurate. The amount reported does not agree with documentation for license sales through the new Point-of-Sale system, hand-written receipts, cash register totals, and the validated deposit slip.

- Further, the region failed to provide explanations on the monthly reconciliation for deposits that were over or short.

- The Office Manager does not adequately review the monthly reconciliation for accuracy and completeness. Further, the Regional Manager does not provide adequate oversight to ensure this reconciliation is done properly.

- The Department has no written procedures for processing license cancellations or refunds, nor written procedures for issuing licenses at no cost. Duplicate shellfish licenses issued at no cost are being processed without supervisor review and approval in Vancouver.

- The Vancouver Regional Office could not account for $3,965 in sales for license year 2000. These licenses were sold prior to the installation of the new computerized Point-of-Sale license system. This total is composed of $3,200 worth of license inventory and $765 in reported sales. We disclosed $382 of this total as misappropriated in our last audit report, through November 30, 2000. Due to the control weaknesses cited above, the Department could not determine whether unsold licenses or sales proceeds were lost. Nor could the Department assign responsibility for any missing funds to a specific individual.

Cause of Condition

The Regional Office does not have adequate internal controls over the cash receipting process, or staff who understand the cash receipting process. In addition, there is a lack of management oversight to ensure public funds are safeguarded from misappropriation.

Effect of Condition

The absence of controls over cash receipts increases the risk that public funds could be misappropriated without detection in a timely manner, if at all. Weak controls also increase the risk that responsibility for loss or misappropriation could not be determined, placing all staff members at risk of suspicion should such an action occur.

Recommendations

We again recommend the Department establish effective internal controls over cash receipts to ensure the protection of public assets.

We also recommend that staff receive necessary training to meet the qualifications of their positions.

We further recommend that management fulfill their responsibility by increasing oversight and review of the cash receipting process.

Department's Response

Thank you for the opportunity to respond to the fiscal year 2001 audit of the Department of Fish and Wildlife (WDFW). I believe the primary personnel issues have been addressed with the hiring of a permanent Regional Office Manager. I am also confident that the corrective actions taken since the audit have addressed the weaknesses in the report.

The Department concurs with the finding that control weaknesses existed at the time of the audit. It was unfortunate that the lack of office leadership, appreciation of timely and accurate financial reporting and the need for the separation of duties, compromised the Department's financial integrity. This is contradictory to my commitment to improved business practices and financial accountability.

As you mentioned in your audit report, the Regional Office has made improvements in its internal controls. The Department has made further improvements since the audit was conducted. Specifically, the following changes have been made to strengthen the financial controls and procedures in the Region 5 Office:

- *All sales are now recorded into the cash register.*

- *Access to the cash register has been restricted. An additional safe has been purchased with limited cash in each safe and access restricted.*

- *A permanent Officer Manager has been hired which has allowed the controls performed by the Customer Service Specialist to be shifted to the Office Manager. Daily reconciliation of cash and sales are being conducted. No significant discrepancies have occurred and those minor ones that have occurred have been documented in the daily and monthly reports.*

- *New pre-numbered Washington Department of Fish and Wildlife receipt forms were ordered and are expected by mid January.*

- *The Department is in the process of drafting procedures for processing license cancellations and refunds. Before final issuance of these procedures, the Department will share them with the State Auditor's Office to see if they meet acceptable audit standards.*

Although this finding is contrary to my commitment to better business practices, I remain optimistic that the Department will meet governmental accounting and auditing standards. We have filled two key manager positions that will help us attain the needed leadership and oversight of staff who are responsible for handling public funds. Our new Regional Office Manager and Licensing Division Manager both play key roles and are integral to our success. These two individuals and their respective employees clearly understand the need for and the emphasis on financial management and integrity.

I also wanted to mention once again that I appreciate the professionalism of your audit staff. We in the Department depend on their knowledge and experience to help us meet governmental financial standards and expectations.

Auditor's Remarks

We thank the Department for its response to our recommendations. We appreciate the Department's cooperation and assistance during our audit. We will review the Department's progress toward improving internal controls during our next regular audit.

Schedule of Prior Year Findings

Finding Number	Finding Caption	Status
00-1	Controls over accounts receivable and the safeguarding of related cash receipts need improvement at the Employment Security Department.	Resolved
00-2	Public funds were misappropriated at the Vancouver Regional Office of the Department of Fish and Wildlife.	Unresolved. Fiscal year 2001 finding
00-3	The Department of Transportation's Washington State Ferries Division does not have adequate controls over sales and revenue collections.	Unresolved. Fiscal year 2001 finding
00-4	Public funds were misappropriated and accounting records were falsified and destroyed at the Washington State Gambling Commission.	Resolved
00-5	The Department of Personnel has not established effective internal control policies and procedures.	This is a two-year audit and was not audited during fiscal year 2001.
00-6	The Liquor Control Board does not have adequate internal controls over revenue collected in its State Liquor stores.	Unresolved. Fiscal year 2001 Finding
00-7	Public funds were misappropriated and accounting records were falsified at State Liquor Store No. 7 in Yakima.	Resolved
00-8	Public funds were misappropriated and accounting records were falsified at State Liquor Store No. 66 in Kent.	Resolved
00-9	The Office of the Superintendent of Public Instruction (OSPI) does not have adequate internal controls over receivables.	Unresolved. This issue is cycled to the fiscal year 2002 audit
00-10	The Office of the Superintendent of Public Instruction did not comply with state laws and regulations requiring control over fixed assets.	Unresolved. This issue is cycled to the fiscal year 2002 audit
00-11	Public funds were misappropriated and leave records were falsified and destroyed at the Washington State Library.	Resolved
00-12	The Department of Licensing does not have adequate controls over cash receipting at selected licensing services offices.	Resolved
00-13	The Department of Veterans Affairs does not have adequate controls over cash receipts.	Resolved
00-14	The Department of Corrections did not comply with state laws and regulations regarding control over local cash accounts.	Resolved

Finding Number	Finding Caption	Status
00-15	The Department of Corrections did not comply with state laws and regulations regarding controls over fixed assets.	Resolved
00-16	Public funds were misappropriated and accounting records were falsified and destroyed at the Airway Heights Correction Center.	Resolved
00-17	The Washington State Patrol does not have adequate controls over cash receipts.	This is a two-year audit and was not audited during fiscal year 2001.
00-18	The Department of Labor and Industries made inappropriate medical payments totaling $15,391.	Resolved
00-19	The Department of Labor and Industries used its 1999-2001 appropriation to pay approximately $1,807,000 in expenses for the prior biennium.	Resolved
00-20	The Board of Volunteer Firefighters and Reserve Officers employee was beneficially interested and participated in a contract between the Board and the employee's spouse, which is a conflict of interest.	This is a two-year audit and was not audited during fiscal year 2001.
00-21	The Board of Volunteer Firefighters and Reserve Officers does not have adequate controls over its cash receipting and pension system database.	This is a two-year audit and was not audited during fiscal year 2001.

Conclusion

We identified conditions significant enough to report as findings at several state agencies. These conditions related to weaknesses in policies, procedures and internal controls over revenue and expenditure processes, cash receipting, consumable inventories and assets. We also identified issues in our statewide audit areas that need either a legal review, that may require a change in state law or state funding to comply with state law.

Overall, the agencies of the state of Washington have consistently exhibited a commitment to solid accounting practices and systems of internal control. The agencies have been very responsive to recommendations for improvement, resulting in a cooperative partnership to continually improve internal controls and accountability.

We thank the Office of Financial Management and the state agencies for their cooperation and assistance during the fiscal year 2001 audit. We look forward to the opportunity to continue to assist state agencies in ensuring the financial resources are properly safeguarded and we have accountability to the citizens of the state of Washington.