State of Washington
July 1, 2021 through June 30, 2022

2022-001 The State lacked adequate internal controls over financial reporting to ensure accurate recording and monitoring of financial activity in its financial statements.

Background

State management is responsible for designing, implementing and maintaining internal controls that provide reasonable assurance financial statements are fairly presented and financial reporting is reliable. We identified deficiencies in internal controls that could adversely affect the State's ability to prevent—or quickly detect and correct—misstatements in the financial statements.

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

Employment Security Department

The Employment Security Department (ESD) is led by a Governor-appointed Commissioner. ESD provides economic security to Washington's residents by helping them find jobs, bridge gaps in employment, and provide paid family and medical leave. ESD delivers employment services, manages unemployment insurance benefits, collects and analyzes labor market information, and administers the state's Paid Family and Medical Leave program. ESD is one of Washington's largest state agencies, employing about 2,100 permanent and non-permanent employees.

State Board for Community and Technical Colleges

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 and consolidate community and technical college financial data for reporting in the State's general ledger accounting system. During the previous five audits, we identified and communicated deficiencies in internal controls over the reporting of community and technical college financial data. This issue was reported as a finding in the prior five audits.

Description of Condition

We identified the following deficiencies that, when taken together, represent a material weakness in internal controls over financial reporting:

ESD

Using a statistically valid sampling method, we randomly selected and examined a sample of 59 paid Pandemic Unemployment Assistance (PUA) claims totaling $14,741.

- We found ESD subsequently reviewed and disqualified 15 claims paid for multiple reasons, with the most common being that the claimant failed to provide acceptable wage documentation. Of the 15 disqualified claims, ESD did not attempt to collect one payment totaling $211.
- We also found that 31 of the claims, totaling $7,838, were actually for expenditures that occurred in prior fiscal years.

In addition to reporting prior year unemployment claims in the current period, ESD did not initially estimate and record an accrual for unemployment benefits earned in the current period (fiscal year 2022) that will likely be paid in future periods.

We also found that ESD did not completely reconcile its bank accounts to the accounting records at fiscal year-end (June 30, 2022), and inaccurately calculated the allowance for doubtful receivables related to claimant overpayments.

SBCTC

SBCTC did not complete a timely and accurate reconciliation of college financial data with the amounts recorded in the State's accounting system before the State closed its books.

Cause of Condition

ESD

- ESD did not consistently require documentation of wages for PUA claims at the time of payment. Without having this requirement in place, the Department was unable to verify claimants' wages and employment status to ensure they met eligibility requirements. Further, ESD did not attempt to recover the overpaid claim because a system problem did not move it forward to adjudication.
- Claimants can file benefit payments for previous periods, and ESD had a large backlog of claims since the start of pandemic-related benefits. The errors in reporting unemployment benefits in the proper period was caused by staff failing to consider the size of prior period payments and apply accrual accounting, as well as a lack of configured reports available in ESD's Unemployment Tax and Benefits System.
- The bank reconciliation errors were caused by a lack of management oversight during the review.
- Error in the calculation of the allowance for doubtful receivables was caused by the use of non-current data in the calculation.

SBCTC

SBCTC did not dedicate sufficient time or resources to reconciling college financial data to the State's accounting system and making appropriate adjustments.

Effect of Condition

ESD

We found the following errors in the financial statements:

- Because we used a statistical sampling method to randomly select the payments we examined in the audit, we estimate the unassessed overpayments to be $7.7 million, which was not recorded as an accounts receivable in the financial statements. This error was not corrected in the financial statements.
- We also estimate that ESD should have reported $382 million in claims expense in prior periods. This error was corrected in the financial statements.
- We estimate appealed claims totaling $150 million and claims flagged for further review totaling $55 million were not accrued and reported in fiscal year 2022. The error, totaling $150 million, was corrected and the error totaling $55 million was not corrected in the financial statements.
- Various transactions, totaling $128 million, were excluded from the bank reconciliations. When combined with other errors we noted, ESD overstated cash by $87,905,305. These errors were not corrected in the financial statements.
- By using incorrect data and miscalculating the allowance for uncollectible receivables unrelated to fraud, we estimate ESD understated net receivables by about $26.4 million. This error was not corrected in the financial statements.

SBCTC

We found numerous unexplained variances between consolidated college financial data and amounts recorded in the State's accounting system. Some of these variances include:

- In governmental activities funds, the State's accounting system had lower balances than the consolidated college financial data. These variances included depreciable assets ($130 million), expenses ($65 million), charges for services ($284 million), and grants and contributions ($3 million).
- In the higher education special revenue funds, the State's accounting system had larger balances than the consolidated college financial data for charges for services ($36 million), federal grants-in-aid ($16 million) and education expenditures ($176 million).
- Cash in the State's accounting system was $3 million lower than the consolidated college financial data.

- In the higher education student services funds, cash in the State's accounting system was $7 million higher than the consolidated college financial data.
- These errors were not corrected in the financial statements.

Recommendations

ESD

We recommend ESD:

- Establish an effective, consistent process for verifying wages and attempt to collect unallowable PUA benefit payments
- Report claims on an accrual accounting basis to ensure they are reported in the proper period
- Perform a thorough review of the bank reconciliations to ensure they are accurate
- Review the calculation of the allowance for doubtful receivables to ensure the correct data has been used

SBCTC

We recommend SBCTC perform a complete and timely reconciliation of college financial data to the State's accounting system throughout the fiscal year.

State's Response

The State understands the importance of establishing strong internal controls over recording and reporting financial transactions. OFM will continue to work with both agencies to improve their processes. Additionally, OFM will work with State Board of Community and Technical Colleges to fully reconcile their agency system with the State's accounting system.

OFM is currently revising its accounting trainings for 2023 to help all agencies improve agency staff understanding of appropriate reporting requirements and generally accepted accounting principles.

Auditor's Remarks

We appreciate the State's commitment to resolve this finding and thank OFM for its cooperation and assistance during the audit. We will review the corrective action taken during the next audit of the State's annual comprehensive financial report.

Applicable Laws and Regulations

Government Auditing Standards, July 2018 Revision, paragraphs 6.40 and 6.41, establish reporting requirements related to significant deficiencies or material weaknesses in internal control, instances of fraud, and noncompliance with provisions of laws, regulations, contracts, or grant agreements.

The American Institute of Certified Public Accountants defines significant deficiencies and material weaknesses in its *Codification of Statements on Auditing Standards*, section 265, Communicating Internal Control Related Matters Identified in an Audit, paragraph 7.

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:
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> > (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.

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

> Section 20.15.30 – Annual requirements for agencies related to statewide reporting.
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> > The Office of Financial Management (OFM) prepares the state's Annual Comprehensive Financial Report (ACFR) annually. While OFM has final responsibility for the contents of the ACFR, the data in the financial statements and many of the notes to the financial statements are generated from Agency Financial Reporting System (AFRS) transactions input by agencies. Because agencies are in control of transactions entered into AFRS, OFM relies on agency internal control systems and the monitoring of those systems to assert in writing that the ACFR is correct and complete.