MANAGEMENT LETTER

DATE: June 2, 2011

TO: Metropolitan King County Councilmembers

FROM: Cheryle A. Broom, King County Auditor

SUBJECT: Washington State Auditor's Office 2009 Audit Findings

Summary

This memo discusses our review of the Washington State Auditor's Office audit reports issued for King County, the Water Quality Enterprise, and the Public Transportation Enterprise.

An unqualified (clean) audit report was issued for the financial statements and for the County’s compliance with requirements applicable to federal programs that were audited as part of the federal single audit. There were four audit findings issued related to the financial statement audit; six audit findings for the Federal Single Audit; seven audit findings for the Accountability Audit Report; several findings related to the Water Quality Enterprise; and no findings for the Transportation Enterprise Fund audit. This memo highlights these findings and is intended to inform the County Council that corrective actions were taken or are planned to address them.

The memo also highlights rising liabilities to King County related to post-employment health benefits. Such liabilities rose from $6.6 million in 2007 to $22 million in 2009.

Background

Each year the Washington State Auditor's Office (SAO) conducts a financial audit of King County’s Comprehensive Annual Financial Report (CAFR) and a Federal Single Audit. The Federal Single Audit determines whether or not a non-federal entity (King County) has complied with federal laws and regulations. The SAO also conducts the individual financial audit of the King County Public Transportation Enterprise. This year, a CPA firm conducted the audit of the King County Water Quality Enterprise.

The financial audits are used to determine whether information in the financial statements is free of material misstatements and can be relied upon to present a true and accurate picture of the County’s financial condition. If the auditors determine that the financial information presented is acceptable and reliable, they issue an unqualified (clean) audit report. If auditors conclude that the financial information is not an accurate reflection of the entity under audit, they issue a qualified (unclean) opinion. Additionally, the SAO issues an Accountability Audit Report, which addresses the County’s compliance with selected state laws and regulations and its own policies and procedures.
2009 Financial Statement Audit

The SAO issued their King County Financial Statements and Federal Single Audit report on September 30, 2010, which covered the period January 1, 2009 through December 31, 2009. The report stated that King County's financial statements presented fairly the financial position and other aspects of King County's operations and was in conformity with generally accepted accounting principles.

The SAO audit found that the County has improved its documentation of the financial statement preparation process and provided more timely financial information for the current audit. However, the SAO found several significant deficiencies in controls over financial reporting:

(1) The SAO noted the County's year-end financial statements are complex and therefore are prepared by multiple employees, each of whom prepares a different section of the statements. As such, this increases the risk that the County's financial statements could contain material misstatements or errors. The SAO found the County did not perform a sufficiently detailed review and reconciliation of the financial statements to ensure the statements were accurate and complete.

(2) The County, due to various factors, did not produce a single, final set of financial statements and notes in a timely manner.

(3) The County does not have an adequate reconciliation process over escrow accounts to ensure all funds are accounted for.

(4) The County has not adequately communicated information and applicable reporting requirements to its departments that spend about $250 million in Federal grant funds annually. The SAO further reported that the County does not perform a sufficiently detailed review and reconciliation of the Schedule of Expenditures of Federal Awards (SEFA) that employees prepare to ensure it is accurate, complete and adequately supported.

Based on these findings, the SAO recommended the County:

(1) Dedicate sufficient resources to ensure accurate, complete, and timely preparation of its financial statements.

(2) Perform a detailed review and reconciliation of the financial statements and notes.

(3) Implement policies and procedures to ensure assets are reported and recorded timely to ensure the Work In Progress (WIP) account and capital assets are correctly reported, as well as, the associated accumulated depreciation and depreciation expense.

1 Government Auditing Standards, July 2007 Revision, Section 5.11 defines a significant deficiency as "a deficiency in internal control, or combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with GAAP (Generally Accepted Accounting Principles) such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected."
(4) Reconcile escrow accounts to ensure accounts are accounted for properly.

(5) Improve processes to ensure adequate oversight of financial reporting, including a detailed review of the financial statements and the SEFA.

(6) Provide necessary information and training to departments that expend grant funds to allow them to correctly identify federal grants, the amounts expended, and reporting requirements.

In response, the County stated it concurred with the need to strengthen internal controls involving financial statement reporting but disagreed with certain statements or characterizations of the findings.

(1) In general, the County reported the accounting classification errors were extremely small (0.25 percent) and, collectively, they did not materially affect the County’s financial statements nor impact the General Fund or budgetary compliance.

(2) Concerning delays in the audit schedule, with the exception of accounting adjustments made to the Water Quality Fund, the County stated it made only one other accounting adjustment after the initial April 15th submittal; thus, other factors cited by SAO should not have affected timely completion of the audit.

(3) The County stated it submitted the Consolidated SEFA to the SAO on April 1, one month earlier than any prior year, and the County dedicated additional staff to the review period to make the earlier date. The County believes that it has adequately communicated information and applicable reporting requirements to its departments spending grant funds.

(4) The County has a new escrow agreement and is reviewing accounting procedures to assure all escrow accounts are reported correctly and has instituted new accounting review procedures for fixed asset capitalization for general government assets.

(5) Finally, the County stated it believes its financial statement review procedures are adequate; is working to improve the review process; and has developed a customized quality control checklist to supplement industry standard checklists already used, which should reduce errors.

**Federal Single Audit**

The SAO found no instances of noncompliance that were material to the County’s financial statements. SAO did, however, identify some significant deficiencies and material weaknesses with the internal controls over financial reporting, as discussed below. In terms of the Federal Awards component of the single audit, the SAO identified significant deficiencies in the design or operation of internal control over major federal programs but did not identify any material weaknesses. The SAO issued an unqualified opinion on the County's compliance with requirements applicable to its major federal programs, with the exception of the Public Health Emergency Preparedness and Response Grant for which SAO issued a qualified opinion on compliance with applicable requirements.
Single Audit Financial Statements

King County’s internal controls were inadequate to ensure compliance with requirements of its Public Health Emergency Preparedness and Response Grant.
The Public Health Emergency Preparedness and Response Grant funds activities and supplies to help public health departments evaluate and coordinate responses to public health and other emergencies. It is passed through to the County by the state Department of Health through reimbursements. Federal law and grant rules require recipients of federal funds to establish and follow internal controls to ensure program requirements are followed. These controls include knowledge of grant requirements and monitoring of program activities. During 2009, the County charged $3,396,423 to the grant and the SAO found weaknesses in internal controls and noncompliance with a number of federal requirements mainly related to allowable cost principles and cash management. The County partially or wholly agreed with these findings and recommendations to account for fringe benefits and paid time off consistent with grant requirements and more frequent monitoring of grant expenditures. The County has made or is making corrections to their internal control processes.

The County does not have adequate internal controls over reporting and did not comply with reporting requirements for the Special Supplemental Nutrition Program for Women, Infants and Children.

The Special Supplemental Nutrition Program for Women, Infants and Children (WIC) provides supplemental nutritious foods, nutrition education, and referrals to health care for low-income people during critical periods of growth and development. In 2009, the County charged $4,870,683 to this federal program. Each year, the County must submit an expenditure report to the state that identifies the costs it incurred in administering the WIC program in a number of categories for the October through September fiscal year. The SAO found the County lacked internal controls to ensure it completed the required time study and expenditure report on time. The County agreed with these findings and has initiated corrective action to ensure timely reporting per grant requirements.

King County’s internal controls were inadequate to ensure compliance with federal grant requirements of the Homeland Security Grant Program.

The Homeland Security Grant Program provides support to state and local governments to prepare for, prevent, respond to, and recover from disasters. In 2009, the County spent $3.4 million of Homeland Security Grant Program funding it received through the state Military Department to pay for equipment, planning, training and exercises, management, and administration. The SAO found internal control weaknesses and noncompliance with the several federal requirements related to equipment management, reporting, and subrecipient monitoring. The County wholly or partially concurred with these findings and is taking steps to correct deficiencies in the three areas reported.

King County’s internal controls were inadequate to ensure compliance with requirements of its Child Support Enforcement Grant Program.

The Child Support Enforcement Grant Program enforces support obligations owed by non-custodial parents, locates absent parents, establishes paternity, and obtains child and spousal support. During 2009, the County charged $8,008,481 to the Child Support Enforcement Grant.
The SAO reviewed two of the four County departments that received the bulk of the grant money: the Prosecuting Attorney's Office and the Department of Judicial Administration. The SAO found the Department of Judicial Administration lacked adequate internal controls to ensure compliance with several grant reporting requirements. The County agreed with SAO's findings and recommendations and is taking steps to correct the reporting deficiencies.

**The County's internal controls are inadequate to ensure compliance with subrecipient monitoring requirements for the Community Development Block Grant Program.**

Community Development Block Grants provide money to provide housing and expanded economic opportunities, principally for persons of low and moderate income. The County spent $7,656,525 in federal funding under this program and paid $4,550,097 of this to 30 subrecipients. The County is responsible for ensuring subrecipients who spend $500,000 or more in federal money in a fiscal year have audits in accordance with Federal Office of Management and Budget (OMB) Circular A-133.

The SAO found that the County informed subrecipients who spent $500,000 or more in federal money that they were required to have an audit; however, County employees responsible for grant monitoring were unable to show these audits occurred. The SAO recommended the County establish internal controls that provide reasonable assurance that subrecipients who spend $500,000 or more in federal money during a fiscal year complete the required audits. The County disagreed that it did not have adequate internal controls to ensure compliance with subrecipient monitoring requirements for the Community Development Block Grant Program, but agreed that the documentation of certain review and confirmation procedures could be improved. The County is taking steps to improve that documentation.

**King County did not maintain adequate records to support expenditures charged to its Centers for Disease Control and Prevention Investigations and Technical Assistance Grant Program.**

The County received Centers for Disease Control and Prevention Investigations and Technical Assistance Grant funding which assists state and local health authorities and other health organizations in controlling communicable and chronic diseases and disorders, and preventable health conditions. The County spent $4,845,087 in federal funding under the program during fiscal year 2009. Of this amount, $1,767,470 was reported for the Emergency Preparedness and Response program. The SAO found that several transactions charged to the grant for payroll and benefits lacked required documentation and the County's method of allocating paid time off to the grant was inadequate to ensure charges are appropriate. The County partially agreed with the finding and is taking some steps to address the finding, in part, through implementation of a new payroll and general ledger system in 2012. The County stated it had adequate controls to track staff charging to federal grants and the SAO finding was an isolated incident since it was based on only 2 out of 45 employees.

**Accountability Audit Report**

On May 25, 2010, the SAO issued its annual Accountability Audit Report of King County, which identified findings and recommendations in seven areas which are discussed below. The SAO also made some "overarching conclusions" on the County's efforts to improve oversight and safeguards over cash receipts, expenditures, and assets. In many instances, the SAO found monitoring was insufficient to ensure policies are complete and that staff follows them. Such
lack of emphasis on accountability, SAO stated, opens the County up to greater risk of loss and less ability to control expenditures and increases the risk for noncompliance with laws, regulations, and contractual requirements.

(1) Waivers to bid requirements did not comply with County policy.

State law requires the County to make purchases on a competitive basis, with certain exceptions for specific reasons. County policies allow waivers for single source of supply and for purchases that involve special facilities or special market conditions. The SAO found that the County inappropriately applied special market conditions and special facilities conditions in order to waive bid requirements for consulting contracts let by the Departments of Public Health and Natural Resources and in another case involving a contract for office supplies. The County, however, disagreed with these findings and believed the waivers identified were issued in accordance with County policy.

(2) The County does not have adequate internal controls to ensure interfund transactions are appropriate, timely, and accounted for accurately.

The County Council has given the Executive Finance Committee the authority to administer interfund borrowing. The Committee adopts rules and procedures pertaining to loans between County funds. The rules and procedures provide the duration and interest rate to be charged on such loans. Committee members are the County Executive or designee, the County Finance Director, the County Budget Director, and the Chair of the County Council or designee. The County reported a year-end outstanding interfund loan balance of $154.4 million in 2009.

The SAO reported several findings related to interfund loans as well as an inadequate process to monitor cash balances in funds. The County disagreed that there is inadequate monitoring of fund cash balances and interfund loans and stated the SAO is holding the County accountable to an unreasonable and outdated Budget, Accounting, and Reporting System (BARS) Manual accounting standard. The County stated it does follow standard accounting practices related to such reporting. The County did agree to review its monthly reporting to ensure it reflects management’s intentions and to review the communication of loan status reports to the County Council. Since the BARS manual does not consider the pooled cash environment and this audit finding largely stems from the BARS manual, the County submitted a letter to SAO staff to request an update of the BARS manual, and included specific recommendations for the auditor’s consideration.

(3) The County’s controls are inadequate to ensure spouses, domestic partners, and dependents added to employees’ insurance benefit plans are valid.

Employees may add spouses, domestic partners, or dependents to their insurance plans when they are hired, during open enrollment, or within a certain number of days after events such as marriage or the birth or adoption of a child. Employees can add a spouse, domestic partner, or dependent by completing forms online or by submitting printed copies to the County’s Benefits, Payroll, and Retirement Operations Section.

The SAO issued a finding that the County’s procedures for verifying eligibility were inadequate and, therefore, the County cannot ensure all individuals receiving benefits are eligible. The County did not wholly disagree with this, but cited the costs associated with additional
verification. The County agreed to review its process in comparison with other large
governments in Washington and consider the benefits of requiring additional documentation.

In a separate communication with our office, a Finance and Business Operations Division
(FBOD) official said that the County, in 2012, after the implementation of a new payroll and
financial accounting system, plans to contract for a full audit of all covered employees and their
dependents—subject to County Executive and County Council approval during the 2012 budget
process. The audit would require proof of marriage, domestic partnership, children, and any
other dependents that meet the County’s benefit eligibility requirements. The official stated that
at the completion of the audit, the County will assess whether or not it is cost effective to collect
documentation or proof, on an ongoing basis.

(4) The King County Records and Licensing Department (Division) does not adequately monitor
employees who transfer vehicle and vessel titles.

In 2009, the County processed 16,876 vehicle and vessel title transfers as an agent of the state
Department of Licensing. During a 2007 audit, the SAO noted the lack of monitoring allowed a
licensing employee to process title transfer transactions for herself, family members, and friends
at below market value for at least one year leading to an estimated $2,300 in uncollected taxes.

The Department of Licensing has guidelines for supervisors and staff on ways to discourage
employees from processing transfers for their own vehicles and vessels or those of relatives
and friends. The SAO found in the 2009 audit that the County still is not monitoring these title
transfers. In response, the King County Licensing Division has issued new policies about
employees not processing personal title transactions and developed a process to track trends in
processing that would flag instances when an operator might be undervaluing a title transaction.

(5) The King County Elections Department lacks internal controls over cash receipting.

The SAO found that the Elections Department collected $258,060.49 during the audit period.
Candidate filing fees accounted for 51 percent of the receipts and the sale of the voter
registration database accounted for another 44 percent with miscellaneous receipts accounting
for the remainder. The funds were collected through an on-line candidate filing system, by
checks received through the mail by central accounting, and over the counter at the Elections
Department. During the audit period, the department collected $50,530 in checks and cash over
the counter.

The SAO identified several weaknesses in internal controls over cash handling at the Elections
Department. The County generally agreed with the findings and recommendations and has
taken steps to improve cash handling practices and procedures.

(6) The Sheriff’s Office does not have adequate internal controls over monitoring and recording
evidence for collected and forfeited property.

The Sheriff’s Office collects evidence and seizes property while investigating cases. All
evidence and property seized must be secured pending a court disposition or a determination
by the Sheriff’s Office. The Sheriff’s Office policy requires officers to comply with the
Washington State Patrol guidelines on weighing and packaging evidence; however, the
Washington State Patrol guidelines for external agency consideration do not provide specific
guidelines and criteria on weighing and packaging evidence. The SAO also identified findings related to cash handling and disposition of evidence.

The SAO found that the Sheriff’s Office’s lack of specific guidelines, criteria and monitoring resulted in discrepancies in the weighing and packaging of evidence. The Sheriff’s Office acknowledged it lacked a policy on weighing of suspected narcotics or drugs and agreed to make policy changes and improve internal controls to address this issue. The Sheriff’s Office also agreed to make changes related to evidence retention and making deposits from cash forfeitures in a timelier manner.

(7) The Sheriff’s Office does not have adequate internal controls over citations.

The Sheriff’s Office Records Unit receives approximately 38,000 issued traffic citations annually from deputies. The Sheriff’s Office General Orders Manual states citation books are to be locked in a secure location and issued only by a supervisor. The SAO examined 27 citation booklet receipt covers and found the receiving officer, not the supervisor, signed for them contrary to Sheriff’s Office policy. The Sheriff’s Office agreed to improve internal controls and implement changes to address the issue as well as enforce the codified requirement that only supervisors issue citation books.

**Public Transportation Enterprise Audit**

On October 11, 2010, the SAO issued its audit of King County’s Public Transportation Enterprise’s financial statements covering the period January 1, 2009 through December 31, 2009. The SAO found that the financial statements present fairly, in all material respects, the financial position of the King County Public Transportation Enterprise, as of December 31, 2009, and were in conformance with applicable accounting principles. The results of SAO’s tests disclosed no instances of noncompliance or other matters requiring disclosure under Government Auditing Standards.

**Water Quality Enterprise Audit**

The Water Quality Enterprise Fund (Water Quality) is included in King County’s financial statements, which in 2009 were audited by a CPA firm that provided its reports to the SAO. The CPA firm found material weaknesses in internal controls and a lack of formal documentation of accounting policies and procedures specific to Water Quality, which they believed had the potential to adversely affect the County’s ability to prepare accurate financial statements.

The CPA firm made three recommendations:

(1) That management develop and implement sound policies and procedures, particularly over industry specific and management estimate accounts.

(2) That Water Quality designate a fixed asset accountant for the purpose of reviewing and monitoring procedures surrounding construction work in progress and assets in service.

(3) That a financial manager be designated as responsible for performing a more robust review of correcting journal entries, reviewing monthly reconciliations and reviewing year-end balances to ensure account balances are appropriately reflected in the financial statements.
The County agreed with the findings and three recommendations and has taken steps to correct the problems. The County stated the errors have been corrected and, since the corrections mainly involved adjustments to fixed asset account classifications and depreciation expenses, there was no impact on either utility rates or bond reserve requirements. FBOD reports it is working with Water Quality staff to ensure proper reporting, oversight, and staff resources are available to address the issues raised in the audit.

**Notable 2009 Financial Changes**

Increasingly, costs for funding post employment health benefits for some former King County employees have been rising. King County has adopted the provisions of Governmental Accounting Standards Board (GASB) Statement 45, “Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.” GASB Statement 45 is an accounting and financial reporting provision requiring government employers to measure and report the liabilities associated with post-employment benefits other than pension (OPEB). OPEBs, for example, may include post-retirement medical, pharmacy, dental, vision, life insurance, long-term disability, or long-term care benefits that are not associated with a pension plan. In 2007, under GASB Statement 45, King County elected to record a $6.65-million liability for unfunded OPEBs and, in 2009, the recorded liability rose to $22.9 million.

**King County Auditor’s Office Recommendations**

We have no recommendations, nor are we monitoring any specific issues raised by the SAO, at this time.

Brian Estes, Senior Principal Management Auditor, conducted this review. Please contact Brian at 296-1313 or me at 296-1655 if you have any questions about the issues discussed in this management letter.

CB:BE:lo

cc: Carolyn Whalen, County Administrative Officer, Department of Executive Services (DES)  
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