

Administrative Policy No. 16.11

Subject:	External Audit and Questioned Costs
Information Contact:	External Audit Compliance Manager Office of the Secretary MS 45804, (360) 664-6027
Authorizing Source:	Office of Financial Management State Administrative and Accounting Manual (SAAM) 31 U.S. Code Chapter 75 - Requirements for Single Audits, §7501 - 7506 Title 2 CFR Part 200 - Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards
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Approved By:	<u>Original signed by Lori Melchiori</u> Senior Director, Office of Policy and Rules

Purpose

This policy supersedes AP 19.55.01 and establishes procedures for Department of Social and Health Services (DSHS) external audit functions, the duties of the audit committee for oversight of DSHS external audit activities and outlines the procedures for handling external audit findings, questioned costs, and completion of and monitoring of corrective action plans.

DSHS undergoes periodic examinations or audits of fiscal and administrative management to verify that funds and resources are used and reported in accordance with the appropriate methods prescribed by law, generally accepted accounting principles, and DSHS rules and regulations. These activities evaluate whether DSHS has adhered to applicable federal or state laws, rules, and its own policies and procedures, and properly accounts for public and federal funds.

Scope

This policy applies to all audits and reviews performed by external auditors for all DSHS programs and organizational units, as well as audits of DSHS contractors and service providers.

This policy does not apply to:

- Internal DSHS audits. For DSHS audits refer to [Administrative Policy 16.01](#).
- Employee overpayments. For employee overpayments refer to [Administrative Policy 19.25.01](#).
- Questioned costs identified via external or internal audits of DSHS contractors, clients, providers, and vendors.

Definitions

Audit - An independent and objective appraisal to examine or review the fair presentation of financial statements, economy and efficiency of operations, effectiveness of achieving program results, compliance with laws and regulations, and the detection of fraudulent activities. For purposes of this policy and procedure, audits include but are not limited to external reviews, site visits, desk audits, and fraud investigations.

Audit Committee - A committee designated to assist DSHS management in performing its oversight responsibilities as they relate to financial and other reporting practices, internal control, compliance with laws, regulations, ethics, and economy and efficiency of operations, financial reporting process, and DSHS' process for monitoring compliance with laws and regulations and the code of conduct. The committee consists of seven members: the DSHS secretary, chief of staff, deputy chief of staff, three assistant secretaries, and the chief risk officer as designated by the secretary.

Audit Finding – A deficiency which an auditor is required by federal regulations to report in the schedule of findings and questioned costs.

Audit Liaison - Each administration's point of contact for the routine management and functioning of external audit activities.

Corrective action plan (CAP) - A plan prepared by a division director or designee and approved by the administration's assistant secretary in response to an audit finding, which includes:

- Specific corrective actions the division will take to correct the audit, review, or survey finding
- Specific target dates by when the division will complete the corrective actions;
- Monthly updates to include action taken to-date; and
- The completion date for each action item.

DSHS - The Department of Social and Health Services (DSHS).

External audit – An audit conducted by an external agency not associated with the department that is voluntarily or involuntarily under audit.

- Any review or investigation regarding:

- Compliance, financial, or operational information,
- Safeguarding and verification of assets,
- Economical and efficient use of resources, and
- Effectiveness of operations or programs
- Results with an opinion on the organization's financial condition and financial reporting risks or assess the organization's compliance with applicable federal/state or industry-specific regulations, laws, and standards.
- Takes place within a defined set of rules or laws and there are strict requirements on auditors in evaluating internal controls and financial reporting.

External Audit Compliance Manager - The administrative officer responsible to oversee external audits and keeps the DSHS secretary and audit committee apprised.

Improper payment - Any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements.

Incorrect amounts - Overpayments or underpayments that are made to eligible recipients (including inappropriate denials of payment or service, any payment that does not account for credit for applicable discounts, payments that are for an incorrect amount, and duplicate payments). An improper payment also includes any payment that was made to an ineligible recipient or for an ineligible good or service, or payments for goods or services not received (except for such payments authorized by law).

Internal Auditors - Employees of the DSHS Internal Audit unit who conduct independent and objective assurance and audit consulting services within DSHS.

Program – The affected DSHS programs, including the division, office, or staff designated by the assistant secretary or division director as being responsible for compliance with this policy.

Questioned Costs – A cost that is questioned by the auditor because of an audit finding:

Which resulted from a violation or possible violation of a statute, regulation, or the terms and conditions of a Federal award, including for funds used to match Federal funds;

- Where the costs, at the time of the audit, are not supported by adequate documentation; or
- Where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.
- Questioned costs are not an improper payment until reviewed and confirmed to be improper as defined in OMB Circular A-123 appendix C.

Senior executives – Cabinet and subcabinet members of senior management including the secretary, assistant secretaries, and senior directors.

Single Audit – An organization-wide financial statement and federal awards’ audit of a non-federal entity that expends \$750,000 or more in federal funds in one year. It is intended to provide assurance to the federal government that a non-federal entity has adequate internal controls in place, and is generally in compliance with program requirements. Non-federal entities typically include states, local governments, Indian tribes, universities, and non-profit organizations. The Single Audit test model examines non-federal entity post-award reporting requirements under the Single Audit Act.

Policy Requirements

- A. Each administration will designate an audit liaison who will serve as the primary point of contact for audit activities.
 - a. Administrations will coordinate all audit activities for audits conducted by Federal Auditors.
 - b. Audit liaisons will notify the external audit compliance manager of federal audits and keep the external audit compliance manager apprised of audit progress and results.
 - B. DSHS staff will cooperate with and assist external auditors. If employees are contacted by an external auditor, they must notify their audit liaison.
 - C. To help ensure that external audit activity is coordinated, the external audit compliance manager must be informed of all external audit activity.
 - a. The external audit compliance manager will notify the appropriate audit liaison of external audits and coordinate through the liaisons for audit requests.
 - b. The external audit compliance manager will ensure an understanding of the objectives and scope of the audit, and assist the external auditors in achieving legitimate objectives with the least impact on DSHS operations.
- DSHS will provide external auditors with access to all records, physical properties, and personnel necessary to carry out the audit, except those deemed by DSHS to be legally privileged or protected. Availability of records is subject to DSHS record retention policies.
- D. DSHS will promptly follow-up and take corrective action on audit findings.
 - E. Corrective action plans must provide the name(s) of the contact person(s) responsible for corrective action, the corrective action planned, and the anticipated completion date. If the administration does not agree with the audit findings or believes corrective action is not required, then the corrective action plan must include an explanation and specific reasons. Administrations will:
 - a. Correct identified deficiencies (exceptions).
 - b. Implement recommended improvements or appropriate administrative or physical controls to resolve the noncompliance.

- c. Include follow-up and review system that evaluates the effectiveness of the corrective actions.

- F. Senior executives and DSHS cabinet members will notify the external audit compliance manager of any significant issues raised by external auditors, or any other audit agency or authority.

- G. The external audit compliance manager reports administratively to a senior executive in the Office of the Secretary and functionally to the DSHS audit committee.

- H. The external audit compliance manager will provide quarterly updates to the audit committee covering external audit activities.

- I. External auditors participating in external audit activities must maintain lawfully and professionally required levels of protection for the confidentiality and security of records and information.

- J. The audit committee ensures independence and objectivity in the prioritization and analysis of audit related issues, and provides reasonable assurance that management is exercising due professional care.
 - a. The Facilities, Finance, and Analytics Administration (FFAA) is the primary DSHS organization that processes financial adjustments resulting from audit activities. Administrations must notify FFAA when an external audit identifies questioned costs in the event funds need to accrue. There must be coordination between DSHS and the Health Care Authority (HCA) if Medicaid payments are involved. DSHS administrations may make their own financial adjustments and coordinate with FFAA as needed. For the Economic Services Administration, questioned costs will not be repaid until the audit resolution process is complete.
 - i. The National External Audit Review (NEAR) Center will review the independent auditor's report and make a determination to sustain the disallowance (questioned costs) or of no penalty.
 - ii. If the NEAR determination sustains the disallowance, DSHS may submit a request for reconsideration to the assistant secretary of the federal Administration for Children and Families (ACF).
 - iii. If DSHS disputes the assistant secretary's decision, it may file an appeal with the ACF Departmental Appeals Board (DAB). The DAB provides impartial, independent review of disputed decisions.

Roles and Responsibilities

The following is a general outline of the responsibilities of those involved in audits conducted under the scope of this policy. Due to the unique nature of each audit, the responsibilities listed below may not apply to all audits and some responsibilities may be delegated by the external audit compliance manager.

A. Audit committee

1. Provides oversight in the preparation for and follow-up to external audits of DSHS programs and services to help ensure the agency has a thoughtful, proactive, and coordinated approach to audits, consultations, and corrective action plans.
2. Provides independent assurance and advice to the DSHS senior executives on the risk, control, and compliance framework and its financial reporting responsibilities.
3. Reviews evaluations of risk, control, and governance processes.
4. Reviews external audit results.
5. Serves as a mediator and resolve intra-agency audit disputes as needed.

B. External audit compliance manager

1. Directs and manages the work of external audit according to the United States Government Accountability Office of Government Auditing Standards.
2. Provides oversight and is a resource for external federal audits conducted by regulatory offices of funding sources.
3. Meets with senior management throughout the year to discuss ongoing audits.
4. Manages the external audit engagements.
 - a. Attends entrance and exit conferences.
 - b. Monitors all external audit activity.
 - c. Notifies DSHS's internal audit unit of all external audits.
 - d. Facilitates cooperation with external auditors in the performance of their duties and to avoid duplication of effort.
 - e. Coordinates with the external auditors on requests for specific information or to arrange interviews with personnel.
 - f. Coordinates with audit liaisons for meetings or documentation requests.
 - g. Reviews draft audit reports prior to issuance by the external audit entity.
 - h. Reviews and approves responses to audit reports prior to submission to the external audit entity.
 - i. Reviews the response to audit reports prior to submission to the audit liaison official.
 - j. Coordinates the distribution of all external audit reports and corrective action plans.
 - k. Monitors the implementation status of audit recommendations.
 - l. Advises appropriate members of executive management on the status of unresolved audit findings and progress on corrective action plans.
 - m. Retains all required external audit documents for a minimum of six years.
5. Meets quarterly with the audit committee to:
 - a. Provide a quarterly progress report on the status of external audits.
 - b. Communicate any significant issues related to external audit findings.
6. Reviews billings from external auditing entities.
 - a. Ensures hours billed are accurate.
 - b. Maintains records of length of audits, total hours, and amount billed.
7. Ensures there are data sharing agreements with external auditing entities.

- a. Works with Contracts and Legal Services to ensure the data sharing agreement is current.
 - b. Maintains a copy of the data sharing agreement.
 - c. Advises appropriate members of executive management of any known data breaches that occur with external auditing entities.
8. Ensures all counties and federally recognized tribes of Washington receive a single audit each year.
- a. Creates a spreadsheet to document the timing of the single audits and any findings that are made.
 - b. Works with the administrations and other state agencies to ensure findings are addressed with corrective action plans.
9. Professionalism
- a. Promotes an ethical culture in the profession of external auditing. A code of ethics is necessary and appropriate for the profession of auditing, founded as it is on the trust placed in its objective assurance about governance, risk management, and internal controls.
 - b. Respects the value and ownership of information received, and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.
 - c. Has no direct operational responsibility or authority over any of the activities audited.

C. Audit Liaisons

1. Audit liaisons are the primary points of contact for audit activities within the administration.
2. Notify the external audit compliance manager of federal external audits by a regulatory office or a funding source.
3. Manage audit activities within the administration.
 - a. Notify assistant secretary and division director(s) of upcoming audit
 - b. Coordinate and attend entrance and exit conferences.
 - c. Work with divisions to develop audit responses and CAPs
 - d. Submit approved responses and CAPs to the external audit compliance manager
 - e. Monitor and track CAPS through completion
 - f. Ensure timely and thorough completion of CAPs
 - g. Submit a certificate of completion of corrective action plan to the external audit compliance manager certifying the final correction of all audit findings within their administration.
 - h. Monitor all questioned costs and work with accounting teams to ensure funds are returned appropriately. The accounting team will notify FFAA of questioned costs in the event funds need to be accrued.
4. Maintain documentation supporting the resolution of questioned costs.
5. Maintain audit documentation

6. Keep the external audit compliance manager apprised of progress, issues/concerns, and resolution.

D. Assistant secretaries

1. Approve responses to the external audit compliance manager for audit findings for their administration.
2. Approve all external audit CAPs for their administration.
3. Ensure completion of CAPs.
4. Sign a certificate of completion of corrective action plan certifying the final correction of all audit findings within their administration.

E. Division directors

1. Prepare and submit copies of their program's response to external audit findings to their audit liaison by requested deadlines.
2. Prepare and submit copies of their CAPs to their audit liaison by requested deadlines.
3. Oversee and perform corrective action(s) in response to external audits.
4. Report to their audit liaison on the action(s) taken to correct each finding.

F. FFA Office of Accounting Services (OAS)

1. Create accruals for questioned costs when requested by the administration.
2. Monitor accruals and coordinate with the administration through resolution of the questioned costs.

G. DSHS personnel

1. Provide assistance in fulfillment of external audit activities.
2. Consult with the external audit compliance manager or the administration's audit liaison when unsure about how certain information may relate to the audit or when having questions pertaining to the audit.
3. Contact the external audit compliance manager or audit liaisons regarding what information must be provided for the audit or if there are any questions pertaining to the audit.

Procedures

The audit process normally consists of the following phases:

A. Notification

DSHS receives communication, generally in the form of a letter, informing of an upcoming audit, review, site visit, desk audit, or fraud investigation and requesting documentation (e.g. organizational charts, system documentation, flow charts, financial records or statements).

- a. The external audit compliance manager must be notified immediately when an audit action is initiated by an external entity. This includes but is not limited to:
 - i. Single statewide audit;
 - ii. Whistleblower audits by the State Auditor's Office;
 - iii. Investigations of fraud by the State Auditor's Office

- b. Depending on the circumstances, audit coordination will occur with the relevant administration.
- c. The external audit compliance manager will notify senior executives as needed, but at a minimum the deputy chief of staff or chief of staff.

B. Entrance conference

The opening meeting includes management and administrative staff involved in the audit and is an opportunity to discuss the scope of the audit, available resources, and other concerns.

- a. The external audit compliance manager or audit liaison will attend the entrance conference to facilitate full communication of audit objectives, schedule, and protocol.
- b. Other attendees may vary depending on the type and scope of the audit.

C. Fieldwork

The auditor may interview staff, review procedure manuals and business processes, review statements and records, test compliance, and assess the adequacy of internal controls.

- a. The external audit compliance manager and/or audit liaison will schedule audit activities, monitor audit actions, and resolve audit-related concerns.
- b. Administrations must cooperate with the auditor to the extent requested; however, availability of records and responsible personnel and conflicts of scheduled activities will be negotiated as necessary where conflicts of priority arise. If problems occur which cannot be satisfactorily resolved, contact the external audit compliance manager. Records, except those deemed legally privileged or protected, must be provided to auditors and must stay within the identified documents and information outlined in the scope of the audit. The availability of records is subject to records retention policies, which allows destruction of records within prescribed limits.

D. Draft report

After all fieldwork is completed, the auditor will prepare a draft report that documents objectives, procedures, conclusions, and recommendations.

- a. The auditor, upon completion of work, will generally brief the appropriate administrative officials and the external audit compliance manager of any recommendations, findings, or problems noted during the course of the examination. At that time, the findings, recommendations and conclusions must be thoroughly discussed and any factual or incorrect items clarified. Discrepancies noted by the auditor and subsequently corrected by the administration may still be included in the final report.
- b. The external auditors will generally provide the external audit compliance manager a draft report to review before a final report is issued. Any disagreements on the items noted in the draft report between the examined area and the external auditor must be thoroughly discussed by the external audit

compliance manager or audit liaison, and if agreement cannot be reached, the audit liaison will contact the external audit compliance manager for further actions. DSHS will have a minimum number of days to review the draft report and provide any edits to the external auditor.

- c. If the finding contains questioned costs, the administration must determine the accuracy of the questioned costs. The administration will provide any additional research and data collection needed to support the program's position if variances are noted.
- d. The external audit compliance manager or audit liaison will attend the final briefing on the draft audit report. Depending upon the administration, several review meetings may be held at appropriate supervisory levels. Attendees may vary depending on the type and scope of the audit.
- e. After the last briefing on the draft audit report is conducted, the report will be prepared in final format. When a final draft is made available by the auditors, a copy will be presented to the External Audit Compliance Manager for final review who will then forward it on to the administration involved.
- f. When items of a serious nature or a repetition of a previous comment requiring corrective action are to be included within an external audit report, the external audit compliance manager will review the items with appropriate members of executive management.
- g. If a recommendation by an external auditor requires that DSHS invest additional or incremental resources to undertake corrective action or implement selected recommendations, the external audit compliance manager will, prior to final approval and official release, apprise appropriate members of executive management of the estimated resource commitment required by the recommendations. The external auditor's recommendations or DSHS's response in the audit report will reflect DSHS' agreement or refusal to make such a resource commitment.

E. Final audit report

Depending on the nature and scope of the audit, a report may or may not be provided to DSHS.

- a. The external audit compliance manager will receive a copy of the final audit report.
- b. The external audit compliance manager coordinates the distribution of the final audit report.

F. Responses to audit reports

The type of response that may be required by DSHS concerning the results of the audit will vary depending on the specific scope of the audit.

- a. The administrations involved will prepare a response to any audit finding or problems noted in the final report, indicating corrective action already taken or under review, and forward the response to the external audit compliance manager for review and inclusion in the formal audit response. Administrations

will have a minimum number of days to provide their response to the external audit compliance manager.

- b. The external audit compliance manager will prepare the formal audit response and coordinate the review by senior executives:
 - i. Senior director of communications;
 - ii. Deputy chief of staff;
 - iii. Chief of staff;
 - iv. Secretary
- c. The secretary reviews and approves all official responses to audit reports prior to submission to the audit entity.
- d. The formal audit response includes corrective actions to be taken by DSHS in response to any findings noted in the report.

G. Office of Financial Management (OFM)

OFM must maintain a system for tracking findings to provide information on the resolution of all findings contained in audits of state agencies and institutions, and must follow-up on audit findings, including compiling the Corrective Action Plan and Summary Schedule of Prior Audit Findings sections.

- a. The external audit compliance manager will summarize DSHS' internal CAP and formal response to the finding for OFM's use.
- b. The external audit compliance manager will work with OFM and the required administration in regards to any needed edits to the OFM CAP.

H. Exit conference

In the exit conference, management and the auditor review and discuss the report, provide feedback on implementing recommendations, discuss any other issues related to the audit, and comment on the audit process.

I. Audit recommendations and corrective action

The external auditor will provide recommendations for improvement or actions identified in the final report to resolve audit findings.

- a. Actions are to be completed by the audited administration. Upon completion, notify the external audit compliance manager.
- b. If questioned costs are included, the administration will work with granting authority to determine if the questioned costs must be returned.
 - i. When required, programs will coordinate with OAS for the resolution or return of all questioned costs. For Medicaid, programs must also work with HCA to ensure the return of questioned costs reported correctly on the CMS 64. 7.
 - ii. Programs must maintain all audit documentation.
- c. Questioned costs and liability accrual
 - i. All questioned costs may result in a liability accrual in GL 5113 – Potential Liabilities for the non-state share. OAS will ensure the liability is accrued if appropriate and both of the following conditions are met:

1. It is probable the program will have to return the funds.
 2. The amount of the questioned costs can be reasonably estimated by the affected program and OAS.
- d. Depending on the nature and severity of the recommendation or corrective action, DSHS may be asked to provide status reports of all unresolved audit findings to the external audit compliance manager.
 - e. The external audit compliance manager will notify the responsible administration, secretary, and audit committee of unresolved audit findings.
 - f. Every effort must be made to take corrective action and implement recommendations.
- J. Certificates of completion
- a. Once a corrective action plan is completed and questioned costs have been repaid, if required, the administration will complete a certificate of completion.
 - b. The certificate of completion declaring that actions have been completed and all funds have been repaid to grantors must be signed by the assistant secretary.
 - c. A signed completed corrective action plan and certificate of completion must be sent to the external audit compliance manager.
 - d. The external audit compliance manager will compile the audit finding, the CAP, and the COC and present them to the secretary or chief of staff for signature.