

**Washington State Auditor's Office**  
**Accountability Audit Report**

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**Department of Labor and Industries**

Audit Period  
July 1, 2006 through June 30, 2007

Report No. 6703

Issue Date  
**January 7, 2008**



WASHINGTON  
**BRIAN SONNTAG**  
STATE AUDITOR



**Washington State Auditor  
Brian Sonntag**

January 7, 2008

Ms. Judy Schurke, Director  
Department of Labor and Industries

***Report on Accountability***

Please find attached our report on the Department of Labor and Industries' accountability and compliance with state laws and regulations and its own policies and procedures.

We also perform an annual audit of the statewide basic financial statements as required by state law (RCW 43.09.310). We also annually audit federal programs administered by the state of Washington for compliance with federal laws and regulations. The results of these audits are published in reports issued by the Office of Financial Management.

Sincerely,

**BRIAN SONNTAG, CGFM**  
STATE AUDITOR

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# Audit Summary

## State of Washington Department of Labor and Industries

### ***ABOUT THE AUDIT***

This report contains the results of our independent accountability audit of the Department of Labor and Industries for the period from July 1, 2006, through June 30, 2007.

We evaluated internal controls and performed audit procedures on the financial activities of the Department. We also determined whether the Department complied with state laws and regulations and its own policies and procedures. Our work focused on specific areas that have potential for noncompliance, misappropriation or misuse of public resources.

### ***RESULTS***

In most areas, the Department complied with state laws and regulations and its own policies and procedures.

However, we identified conditions significant enough to report as findings:

- The Department did not comply with rules limiting payments for prescription medications dispensed to a 30-day supply.
- The Department did not adequately monitor claims when opioids were prescribed to injured workers.
- The Department's internal controls are inadequate to ensure warrants are safeguarded.
- The Department's Pension Payment System lacks adequate internal controls to ensure public resources are safeguarded.

We also noted certain matters that we communicated to Department management. We appreciate the Department's commitment to resolving these matters.

### ***RELATED REPORTS***

Our report on the workers' compensation funds actuarial assessments and financial statement audit will be issued by December 31, 2007, as required by state law (RCW 51.44.115).

Our opinion on the state of Washington's basic financial statements is included in the state's Comprehensive Annual Financial Report. That report is issued by the Office of Financial Management in December of each year.

In accordance with the Single Audit Act, we annually audit major federal programs administered by the state of Washington. Rather than perform a single audit of each agency, we audit the state as a whole. The results of that audit are published in a report issued by the Office of Financial Management.

In addition to these reports, we issued a report pursuant to the State Employee Whistleblower Act (RCW 42.40), which is available on our Web site.

## ***CLOSING REMARKS***

We appreciate the Department's prompt attention to resolving prior audit issues and its commitment to ensuring compliance with conditions reported in this audit. We also thank Department management and personnel for their assistance and cooperation.

# Description of the Department

## State of Washington Department of Labor and Industries

### ***ABOUT THE DEPARTMENT***

The Department of Labor and Industries delivers an array of services to the public. The Department helps employers meet safety and health standards and inspects workplaces for hazards. The Department administers the state's Worker's Compensation Program, which provides medical and limited wage replacement coverage to workers who suffer job-related injuries or illness. The Department also regulates self-insured employers, provides financial and medical help to victims of violent crimes, conducts electrical, elevator and boiler inspections, registers construction contractors, issues various licenses and enforces prevailing wage regulations. Its main source of revenue is industrial insurance premiums collected from employers.

The Department employs approximately 2,600 individuals at its headquarters building in Tumwater and 22 service centers across the state. The Department has an annual budget of approximately \$235 million.

### ***AUDIT HISTORY***

We audit the Department annually. The past five audits of the Department have resulted in 24 findings. During that period, the number of findings has ranged from two in 2006 to seven in 2003.

# Audit Areas Examined

## State of Washington Department of Labor and Industries

In keeping with general auditing practices, we do not examine every portion of the Department of Labor and Industries' financial activities during each audit. The areas examined were those representing the highest risk of noncompliance, misappropriation or misuse. The following areas were examined during this audit period:

### **ACCOUNTABILITY**

We evaluated the Department's accountability and compliance with certain state laws and regulations and its own policies in the following areas:

- Pension benefits (PPS)
- Medical benefits (MIPS)
- Fixed assets
- Crime victim's compensation
- Benefit Payment System (BPS)
- Automated Purchasing System
- Employer accounts
- Returned warrants/mailroom
- Contracts
- Vocational rehabilitation
- Reconciliations between unique systems and Agency Financial Reporting System (AFRS)
- Agency Financial Reporting System user access
- Payments with pseudo or no vendor numbers
- Bad debt expense
- Specialty billings

### **FINANCIAL**

We contracted with a certified public accounting firm (CPA) to conduct an audit of the workers' compensation financial statements. The accounting firm issued an unqualified report concluding that the financial statements were fairly presented in accordance with generally accepted accounting principles.

We perform an annual audit of the statewide basic financial statements as required by state law (RCW 43.09.310). These financial statements are included in the Comprehensive Annual Financial Report (CAFR) prepared by and available from the Office of Financial Management. The CAFR reflects the financial activities of all funds, organizations, institutions, agencies, departments and offices that are part of the state's reporting entity.

We will review and rely on the CPA audit of the Department's account balances and financial activity related to:

- Insurance premiums
- Claims and judgments payable
- Insurance premiums and claims
- Other receivables

## ***FEDERAL PROGRAMS***

Federal grant audit work is performed on a statewide basis, in accordance with the revised Single Audit Act. We select federal programs for audit using risk-based criteria set forth in the U.S. Office of Management and Budget Circular A-133.

We evaluated internal controls and tested compliance with federal requirements, as applicable, for the following major federal programs at the Agency:

- Crime Victim's Compensation, CFDA 16.579
- Occupational Safety and Health Program, CFDA 17.503

# Schedule of Audit Findings and Responses

## State of Washington Department of Labor and Industries

**1. The Department did not comply with rules limiting payments for prescription medications dispensed to a 30-day supply.**

**Description of Condition**

During fiscal year 2007 the Department's Workers Compensation Program paid approximately \$25 million for prescription medications determined to be proper and necessary to treat accepted conditions of an injured worker's claim. To prevent overuse and abuse of these drugs, the Department is required to limit payments for prescriptions to a 30-day supply dispensed at one time. Payments for prescriptions are processed through the Department's medical point-of-sale system.

In reviewing payments made through the point-of-sale system between July 2006 and February 2007, we found more than \$1.1 million in payments were made for prescriptions that exceeded the 30-day limit. In some instances, prescriptions were filled for more than 300 days and in some instances, the number of days was not specified.

Some of the drugs paid for by the Department in excess of a 30-day supply were Schedule II controlled substances. Distribution of these drugs is carefully controlled and monitored by the U.S. Drug Enforcement Authority. Oral prescriptions of these drugs are allowable, but the supply is to be limited to 30 days per prescription. We found the Department was paying for long-term prescriptions of these medications:

Oxycodone and brand names	1,235 payments	\$129,761
Hydrocodone and brand names	1,391 payments	\$34,182
Morphine sulfate	307 payments	<u>\$22,060</u>
		<b>\$186,003</b>

**Cause of Condition**

The Department has no controls in place to suspend or reject bills when the amount supplied by providers to the injured worker is in excess of 30 days.

**Effect of Condition**

By not rejecting these payments, the Department was paying for bills that were not in compliance with state regulations.

**Recommendation**

We recommend the Department establish controls in the point-of-sale system to reject payments of pharmacy bills for prescriptions filled in excess of a 30-day supply.

## **Department's Response**

*L&I concurs with the overall findings that payments were made for prescriptions that exceeded the 30 day limit. The agency is now making changes to its bill payment system to correct this problem. Proper payment controls will be in effect January 1, 2008.*

## **Auditor's Remarks**

We appreciate the Department's commitment to resolve this issue. We will follow up during our next audit.

## **Applicable Laws and Regulations**

Washington Administrative Code 296-20-03011(1) states:

Amount dispensed. The department or self-insurer will pay for no more than a thirty-day supply of a medication dispensed at any one time.

The State of Washington Office of Financial Management's *State Administrative and Accounting Manual*, section 20.20.20a, states in part:

Each agency director is responsible for establishing and maintaining an effective system of internal control throughout the agency.

# Schedule of Audit Findings and Responses

## State of Washington Department of Labor and Industries

### 2. The Department does not adequately monitor claims when opioids are prescribed to injured workers.

#### Background

During fiscal year 2007, the Department's Workers Compensation Program paid approximately \$25 million for prescription medications determined to be proper and necessary to treat accepted conditions of an injured worker's claim. The rules governing opioid treatment and provider reporting requirements were developed by an advisory committee of state agency representatives and medical experts. Beginning in 2000, the Department began to pay for opioid prescriptions for pain relief. Among the compounds that fall within this class are morphine and codeine. Morphine is often used before or after surgery to alleviate severe pain. Codeine is used for milder pain. Other examples of opioids that are prescribed to alleviate pain include oxycodone, hydrocodone and meperidine. These drugs are known to be addictive should their use not be carefully monitored and controlled.

Claims managers are responsible for making authorization decisions for all conditions, procedures and prescription drugs prior to payment. Claims managers must decide to accept, temporarily allow or deny payment for medical treatment.

#### Description of Condition

We reviewed 75 claims, for which over \$780,000 for prescription opioids were paid for by the Department, and noted:

- Required provider initial reports, progress reports and treatment plans were not obtained for any of the claims reviewed.
- Claims managers did not properly approve, temporarily approve or deny payment for opioid prescriptions in 32 (43 percent) of the claims we reviewed. In four cases, payments for opioids were authorized indefinitely.

#### Cause of Condition

The Department did not adequately monitor claims to ensure providers were submitting required reports. In addition, claims managers did not follow Department policy requiring documentation of authorization decisions for opioids.

#### Effect of Condition

Without obtaining required reports and performing adequate monitoring, claim managers cannot reasonably assess whether payments for opioid prescriptions are proper and necessary.

## Recommendation

We recommend the Department ensure proper documentation is received to support payments for opioid prescriptions. We also recommend claims managers adequately monitor claims and document their authorization decisions as required by Department policy.

## Department's Response

*The Department actively reviewed the claims samples from the auditor's office and agrees that more appropriate monitoring and requests for required reports from attending doctors is needed. We are currently working with members of Health Services Analysis and the Office of the Medical Director to ensure stronger controls are in place for the authorization of this treatment.*

## Auditor's Remarks

We appreciate the Department's commitment to resolve these issues. We will follow up during our next audit.

## Applicable Laws and Regulations

Washington Administrative Code 296-20-03019 states:

Chronic, non-cancer pain may develop after an acute injury episode. It is defined as pain that typically persists beyond two to four months following the injury.

The department or self-insurer may pay for oral opioids for the treatment of chronic, non-cancer pain caused by an accepted condition when that treatment is proper and necessary.

Washington Administrative Code 296-20-03020 states:

No later than thirty days after the attending physician begins treating the worker with opioids for chronic, non-cancer pain, the attending physician must submit a written report to the department or self-insurer in order for the department or self-insurer to pay for such treatment. The written report must include the following:

- A treatment plan with time-limited goals;
- A consideration of relevant prior medical history;
- A summary of conservative care rendered to the worker that focused on reactivation and return to work;
- A statement on why prior or alternative conservative measures may have failed or are not appropriate as sole treatment;
- A summary of any consultations that have been obtained, particularly those that have addressed factors that may be barriers to recovery;
- A statement that the attending physician has conducted appropriate screening for factors that may significantly increase the risk of abuse or adverse outcomes (e.g., a history of alcohol or other substance abuse); and
- An opioid treatment agreement that has been signed by the worker and the attending physician. This agreement must be renewed every six months. The

treatment agreement must outline the risks and benefits of opioid use, the conditions under which opioids will be prescribed, the physician's need to document overall improvement in pain and function, and the worker's responsibilities.

Washington Administrative Code 296-20-03021 states:

In addition to the general documentation required by the department or self-insurer, the attending physician must submit the following information at least every sixty days when treating with opioids:

- Documentation of drug screenings, consultations, and all other treatment trials;
- Documentation of outcomes and responses, including pain intensity and functional levels; and
- Any modifications to the treatment plan.

The physician must use a form developed by the department, or a substantially equivalent form, to document the patient's improvement in pain intensity and functional levels. This form may be included as part of a sixty-day report.

Washington Administrative Code 296-20-03022 states:

The department or self-insurer will continue to pay for treatment with opioids so long as the physician documents:

- Substantial reduction of the patient's pain intensity; and
- Continuing substantial improvement in the patient's function.

Once the worker's condition has reached maximum medical improvement, further treatment with opioids is not payable. Opioid treatment for chronic, non-cancer pain past the first three months of such treatment without documentation of substantial improvement is presumed to be not proper and necessary.

Washington Administrative Code 296-20-03023 states:

Payment for opioid medications may be denied in any of the following circumstances:

- Absent or inadequate documentation;
- Noncompliance with the treatment plan;
- Pain and functional status have not substantially improved after three months of opioid treatment; or
- Evidence of misuse or abuse of the opioid medication or other drugs, or noncompliance with the attending physician's request for a drug screen.

Washington Administrative Code 296-20-03024 states

The department or self-insurer may pay for non-opioid medication for the treatment of chronic, non-cancer pain when it is proper and necessary.

For example, some drugs such as anti-convulsants, anti-depressants, and others have been demonstrated to be useful in the treatment of chronic pain and may be approved when proper and necessary.

The State of Washington Office of Financial Management's *State Administrative and Accounting Manual*, section 20.20.20a, states in part:

Each agency director is responsible for establishing and maintaining an effective system of internal control throughout the agency.

# Schedule of Audit Findings and Responses

## State of Washington Department of Labor and Industries

### 3. The Department's internal controls are inadequate to ensure warrants are safeguarded.

#### Background

The Department routinely receives warrants that are returned due to an incorrect address or damage that occurred during delivery. Warrants issued for non-routine transactions, such as first-time pension payments and credit balances on employer accounts, also are returned to the Department after they are printed by the Department of Information Services.

In May 2007, the Department notified our office of a suspected loss of public funds involving returned warrants.

#### Description of Condition

During our review of internal controls over returned warrants we noted:

- Warrants received in the mailroom were not always opened by two employees and logged. In addition, warrants sometimes were put aside for several hours before being processed. Department policy requires two employees to open the mail, immediately log the warrants and sign the returned warrant log.
- The combination to the safe where warrants are held overnight has not been changed since 1991. Department policy states the combination should be changed at least once per year.
- More than 100 employees or contractors had key-card access to the mailroom.
- Entries in the safe log did not always provide a clear audit trail of who deposited and removed items. In addition, the log was not reviewed by a supervisor or kept in a secured location.
- Returned warrants distributed to the Department's program offices were not always logged and safeguarded. In addition, returned warrants for one program were primarily handled by an employee who also had the ability to create and release payments.

#### Cause of Condition

During the audit period there were not Department policies and procedures in place directing staff in how to adequately safeguard returned warrants.

## Effect of Condition

The Department identified seven warrants that were misappropriated, totaling \$8,961. In addition, the Department could not assign responsibility for one other missing warrant totaling \$340,000. This warrant has not been redeemed, but could not be accounted for by the Department. The warrant was subsequently cancelled with assistance from the State Treasurer's Office.

## Recommendation

We recommend that the Department:

- Establish and follow procedures to ensure a clear chain of custody is maintained when warrants are returned and circulated through the building.
- Ensure that warrants are not returned to employees who also have the ability to initiate and/or release payments.
- Ensure mailroom staff is following Department policy.
- Restrict access to the mailroom to only those employees who work in the mailroom.

## Department's Response

*We concur with most of the audit conditions and recommendations. The agency is already working on or has implemented corrective actions.*

- *The mailroom supervisors will monitor operations to ensure the staff is in compliance with agency policies. Since June 27, 2007, all returned warrants are being opened and logged in the mailroom by two employees as soon as they are received from Consolidated Mail Services. Completed logs are reviewed and approved by one of the mailroom supervisors. Individual program logs are also reviewed and approved by the programs subsequently receiving the returned warrants. Mail room staff have reviewed all relevant agency policies and procedures.*
- *The safe combination was changed on August 9, 2007, following the change in supervisors. It was again changed December 4, 2007. In the future, it will be changed when staff changes and at a minimum annually. It will be changed more frequently if deemed advisable.*
- *We partially disagree with the recommendation. Due to business requirements, it is necessary that individuals other than mailroom staff have access. On March 9, 2007, the mailroom was secured with the installation of cardkey readers. Access is limited and monitored. A list of all employees and vendors with access to the mailroom has been obtained from Washington State Patrol. The list is currently being reviewed and will be restricted to staff and personnel critical to the business and operational needs of the agency.*
- *On August 9, 2007, a safe log was established. It will be reviewed daily by the supervisor and kept secured after hours.*
- *The agency is currently developing a new process that will centralize processing of all returned warrants rather than them being distributed to individual programs.*

## **Auditor's Remarks**

We appreciate the Department's commitment to resolve these issues. We will follow up on this issue during our next audit.

## **Applicable Laws and Regulations**

RCW 43.09.185 states:

State agencies and local governments shall immediately report to the state auditor's office known or suspected loss of public funds or assets or other illegal activity.

The State of Washington Office of Financial *Management's State Administrative and Accounting Manual*, section 20.20.20a, states in part:

Each agency director is responsible for establishing and maintaining an effective system of internal control throughout the agency.

# Schedule of Audit Findings and Responses

## State of Washington Department of Labor and Industries

### 4. The Department's Pension Payment System's internal controls are inadequate to ensure public resources are safeguarded.

#### Background

The Department's Pension Payment System is used to track and process pension payments issued to permanently disabled workers. The system processes more than \$500 million in benefits each year.

#### Description of Condition

We first reported the system's lack of adequate internal controls in fiscal year 2004. Since then, the Department has addressed many of our concerns, including increasing its review of account changes and restricting user access. During the current audit, we noted some deficiencies have not been addressed:

- The system does not calculate pension benefits. Department staff manually calculates benefits, which increases the risk of overpayments or underpayments. In addition, an independent review is not conducted for all manual pension calculations to ensure they are correct.
- All one-time pension payments are not independently reviewed. Only 20 percent of payments under \$25,000 are subject to review.
- System security is not adequate.

#### Cause of Condition

The Pension Payment System is a legacy system, implemented in 1993, without adequate internal controls. Due to the lack of available resources, the Department has not yet made system programming changes to eliminate the system weaknesses.

#### Effect of Condition

The system weaknesses increase the risk that payments could be made to people who are no longer eligible for benefits. Additionally, the weaknesses increase the risk that inappropriate payments, due to error or misappropriation, could occur.

#### Recommendation

We recommend the Department strengthen its internal controls over the Pension Payment System.

## **Department's Response**

*The Department agrees with the auditor's findings, in part. The Department has taken steps towards the automation of manual calculation of pension benefits and implemented the following system and procedural changes to address this finding:*

*In January 2007, the Department began defining business rules, staffing needs and programming effects for the development of an automated calculation benefits system for the Pension Section. The automated calculation system endeavor is underway. Due to the magnitude and complexity of the system changes required, they will be implemented in phases. The first phase will be implemented by December 31, 2007.*

*In regards to the one-time pension payments, we acknowledge the concerns with the lack of internal controls, but with the constraints of the program's limited resources, it is not feasible to have all one-time payments under \$25,000 reviewed and approved at this time.*

## **Auditor's Remarks**

We appreciate the Department's willingness to make significant improvements to the system. We reaffirm our recommendation that all one-time payments should be reviewed and approved.

We will review the Department's progress during our next audit.

## **Applicable Laws and Regulations**

The State of Washington Office of Financial Management's *State Administrative and Accounting Manual*, section 20.20.20a, states in part:

Each agency director is responsible for establishing and maintaining an effective system of internal control throughout the agency.

# Status of Prior Audit Findings

## State of Washington Department of Labor and Industries

The status of findings contained in the prior years' audit reports of the Department of Labor and Industries is provided below:

1. **The Department of Labor and Industries pension payment system lacks adequate internal controls to ensure public resources are safeguarded.**

Statewide Accountability Report, dated July 20, 2007

### **Background**

During our audit of the Pension Payment System, we noted multiple weaknesses related to inadequate internal controls and system security.

### **Status**

These weaknesses have not been resolved. As a result, we are repeating this finding in our current accountability audit report for the Department.

2. **The Department of Labor and Industries Crime Victim's Compensation Program lacks adequate internal controls to ensure public resources are safeguarded.**

Statewide Accountability Report, dated July 20, 2007

### **Background**

During our audit of the Crime Victim's Compensation Program's controls, we found significant weaknesses that led to a misappropriation of over \$400,000.

### **Status**

These weaknesses have been resolved.



## **ABOUT THE STATE AUDITOR'S OFFICE**

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The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

Our mission is to work in cooperation with our audit clients and citizens as an advocate for government accountability. As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

The State Auditor's Office has 300 employees who are located around the state to deliver our services effectively and efficiently. Approximately 65 percent of our staff are certified public accountants or hold other certifications and advanced degrees.

Our regular audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. We also perform fraud and whistleblower investigations. In addition, we have the authority to conduct performance audits of state agencies and local governments.

The results of our audits are widely distributed through a variety of reports, which are available on our Web site. We continue to refine our reporting efforts to ensure the results of our audits are useful and understandable.

We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive program to coordinate audit efficiency and to ensure high-quality audits.

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**Ted Rutt**  
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**Chuck Pfeil, CPA**  
**Linda Long, CPA, CGFM**  
**Jim Brittain, CPA**  
**Jan Jutte**  
**Mike Murphy**  
**Mindy Chambers**  
**Mary Leider**  
**(360) 902-0370**  
**(866) 902-3900**

**Web Site**

**[www.sao.wa.gov](http://www.sao.wa.gov)**