

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Continued)**

**State of Washington
July 1, 2017 through June 30, 2018**

Financial Findings Reported Under Government Auditing Standards

2018-001 The State should improve internal controls over specific areas of recording and reporting financial activity in the State's financial statements.

Background

State management is responsible for ensuring that balances reported on the financial statements are accurate and fairly presented, in all material respects. The state has numerous colleges and universities, which prepare independent financial statements and provide financial data for aggregation into the state's comprehensive annual financial report (CAFR). Management is responsible for ensuring that the balances included in the State's financial presentation are correctly classified and accurate.

Government Auditing Standards, prescribed by the Comptroller General of the United States, requires the auditor to communicate material weaknesses, as defined below in the Applicable Laws and Regulations section, as a finding.

State Board for Community and Technical Colleges (SBCTC)

The State Board for Community and Technical Colleges (SBCTC) advocates for, coordinates and directs Washington's system of 34 public community and technical colleges. One of SBCTC's responsibilities is to collect community and technical college financial data for reporting in the State's general ledger.

University of Washington (UW)

The University of Washington (UW) is one of the oldest state-supported institutions of higher education on the Pacific Coast. The University's primary mission is the preservation, advancement and dissemination of knowledge. One of the University's responsibilities is to provide information for reporting in the State's general ledger and financial statements.

Office of Financial Management (OFM)

The Office of Financial Management (OFM) is responsible for preparing the State's financial statements in accordance with generally accepted accounting principles (GAAP). These statements provide a thorough and detailed presentation of the State's overall financial condition.

OFM is responsible for the overall coordination of financial data across the State used to prepare these statements. At year-end, OFM is also responsible for ensuring the accuracy of the financial information presented in the statements.

Department of Licensing (DOL)

The Department of Licensing (DOL) is responsible for collecting the State's revenues related to vehicle and vessel registration. DOL collects these fees for the State, counties, cities and towns for improvements related to roads, streets and highways including facilities for pedestrians, bicyclists or equestrians.

Description of Condition

We identified the following deficiencies in internal controls over financial reporting that, when taken as a whole, represent a material weakness over financial reporting.

SBCTC

In 2015, SBCTC implemented a modernized computer system to replace the existing legacy software. Two colleges converted to a new financial system that same year.

At the time of our audit, one of the colleges using the new system has not closed its financial records since the 2016 fiscal year-end. As a result, several balance sheet accounts related to this College were inaccurate in the State's accounting system.

After the 2018 fiscal year-end, SBCTC consolidated and reconciled the college's balances to accurately report them for the 2018 fiscal year-end in the State's accounting system. However, some of the adjustments SBCTC made to reconcile at year-end were inaccurate.

UW

UW produces full accrual annual financial statements, reporting as a business-type entity. The State has a different chart of accounts and reports some of the University's activities using a different accounting basis. Therefore, a number of adjustments are required to consolidate and report the University's financial information in the State's financial statements. We found several errors in the consolidation and adjustment process.

OFM

To prepare the State's financial statements, OFM makes a number of year-end adjustments to ensure amounts are properly reported on the State's financial statements. Adjustments were made to recognize revenue on the full accrual basis of accounting on the statement of activities and to implement new accounting standards related to pensions and other post-employment benefits (OPEB). We found errors in these adjustments.

DOL

For fiscal year 2018, DOL reported collections of \$595 million for motor vehicle and vessel registrations, far exceeding the \$243 million it expected to collect. DOL identified one error that caused a \$51 million overstatement of revenue but could not explain the remaining increase.

Cause of Condition

SBCTC

SBCTC did not dedicate sufficient time or resources to ensure it made accurate fiscal year-end adjustments to a college's financial data.

UW

The process of adjusting UW financial information for reporting in the State's financial statements is complex, and OFM did not dedicate sufficient resources to review every adjustment for classification at fiscal year-end.

OFM

OFM has consistently aimed to produce one of the fastest statewide financial reports in the nation. As a result of this goal, OFM has a short turnaround time to review the final statements, notes, and schedules and to ensure all year-end adjustments are posted accurately.

OFM did not dedicate sufficient resources to review all fiscal year-end adjustments for accuracy. Additionally, OFM had additional responsibilities beyond financial statement preparation that created additional stress on the agency at fiscal year-end.

DOL

During fiscal year 2018, DOL experienced difficulty correctly identifying and classifying revenue in its accounting records. It recorded a significant amount of revenue in a clearing account because the source of the revenue could not be determined. At fiscal year-end, DOL elected to report the amounts as motor vehicle license revenue because the true source of the revenue was still unknown.

Effect of Condition

SBCTC

SBCTC made several errors in consolidating, reconciling and adjusting college financial data for reporting in the State's accounting system. Specifically:

- Higher Education Special Revenue fund accounts payable was overstated by \$137 million
- Higher Education Student Services fund accounts receivable was overstated by \$51 million

These errors were not corrected in the state's financial statements.

UW

During our final review of the State's financial statements, we identified the following misstatements:

- Due from other funds was misclassified as accounts receivable in the Higher Education Special revenue fund, causing a misstatement of \$666 million. This was corrected in the state's financial statements.

- Due to other funds was misclassified as accounts payable in the Higher Education Endowment fund, causing a misstatement of \$666 million. This was corrected in the state's financial statements.
- Benefits were misclassified as Salaries in the Higher Education Student Services fund, causing a misstatement of \$75 million. This error was not corrected in the state's financial statements.

OFM

Several year-end adjustments were inaccurately recorded on the State's financial statements:

- On the Government Wide Statement of Activities, other revenues were overstated by \$578 million and property tax revenues were understated by the same amount. This was corrected in the state's financial statements.
- On the governmental fund statements, year-end adjustments for pension and OPEB were inaccurately recorded as follows:
 - Deferred outflows on OPEB and total OPEB liability were overstated by \$38.9 million in the General Fund. Additionally, net pension liability was overstated by \$2.5 million.
 - Deferred outflows on OPEB and total OPEB liability were overstated by \$25 million in the Higher Education Special Revenue fund. Additionally, net pension liability was overstated by \$8.5 million.
 - Deferred outflows on OPEB were overstated by \$13.5 million in non-major governmental funds.

These errors were corrected in the state's financial statements.

DOL

License, permits and fees revenue reported by DOL were overstated by an estimated \$352 million in the motor vehicle fund.

This error was not corrected in the state's financial statements.

Recommendations

We recommend the following:

SBCTC

- Perform timely, complete and accurate reconciliations and adjustments of community and technical college financial data reported in the State's accounting system at year-end
- Continue to work with colleges using the new software system to resolve issues so correcting entries can be posted and their financial records can be closed

UW

- UW and OFM work together more closely to ensure an accurate understanding of the year-end process for consolidating, adjusting and reporting year-end financial data in the State's accounting system

OFM

- OFM dedicate more resources to reviewing complex year-end adjustments

DOL

- Perform complete reconciliations of revenues to ensure the sources of receipts are promptly identified and accurately recorded in the State's accounting system

State's Response

The State recognizes the significance and priority of internal controls over recording and reporting financial transactions.

OFM will continue to work with the Department of Licensing, University of Washington, and the State Board of Community and Technical Colleges to improve internal controls over the processing and reporting of financial activities.

OFM continually strives to strengthen its process for analyzing financial data to identify potential issues and adjust those items that are material to the state's financial statements.

Auditor's Remarks

We appreciate the state's commitment to resolving this finding and thank the state for their cooperation and assistance. We will review the status during the next audit.

Applicable Laws and Regulations

RCW 43.88.160 Fiscal management – Powers and duties of officers and agencies, states in part:

- (4) In addition, the director of financial management, as agent of the governor, shall:
 - (a) Develop and maintain a system of internal controls and internal audits comprising methods and procedures to be adopted by each agency that will safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies for accounting and financial controls. The system developed by the director shall include criteria for determining the scope and comprehensiveness of internal controls required by classes of agencies, depending on the level of resources at risk.

Government Auditing Standards, December 2011 Revision, paragraph 4.23 states:

- 4.23 When performing GAGAS financial audits, auditors should communicate in the report on internal control over financial reporting and compliance, based upon the work performed, (1) significant deficiencies and material weaknesses in internal control; (2)

instances of fraud and noncompliance with provisions of laws or regulations that have a material effect on the audit and any other instances that warrant the attention of those charged with governance; (3) noncompliance with provisions of contracts or grant agreements that has a material effect on the audit; and (4) abuse that has a material effect on the audit.

The American Institute of Certified Public Accountants defines material weaknesses and significant deficiencies in its Codification of Statements on Auditing Standards, Section 265 as follows:

.07 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Material weakness. A deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Significant deficiency. A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

.A11 Indicators of material weaknesses in internal control include:

- Identification of fraud, whether or not material, on the part of senior management. For the purpose of this indicator, the term “senior management” includes the principal executive and financial officers as well as any other members of senior management who play a significant role in the entity's financial reporting process;
- Restatement of previously issued financial statements to reflect the correction of a material misstatement due to fraud or error;
- Identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected and corrected by the entity's internal control; and
- Ineffective oversight of the entity's financial reporting and internal control by those charged with governance.

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

Section 20.15.30.a Who is responsible for internal control?

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

Section 20.15.40.c Control Activities

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

Section: 20.15.50.a - Annual assurance

A risk assessment and internal control review process provides management with reasonable assurance that controls are operating as expected. In addition, the process should be used to determine if internal control modifications are needed by considering events that have occurred, processes or procedures that have changed, new projects or programs that are being planned or implemented, and other changes within the agency that may have additional risks. If the review uncovers internal control weaknesses or if prior weaknesses still exist, they should be documented and addressed.

Periodically, an agency should conduct a comprehensive review of the internal control structure to determine if it is adequately addressing agency risks. This can be done agency-wide at one time or by sections of the agency over a period of time.

Agencies must maintain adequate written documentation of activities conducted in connection with risk assessments, review of internal control activities and follow-up actions. This documentation includes any checklists and methods used to complete these activities. Refer to Subsection 20.25.50 for required documentation. For sample checklists and procedures, refer to the OFM Administrative and Accounting Resources website at: <http://www.ofm.wa.gov/resources/default.asp>.

Agencies have the flexibility to assign appropriate staff to complete the risk assessments and review of internal control activities required by this policy. The internal control officer is the person appointed by the agency head who is assigned responsibility for coordinating and scheduling the agency-wide effort of evaluating and reporting on reviews and improving control activities. The internal control officer also provides assurance to the agency head that the agency has performed the required risk assessments and the necessary evaluative processes. This communication may be ongoing and informal, but at least once per year, this assurance must be made in writing to the agency head. The internal control officer is responsible for ensuring that the required documentation is maintained and available for review by agency management, the State Auditor's Office (SAO), and OFM.