

**Schedule of Findings and Questioned Costs
For the Fiscal Year Ended June 30, 2015**

Financial Findings Reported Under Government Auditing Standards

2015-001 The State's internal controls over Medicaid payments processed by ProviderOne are inadequate to ensure those payments are properly processed and recorded.

Background

It is the responsibility of state management to design and follow internal controls that provide reasonable assurance regarding the reliability and accuracy of information used for financial reporting. We identified deficiencies in internal controls that could adversely affect the State's ability to accurately report its financial statements.

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

Description of Condition

The Health Care Authority (HCA) has contracted with a vendor, which uses a system known as ProviderOne to process payments for Medicaid. For the fiscal year ended June 30, 2015, ProviderOne processed approximately 53 million transactions totaling \$8.1 billion.

We identified the following deficiency in internal control that represents a significant deficiency:

- During the previous two audits, we identified and communicated deficiencies in controls over the ProviderOne system. Although HCA has made improvements, including obtaining a service organization control audit report (also called SSAE 16) for three months of the prior fiscal year; no report was obtained for this year. This report is essential as it determines whether controls are properly designed and operating as intended in the processing and recording of Medicaid payments.

Cause of Condition

The HCA and the vendor did not adequately address responsibilities, controls and requirements for monitoring in the contract for the ProviderOne system. Specifically, the contract with the vendor did not require the vendor to obtain a service organization control audit report (also called SSAE 16).

At the time of the contract, HCA did not have complete knowledge of the extent of their monitoring responsibilities for ProviderOne.

Effect of Condition

- The failure to assure that the vendor received an internal control audit for the ProviderOne system 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.

As a result of the internal control deficiency, we were required to perform additional audit procedures to verify the accuracy of human services expenditures reported in the state’s general fund.

Recommendation

To strengthen internal controls over the ProviderOne system, we recommend:

- HCA work with its vendor to obtain a service organization control audit report on an annual basis that covers an entire fiscal year.

State’s Response

The state recognizes the significance and priority of internal controls over recording and reporting financial transactions. Currently the vendor provides an independent service organization control audit every other year. The state is negotiating with the vendor to provide annual audit reports that cover an entire fiscal year, and will request funding from the legislature to do so.

Auditor’s Concluding 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.

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.

2015-002 The State should improve internal controls over the processing and recording of Unemployment Insurance premium payment and wage information to ensure accurate reporting.

Background

It is the responsibility of state management to design and follow internal controls that provide reasonable assurance regarding the reliability and accuracy of information used for financial reporting. We identified deficiencies in internal controls that could adversely affect the State's ability to accurately report its financial statements.

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

Description of Condition

The Employment Security Department administers Washington State's unemployment insurance program. A new system called Next Generation Tax System (NGTS) was implemented in March 2014 to process employer wage reports and payments. NGTS processed approximately \$1.2 billion in Unemployment Insurance Premium payments and approximately \$43 billion in taxable wage information from employers since the system's implementation through June 2015.

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

System processing

- Adjustments can be entered and processed in NGTS without review and approval of a second individual.
- NGTS incorrectly assesses tax rates for employer experience ratings when a business is purchased by a successor owner.
- Detail Benefit Charges within NGTS do not consistently agree to the Summary Benefit Charges.
- Employer payments and tax and wage information identified for manual review are not consistently processed timely.
- Tax & Wage report and payment exceptions identified by processing edits are systematically routed by NGTS to on-line exception queues for review and correction by ESD personnel. However, we observed workflow items are not consistently processed timely.
- NGTS incorrectly assesses the predecessor and successor rate to employer accounts. We identified employer accounts where a higher predecessor rate was assessed and an incorrect billing statement was mailed to employers which resulted in overpayments to employer accounts.

Defects within NGTS, including inaccurate and incomplete reports

- Employer Unemployment Insurance Premium payments and tax and wage reports were not consistently posting accurately to employer accounts in NGTS.
- Reports generated from NGTS were incorrect and could not be relied upon to verify the accuracy or completeness of changes made to employer accounts.
- NGTS account balance reports do not accurately reflect ending and beginning account balance from month to month. NGTS reports cannot be relied upon for use in reconciling premiums to the State's general ledger account system, AFRS.

Reconciliations

- Controls are inadequate over interfaces between internal and external systems. There are no reconciliations between systems to ensure information transmitted by interfaces is accurate and complete.
- Daily reconciliations between the bank and NGTS are attempted, however, due to a variety of system errors, the bank and NGTS are often out of balance.

Cause of Condition

This is the first year that the Employment Security Department has used the NGTS system. Prior to implementing the system, the Department did not perform adequate testing to ensure the system could process accurate and complete Unemployment Insurance Premium payments, tax and wage reports, unemployment insurance rates, and employer receivables.

Effect of Condition

We identified the following errors during our audit of the financial statements:

- Other Receivables was understated by a net total of \$74 million due primarily to the following:
 - The employer receivable portion of the balance was overstated by \$68.9 million due to reliance on an inaccurate NGTS generated report. The allowance for uncollectible portion of this balance was overstated by \$50.8 million. These errors were corrected.
 - The claimant overpayment portion of the balance was understated by \$7.2 million due to a prior year calculation error. The allowance for the uncollectible portion of this balance was overstated by \$88.2 million due to a clerical accounting error. These errors were corrected.
 - After these corrections were made we found an additional understatement of \$3.3 million. This error was not corrected.
- Accrued Liabilities were reported at \$8 million in fiscal year 2014. In the current year, accrued liabilities were reported at \$0 because the Department was not clear on how

employer overpayments were being tracked by NGTS. This is an unquantifiable and uncorrected likely misstatement.

- Cash was understated by \$6.7 million and expenses understated by the same amount because checks that had been outstanding for over a year had not been written off. This error was not corrected.

Additionally, the internal control weaknesses in NGTS resulted in the following:

- We identified employer accounts with incomplete or inaccurate wage and payment information. In some instances, these accounts were assessed penalties and interest that was not due, which then resulted in employers being assessed an incorrect tax rate.
- Unverifiable and invalid credits were posted to employer accounts.
- The lack of interface controls to ensure reconciliations are performed between systems resulted in the inaccurate and incomplete transmission of information by the interface.

Recommendation

We recommend the following:

- Establish internal controls to ensure the complete and accurate processing of employer payments and tax and wage reports for Unemployment Insurance Premium payments.
- Identify and correct defects within NGTS, including inaccurate and incomplete reports.
- Perform reconciliations between systems to ensure information transmitted by interfaces is accurate and complete.

State's Response

We appreciate the feedback received from the State Auditor's Office and agree with their recommendations. The state recognizes the significance and priority of internal controls over the processing, and reporting of financial transactions, therefore, the following actions will be taken to resolve the issues identified in the audit report:

- *Review the NGTS system and reports currently generated for accuracy and completeness and make revisions as necessary.*
- *Establish and perform reconciliation between systems and of the General Ledgers in Agency Financial Reporting System (AFRS) to ensure that the financial transactions and information are accurate and complete.*
- *Create new internal control policies and procedures that will be reviewed and monitored by management on an ongoing basis.*

Auditor's Concluding Remarks

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