

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

State of Washington July 1, 2022 through June 30, 2023

2023-001 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 significant deficiencies in internal controls, as defined below in the Applicable Laws and Regulations section, as a finding.

Health Care Authority

The Health Care Authority (HCA) contracted with a vendor, which uses a system called ProviderOne, to process Medicaid payments. During the previous ten audits, we identified and communicated deficiencies in controls over the ProviderOne system. For fiscal year 2023, ProviderOne processed about 147 million transactions totaling \$17.9 billion.

Employment Security Department

The Employment Security Department (ESD) provides economic security to Washington's residents by helping them find jobs and bridging gaps in employment. ESD delivers employment services, manages unemployment insurance benefits, and collects and analyzes labor market information. Occasionally, ESD overpays claimants. Overpayments are assessed when benefits are retroactively determined to be incorrectly paid. This can happen due to a claimant receiving conditional payment while the claim is being reviewed, the claimant not providing additional information, errors, and various other reasons. In these instances, receivables (net of the amounts estimated to be uncollectible) are reported in the general ledger at fiscal year-end.

Description of Condition

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

HCA

HCA relies on internal controls that the vendor performs, but it has not obtained a service organization control audit report (also called a SOC 2 report) for the ProviderOne system for fiscal year 2023. This report is essential because it determines whether the vendor has properly designed its controls and that they are operating as intended in the processing and recording of Medicaid payments. This issue has been reported as a finding every other fiscal year since fiscal year 2013.

ESD

ESD incorrectly calculated the amount of receivables they estimate to be uncollectible related to claimant overpayments

Cause of Condition

HCA

HCA and its vendor did not adequately outline in their original contract the responsibilities, controls and requirements for monitoring the ProviderOne system. Specifically, the contract did not require the vendor to provide a SOC 2 report to demonstrate that its internal controls were effective. At the time of the contract, HCA management did not completely understand the extent of its monitoring responsibilities for the ProviderOne system.

ESD

Management is responsible for ensuring the calculation of receivables expected to be uncollectible is accurate. The error in the calculation was not detected during management's review.

Effect of Condition

HCA

HCA's failure to ensure that the vendor conducted an internal control audit of the ProviderOne system and provide a report of the audit could lead to:

- Inaccurate financial reporting in the state's General Fund
- Misuse, loss or misappropriation, inaccurate payments, and unauthorized software changes to the ProviderOne system

ESD

We found the amount of receivables estimated to be uncollectible related to claimant overpayments to be overstated and net receivables to be understated by \$330.5 million. This error was corrected in the state's financial statements.

Recommendation

HCA

We recommend HCA work with its vendor each year to obtain a SOC 2 report that covers an entire fiscal year.

ESD

We recommend ESD perform a thorough review of the allowance for uncollectible receivables to ensure it is calculated correctly.

State's Response

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

The State disagrees that annual assurances over ProviderOne controls are necessary, and the Authority did not address monitoring in its ProviderOne contract language. Currently, the vendor provides an independent service organization control (SOC2) audit every other year. The estimated additional cost to purchase an annual SOC2 audit report is \$470,000 each biennium.

In 2023, the Authority has requested funding from the legislature to contract for the additional SOC2 audit report to resolve the audit finding. If the decision package is approved, the contract would be amended in July 2025 and audits would begin on a yearly basis.

In addition, the State understands the importance of correctly calculating receivables that are estimated to be uncollectible as it relates to claimant overpayments. ESD plans to implement accounting training specifically for financial statement reporting purposes during this fiscal year so that staff have the skills and abilities needed to understand 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 recognize the challenges of gaining assurance about controls performed by vendors. However, given the importance of these controls to the ProviderOne system, we continue to conclude that annual assurance is necessary. We reaffirm our finding and 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:

(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

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.