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**STATE OF RHODE ISLAND  
AND PROVIDENCE PLANTATIONS**

**Findings and Management Comments  
Audit of the Fiscal 2015  
Financial Statements**

Dennis E. Hoyle, CPA  
Auditor General

State of Rhode Island and Providence Plantations  
General Assembly  
Office of the Auditor General

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# Office of the Auditor General

State of Rhode Island and Providence Plantations - General Assembly  
Dennis E. Hoyle, CPA - Auditor General

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March 17, 2016

Finance Committee of the House of Representatives and  
Joint Committee on Legislative Services, General Assembly  
State of Rhode Island and Providence Plantations:

We have audited the financial statements of the State of Rhode Island for the year ended June 30, 2015 and have issued our report thereon dated December 17, 2015 (as included in the State's Comprehensive Annual Financial Report for fiscal 2015).

This communication includes findings and management comments resulting from our audit of the financial statements as categorized below:

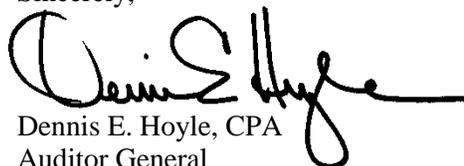
- 5 strategic issue findings related to information technology, financial operations, the internal control framework, and the OMB's role in overseeing federal program activity;
- 15 findings considered significant deficiencies or material weaknesses in internal control over financial reporting;
- 3 findings concerning compliance or other matters required to be reported by *Government Auditing Standards*;
- 8 findings reported by the auditors of component units; and
- 17 management comments – less significant issues that still warrant the attention of management.

As required by *Government Auditing Standards*, we have also prepared a report, dated December 17, 2015 and included herein, on our consideration of the State's internal control over financial reporting, its compliance with certain provisions of laws, regulations and contracts, and other matters required to be reported by those standards.

The State's management has provided their comments and planned corrective actions, which have been included herein, relative to these findings and management comments.

Other findings and recommendations related to the State's administration of federal programs will be issued separately in the State's *Single Audit Report* for the fiscal year ended June 30, 2015.

Sincerely,



Dennis E. Hoyle, CPA  
Auditor General

# State of Rhode Island and Providence Plantations

## Findings and Management Comments Audit of the Fiscal 2015 Financial Statements

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The State must develop a strategic plan to complete the Enterprise Resource Planning (ERP) system and address business continuity risks resulting from certain critical legacy systems such as the payroll system used to process employee payroll totaling \$1 billion annually. Overall, the State has not sufficiently addressed information technology (IT) security risks, an increasing concern given the State's very complex computing environment. These broader strategic issues, as well as weaknesses identified in the State's internal control over financial reporting, result from our annual audit of the State's financial statements for the year ended June 30, 2015.

The State's management has responsibility for, and maintains internal control over, financial reporting. *Government Auditing Standards* require that we communicate deficiencies in internal control over financial reporting based on our audit.

**Strategic issue findings** result from matters we observe during the audit that are generally broader in scope and may require a strategic planning focus to address the issues identified.

A **deficiency in internal control** exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

Control deficiencies classified as **material weaknesses** represent a higher likelihood that a material misstatement could occur and not be prevented or detected than those findings classified as **significant deficiencies**.

**Other compliance matters** involve issues regarding compliance with State or federal law or other matters required to be communicated by *Government Auditing Standards*.

**Management comments** are matters not meeting the above criteria but still warrant the attention of management. These include opportunities to enhance controls or result in other operational efficiencies.

The newly categorized strategic issue findings are generally conditions that have existed for several years and will likely require additional IT investment. Developing new or enhancing existing systems demands significant monetary and technical resources. RIFANS, the State's centralized accounting system is largely effective and reliable for the functionalities that are operational; however, there is substantial opportunity for further efficiencies through completion of the State's (ERP) system.

One of the impediments to completing RIFANS has been the lack of a sufficient and consistent funding mechanism. The Information Technology Investment Fund (ITIF), created by section 42-11-2.5 of the General Laws, could be used to continue the development of RIFANS. The availability of funding from the ITIF should be an important element of an overall strategic plan to complete RIFANS and other mission critical financial systems.

The State needs to ensure its IT security policies and procedures are current and well communicated. A complete assessment of compliance for all IT applications and systems should be performed prioritizing those deemed to pose the most significant operational risk.

The Department of Transportation's use of multiple systems to meet its operational and financial reporting objectives results in unnecessary complexity and control weaknesses since these systems were never designed to share data.

The State's Office of Management and Budget (OMB) has not fully addressed all the required functionalities outlined in the General Laws regarding oversight of federal grants within the State.

The State should apply the principles contained in the revised internal control framework (COSO and GAO Green Book) for evaluating and documenting the State's system of internal controls designed to safeguard public resources and provide accurate financial reporting.

Certain standard IT control processes, such as program change control, have not been implemented uniformly on an organization-wide basis. The State did not perform a recommended test of its disaster recovery plan during fiscal 2015 due to funding concerns. Annual tests of the disaster recovery plan are critical to ensure that operations can be restored in the event of a disaster or disruption of service.

Medicaid managed care organizations (MCOs) were overpaid more than \$200 million due to overstated capitation rates for the Medicaid expansion population - approximately \$133 million remained due to the State at June 30, 2015. Due to contract provisions in effect during fiscal 2015, the MCOs will be allowed to keep a portion of the excess capitation payments. Gain share provisions in the contract were intended to reward the MCOs for overall cost efficiencies attained through enhanced case management, preventative care, and enhanced coordination of services. The significant amounts due back to the State, in this instance, resulted from excessive capitation amounts and not from efficiencies achieved by the MCOs.

Certain Division of Motor Vehicles' revenues/receipts were not recorded during fiscal 2015. Monitoring and reconciliation procedures should be enhanced to ensure timely recording of all revenues and cash receipts.

Certain duties performed by the Office of the General Treasurer are not adequately segregated resulting in control deficiencies. Statewide accounting controls over receivables can be enhanced.

Due to an error by the State's trustee, the State missed a scheduled debt service payment which resulted in a technical event of default. Because the potential consequence of any default, technical or otherwise, is severe and could affect the State's reputation in the financial markets, a review of existing procedures is necessary to ensure adequate safeguards are in place to prompt timely remittance of all required debt service.

The Unemployment Insurance benefit application system has deficient (1) user administration security controls and (2) access controls for its user group, which has led to segregation of duties concerns. System user roles do not match the level of access employees should be assigned based on their job title/description resulting in the ability to modify data within claimant applications without supervisory review or approval.

We have also included control deficiencies and material noncompliance reported by the independent auditors of component units (e.g., Met School, Central Falls School District, Rhode Island Turnpike and Bridge Authority, and the Convention Center Authority) included within the State's financial statements. While their financial activity is reported within the State's CAFR, their accounting and control procedures are generally independent of the State's control procedures.

Our report also includes 17 management comments, which are less significant findings that highlight financial-related operational, policy or accounting control matters. These address accounting for DCYF trust funds, accumulating data for the disclosure of significant commitments, monitoring of internal service funds, authorized bank signatories, accounting for federal disaster declarations and recoveries, subrecipient monitoring and other accounting and financial reporting issues.

Management's response to the findings and management comments and planned corrective actions are included in our report.

2015



***Strategic Issue  
Findings***

**Strategic Issue Finding 2015-001**

*(repeat finding)*

**STRATEGIC AND BUSINESS CONTINUITY PLANNING FOR CRITICAL FINANCIAL  
COMPUTER SYSTEMS**

**The State lacks a strategic plan to (1) complete its implementation of a comprehensive Enterprise Resource Planning (ERP) financial system, which began in 2001, and (2) ensure that critical legacy financial systems, such as the payroll system, which pose a business continuity risk, will be available to support State operations.**

The Rhode Island Financial and Accounting Network System (RIFANS) is used to meet the State's accounting and financial reporting responsibilities. RIFANS, utilizing the Oracle E-Business Suite, was intended as a comprehensive, integrated ERP system for the State. The intent of an ERP system is to optimize integration thereby enhancing efficiency.

The State purchased multiple modules within the Oracle E-Business Suite but has not implemented certain modules (e.g., human resources, grants and projects, and human resources benefits). Completion of the system has stalled over the years due to (1) lack of committed financial resources, (2) skepticism and uncertainty that the Oracle modules are the desired solution, and (3) inability to attract and retain Oracle trained personnel to maintain/implement existing or additional system functionalities.

Because the ERP system is incomplete, important functionalities are currently met either through legacy systems or through multiple departmental processes without the intended integration and efficiencies. This results in business continuity risk, decreased efficiency and effectiveness, and control weaknesses.

Despite the acknowledged challenges in advancing or completing the ERP system, the importance of these functionalities to overall State operations requires continued attention. Significant costs are likely to be incurred replacing or improving the individual departmental systems, many of which are unsupported, utilize outdated legacy account structures, and lack the benefits of widely available technology. These costs must be evaluated against comprehensive, uniform ERP solutions.

Some of the State's critical systems utilize outdated technology which makes these operations vulnerable from a business continuity and systems security perspective. Certain legacy systems utilize software that is no longer supported and the availability of skilled personnel to work on the systems is limited.

The State's payroll system is a key example of a critical computer system that results in business continuity risk. The payroll system processes payroll for over 14,000 employees totaling more than \$1 billion in fiscal 2015 and meets the provisions of 100 separate collective bargaining agreements as well as contributions to health and pension benefit plans and other required withholdings. The payroll system utilizes outdated technology and is maintained by a very small group of employees. It still utilizes a legacy account structure that was replaced upon implementation of RIFANS. External support for the system, if required, would largely be unavailable. Documentation of the system has not been maintained consistent with current IT standards further challenging consideration of external support or development of a replacement system.

Implementing a new payroll system that meets current information technology standards would be a significant challenge and undertaking; however, planning for that eventuality is necessary. Payroll processing alone is a critical functionality that should be better integrated into the ERP system. Further, conversion to a modern platform is needed to allow other integrated functionalities to progress such as grants and project management and cost allocation.

While RIFANS is largely effective and reliable for the functionalities that are operational, there is substantial need and opportunity for further efficiencies to be accomplished through completion of the ERP system. Inefficiencies result when departments pursue individual solutions to their needs, where a comprehensive ERP solution could yield a uniform, more efficient, and overall cost-effective solution. For example, the Executive Office of Health and Human Services engaged a consultant to develop a cost allocation plan and process just for its Medicaid program operations.

Because both the financial and technical personnel resources necessary to complete the ERP system as originally envisioned are scarce, the State has been understandably reluctant to proceed. Further, the challenge in attracting qualified technical employees to support or assist in the implementation of new IT projects has the State considering outsourcing to meet these needs. The potential loss of integration and weakened controls that would result if various functionalities are outsourced and are not resident within the ERP system must be adequately considered.

A comprehensive strategic plan, consistent with the vision of an integrated ERP system, should be prepared. The strategic vision for the ERP system and other mission critical financial systems must resolve the continuing skepticism and uncertainty regarding whether completion of the ERP system by implementing additional Oracle modules is the desired solution. Regardless, the plan must ensure that the desired integration aspects of the ERP system can be met. Many of the ERP functionalities pending implementation are interdependent. Consequently, implementing these functionalities is challenging and requires a coordinated timeline. Further, due to the significant scope of the remaining components, adequate resources must be identified and committed to the tasks.

One of the impediments to completing RIFANS has been the lack of a sufficient and consistent funding mechanism. The Information Technology Investment Fund (ITIF), created by section 42-11-2.5 of the General Laws, could be used to continue the development of RIFANS. The ITIF (a restricted receipt account within the General Fund) receives the proceeds of land sales and other dedicated receipts. The balance in the fund at June 30, 2015 totaled \$26.2 million. We observed that projects financed thus far are generally smaller in scope, however, a recent project to implement a uniform time and effort data collection system for state employees is being funded through the ITIF. Data was not available to determine how much of the June 30, 2015 balance is already committed for projects or remains available for future projects. The availability of funding from the ITIF should be an important element of an overall strategic plan to complete RIFANS and other mission critical financial systems.

#### RECOMMENDATION

2015-001      Develop and implement a comprehensive strategic plan to address the completion of the State's ERP system and the business continuity risk presented by critical legacy financial systems. Identify the resources needed (personnel and financial) to either a) support a fully-integrated State ERP system or b) transition to and monitor systems or functions outsourced by the State.

#### Corrective action plan / auditee views:

*Realizing the need to complete a comprehensive ERP system, the Department has begun the process of delivering new systems to complete this vision based on a Software as a Service (SAS) model to integrate with our current payroll, personnel and financial systems. This includes a new time and attendance system that is currently scheduled to be delivered in phases starting in the first quarter of 2017. This new system will be supported by an outside vendor and will be able to integrate with our current payroll system and also be able to integrate with future payroll and HRIS systems.*

*The Department also utilized the SAS model to implement an employee recruiting model which went live in FY 16. The Neogov service is supported by an outside vendor and utilized as a SAS.*

*In early FY17, the department will also be rolling out learning management system (LMS) statewide. This will also be delivered by an outside vendor and be purchased as a SAS.*

*DoIT and ODE will be developing a comprehensive strategic plan to address our current payroll, personnel and financial systems. This plan will address how to best replace our current systems with our newly purchased SAS modules. The plan will also identify what other modules will be needed to complete a comprehensive ERP system along with a timeline to implement the new vision.*

*Anticipated Completion Date: September 30, 2016*

*Contact Person: Thom Guertin, Chief Digital Officer  
Phone: 401.574.9219*

**Strategic Issue Finding 2015-002**

*(repeat finding)*

**COMPREHENSIVE INFORMATION SYSTEMS SECURITY POLICIES AND PROCEDURES**

**The State needs to ensure its IT security policies and procedures are current and well communicated. A complete assessment of compliance for all IT applications and systems should be performed prioritizing those deemed to pose the most significant operational risk.**

The Division of Information Technology (DoIT) within the Department of Administration (DOA) has responsibility for the State's varied and complex information systems. This includes ensuring that appropriate security measures are operational over each system and the State's information networks. Information security is critically important to ensure that information technology dependent operations continue uninterrupted and that sensitive data accumulated within State operations remains secure with access appropriately controlled.

The oversight and management of the State's information security program relies upon the implementation of DoIT's comprehensive information systems security plan that was finalized during fiscal 2006. The information systems security plan consists of detailed policies and procedures that are designed to safeguard all of the information contained within the State's critical systems. Many of these policies require updating to current standards, and other critical areas of the IT security plan need to be addressed with new policies.

The State has still not ensured that all of its critical information systems are compliant with these formalized policies and procedures. Due to the number and complexity of systems within state government, a risk-based approach should be implemented where those systems deemed most critical or most at risk are prioritized for assessment.

The State should contract for the performance of IT security compliance reviews of its mission critical systems until such time that sufficient internal resources are in place to ensure that the State can conduct such reviews on a periodic basis for all mission critical systems. In addition, new information systems or significant system modifications should be subjected to a formalized systems security certification by DoIT or an external IT security consultant prior to becoming operational.

Lastly, the State should make appropriate use of external system assessments and reviews whenever available. In many instances, State systems are operated by external parties or interface with external processing entities. These entities often provide Service Organization Controls (SOC) reports which typically include identification and testing of key controls within the application or organization. A number of these reports are available and should be accumulated and reviewed within DoIT as part of a risk-based approach to assessing and ensuring IT security compliance. This may assist in broadening the monitoring of the State's many systems in light of the minimal resources allocated to this function.

The State must evaluate each mission critical information system's compliance with formalized system security standards. This process will identify those mission critical systems that represent significant information system security risks within its operations. Once completed, the State should prepare a corrective action plan that prioritizes significant security risks identified and ensures that all security deficiencies are addressed in a timely manner.

### RECOMMENDATIONS

- 2015-002a Update existing policies and implement new policies where required to ensure DoIT's IT security policies and procedures conform to current standards and address all critical systems security vulnerabilities.
- 2015-002b Complete an initial assessment of compliance with systems security standards for the State's mission critical systems. Contract for the performance of IT security compliance reviews and accumulate and make use of available Service Organization Control reports, whenever available, to extend IT security monitoring of critical systems.
- 2015-002c Prepare a corrective action plan that prioritizes significant system security risks with the goal of achieving compliance of all significant State systems with DoIT's formalized system security standards.

#### Corrective action plan / auditee views:

*2015-002a - Department of Administration has identified a policy review committee and is in the process of undertaking policy review for all new policies. Some new policies have been implemented in 2015, and all have been published to an internal website accessible by all employees with access to computers. New policies have been written. Older policies have been reviewed and modified, and are currently undergoing review by the committee. Older policies will be deprecated by new ones.*

Anticipated Completion Date: December 30, 2016

*2015-002b - DoIT has automated tools available, purchased in 2015 that will help us automate the assessment of systems for compliance. These tools are already in use for some systems, and others will be rolled in on an ongoing basis. Other systems that require personnel to perform assessments may require the addition of FTEs due to their sensitive nature. In addition, we are examining partnering with a security firm, such as Dell Secureworks, to assist in some areas. A new policy, Security Planning Policy 10-18, requires all new systems to create and maintain a Systems Security Plan that identifies controls that ensure data security. We do, whenever possible, require that third party vendors provide us with SOC reports or equivalent.*

Anticipated Completion Date: December 30, 2016

2015-002-c - A policy that is currently up for review, the Risk Assessment Policy 10-25, requires that assessments be performed on all systems. Once this policy is in place and the results of the assessments are known, corrective action plans will be created on a per-system basis.

Anticipated Completion Date: June 30, 2016

Contact Person: Kurt Huhn, Chief Information Security Officer  
Phone: 401.462.4706

**Strategic Issue Finding 2015-003**

(repeat finding)

FINANCIAL REPORTING – INTERMODAL SURFACE TRANSPORTATION FUND – USE OF RI DEPARTMENT OF TRANSPORTATION FINANCIAL MANAGEMENT SYSTEM (FMS) AND RIFANS ACCOUNTING SYSTEM

**Use of two computer systems to account for the activities of the Intermodal Surface Transportation (IST) Fund is unduly complex.**

Financial statements for the Intermodal Surface Transportation (IST) Fund are prepared primarily from the State’s RIFANS accounting system; however, a significant amount of data required for financial reporting is also derived from RIDOT’s Financial Management System (FMS). Because these two accounting systems were not designed to easily share data, preparation of the annual financial statements for the IST Fund is unduly complex.

The RIDOT FMS is an integrated, multi-module system intended to meet RIDOT’s comprehensive project accounting needs, including purchasing, billing, construction management and general ledger functions. While the majority of RIDOT financial transactions originate in the FMS, the State’s accounting systems are used to process cash disbursements to vendors and employee payroll. A significant interrelationship exists between the two systems requiring each system to generate and transmit data files to complete various processing cycles. By design, all financial transactions (some in summary) are intended to be replicated within the State’s RIFANS accounting system. While recording transactions in two accounting systems is inherently duplicative, this would be less problematic if the configuration and accounting conventions were the same. For example:

- ❑ RIDOT FMS and RIFANS each utilize separate and distinct account structures, which necessitates mapping to “crosswalk” the two charts of accounts.
- ❑ Since no direct interface exists between the two systems, transmission files are utilized to transfer expenditure data between the RIDOT FMS and RIFANS to disburse vendor payments. Timing differences exist and have to be identified as part of the reconciliation process.
- ❑ RIDOT establishes and maintains purchase order balances on a detailed line item basis for the entire project duration; purchase order balances in RIFANS are in summary form and only for the amount expected to be expended during that fiscal year.
- ❑ Expenditures are recorded in the RIDOT FMS after disbursement in RIFANS; expenditures are recorded in RIFANS when entered and approved for payment.
- ❑ RIDOT FMS tracks activity at the project level as this is the level at which funding sources (e.g., federal, state and other) are determined and infrastructure or maintenance categorizations are made. RIFANS accumulates activity at the major program level (e.g., interstate highways).

In essence, the RIDOT FMS contains detailed project-level data which loses its project character when transmitted to RIFANS. However, the project-level data is needed for certain financial reporting purposes. When the project-level RIDOT FMS data is used, it must be reconciled and adjusted to conform to RIFANS accounting conventions. Various supplemental manual and reconciliation processes have been implemented to provide the information needed for financial reporting.

Due to the use of two separate accounting systems, RIDOT has implemented a process of reconciling RIDOT FMS to RIFANS on a monthly basis, as a control, to ensure both systems accurately reflect RIDOT activity. Specific areas of the reconciliation process have been automated but the cause for differences must be manually identified and corrected in the appropriate system.

An analysis should be performed to determine whether continued use of the two accounting systems in the current configuration is the best way to accomplish financial reporting for the IST Fund. Options include better aligning the design and configuration of the two systems or alternatively using the RIDOT FMS for financial reporting purposes rather than RIFANS. Recognizing that a significant investment has already been made and that further integration of the two systems would require additional investment, RIDOT should establish short-term and long-term goals for a more efficient process to yield reliable information in support of timely financial reporting. Addressing these issues should be part of the comprehensive strategic plan described in Finding 2015-001.

#### RECOMMENDATION

2015-003      Reevaluate the continued operation of two separate accounting systems to support financial reporting for the IST Fund. Establish short and long-term goals to ensure reliable information is available to support timely financial reporting.

#### Corrective action plan / auditee views:

*The Department will reevaluate the continued operation of two separate accounting systems to support financial reporting for the IST fund.*

*This will include an evaluation of the benefits and risks associated with each potential operational option (i.e., (a) maintaining the status quo; (b) enhancing the design and configuration of the two systems for better efficiency; (c) using FMS for financial reporting purposes; or (d) modifying RIFANS to accommodate RIDOT's project accounting needs, including upgrading the RIFANS purchasing module, implementing an integrated timekeeping system, and activating the RIFANS modules for Accounts Receivable and Grants.*

*It must also be emphasized that implementing any of the above-mentioned options, other than the status quo, will require a substantial dedication of staff resources (i.e., RIDOT Financial Management Office, State Controller's Office, DOIT, etc.), a significant investment of State funds, which are currently unavailable because of budgetary constraints, and a commitment that this initiative will be a top priority for the duration of the project..*

Anticipated Completion Date:    *To be determined.*

Contact Person:                      *Loren Doyle, Chief Financial Officer*  
*Phone: 401.222.6590*

**Strategic Issue Finding 2015-004***(repeat comment)*ADOPTION OF REVISED FRAMEWORK FOR COMPREHENSIVE DOCUMENTATION OF THE STATE'S INTERNAL CONTROL STRUCTURE

**The State should apply the principles contained in the revised internal control framework to evaluate and document the State's system of internal controls designed to safeguard public resources and support accurate financial reporting.**

The Committee of Sponsoring Organizations (COSO) designed a framework for internal control that consists of three categories of objectives – *operations, reporting and compliance* – and five components – *control environment, control activities, risk assessment, information and communication, and monitoring*. In 2013, COSO revised its framework, preserving an entity's responsibilities for the five components of internal control but expanding its guidance by setting 17 specific principles to be addressed for the five components, and updating the framework's discussion of the business and operating environment.

In an effort to tailor this framework to the public environment, in September 2014, the federal Government Accountability Office (GAO) issued an update to its "Green Book", *Standards for Internal Control in the Federal Government*. The "Green Book" is required for federal agencies as a basis for establishing effective internal control systems; however, it can be useful to other governments when applying the principles contained within the COSO internal control framework.

Implementation of the revised internal control framework presents opportunities for the State to reassess the design of its current control structure with particular regard to assessing risk and monitoring control results, both essential components of internal control. Further, given the complexity of the State's various information systems, effective controls for addressing the principles relevant to information and communication are critical to ensuring the integrity of the accounting data and streamlining the flow of data.

Both within and outside government, there is an expectation for management to take increasing responsibility for the adequacy of design and operation of an entity's control structure. Application of these principles provides an appropriate framework for that process.

RECOMMENDATION

2015-004      Adopt the internal control framework and apply the principles prescribed in the revised "Green Book". Reassess, document, and monitor control procedures following the guidelines of the internal control framework.

Corrective action plan / auditee views:

*The Bureau of Audits adopted the 2013 COSO revised framework within their risk based audit program. This ongoing audit program evaluates and documents internal controls relative to the revised framework.*

*An additional review will be performed by a cross functional committee to evaluate how to practically supplement this process.*

Anticipated Completion Date:    June 30, 2017

Contact Person: Marc Leonetti, State Controller  
Phone: 401.222.2271

**Strategic Issue Finding 2015-005**

*(new finding)*

OFFICE OF MANAGEMENT AND BUDGET – RESPONSIBILITIES FOR OVERSIGHT OF FEDERAL GRANT ACTIVITY

**Various responsibilities, related to the oversight of federal grants and assigned to the State’s Office of Management and Budget (OMB), have not been fully addressed operationally.**

The sections of the Rhode Island General Laws, creating the Office of Management and Budget (OMB) within the Department of Administration, delineate various responsibilities to the OMB including those related to oversight of the State’s federal grant programs. We have highlighted in past audits, through conduct of the annual Single Audit of the State, that the administration of federal programs is almost exclusively the purview of the departments and agencies - there are few uniform statewide grant administrative procedures and little statewide oversight of federal grant activities. Federal grants support approximately 41% of state operations accounted for within the General Fund.

The creation of the OMB was in part intended to address those concerns by vesting responsibility for oversight of federal grant activities within a group outside of the day-to-day administration of grant programs. Certain of the specific responsibilities of the OMB, as contained in the enabling statute, are highlighted below:

**§ 35-1.1-5 Federal grants management.** – (a) The office of management and budget shall be responsible for managing federal grant applications, providing administrative assistance to agencies regarding reporting requirements, providing technical assistance and approving agreements with federal agencies pursuant to § 35-1-1. The director shall:

(2) Ensure that the state establishes and maintains statewide federally-mandated grants management processes and procedures as mandated by the federal Office of Management and Budget;

(6) Assist the state controller in managing and overseeing the disbursements of federal funds in accordance with § 35-6-42;

(7) Assist the state controller in the preparation of the statewide cost allocation plan and serve as the monitoring agency to ensure that state departments and agencies are working within the guidelines contained in the plan; and,

(8) Provide technical assistance to agencies to ensure resolution and closure of all single state audit findings and recommendations made by the Auditor General related to Federal funding.

Opportunities exist to enhance the role of the OMB in overseeing the operation of the State’s many federally funded programs consistent with the intent of the enabling statute. Higher-level monitoring of federal grant activities is necessary to ensure overall compliance with federal requirements and also to prompt timely corrective action when warranted. There are a number of recurring findings related to the administration of federal programs included in our Single Audit Report that remain unresolved.

We acknowledge OMB's efforts to provide training on new federal requirements, build a centralized database of federal awards, and facilitate FFATA reporting.

Further areas that should be enhanced include ensuring there are uniform, efficient and effective statewide processes in place to meet the various requirements of federal grant administration (e.g., cost allocation, cash management, federal reporting). The OMB should be the agency advocating for needed IT applications that would facilitate and standardize many of the "backroom" operations that are now unique to each department and often result in control weaknesses over federal program administration.

RECOMMENDATION

2015-005      Enhance the operational activities of the OMB to comply with the enabling statute and to meet the need to provide centralized monitoring of federal programs, which constitute a material portion of the State's overall activities.

Corrective action plan / auditee views:

*The Office of Management and Budget's Grants Management Office is embarking on a process to identify and implement a technology solution that automates and administers the grants management business processes across state agencies. The end-to-end grants management system will turn disparate systems, data sources, files, and processes into a single, centralized depository for use by all state agencies. The system will integrate with state's financial, budget, and time and attendance systems and will automate workflow to improve efficiency and promote transparency. As envisioned, the system will be configured to accept and transmit data from and to federal systems such as www.grants.gov, www.sam.gov, and www.USASpending.gov to ensure the timely, efficient, and effective flow of information between state and federal agencies. The planned grants management solution includes functionalities that will result in the fulfillment of the statutory responsibilities outlined in Chapter 35-1.1-5.*

*The Grants Management Office is working closely with the Office of Digital Excellence on this project and will engage a project manager/business analyst by April 1, 2016, to assist in the software selection and implementation process. An early deliverable for the project manager is mapping the current business processes and developing a future-state business process that reflects best practice. The business process mapping will include the development of written policies and procedures to ensure compliance with applicable federal rules. The project manager will also assist with the development of system requirements, selection of software, and implementation of the grants management solution.*

Anticipated Completion Date:    September 2017

Contact Person:                      Laurie Petrone, Director, Office of Federal Grants  
Administration  
Phone: 401.574.8423

2015



***INDEPENDENT AUDITOR'S  
REPORT ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND  
OTHER MATTERS BASED ON AN  
AUDIT OF FINANCIAL STATEMENTS  
PERFORMED IN ACCORDANCE  
WITH GOVERNMENT AUDITING  
STANDARDS***



# Office of the Auditor General

State of Rhode Island and Providence Plantations - General Assembly

**Dennis E. Hoyle, CPA - Auditor General**

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## **INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Finance Committee of the House of Representatives and  
Joint Committee on Legislative Services, General Assembly,  
State of Rhode Island and Providence Plantations:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Rhode Island and Providence Plantations (the State), as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the State's basic financial statements and have issued our report thereon dated December 17, 2015. Our report includes a reference to other auditors who audited the financial statements of:

- the Tobacco Settlement Financing Corporation, a blended component unit which represents 1% of the assets and deferred outflows and 1% of the revenues of the governmental activities and 1% of the assets and 3% of the revenues of the aggregate remaining fund information;
- the Convention Center Authority, a major fund, which also represents 48% of the assets and deferred outflows and 2% of the revenues of the business-type activities;
- the HealthSource RI Trust, an agency fund, and the Ocean State Investment Pool, an external investment trust, which represents less than 1% of the assets and revenues of the aggregate remaining fund information; and
- all the component units comprising the aggregate discretely presented component units.

This report includes our consideration of the results of the other auditors' testing of internal control over financial reporting and compliance and other matters that are reported on separately by those other auditors. However, this report, insofar as it relates to the results of the other auditors, is based solely on the reports of the other auditors.

## Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed in the accompanying schedule of findings and responses, we and the other auditors identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the State's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: Findings 2015-009, 2015-012, 2015-016, 2015-018, 2015-019 and 2015-021. Other auditors of the discretely presented component units considered the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: Findings 2015-024, 2015-025, 2015-026 and 2015-027.

*A significant deficiency* is a deficiency, or 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. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies: Findings 2015-006, 2015-008, 2015-011, 2015-013, 2015-014, 2015-015, 2015-017, 2015-020, 2015-022 and 2015-023. Other auditors of the discretely presented component units considered the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies: Findings 2015-028, 2015-029 and 2015-030.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests and those of the other auditors disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as Findings 2015-007, 2015-010 and 2015-031.

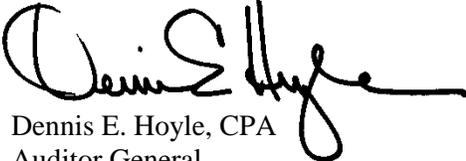
Finance Committee of the House of Representatives and  
Joint Committee on Legislative Services, General Assembly

### **State's Response to Findings**

The State's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The State's responses were not subjected to the auditing procedures applied in the audit of the financial statements and accordingly, we express no opinion on the responses.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the State's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Dennis E. Hoyle, CPA  
Auditor General

December 17, 2015

2015



***Schedule of  
Findings and Responses***

**Finding 2015-006**

*(significant deficiency - repeat finding)*

**SEGREGATION OF DUTIES WITHIN FUNCTIONS PERFORMED BY THE OFFICE OF THE GENERAL TREASURER**

**Certain duties performed by the Office of the General Treasurer are not adequately segregated resulting in control deficiencies.**

Appropriate controls over cash receipts and disbursements require segregation of duties. The functions of authorizing and recording transactions should be totally separate from functions related to the disbursement and movement of funds, cash receipts, and reconciliation of bank and book balances.

During fiscal 2015, we observed numerous journal entries initiated and approved by Treasury personnel that were not consistent with the appropriate level of segregation of duties over cash receipts and disbursements thereby weakening controls.

Due to the incomplete implementation of the RIFANS accounting system, receipt transactions are directly recorded as general ledger transactions. Since Treasury has been designated as the “final approver” of cash receipt transactions upon confirmation of the bank deposit, Treasury has general ledger access that would ordinarily not exist in a control environment following the desired level of segregation of duties. While the State has attempted to implement compensating controls to mitigate these risks, there are limits to the effectiveness of these compensating controls due to the existing configuration of the accounting system and the organizational structure in place.

Optimally, certain duties now performed by Treasury should be reassigned to a separate unit within the Office of Accounts and Control that would handle the authorization and accounting for these transaction types. Until such an interdepartmental reallocation of duties could be effected, certain transaction types should not be performed by Treasury and routed through modified workflows for authorization and recording.

**RECOMMENDATIONS**

- 2015-006a Reorganize accounting responsibilities currently performed by the Office of the General Treasurer to the Office of Accounts and Control to ensure proper segregation of duties over cash receipt and disbursement functions.
- 2015-006b Redirect workflows for certain accounting transaction types so that adequate segregation of duties over cash receipt and disbursement functions is maintained.

**Corrective action plan / auditee views:**

*As noted by the Auditor, this is a repeat finding from prior fiscal year audits.*

*Treasury Management recognizes the merit of the Auditor’s recommendation with respect to control improvement.*

*The lack of a state-wide deployment and system limitations in the state’s RIFANS ERP system have necessitated that the Office of the General Treasurer perform certain accounting transactions to meet stringent timelines for funds transfers and also to ensure the timely recording of transactions generated by subsidiary accounting systems within other state agencies.*

*The Office of the General Treasurer fully supports the completion of the RIFANS ERP system. In light of the practical and systemic constraints to completion, Treasury Management has made substantial effort to ensure that appropriate compensating controls are in place to mitigate the risk imposed by system limitations inherent to the state's implementation of the RIFANS ERP system.*

*Since being alerted to this finding in the FY 2014 audit, Treasury Management has taken concrete steps to improve controls and is exploring additional options to develop enhancements to its control procedures.*

*By way of example:*

*In FY 2015, Treasury Management requested that the Office of Accounts and Control modify the RIFANS system to segregate the initiation and approval functions for certain journal entries approved by the Chief Fiscal Manager. The initial iteration of the changes prevented the CFM from being able to open and review the journal entries she was charged with approving for the department. Treasury Management and the Controller's office coordinated to make further enhancements to RIFANS that would overcome this limitation and accommodate the improvement. The CFM now has the role of "approval-only", and RIFANS will allow her to review the details of each entry subject to her approval.*

*In early FY 2016, Treasury Management made substantial changes to the process by which the state handles NSF (non-sufficient funds) or RDI (returned deposit items). These items represent nearly one-third of the transactions identified by the auditor within the scope of this finding. (NSF items are returned checks or other deposit items whereby the payer had insufficient funds in their account to support the payment to the state.) Treasury Management coordinated with both its banking partners and the Office of Accounts and Controls to implement a completely new process for NSF/RDI items. Today, the bank will automatically represent NSF items on two consecutive Fridays. This modification substantially reduces the number of NSF/RDI items processed by Treasury. A new reconciliation mechanism for this process reduces the number of journal entries from an average of 1,300+ per year to just 300. An ancillary benefit of this process is that it substantially improves cash collection and reduces the number of bounced checks returned to agencies for collection.*

*With respect to the recommendation to reorganize responsibilities from Treasury to Accounts and Controls, Management believes a wholesale reorganization may have substantial negative impacts on control and financial reporting. These impacts include, but are not limited to, a substantial increase in the number of reconciling variances (as the timely and accurate recording of entries by staff unfamiliar with the reconciliation process may not occur) and a dramatic delay in the completion of monthly bank account reconciliations.*

*Treasury Management, in consultation with the Controller's office will continue to review workflows and business practices to improve segregation where possible and to ensure compensating controls are as robust as possible given the systemic constraints.*

*To that end, Treasury Management will solicit for consulting services from a public accounting firm to analyze current policies and practices, and to facilitate the development of further enhancements to control and segregation policies.*

*Additionally, Treasury Management will continue to engage with the Office of Accounts and Controls to discuss the possibility of delegating certain approval functions to DOA personnel where feasible.*

*Notwithstanding the forgoing, Treasury management disagrees that this finding now reflects “control deficiencies” or “weakened controls” vis-à-vis prior year audits, especially in consideration of the substantial improvements to technical and procedural operations effectuated over the past year.*

*Anticipated Completion Date: Fiscal 2017*

*Contact Person: Patrick Marr  
Deputy Treasurer for Operations  
Phone 401.462.7664*

**Finding 2015-007**

*(other compliance matter – new finding)*

**OVERPAYMENTS TO MEDICAID MANAGED CARE ORGANIZATIONS**

**Medicaid managed care organizations (MCOs) were overpaid more than \$200 million due to overstated capitation rates for the Medicaid expansion population.**

Approximately \$208 million was estimated as overpayments to MCOs providing services to Medicaid enrollees of which \$133 million remained due to the State at June 30, 2015. These amounts mostly result from monthly capitation amounts paid for the Medicaid expansion population, a newly covered group under the federal Affordable Care Act, that were well in excess of the actual claims activity.

The Executive Office of Health and Human Services (EOHHS) faced early challenges in establishing a capitation rate for this population due to the high utilization of services expected at the inception of coverage. However, these estimated overpayment amounts due to the State are well in excess of any typical risk share/gain share contract settlement amounts that routinely exist each year. Risk share/gain share amounts due to or from the State are measured at the close of contract periods, with final settlement at the end of the claims run-out period - one year later.

These amounts have been recognized within the overall Medicaid program receivables and payables calculated for inclusion in the State’s financial statements at June 30, 2015. The amounts paid for the Medicaid expansion population were 100% funded by the federal government – consequently once the overpayments are collected by the State such amounts are due to the federal government. The managed care organizations are unintentionally benefitting from a significant and extended, no-interest cash flow infusion.

Due to contract provisions in effect during fiscal 2015, the MCOs will be allowed to keep a portion of the excess capitation payments. Gain share provisions in the contract were intended to reward the MCOs for overall cost efficiencies attained through enhanced case management, preventative care, and enhanced coordination of services. The significant amounts due back to the State, in this instance, resulted from excessive capitation amounts and not from efficiencies achieved by the MCOs.

We acknowledge the challenge in establishing an appropriate capitation rate for this newly covered population and understand actuaries were involved in establishing those rates. However, given the size of these overpayments, we recommend that the contracts with the managed care organizations be amended to allow for interim recoupment of these excess payments in situations where the overpayment amounts are so significant. The underlying assumptions should be reexamined and adjusted to ensure that the capitation rates do not continue to result in material excess payments.

## RECOMMENDATIONS

- 2015-007a Amend contracts with the managed care organizations to allow interim recoupment of overpayments that exceed normal risk share / gain share amounts.
- 2015-007b Reexamine the assumptions underlying the determination of capitation rates to ensure the rates do not result in significant overpayments to the managed care organizations.

### Corrective action plan / auditee views:

*Effective January 1, 2014, the Affordable Care Act (ACA) allowed states to expand Medicaid eligibility to adults up to 138% of the federal poverty level. The State of Rhode Island covered this new population using managed care plans. The assumptions used to develop the Medicaid Expansion capitation rates recognized that all persons eligible would not be covered immediately on January 1, 2014, and that coverage would not reach a mature state until December 31, 2014. The State used risk corridors and risk-sharing arrangements around the rates to limit the contract partners' exposure and to mitigate the risk of over-adequacy or under-adequacy in the rates.*

*Initially, two sets of capitation rates were developed. One set covered the first six months of CY 2014 and the second set of rates applied to the 12-month period from July 1, 2014, through June 30, 2015. The division of the contract period into two rate periods allowed the State to recognize the anticipated selection bias during the initial rollout of the Medicaid Expansion program in the rates and to align with other managed care contract periods.*

*When developing capitation rates for FY 2015, the Medicaid Expansion capitation rates were revised for the period July 1, 2014, through June 30, 2015, resulting from reconsideration of the original assumptions used in the previous rate calculations. The revision was due to additional information from the State's experience to date with enrollment into Medicaid Expansion and the health characteristics presented by this population, information which was not previously available for the original rate development.*

*(Capitation rates for FY 2016 for the Medicaid Expansion group were further refined based on the MCO's financial statements related to the risk-sharing reporting. Certain enrollment-driven assumptions were updated to reflect 2016 enrollment projections, as were other assumptions, including pent-up demand, adverse selection, and adverse risk margin based on these financial statements. The FY 2016 capitation rates were developed using a 50/50 blend of the original rating methodology and the MCOs risk-share financial reports since there were insufficient historical experience to draw upon from the State's encounter system. The Actuary wanted to incorporate actual experience in the rates while being cognizant of the limitations of the data. An analysis of the FY 2016 capitation rates does not indicate material excess payments to the MCOs.)*

*For each capitation rate revision, the capitation rates were compiled in accordance with Title 42 CFR 438.6 and 438.60, and reviewed by CMS.*

*When it was observed, based on monthly risk/gain share financial reports, that the MCOs were incurring and reporting medical expenses that were significantly less than the medical portion of the capitation dollars paid to the MCOs, the State began recouping a portion of the MCOs gain share. The State recouped gain share monies in December 2014, (based on a calculation of 80% of the MCOs reported gain share balance due to the State as of June 2014), and again in January 2015, (calculated at 70% of the gain share balance due as of November 2014).*

*On December 15, 2014, and on January 27, 2015, the State received letters from United Healthcare disputing the State's actions to recoup these monies based on the timing indicated in the MCO's contract, stating that, per the contract, "Final settlement is based on review of the complete experience for the contract period following the full twelve-month run out ...".*

*Because there was no specific language in the MCOs' contracts to make partial settlement payments or recoupments on an interim basis prior to the end of the contract period and/or the final settlement period, and, on the advice of State Counsel, recoupment activities for the Medicaid Expansion contracts stopped. The State's Legal Counsel also notified United Healthcare that the State would not be performing interim recoupments for Medicaid Expansion.*

*The State has acted to address this situation going forward by updating the MCO contract. As a result of changes reflected in Amendment 9, effective July 1, 2015, Attachment N, Special Terms and Conditions, Reconciliation and Payment, now includes the following language:*

*If, six (6) months after the start of a Risk Share/ Gain Share contract period, the Contractor's Risk Share/Gain Share report indicates that medical expenses have either exceeded the medical portion of the capitation dollars paid to the Contractor or are less than the medical portion of the capitation dollars paid to the Contractor by at least 30% or more, EOHHS may make partial settlement payments or recoupments on an interim basis prior to the end of the contract period and/or the final settlement period. Related risk share payments shall be based on cash expenditures as shown in the Risk Share/Gain Share Report. Related gain share recoupments shall be based on Risk Share/Gain Share reports that are inclusive of IBNR. EOHHS will provide the Contractor with the payment or recoupment dollar amount not less than 45 calendar days in advance of the actual date of the payment or recoupment.*

*On February 10, 2016, notice was sent to the MCOs that the State will be recouping, over a 3-month period, beginning in April 2016 and continuing into June 2016, 80% of the outstanding gain share balance for the Medicaid Expansion contract ending June 30, 2015, with the remaining gain share balance to be recouped at the time of the final contract settlement.*

*Per the Recommendations of the State Auditors, 2015-007a, the managed care organization contracts have been amended to allow for interim payments and recoupments when the over- or under-payment amounts are significant. In addition, per the Recommendation of the State Auditors, 2015-007b, as stated above, the underlying assumptions relating to capitation rate development continue to be re-examined and adjusted to ensure that the rates do not result in significant overpayments or underpayments to the managed care organizations.*

*Anticipated Completion Date: June 30, 2016*

*Contact Person: Deb Florio, Deputy Director  
Phone: 401.462.0140*

**Finding 2015-008**

*(significant deficiency – repeat finding)*

COMPREHENSIVE GENERAL LEDGER CONTROLS OVER RECEIVABLES

**Statewide accounting controls over receivables can be enhanced.**

The State can enhance its comprehensive general ledger controls over amounts owed to the State. Receivable balances are generally maintained by the revenue-collecting department or agency (e.g., Division of Taxation, Courts, and Department of Environmental Management). Summary balances are reported only annually to the Office of Accounts and Control for inclusion in the State’s financial statements. The effectiveness of receivable recording at year-end is dependent upon agencies fully reporting balances to the Office of Accounts and Control and procedures performed by Accounts and Control to identify possible omissions. This manual process provides a level of compensating control but is susceptible to omission. Accounting and monitoring controls over the State’s receivables in aggregate are limited.

Revenues are collected at many points throughout the State and, in many instances, due to volume and complexity (e.g., tax revenues); independent systems must be maintained to control and account for those revenues and related receivables. Controls are enhanced when there are effective general ledger controls over all receivable balances with periodic reconciliation to detail subsidiary accounts receivable systems. Additions and reductions (payments) of receivables should be recorded in aggregate at the general ledger level with the detailed recording at the customer/taxpayer level within the various subsidiary receivable systems.

Currently, general ledger balances are adjusted at fiscal year-end to match the summary balances reported by the various revenue collecting agencies. Long-term receivables, which are included in the State’s government-wide financial statements, are typically recorded and then reversed each year without a “permanent” general ledger or subsidiary ledger detail record of such amounts.

The lack of an integrated revenue and receivables functionality within the RIFANS accounting system requires that receipts/revenue be recorded via journal entry transactions (directly to the general ledger). Typically, receipts/revenue would be recorded in a separate module with expanded functionality that would interface with and post information to the general ledger. Because receipts/revenue are now recorded directly to the general ledger, access to initiate and approve general ledger transactions is broader than would otherwise be allowed.

The Office of Accounts and Control continues to explore implementation of the existing revenue/receivables module that is part of the Oracle E-Business Suite software with the aim of determining whether that module could be effective in enhancing controls over receivables. Other options may also need to be considered, specifically as part of the completion of the State’s ERP system to enhance the State’s controls over receivables, in aggregate, given the complicated and decentralized nature of revenue collection points throughout the State.

RECOMMENDATION

2015-008      Evaluate the effectiveness of the pilot Oracle E-Business Suite revenue/receivables module implementation and assess the need to explore other ERP integrated system options to enhance statewide general ledger controls over receivables.

Corrective action plan / auditee views:

*The Controller's office (office) disagrees with the significant deficiency classification of this finding and the recommendation.*

*The classification as a significant deficiency in internal control over financial reporting is misleading to the reader. The reader should note that the auditors did not propose a financial reporting adjustment in this area as a result of existing controls. Certainly, there is always an opportunity to review and enhance accounting processes; however, that fact alone should not lead to a significant deficiency classification in an audit report.*

*The auditor's recommendation is based more on conceptual theory than a practical solution considering the complex structure and myriad of systems that exist within a governmental environment. For example, the majority of net receivable balances are derived from the Division of Taxation (division) which currently track receivables at a detailed level in a separate system. Furthermore, the division is in the midst of a new integrated tax system project that will significantly enhance functionality in this area. Allocating resources to explore other ERP options (as stated in the recommendation) to exist between the new integrated tax system and the State's general ledger would be ill advised as it will create redundant and inefficient processes.*

*It is also important to note that the office is currently utilizing the Oracle receivables module for certain receivable types and is working to identify other non-tax related receivable types that may be recorded within this module without creating redundant processes.*

Anticipated Completion Date: N/A

Contact Person: Marc Leonetti, State Controller  
Phone: 401.222.2271

**Auditor's response:**

This finding (and corresponding classification) is based on our consideration of the design of comprehensive general ledger controls over all receivables included within the financial statements. Controls are enhanced when new receivables and collection of receivables are recorded as transactions occur rather than through adjustment to match external subsidiary balances.

**Finding 2015-009**

*(material weakness - repeat finding)*

**CONTROLS OVER FEDERAL PROGRAM FINANCIAL ACTIVITY**

**The State needs to improve controls over recording federal revenue to ensure (1) amounts are consistent with the limitations of grant awards from the federal government and (2) claimed expenditures on federal reports are consistent with amounts recorded in the State's accounting system. Further, statewide accounting functionalities within the ERP system should be implemented to support time reporting/payroll, grants management, and cost allocation – all functionalities that are integral to controls over and the management of federal programs.**

Federal programs represented 41% of fiscal 2015 General Fund expenditures. Financial reporting risks include categorizing expenditures as federally reimbursable when grant funds have either been exhausted or the expenditures do not meet the specific program limitations. Further, the State can

improve its overall centralized monitoring of federal program operations to ensure compliance with federal requirements.

Generally, federal revenues are recognized as expenditures, considered reimbursable, are incurred for federal grant programs. Some federal grants are open-ended entitlement programs where the federal government will reimburse the State for all allowable costs incurred under the program. Other federal grants are limited by a specific award amount and grant period. These grant periods are often for the federal fiscal year and are not aligned with the State's fiscal year.

Knowledge of grant requirements, spending authorizations, and limitations on reimbursable expenditures all rests with departmental managers who administer the federal grant programs. Accordingly, the Office of Accounts and Control, in preparing the State's financial statements, relies primarily on the coding of expenditures (by funding source – federal) within the RIFANS accounting system. All expenditures recorded in federal accounts are considered reimbursable from the federal government and federal revenue is recorded to match those expenditures. From an overall statewide perspective, controls over financial reporting are ineffective to ensure that all federal expenditures are reimbursable and federal revenue is recognized appropriately.

The Office of Accounts and Control requires completion of a *Federal Grants Information Schedule* (FGIS) by the administering departments and agencies. The goal of the FGIS is to reconcile RIFANS program activity with amounts drawn and claimed on federal reports. The FGIS process is ultimately limited in its overall effectiveness to improve controls over federal revenue recognition. Presently, there is no statewide control measure to ensure that grant expenditures do not exceed available award authority.

#### *Federal Grants Management and Cost Allocation*

The State's incomplete ERP system - RIFANS - does not meet the State's needs in three important and interrelated areas – time reporting/payroll, grants management, and cost allocation – all functionalities that are integral to management of federal programs. These functions are currently performed independent of RIFANS and generally through multiple systems - most of which are duplicative and utilize old and sometimes unsupported technology.

In general, each department within State government captures time and effort information, distributes costs to programs, and manages its federal grants in its own unique way. None of these processes or systems operates similarly, shares a common control structure or is integrated into RIFANS.

Time and effort data collected within an integrated system could be used to automatically distribute costs to various programs and activities. Because these functionalities are lacking in RIFANS, a high volume of manual accounting entries, supported by data derived from various departmental cost allocation processes and departmental systems, is required to distribute direct and indirect costs to various programs and activities. These manual accounting entries are adequately controlled from an authorization and access perspective but are not uniformly or sufficiently controlled from a sourcing or supporting documentation perspective.

The lack of full integration of these system functions results in delays in federal reimbursement as well as potentially impacts the timeliness and accuracy of reporting these program expenditures in RIFANS. The necessary journal entries required by State agencies to adjust indirect costs to federal programs can lag as much as one or two quarters during the fiscal year while independent time reporting and cost allocation processes get completed.

The State's Office of Management and Budget (OMB) and the Office of Accounts and Control should coordinate statewide accounting and monitoring processes to enhance controls over federal

program financial activity for financial reporting purposes but also to ensure compliance with federal program requirements.

RECOMMENDATIONS

- 2015-009a Improve functionality with the statewide ERP system to facilitate federal grant administration (grants management, cash management, and cost allocation).
- 2015-009b Build statewide processes over federal grant administration within the Office of Management and Budget to supplement accounting controls within the RIFANS accounting system.

Corrective action plan / auditee views:

*Please refer to Corrective Action Plan 2015-001.*

Anticipated Completion Date: *September 2017*

Contact Person: *Laurie Petrone, Director, Office of Federal Grants Administration  
Phone: 401.574.8423*

**Finding 2015-010**

*(other compliance matter–new finding)*

DEBT SERVICE – TECHNICAL EVENT OF DEFAULT

**Due to an error by the State’s trustee, the State missed a scheduled debt service payment which resulted in a technical event of default.**

During fiscal 2015, the State inadvertently missed a scheduled debt service payment. The State utilizes a debt management system to track all long-term debt and schedule required debt service payments. This debt service was appropriately scheduled for payment in the debt management system. The trustee typically “invoices” the State for required debt service. When no invoice was received from the trustee, inquiry was made of the trustee who assured the State that no required payment was due.

The required debt service payment was subsequently made and the trustee accepted responsibility for the error and reimbursed the State for the additional interest due. While resolved and explained, the technical event of default still required a continuing disclosure notification to EMMA (the Electronic Municipal Market Access data repository) and disclosure in subsequent Official Statements to market new bonds. That disclosure included reference to the State’s “intent to implement policies that the situation will not arise again”.

Because the potential consequence of any default, technical or otherwise, is severe and could affect the State’s reputation in the financial markets, a review of existing procedures is necessary to ensure adequate safeguards are in place to prompt timely remittance of all required debt service. The review should include the role of external parties (fiscal advisor, paying agents and trustees) as well the roles of the different agencies within State government that have responsibility for debt management.

RECOMMENDATION

2015-010      Review the existing debt service payment process to ensure adequate safeguards are in place to prompt timely remittance of all required debt service.

Corrective action plan / auditee views:

*As mentioned in the finding, the State's trustee accepted responsibility for this error. Nevertheless, this is an important process that will be reviewed in conjunction with the formation of the new Office of Debt Management within the Treasurer's Office.*

Anticipated Completion Date:    June 30, 2017

Contact Person:                      Marc Leonetti, State Controller  
Phone: 401.222.2271

**Finding 2015-011***(significant deficiency – new finding)*DIVISION OF INFORMATION TECHNOLOGY - DISASTER RECOVERY PLAN

**The State did not perform a recommended test of its disaster recovery plan during fiscal 2015 due to funding limitations.**

The State should implement a plan to ensure that at least annually its enterprise data center and systems disaster recovery plan has been fully tested at its off-site recovery data center. The Division of Information Technology ( DoIT) has not performed a disaster recovery test since fiscal 2014. DoIT has a designated data center recovery facility in New Jersey (operated by a vendor) which it pays \$47,000 per month to keep ready if needed. DoIT explained that the disaster recovery tests have been eliminated due to budgetary cuts.

To increase the likelihood that systems can be restored in the event of a disaster that disables operations at the State’s data center, the State needs to test the viability of its recovery center and its employees’ knowledge and ability to perform the restoration of the enterprise. Typically, industry best practices stipulate that disaster recovery testing be performed twice a year in order to accommodate the ever changing systems environment. At a minimum, the State should ensure that a full disaster recovery test is performed annually.

Since the last test performed in fiscal 2014, the State has undergone a number of changes to its system environment. New systems such as UHIP, STAARS, and numerous patches to RIFANS along with network and communications configuration changes have not been part of an enterprise disaster recovery test. Additionally, we noted that no disaster recovery test has been scheduled to date in the current fiscal year.

RECOMMENDATION

2015-011      Perform an off-site disaster recovery exercise at the State’s designated disaster recovery site on at least an annual basis.

Corrective action plan / auditee views:

*DOIT had submitted a request to fund the January 2016 disaster recovery exercise from the State’s Strategic IT investment fund. That request was denied. DOIT was advised to find alternative funding. If alternate funding is provided, a disaster recovery exercise will take place in June 2016. Note, that a disaster recovery exercise requires significant funding. The funding is for staff, travel and DR services to be completed offsite at our DR vendor location.*

Anticipated Completion Date:    December 30, 2016

Contact Person:                      Michael Lombardi, Assistant Director, IT Operations  
Phone: 401.462.4702

**Finding 2015-012**

(material weakness - repeat finding)

INFORMATION TECHNOLOGY (IT) SYSTEMS - PROGRAM CHANGE CONTROLS

**The State does not follow uniform enterprise-wide program change control procedures for the various IT applications operating within State government.**

Program change controls are a critical IT control component to ensure that authorized changes are appropriately made to programs with testing and acceptance before being placed in production. Additionally, program change control procedures prevent and detect unauthorized program modifications from being made.

Almost all custom developed computer applications require changes or updates during their production lifecycle. These customized, home-grown applications require a formalized change management system in order to properly control changes made to them.

The Division of Information Technology (DoIT) has issued two departmental policy statements that deal directly with program change management controls. Policy #01-02, *IT Applications Development Requirements Approval*, states that “programmer managers must ensure any request for application development be documented in writing, tracked, understood and approved prior to putting any new or changes to existing applications into production”. In related Policy #01-03, *IT Enhancements Move to Production Approval*, DoIT requires that “programming teams must take care to ensure best practices regarding product quality have been utilized prior to putting any new (or changes to existing) systems into production”.

Various methods are used to control program change management. For the most part, these methods rely upon the use of partially implemented change management systems and a series of manual and automated procedural controls that incorporate emails, memorandums and other paper-based forms to document and control application changes. In a number of instances, we found no automated control system that can evidence that only authorized and proper changes have been implemented. Additionally, there is no way of knowing if all elements of a proper change management process have been followed.

The change management process should be standardized so that all movement of code, changes made, testing, acceptance, and implementation provide management with a tracking history. This leads to consistent outcomes, efficient use of resources and enhanced integrity of the application systems which flow through the process. Automated tools vastly help control this process and make the process consistent, predictable, repeatable and aids in the reduction of “human error” in the process.

In response to prior audit recommendations made since fiscal 2007, DoIT has attempted to implement software designed to better maintain and control application system changes. The products selected were never properly configured and implemented to fully utilize their control features. Instead of making the program change process more efficient and productive, the process became cumbersome and time-consuming which led to noncompliance and circumvention of DoIT’s change control policy and procedural guidance.

These packages were never rolled out enterprise-wide, thus leaving agencies to develop their own methods and procedures to control application changes. This has led to multiple methods, both manual and partially automated, to be developed and supported by limited DoIT staff.

DoIT should implement a standardized formal enterprise program change control process for the application systems it supports. To assist this process, DoIT should evaluate enterprise software solutions to complement their program change process. Procedural guidance should be developed that provides

detailing correct use of change management software and mandated internal control practices and procedures, thus ensuring a documented, monitored, and repeatable process.

### RECOMMENDATIONS

- 2015-012a      Reassess the use of a standard software package to determine the appropriate combination of operational, procedural and/or technical adjustments required to use the package in a manner that results in adequate program change control for the entire enterprise.
- 2015-012b      Develop and implement procedures detailing specific requirements for program change control and disseminate and train DoIT support staff in its proper execution.

#### Corrective action plan / auditee views:

*2015-12a - We have determined that the current software package and procedures is not meeting our needs. The taxation system and payroll system both utilized that system. With taxation using a new software program which has its own version control, only payroll remains on the current system. The current system needs to be reviewed on how we can pull the code off the system and migrate to a new version control system. We have obtained a consultant to provide recommendations on how to pull the code and also to provide technical advice. A purchase order has been issued for this task in FY 2016. We will seek tech funding for new system in FY 17.*

Anticipated Completion Date:      *March 31, 2017*

*2015-12b - This finding will be addressed when a new change management process is selected.*

Anticipated Completion Date:      *TBD - Dependent on 2015-012a*

Contact Person:                      *Alan Dias, Assistant Director IT  
Phone: 401.222.6091*

### **Finding 2015-013**

*(significant deficiency - repeat finding)*

#### MONITORING RIFANS ACCESS PRIVILEGES AND AGENCY APPROVAL HIERARCHIES

**The State can enhance certain system access controls within the RIFANS statewide accounting system.**

Authorizing and monitoring access to RIFANS, the State’s centralized accounting system, is a key control over financial reporting. We observed three distinct, but interrelated areas where the State can improve its monitoring of RIFANS access privileges by implementing reporting functionalities that allow for the periodic review of RIFANS user and administrator access. The State’s current lack of monitoring of user and administrator access represents a collective weakness in internal control over financial reporting.

#### RIFANS “Super Users”

Activities of individuals with system administrator or “super user” roles are logged but not reported and reviewed. These individuals have unlimited access to RIFANS functions and data.

Consequently, any RIFANS transactions or activity initiated by system administrators should be monitored. The Division of Information Technology’s (DoIT) policies and procedures require the activities of privileged users (system administrators) to be logged by the system and reviewed for propriety by assigned personnel. During fiscal 2015, a system administrator/“super user” was asked and did approve certain transactions that required intervention due to hierarchy/workflow issues or other unique circumstances.

The State could improve controls over system administrator access by either a) developing reports that specifically report on their system access and daily activities within the system and/or b) developing reports that detail when changes are made to critical data within RIFANS.

#### Agency Hierarchies

Access roles for all RIFANS users are controlled through unique passwords. These roles, which are assigned based on job functions and responsibilities, permit access to various system capabilities. Agency hierarchies permit specific transaction types and dollar authorization limits. Other transaction-specific authorization controls are managed through workflow directories within RIFANS.

The Office of Accounts and Control (Accounts and Control) is responsible for the design and control of system access by RIFANS users. This “blueprint” of the RIFANS control structure is periodically documented through hierarchies detailing access and approval flows for each department or agency. Maintaining off-line documentation of the hierarchies is manually intensive and only provides limited effectiveness in providing an audit trail of additions, deletions, and changes in authorization that are routinely made to RIFANS system access.

In addition, Accounts and Control authorizes changes to system access but the changes are effected by authorized individuals in the Division of Information Technology that have the system access to modify or expand RIFANS access. The resulting changes are not monitored to ensure they were established consistent with Accounts and Control’s approval or that other unauthorized changes were not made.

A reporting functionality is needed to facilitate timely review of changes in RIFANS user access and to also provide documentation of the designed and approved access structure which underlies the State accounting system control structure and objectives.

#### RIFANS Delegated Authority

RIFANS users may delegate their authority to other users in certain situations (e.g., “vacation rules”). The State implemented a policy that restricts employees from delegating their authority to others with a lower level of authority and requiring notification of the delegation to the Office of Accounts and Control in certain circumstances. The Office of Accounts and Control’s monitoring of delegated RIFANS access authority is limited by the lack of a system reporting functionality. Consequently, monitoring is ineffective in determining whether any delegation of authority is consistent with policy or if the delegation is more than temporary.

#### RECOMMENDATIONS

- |           |  |
|-----------|--|
| 2015-013a | Review activities of privileged users (system administrators) on a scheduled basis to ensure that additions, modifications, and deletions initiated by them are appropriate. |
| 2015-013b | Improve controls over RIFANS access by developing the reporting functionality necessary to allow for periodic monitoring of user access for instances of                     |

unauthorized changes to user access and/or noncompliance with policies relating to delegated user access.

Corrective action plan / auditee views:

2015-013a - The auditing feature has been activated to track changes to sensitive data in RIFANS. We are in the process of generating a report and fine tuning the auditing tool to fully address this finding.

2015-013b - This will also be addressed by the auditing feature mentioned in 2015-013a.

Anticipated Completion Date: June 30, 2016

Contact Person: Alan Dias, Assistant Director IT  
Phone: 401.222.6091

**Finding 2015-014***(significant deficiency - new finding)*DEPARTMENT OF REVENUE – DIVISION OF MOTOR VEHICLES

**Certain Division of Motor Vehicles’ revenues/receipts were not recorded during fiscal 2015. Monitoring and reconciliation procedures should be enhanced to ensure timely recording of all revenues and cash receipts.**

Certain Division of Motor Vehicles (DMV) revenue/receipts are received via lock box and processed by a bank. These receipts are deposited in a dedicated bank account and are then recorded by the DMV based on the detailed transactions provided and summarized by the bank. At June 30, 2015, we observed a significant balance in the DMV lock box bank account that had increased steadily over the fiscal year. Subsequent analysis indicated that approximately \$1.8 million had been collected and deposited by the bank but not recorded as revenue/receipts by the DMV. A formula error in a spreadsheet used to accumulate the receipts for accounting purposes resulted in the amounts going undetected. Further, the monthly bank account statement was not monitored by either the DMV or Treasury. DMV did not have access to the bank statement and certain Treasury personnel responsible for bank reconciliations also did not have access to the bank statements. Consequently, the bank balance, which increased each month during the fiscal year, went unnoticed.

Accounting personnel at the DMV should have inquiry only access to the bank statements to enhance their ability to reconcile cash receipts and accounting activity. All bank accounts within the custody of the General Treasurer should be monitored and reconciled to the accounting records. This account was not linked to the State’s general ledger since it is a “temporary collection” account. Amounts are recognized on the accounting records when funds are moved from the “temporary collection” account to one of the State’s regular operating accounts. Bank accounts that are not linked to the State’s general ledger allow these types of errors to go undetected and are not subject to the same control procedures in place for other state bank accounts.

Control and operating procedures should be enhanced at both the DMV and Treasury to ensure that all lockbox receipts are recorded timely.

RECOMMENDATION

2015-014      Enhance controls by monitoring and reconciling all receipts deposited in the lockbox temporary collection account. Link all bank accounts to the general ledger.

Corrective action plan / auditee views:

*The Financial Administrator for the DMV receives all Webster Bank lockbox deposits daily and reconciles this account every week. The Financial Administrator also completes the journal entry weekly to move the funds from Webster Bank to the General Fund.*

Anticipated Completion Date: *The corrective action has been completed and is currently in use by the DMV.*

Contact Persons:                      *Walter Craddock, Associate Director DMV  
Phone: 401.462.5701*

*Clare Sedlock, Deputy Administrator DMV  
Phone: 401.462.5718*

**Finding 2015-015***(significant deficiency – repeat finding)*DEPARTMENT OF REVENUE – CONTROLS OVER TAXES RECEIVABLE

**The Division of Taxation should strengthen controls over taxes receivable balances reported by its systems.**

During our testing, we found two large receivable balances included in the reports at June 30, 2015 that were erroneous – adjustments outstanding for a significant period of time had not been made to the taxpayers’ account balances. Another significant receivable amount resulted from a taxpayer error; however, timely monitoring of receivable balances, particularly new material balances, could have detected the error which affected two taxpayer accounts.

Certain tax types were transitioned to the new State Tax Administration and Revenue System (STAARS) system during fiscal 2015. During the transition, not all reporting functions were available. Personnel could not obtain a report of accounts to be written-off and had to use off-line spreadsheets to determine which accounts were eligible for write-off. We found that several accounts had payment activity in the period between the transition and the write-off, resulting in minor differences between estimated and actual write-offs. The payment activity also raises doubt about the need to write-off the balance as uncollectible.

Due to the incomplete reporting functionalities available within the new STAARS system during implementation, receivable reports at fiscal year-end were created through ad-hoc reports and therefore were not subject to the normal control procedures designed to ensure data integrity and completeness.

RECOMMENDATION

2015-015      Improve controls over the tax receivable systems to ensure accurate reporting of tax receivable balances.

Corrective action plan / auditee views:

*The Division of Taxation questions the materiality of this finding given the volume of total receivables and the context of conversion of the non-mainframe tax databases to the new integrated tax system (STAARS). The Division manages over 70,000 tax receivable balances and collects over \$3.0 billion annually. The two receivables identified would have been subject to delinquency notices and the reconciliation processes and are subject to review under those processes. The Division has no control over receivables related to taxpayer error; however, taxpayer errors are also detected under current delinquency notice and reconciliation processes.*

*The context of conversion to STAARS is also directly related to the reporting issue mentioned in this finding. The Division of Taxation is in the process of implementing an integrated tax system (STAARS) which will retire all of the non-mainframe and mainframe tax databases. In July 2014, the Division of Taxation successfully implemented Release 1 which included 36 different non-mainframe taxes. As of April 30, 2015, all non-mainframe receivables have been converted to STAARS. On November 2, 2015, the Division of Taxation converted its first mainframe tax type, personal income tax, and went live with Release 2 with personal income tax in STAARS. The Division is in the midst of developing and testing Release 3 which is scheduled to go live in November 2016 with all of the remaining mainframe tax types. The taxpayer portal will be implemented in January 2017 and the project will be completed with the integration of Revenue Accounting in June 2017. Reporting functionalities will be available in STAARS with applicable control procedures to ensure data integrity and completeness. Criteria for certain processes,*

including write-offs, will be programmed within STAARS and automated checks will be conducted based on criteria established by the Division. This automation is expected with the full conversion of all systems by June 2017.

Anticipated Completion Date: Incrementally for various receivables during implementation of STAARS throughout 2016 with the goal of being fully compliant by June 30, 2017.

Contact Person: Neena S. Savage, Acting Tax Administrator  
Phone: 401.574.8922

**Finding 2015-016**

(material weakness - repeat finding)

DEPARTMENT OF REVENUE – CONTROLS OVER ELECTRONIC TRANSMISSION OF TAX PAYMENTS AND OTHER INFORMATION

**Electronic data received by Taxation should be encrypted and then uploaded to Taxation’s systems through automated processes which do not require manual intervention or present an opportunity for manipulation. If changes are required to data files, tracking of the specific changes and the individual performing the changes should be controlled and documented.**

Electronic transmission of tax payments and tax information for uploading to the Division of Taxation’s (Taxation) systems represents the majority of taxes collected and data received by Taxation. Ensuring the security and integrity of this data from transmission through posting to taxpayer records is critical.

The vast majority of the State’s tax revenues are received electronically (through either ACH debit/credit or lock box receipts). Funds are deposited automatically into the State’s bank accounts, which causes the State’s financial institutions to send electronic payment confirmation data files to Taxation (these electronic files contain abbreviated tax payment data, such as, taxpayer identification number, payment amount, tax type, and tax period). Through a lock box arrangement with a financial institution, other returns and payments that are mailed to Taxation are processed and converted to electronic data files. Other initiatives have increased the receipt of data in electronic form.

Generally, these electronic files are in an open text format that allows, rather than restricts, manipulation of data prior to recording in Taxation’s mainframe systems. Additionally, the files reside in an unprotected network folder prior to and after upload. These electronic files should be in a file format that is secure and configured to facilitate an efficient upload to Taxation’s systems without need for manual intervention.

Certain personnel are assigned responsibility for downloading electronic files, reconciling detailed electronic information to the amount recorded in the State’s bank accounts, creating manual adjustments, and ensuring that the information is uploaded properly to the mainframe computer systems. While Taxation has taken steps to segregate duties regarding the processing of these files, certain individuals still have access that allows them to perform multiple functions.

To ensure that the proper level of data protection is in place, Taxation, working with the Division of Information Technology (DoIT), performed a “data classification” review of these files during FY 2015. DoIT has policies requiring that all State data being captured, maintained, and reported by any agency or department be “data categorized” based upon three levels of availability and four levels of confidentiality (DoIT policy # 05-02 – *Data Categorization*). As a result of the “data classification”

review, Taxation classified the data as “sensitive”, therefore, requiring it to be encrypted using 256 bit or higher encryption strength. However, although Taxation has performed the “data classification” review, it does not currently have a mechanism to encrypt the data automatically (Taxation is in the process of implementing a new system that is designed to encrypt data automatically).

Taxation utilizes two financial institutions for ACH payments. One institution has the primary contractual responsibility for most operations; however, responsibilities handled by the second institution have still not been transitioned to the primary financial institution. Enhanced coordination with the primary financial institution regarding file layouts and unique processing requirements could alleviate the need to modify the tax payment files prior to upload to Taxation’s systems.

**RECOMMENDATIONS**

- 2015-016a      Implement a mechanism to encrypt data classified as “sensitive” automatically consistent with DoIT policies.
  
- 2015-016b      Secure all electronic files containing taxpayer information residing on the Division of Taxation’s network to ensure data integrity.
  
- 2015-016c      Control all electronic files that contain taxpayer information by requiring the file format to be secure and configured to the computer system in order to allow automatic transmission without any manual intervention.
  
- 2015-016d      Develop monitoring and reporting procedures to ensure the proper upload of data files.

Corrective action plan / auditee views:

*2015-016a - The Division of Taxation continues to work with the Division of Information Technology to meet the encrypted data requirement. All files received by the Division of Taxation are received in encrypted format. A procedure will be put into place by DoIT to encrypt files as they are transferred into the network and to keep them encrypted while they are stored on the secure server. The Division is in the process of encrypting all archived (prior year EFT files) files on the internal servers.*

*2015-016b - All files received by the Division of Taxation are received in encrypted format. A procedure will be put into place by DoIT to encrypt files as they are transferred into the network and to keep them encrypted while they are stored on the secure server. The Division is in the process of encrypting all archived (prior year EFT files) files on the internal servers.*

*2015-016c - DoIT will take over all file transmissions for the Division of Taxation through a Production Control Specialist position. This position will not have access to the STAARS application. (Separation of Duties) All files transmission will be secured on the FTP server accessible to Taxation Staff. Inbound files will then be passed back to the Integration Server, and then processed by the application. This satisfies the 3-tier security standards. Outbound files will follow the same path.*

*Certain payment types such as Fed Wire, do not allow the Division complete control over what is sent. The Division will work with RSI and DoIT to develop procedures to enhance the data quality coming from 3<sup>rd</sup> parties and will also develop edits and programmatic error correction and reporting on invalid data. This will eliminate the need to manually adjust the data in the file. Any adjustments would be auditable through the application.*

*In the new Division of Taxation system (STAARS) all electronic files will be processed through an encrypted file on its FTP server. Then it will be loaded into STAARS and all adjustments will be made after it is loaded into STAARS. However, certain payment types (Fed Wire) do not allow the Division complete control over what is sent; therefore, the Division may have to manually adjust the file prior to loading it into STAARS. The Division of Taxation will be collaborating with the primary and secondary financial institutions to enhance coordination regarding file layouts and unique processing requirements.*

*2015-016d - The Division of Taxation has the ability to report on the total EFT payments received by the bank and the total amount to be processed by STAARS and the Mainframe system. During the STAARS reconciliation process, the Division is able to verify the total amount deposited and the process from EFT in STAARS by running specific reports to confirm the information needed.*

*Anticipated Completion Date: Incrementally for all reports during implementation of STAARS throughout 2016 with the goal of being fully compliant by June 30, 2017.*

*Contact Person: Neena S. Savage, Acting Tax Administrator  
Phone: 401.574.8922*

**Finding 2015-017**

*(significant deficiency - new finding)*

**DEPARTMENT OF REVENUE - OFF-SITE STORAGE OF TAXATION CRITICAL DIGITAL BACKUP FILES**

**Certain critical Division of Taxation back-up data files are not stored off-site – a recommended disaster recovery best practice.**

The Division of Taxation is implementing a new integrated tax system named STAARS (State Tax Administration and Revenue System) to replace its aging legacy mainframe-based system. The implementation is in phases with the full system slated for operation in fiscal 2017 (September 2016).

Industry best practices recommend that any critical computer system be backed up for disaster recovery purposes. Back-ups should be stored off-site thereby allowing system recovery in the event of disaster at the data center. The State has a process where back-up files are transported routinely to an off-site storage location. Although the production environment of STAARS was being backed-up on digital media, the backup media was stored within the data center rather than at an off-site location. This limits the effectiveness of the back-up file storage process particularly for critical system files.

**RECOMMENDATION**

2015-017      Ensure that digital backups are stored off-site for disaster recovery and business continuity purposes.

**Corrective action plan / auditee views:**

*The Division of Taxation agrees with this finding and the resolution of this finding is outside of the Division of Taxation’s control. The Division will work with the Office of Digital Excellence and Department of Information Technology to ensure that all digital back-ups are stored consistent with best practices.*

Currently the Division of Taxation has a series of digital backups that are retained according to current record retention policies. These backups are currently **not** sent off-site. DoIT is working to secure off-site storage of these encrypted backups.

The Division of Taxation does have Failover capability between the EOC and DOA. Currently all servers and databases are replicated at the DOA through Site Recovery Manager. This ensures that the Division of Taxation, in the event of a loss of the data center infrastructure would have all the production data within an hour of the outage. It would allow the Division of Taxation to conduct business as usual.

A full Disaster Recovery plan, which includes SunGard, should be updated now that the Mainframe has been retired for Personal Income Tax. This will need to be updated again in 2017 once the rest of the taxes have been converted off the mainframe.

*Anticipated Completion Date:* The implementation of this corrective action is outside the control of the Division of Taxation; however, the Division will monitor this issue and work to resolve it over the next year.

*Contact Person:* Neena S. Savage, Acting Tax Administrator  
Phone: 401.574.8922

**Finding 2015-018**

*(material weakness - repeat finding)*

DEPARTMENT OF REVENUE – RECONCILIATION OF TAXATION RECEIPTS TO RIFANS

**The Division of Taxation does not reconcile receipts posted to its systems with receipts reported in the RIFANS accounting system.**

Although the Division of Taxation reconciles their cash receipts ledger (subsidiary system) to RIFANS, controls would be improved if receipts reported within its mainframe systems were reconciled to RIFANS. RIFANS data is the basis for much of the information utilized by the State for financial reporting and the reconciliation of that data with Taxation’s systems (the official record for tracking tax payments and refunds) would provide enhanced control over the State’s reporting of tax revenue.

RECOMMENDATION

2015-018      Develop the reporting capability to facilitate reconciliation of receipts reported by Taxation’s systems with RIFANS.

Corrective action plan / auditee views:

*One of the primary purposes of initiating and implementing the integrated tax system (STAARS) over the past 3 years is to overhaul the front end accounting and deposit systems. The system will also allow for real time posting of payments and timely posting of transactions to taxpayer accounts; therefore, any deposit made will be recorded in a more efficient manner. The Release 1 (36 Off-line tax types), 1.5 (IFTA), and 2 (personal income tax) since July 2014 has: i) established better control over non-mainframe taxes types; ii) provided enhanced controls over non-mainframe taxes; and iii) eliminated the need to enter the deposit in multiple databases. The Division is also implementing transitional processes to enhance controls; however, all issues will be resolved when the integrated tax system is fully implemented in June 2017.*

Anticipated Completion Date: *Incrementally for all reports during implementation of STAARS throughout 2016 with the goal of being fully compliant by June 30, 2017.*

Contact Person: *Neena S. Savage, Acting Tax Administrator  
Phone: 401.574.8922*

***Finding 2015-019***

*(material weakness - repeat finding)*

DEPARTMENT OF REVENUE – PERSONAL INCOME TAX - CONFIDENTIAL  
COMMUNICATION

A finding concerning the administration of the personal income tax system was communicated confidentially due to the potential impact on taxpayer compliance.

**Finding 2015-020**

*(significant deficiency - repeat finding)*

INTERMODAL SURFACE TRANSPORTATION FUND - FINANCIAL REPORTING

**Controls can be improved over the preparation of financial statements to ensure consistent and accurate reporting of fund activity in accordance with generally accepted accounting principles.**

The Intermodal Surface Transportation (IST) Fund, a special revenue fund, includes financial reporting for transportation related activities of the State, including the highway construction programs, the expenditure of proceeds from the State's Grant Anticipation Revenue Vehicle (GARVEE) bonds and matching Motor Fuel bonds for specific highway construction related projects in addition to the funds received from the sale of excess land to the I-195 Redevelopment District Commission.

Controls over the Preparation of Financial Statements

Controls can be improved over the preparation of financial statements to ensure consistent and accurate reporting of fund activity in accordance with generally accepted accounting principles as follows:

- ❑ The RIFANS hierarchy approvals for journal entries were not operating correctly during fiscal 2015. Although RIDOT instituted compensating controls by routing journals prepared by one individual to another for approval, the RIFANS control procedures, when operating appropriately, are more reliable and effective to prevent any one individual from initiating and approving a journal entry that could materially affect the financial statements.
- ❑ RIDOT accrues liabilities for pollution remediation related to specific projects. The amount accrued was not properly supported in all cases causing adjustments to be made to the financial statements.
- ❑ Multiple activities and funding streams are included within the IST Fund. Although combined for financial reporting purposes, each activity or funding stream requires separate analysis to ensure amounts are accurately reported. Classification of fund balance by category – nonspendable, restricted, committed, assigned, and unassigned - is dependent upon the analysis of each activity and/or funding stream. Our analysis identified misclassifications of various fund balance categories. Controls over the reporting of fund balance would be improved by vesting the responsibility for maintaining the fund balance accounts with RIDOT.
- ❑ Controls over the reporting and accounting of fees collected by the Division of Motor Vehicles (DMV) and transferred to RIDOT in accordance with RI General Law 39-18.1 can be improved by documenting how the fee structure identified by RI General Law 39-18.1 has been incorporated into the DMV computer system.
- ❑ There were several adjustments to payables, receivables, and transfers booked to the financial statements in order for the statements to be materially correct.

RECOMMENDATIONS

- 2015-020a      Improve controls over financial reporting by updating the RIFANS hierarchy to include RIDOT in all journals posted to the IST Fund and lower the dollar threshold requiring journal entries to be reviewed and approved to an amount that could not materially misstate the financial statements. Ensure RIFANS is requiring review and approval of journal entries in accordance with established

hierarchies.

- 2015-020b Improve controls over the recording of pollution remediation projects, to ensure the amount reported as liabilities are adequately supported by documentation and calculations.
- 2015-020c Ensure the transactions identified through the analysis of each activity and/or funding source within the IST Fund are booked to the general ledger. Also improve controls over the categorization and reporting of fund balance components. Vest responsibility for maintaining the fund balance accounts with RIDOT.
- 2015-020d Strengthen control procedures over the fees collected by the Division of Motor Vehicles (DMV) and transferred to RIDOT to ensure compliance with General Law chapter 39-18.1.
- 2015-020e Improve controls over financial reporting to ensure payables, receivables and transfers are properly recorded in the State's accounting system and financial statements.

Corrective action plan / auditee views:

2015-020a - Updating the RIFANS hierarchy is solely the purview of the Controller's Office, who historically have not been in favor of establishing this process, primarily because it would require RIDOT to approve journal entries and allocations that are not related to the IST Fund.

Anticipated Completion Date: To be determined.

Contact Person: Loren Doyle, Chief Financial Officer  
Phone: 401.222.6590

2015-020b - The department will evaluate and update the policies and procedures with regard to pollution remediation to ensure proper documentation is included to support remediation estimates.

Anticipated Completion Date: December 31, 2016

Contact Person: Loren Doyle, Chief Financial Officer  
Phone: 401.222.6590

2015-020c - The department is in the process of modifying procedures to ensure transactions are properly booked in the General Ledger. RIDOT will work with Accounts and Control to improve controls of the categorization and reporting of fund balance components.

Anticipated Completion Date: December 31, 2016

Contact Person: Richard DeOrsey, Assistant Administrator/  
Financial Management  
Phone: 401.222.6590

2015-020d - RIDOT Financial Management will coordinate with the Division of Motor Vehicles Financial Section to develop a strategy to strengthen control procedures.

Anticipated Completion Date: To be determined.

Contact Person: Loren Doyle, Chief Financial Officer  
Phone: 401.222.6590

2015-020e - The department will improve controls over financial reporting to ensure payables, receivables and transfers are properly recorded.

Anticipated Completion Date: June 30, 2016

Contact Person: Loren Doyle, Chief Financial Officer  
Phone: 401.222.6590

**Finding 2015-021**

*(material weakness - repeat finding)*

**TRANSPORTATION INFRASTRUCTURE REPORTING**

**Controls should be improved over the process used to accumulate reported transportation infrastructure assets, the State’s most material capital asset category, to ensure accurate reporting of such investments.**

Process to Accumulate Infrastructure Outlays

The process performed by RIDOT to determine capitalized infrastructure outlays is manually intensive and requires reconciliation to the State’s accounting system. Amounts reported as capitalized infrastructure are derived from project-level data contained in the RIDOT Financial Management System (FMS). The project information obtained from the FMS includes large amounts of data that must be sorted, subtotaled, categorized and reconciled. This significant volume of transactions and required data analysis increases the risk of error.

RIDOT’s process to accumulate capital outlays utilizes actual construction expenditures but includes estimated amounts for design costs for some projects. Estimates are currently utilized, in certain instances, because RIDOT’s system does not report design costs as part of project expenditures. Design expenditures, which are normally contracted separately from project construction, must be manually allocated or estimated. RIDOT should implement more effective systemic controls to accurately account for actual design costs relating to infrastructure projects.

We noted misstatements relating to the infrastructure balances initially reported for fiscal 2015. Certain projects totaling \$7 million were erroneously reclassified from construction in progress to infrastructure during fiscal year 2015. Although corrected through audit adjustment, these misstatements indicate that controls should be improved over the process for identifying projects to be included in construction in progress and infrastructure.

Also, RIDOT was not consistent in applying estimated internal design costs to overall project costs, which resulted in a potential misstatement of \$244,267.

Explore an Automated Approach to the Accumulation of Capitalized Infrastructure Outlays

The control deficiencies noted here are significantly interrelated to the issues detailed in Strategic Issue Finding 2015-003 which describes the use of two incompatible accounting systems to prepare financial statements for the IST Fund. Due to the use of the two systems, accumulation of infrastructure

outlays meeting the State’s capitalization criteria is performed independent of both systems. Data is drawn from both systems into massive spreadsheets which eventually yield the amounts needed for financial reporting purposes. The design of RIDOT’s FMS envisioned that system providing capital asset (infrastructure) financial reporting information; however, the use of the two systems in the current configuration leads to the inefficient and error-prone spreadsheet approach.

The Department of Transportation and the Office of Accounts and Control should explore whether there may be a less cumbersome and more efficient means, ideally through an automated systems approach, to accumulate infrastructure investments for inclusion in the financial statements.

#### Asset Impairments

Generally accepted accounting principles for governmental entities require that capital assets be evaluated for impairment when events or changes in circumstances suggest that the service utility of a capital asset may have significantly and unexpectedly declined. These standards also require adjustment of the carrying value of capital assets that meet certain impairment criteria. RIDOT was unable to document its consideration of transportation infrastructure assets that may meet the impairment criteria and provide such documentation to the Office of Accounts and Control for the purpose of preparing the State’s financial statements.

#### RECOMMENDATIONS

- 2015-021a      Develop controls over the identification of project expenditures (to include construction costs, design costs, internal payroll, subtotaling of project expenditures, categorization of projects and reconciling between RIDOT FMS and RIFANS) to be recorded as infrastructure investment in the State’s financial statements.
- 2015-021b      Explore ways that capitalized infrastructure outlays could be accumulated through an automated systems approach rather than the inefficient and error-prone spreadsheet approach currently used.
- 2015-021c      Evaluate and document the consideration of whether any of the State’s transportation infrastructure has been impaired consistent with the criteria outlined in generally accepted accounting principles applicable to governmental entities.

#### Corrective Action / Auditee Views

*2015-021a - Financial Management will continue to improve controls over the identification of project expenditures to be recorded as infrastructure investment in the State’s financial statements. In addition, the department is in the process of implementing a Project Pipeline Tracking System which will identify specific project costs.*

Anticipated Completion Date:    *Ongoing*

Contact Person:                      *Loren Doyle, Chief Financial Officer  
401.222.6590*

*2015-021b - The Department does not dispute the auditors’ contention that a properly-aligned, automated systems approach would be a more efficient way to account for infrastructure assets. An internal committee meets regularly to continue implementing the department’s comprehensive Asset Management initiative, including assessing information technology needs. The committee is*

charged with evaluating infrastructure accounting issues and will evaluate an automated systems approach.

Anticipated Completion Date: To be determined.

Contact Person: Loren Doyle, Chief Financial Officer  
Phone 401.222.6590

2015-021c- This issue is currently being evaluated and has been discussed with the Department's various sections. The resolution of this recommendation will require a high level of collaboration and coordination between Financial Management and various department units.

Anticipated Completion Date: To be determined.

Contact Person: Loren Doyle, Chief Financial Officer  
Phone: 401.222.6590

**Finding 2015-022**

*(significant deficiency - repeat finding)*

**INTERMODAL SURFACE TRANSPORTATION FUND – CONTROLS OVER KEY DATA FILES**

**Controls should be enhanced to ensure that data integrity is maintained over key data files used to process vendor payments and to draw federal funds for the Intermodal Surface Transportation (IST) Fund.**

Progress Payment Data Files

Progress payment data moves from the Project Management Portal (PMP) to RIDOT's Financial Management System (FMS) and ultimately RIFANS (the State's accounting system) for vendor payments. Data elements are sometimes manually altered after being transmitted from the PMP but prior to posting to the FMS accounting system.

While the need to manually verify and modify data was explained, the lack of adequate compensating controls increases the risk of inaccurate payments and unauthorized changes. In addition, RIDOT has a policy prohibiting certain actions (e.g., approving and releasing holds of self-initiated progress payments); however, the system does not prevent such actions.

A review of the entire file transfer process, from progress payment file creation in PMP to invoice creation in FMS to vendor disbursement in RIFANS, should be performed to identify critical points where automated controls should be implemented to eliminate all manual involvement.

Federal Billing

There are instances where the Highway Planning and Construction draw down file is modified prior to submission to the Federal Management Information System (FMIS). RIDOT's FMS does not fully provide the level of data required to draw federal funds as required by the Federal Highway Administration which necessitates the file modifications. We observed the following weaknesses:

- ❑ The FMS does not have the capability to link multiple funding sources award numbers (FSAN) to one Federal Aid Project (FAP). The Federal Highway Administration links many FSANs to one FAP and requires RIDOT to draw down funds by the FSAN. Consequently, RIDOT after

creating the drawdown file, manually splits draw requests between multiple FSANs.

- ❑ The file is in an open text format with no encryption. This open text format allows anyone who has access to the server directory to modify the file.
- ❑ There is no change management system in place tracking changes to the file, documenting who made the change, or requiring management approval of changes.

RIDOT should improve its controls and processes over the FMS and the drawdown file to ensure accuracy and completeness of data transmitted to the FMIS.

### RECOMMENDATIONS

- |           |  |
|-----------|--|
| 2015-022a | Review the progress payment file transfer process to identify critical points where automated controls could be implemented to eliminate the need for manual intervention. |
| 2015-022b | Create and implement appropriate approval hierarchies. Automatically identify RIFANS/FMS payment discrepancies for review.   |
| 2015-022c | Improve controls over the RIDOT federal billing process to include transferring files without modification.  |
| 2015-022d | Modify the Financial Management System to allow for multiple funding source award numbers (FSAN) to be linked to one Federal Aid Project.                                  |

#### Corrective action plan / auditee views:

*2015-022a - Discussions and analysis will continue regarding the potential implementation of automated controls in lieu of the manual intervention currently required in certain situations. Manual intervention can occur for a variety of reasons, and budgetary constraints are a limiting factor for the Department's ability to automate the process.*

*Since September 2011, as a compensating control, the Financial Management Office's Accounts Payable Unit has kept a log, including (a) "before and after" screen shots showing the change that was made; (b) sign-offs from both the processor and supervisor; and (c) a notation on the log indicating why the file needed to be changed.*

Anticipated Completion Date: *To be determined.*

*Contact Person: Loren Doyle, Chief Financial Officer  
Phone: 401.222.6590*

*2015-022b - During the FMS system upgrade to Oracle Release 12.4, the issue of implementing Approval Hierarchies will be evaluated. Also, existing reports have been modified to determine discrepancies in invoice payment amounts between FMS and RIFANS.*

Anticipated Completion Date: *December 31, 2016*

*Contact Person: Thomas Lewandowski, Agency IT Manager  
Phone: 401.222.6935*

*2015-022c - This issue has been discussed at length with Tom Lewandowski of DOIT and he has informed Financial Management that this cannot be accomplished with the current FMS system.*

*2015-022d - This issue has been discussed at length with Tom Lewandowski of DOIT and he has informed Financial Management that this cannot be accomplished with the current FMS system.*

*Anticipated Completion Date: To be determined.*

*Contact Person: John Megrđichian, Administrator for Financial Management  
Phone: 401.222.2496*

**Finding 2015-023**

*(significant deficiency – new finding)*

DEPARTMENT OF LABOR AND TRAINING - UNEMPLOYMENT INSURANCE PROGRAM –  
INFORMATION TECHNOLOGY SECURITY CONTROLS

**User password access controls and defined user access roles are not adequate within the Unemployment benefit computer application.**

The Unemployment Insurance benefit application system has deficient (1) user administration security controls and (2) access controls for its user group, which has led to segregation of duties concerns. System user roles do not match the level of access employees should be assigned based on their job title/description resulting in the ability to modify data within claimant applications without supervisory review or approval. No periodic review of access controls is performed to ensure changes to access rights are authorized and there are no automated system controls configured to alert management of any modifications or changes to user access changes or application and data changes.

In addition, certain Unemployment Insurance system users were found to be sharing user IDs and passwords in violation of DoIT policy and thereby weakening access controls to the system. The Department of Labor and Training (DLT) has no formalized and recurring IT security awareness training program to reinforce policies and educate users on the risks of password sharing and other IT security concerns as required by DoIT policy.

During most of fiscal 2015, passwords were not required to be of sufficient strength and complexity (usage of upper case characters, lower case characters, numbers, and special characters and required length) and were not prompted to be changed at frequent intervals.

The combination of poor access controls and poorly designed and administered access roles weakened controls over the administration of unemployment benefits paid through the system.

DLT is currently anticipating implementation of a new unemployment benefit system and accordingly, we understand that modifications are not planned for the existing benefit system. In the interim, the Department should implement reasonable control procedures to mitigate the control weaknesses observed. Further, the Department must ensure that appropriate IT security controls are designed and operational in the new system upon implementation.

RECOMMENDATIONS

- 2015-023a      Implement reasonable interim IT security control procedures to mitigate the known weaknesses in the unemployment benefit system until the new application is implemented.
- 2015-023b      Ensure the new unemployment insurance benefit application being developed meets DoIT IT security policy requirements.
- 2015-023c      Implement an IT security awareness and training program in accordance with *DoIT policy 10-06 Section 3* and industry best practices.

Corrective action plan / auditee views:

*2015-023a - The Department of Labor & Training is reviewing the current IT security controls with special emphasis on roles and responsibilities. New policies exist to limit what can be changed in the system and by whom. Additional changes in the main UI application are currently*

approved and are waiting for approval from UI for implementation. These address many of the concerns in regards to data modification. These changes and implementation are as follows:

- 1) Staff will no longer be able edit the client remark record.
- 2) Expanded auditing capability
- 3) Limit staff who can edit wage records
- 4) New tracking for deleted client PINs
- 5) New reporting for claims paid beyond benefit year date

UI is also conducting a review of the roles and responsibilities of all UI staff. Users will be assigned privileges based on the minimum privileges needed to perform the job function they are assigned. Review of those privileges assigned will be done by UI management staff on a regular basis.

No longer are User ID's shared. In addition, password changes are required quarterly and meet all DoIT Policy requirements for strength and complicity.

In early 2015, DoIT upgraded all security protocols to address systems based roles and responsibilities as defined by UI. Procedures for user access control and changes have been upgraded to alert management of modifications or changes to access or data.

2015-023b - The UI insurance system is being developed to meet current DoIT security policies and well as IRS PUB 1075 security requirements. The DoIT Enterprise Security Team is aware of the development of the new application. Before acceptance the application will be submitted to the Enterprise Security Team for a thorough review.

2015-023c - The UI staff currently undergoes regular security awareness training. Including in that training is review of DoIT security policies as well as local UI policies. Issues such as locking unattended workstations as well as password security are thoroughly addressed in those trainings.

Anticipated Completion Date: April 30, 2016

Contact Person: Robert Genest, Administrator MIS  
Phone:401.462.8012

**Finding 2015-024**

*(material weakness - new finding)*

**RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – RECORDING OF FINANCIAL TRANSACTIONS**

*Criteria:* The Authority is responsible for preparing its financial statements, and designing and implementing internal control over financial reporting to prevent, and correct and detect on a timely basis material errors.

*Condition:* Certain transactions were not recorded in the Authority’s books and records in the period in which the underlying transaction occurred or consistent with the financial elements of the underlying transactions.

*Cause:* Prior to the year ended June 30, 2015, the Authority replaced its Chief Financial Officer. The transition period extended through the fiscal year-end procedures.

*Effect:* Significant audit adjustments were required to record transactions, adjust previously recorded amounts, or reclassify the manner in which previously recorded amounts were presented. As a result, audit adjustments were required in the following areas:

- Record accounts payable and accrued expenses for goods and/or services received prior to year-end as a result of the absence of a process to determine whether expenses or other transactions were properly cut-off as of year-end.
- Reclassify as capital assets amounts recorded as expenses which met the Authority’s asset capitalization policy, and to record as expenses amounts recorded as capital assets which were not consistent with the Authority’s asset capitalization policy.
- Record as an expense electronic toll commission fees which were recorded as a reduction to the Authority’s electronic toll liability.

**RECOMMENDATIONS**

2015-024a We recommend that the management design and implement a process which includes a review of transactions occurring shortly after each reporting period to determine whether all transactions were recorded in the proper period, are properly classified, and to adjust previously recorded transactions based on the most recent information available.

2015-024b We also recommend that a person independent of the person responsible for identifying and recording such transactions review available financial information and approve recorded transactions to determine whether all transactions were properly recorded during the period to which they relate based on the substance of the underlying transaction.

**Corrective action plan / auditee views**

*The CFO has instituted new monthly closing procedures which include a review of the transactions for each month and reclassification if necessary. This will be completed by a person independent of the person responsible for the original recording of the transactions.*

**Anticipated Completion Date: Ongoing**

Contact Person: Maggie Baker, Chief Financial Officer  
Phone: 401.423.7430

**Finding 2015-025**

*(material weakness - repeat finding)*

METROPOLITAN REGIONAL CAREER AND TECHNICAL CENTER (THE MET) – INTERNAL CONTROLS

*Criteria:* Internal controls should be in place to provide reasonable assurance that general ledger accounts are properly reconciled on a timely basis.

*Condition:* During the performance of our audit of the Met's financial statements, we noted the following:

- a. The monthly reconciliation of the operating cash account included large unidentified variances that were not researched or resolved in a timely manner. The June 2015 operating bank reconciliation originally provided to us contained a variance of \$53,681. The updated reconciliation still contains a variance of \$6,306.
- b. The Met had difficulty in providing a detailed accounts payable schedule due to limitations in its financial management system. The detailed payable schedule as of June 30, 2015 was \$18,513 more than the balance in the general ledger.

Both items are repeat findings from 2014.

*Cause:* Management failed to enforce policies and procedures to ensure internal controls are functioning properly in relation to the condition listed above.

*Effect:* Failure to perform reconciliations of significant accounts in a timely and accurate manner is a deficiency in the operation of controls. Specifically,

- a. Failure to reconcile cash accounts to bank statements on a timely basis could potentially result in errors or defalcations not being discovered timely. In addition, management is unable to efficiently monitor the Met's cash on hand.
- b. Failure to reconcile the accounts payable reflected on the general ledger to the detail schedule affects the liquidity analysis and is a failure in financial reporting.

RECOMMENDATION

2015-025 Policies and procedures should be developed and implemented by the Met's management to ensure that appropriate internal controls are enforced.

Corrective action plan / auditee views

- a. *The Met has implemented a process where monthly reconciliations are performed by the Bookkeeper once bank statements for the prior month have been received. The Met also requires that monthly reconciliations be signed off by both the Chief Accountant and Business Manager in order to insure timeliness and accuracy. The reason for the unknown variance was due to an incorrect adjusting entry made at year end. Once the entry was reversed, the reconciliation was in line with prior reported balances. Timeliness of the resolution was an issue due to a change in personnel in the Chief Accountant role.*

- b. *The Met has procured a new Financial Accounting and Management system and has worked in tandem with the Rhode Island Department of Education and other municipal school districts to select the most appropriate and qualified vendor, through the State of Rhode Island's competitive procurement process which, can meet all required accounting standards and internal control requirements. The Met is currently implementing this new system and it is anticipated that his new system will be fully functional in January of 2016.*

Anticipated Completion Date: Ongoing

Contact Person: Lucas Lussier, Chief Financial Officer  
Phone: 401.752.2600

**Finding 2015-026**

*(material weakness - repeat finding)*

CENTRAL FALLS SCHOOL DISTRICT – SEGREGATION OF DUTIES

*Criteria:* Segregation of duties is an instrumental component to having an effective system of internal controls. Proper segregation of duties decreases the District's risk of intentional or unintentional misuse or misappropriation of District assets. Duties and responsibilities should be assigned to personnel so that no one person is responsible for all aspects of a financial transaction. In addition, monthly reconciliations should be signed as reviewed and approved by someone independent of the preparation process.

*Condition:* During our audit we noted that there is a lack of segregation of duties being performed by personnel in the finance department. We noted instances where finance personnel responsible for reconciling monthly bank accounts were also responsible for collecting and depositing receipts, preparing billing for certain benefits, and maintaining the general ledger. We also noted that certain personnel had the ability to generate and post journal entries to the general ledger accounting system without first obtaining an approval of those entries.

*Cause:* Lack of adequate staffing and/or failure to properly establish a formalized system of internal controls over the segregation of duties.

*Effect:* Increase in the risk of intentional or unintentional misstatements occurring and going undetected by management.

RECOMMENDATION

- 2015-026 We recommend that the District establish a committee to review the current staffing of the finance department as well as the roles and responsibilities of all finance personnel. We further recommend that this committee be charged with developing formal policies and procedures governing the roles and responsibilities for all members of the finance department. The roles and responsibilities should focus on maintaining adequate segregation of duties and also rotation of those duties on a periodic basis so that all employees are properly trained. In addition, the policies should require that all bank reconciliations be reviewed and signed as approved on a monthly basis by the finance director or another management official if the reconciliations are being completed by the finance director.

Corrective action plan / auditee views:

*Effective in FY16, monthly reconciliations will be reviewed and signed by the Director of Finance. Due to a lack of consistency in finance positions, the Director has not been able to develop internal controls. One of the first tasks of the permanent Director of Finance would be to establish a committee to review current staffing and roles and responsibilities.*

Anticipated Completion Date: Ongoing

Contact Person: Therese M. Lusignan-Chalko, Financial Director  
Phone: 401.727.7700

**Finding 2015-027**

*(material weakness - repeat finding)*

CENTRAL FALLS SCHOOL DISTRICT – JOURNAL ENTRIES

Criteria: Adjusting journal entries should be approved by a designated member of management and contain descriptions and supporting documentation.

Condition: During our review of the general journal entries we noted that entries often lack proper approval by a responsible employee. All journal entries should be accompanied by full explanations and referenced to verifiable supporting data and contain a signature of proper approval by someone other than the person responsible for preparing and posting the entry.

Cause: Lack of sufficient internal controls over the review and approval process.

Effect: Increase in the potential for unauthorized or fraudulent transactions being posted to the general ledger. The District has the responsibility to safeguard its assets from loss or misuse.

RECOMMENDATION

2015-027 We recommend that the District implement internal controls and policies and procedures for posting of journal entries to the District's general ledger. We recommend the individual journal entries be approved by the Finance Director and/or another management official prior to posting and approval be documented on paper copy of entries filed in journal entry binders. We also recommend journal entries contain supporting documentation as well as affected account descriptions and purpose of entry. This will ensure a verifiable trail for transactions posted to the general ledger and ultimately the District's financial statements. In addition, we recommend that on a periodic basis a journal entry report be generated from the general ledger and that the report be provided to the Board of Trustees for review and approval. This approved report should be signed and maintained with the minutes to the Board meeting as evidence of the procedure being performed.

Corrective action plan / auditee views:

*The interim Finance Director started approving all Journal Entries in April 2015; a register containing supporting documentation for all Journal Entries is now maintained by the staff accountant.*

Anticipated Completion Date: Ongoing

Contact Person: Therese M. Lusignan-Chalko, Financial Director  
Phone: 401.727.7700

**Finding 2015-028**

*(significant deficiency - repeat finding)*

CENTRAL FALLS SCHOOL DISTRICT – COMPLETE GENERAL LEDGER

**Criteria:** The general ledger accounting records of the district should contain and report all assets, liabilities, fund balances, and the financial activity of the District.

**Condition:** During our audit testing we became aware of several bank accounts which were not reported in the general ledger accounting records of the District. Although the balances in those accounts were not significant, the District should have adequate procedures in place to ensure that all accounts are properly reflected in the general ledger accounting records.

**Cause:** Lack of management oversight and failure to ensure the completeness of the general ledger accounting records.

**Effect:** Incomplete accounting records could result in the misstatement of financial position and results of operations. In addition, lack of accountability and controls over these accounts increases the risk of intentional or unintentional misappropriation of funds.

RECOMMENDATION

2015-028 We recommend that the District establish policies and procedures to ensure that all financial activity is properly reported in the general ledger accounting records. All periodic bank statements should be reconciled to the general ledger accounting records and signed by someone independent of the person preparing the reconciliation as evidence that the procedures were performed. Any bank or investment statement that is received by the District but which cannot be traced to the general ledger should be provided to the Superintendent of Schools for review.

Corrective action plan / auditee views:

*As explained to the auditors, the bank accounts noted are scholarships controlled by the family of a deceased member or a fund to support extra-curricular activities. Signatory on the account is not employed by the School District. All other cash accounts have been added to the general ledger.*

Anticipated Completion Date: Ongoing

Contact Person: Therese M. Lusignan-Chalko, Financial Director  
Phone: 401.727.7700

**Finding 2015-029**

*(significant deficiency - repeat finding)*

CENTRAL FALLS SCHOOL DISTRICT – CUT OFF PROCEDURES

*Criteria:* Establishment of adequate cut-off procedures is necessary to ensure the reporting of activity and balances are recorded in the proper period. The proper reporting of activity will help to ensure that management is making financial decisions based on the appropriate facts.

*Condition:* During our audit we noted instances where the District did not properly report receipts and receivables.

*Cause:* Finance personnel were reporting the Medicaid revenue on the cash basis of accounting and as a result, the District's internal financial reports did not include a receivable for the quarterly administrative component of the Medicaid funding. In addition, the District did not have a policy or procedure for recording the revenue collected by a third party for retiree medical coverage. This activity was maintained in a separate cash account and was only recorded periodically when a check was disbursed to the District's General Fund.

*Effect:* Understatement of the financial position and activity of the District. Although the Medicaid billing is reported as a deferred inflow of resources on the Fund Statements, and therefore does not impact the operating results of the District, it does impact the financial position and activity of the Government-wide Statements of the District.

RECOMMENDATION

2015-029      We recommend that management review the current policies and procedures for recording the financial activity to ensure that all financial activity is recorded in a timely manner and in the proper period. Procedures should be implemented to ensure that all revenue, expenditures, and expenditure reimbursement activity is reported in the proper period.

Corrective action plan / auditee views:

*Effective with the 2016 fiscal year, policies and procedures will be in place to record all financial activity in the proper period.*

Anticipated Completion Date:    *Ongoing*

*Contact Person:*                      *Therese M. Lusignan-Chalko, Financial Director*  
*Phone: 401.727.7700*

**Finding 2015-030**

*(significant deficiency - repeat finding)*

CENTRAL FALLS SCHOOL DISTRICT – CAPITAL ASSETS

*Criteria:* Capital assets are maintained by the District and reported in the Government-Wide Statement of Net Position. Although these capital assets and the related depreciation do not impact the Fund Statements of the District, they do have an impact on the overall governmental net position. Additionally, the District is required to maintain capital asset records for all assets that are purchased with federal grant funds.



*Anticipated Completion Date: Ongoing*

*Contact Person: James McCarvill, Executive Director  
Phone: 401.351.4295*

2015



*Management Comments*

**Management Comment 2015-1**

(new comment)

IDENTIFICATION OF PAYMENTS OF FEDERAL AWARDS TO SUBRECIPIENTS

Beginning in fiscal 2016, the State will be required under federal *Uniform Administrative Requirements, Cost Principles, and Audit Requirements* to identify federal awards passed-through to subrecipients on the Schedule of Expenditures of Federal Awards, included in the State’s Single Audit report. This information is not currently readily available in the State’s accounting system. Efforts must begin to enhance the accounting system’s ability to reliably accumulate the pass-through award amounts for each federal grant.

Modifications may be necessary to the current natural account codes that would allow for the consistent identification of subrecipient payments. Training may also be necessary to assist agencies in evaluating subrecipient and vendor relationships.

RECOMMENDATIONS

- MC-2015-1a    Modify natural account codes as necessary to consistently identify payments to subrecipients in the accounting system.
- MC-2015-1b    Develop statewide procedures and training to ensure appropriate evaluation of subrecipient and vendor relationships.

Corrective action plan / auditee views:

*For FY2016 the federal expenditures will be analyzed to determine the most efficient effective manner in which to identify federal disbursements to sub-recipients.*

*Beginning in FY2017 there will be modifications made to the chart of accounts segment for natural accounts to accommodate the separation of federal payments to sub-recipients from other payments.*

*In conjunction with the implementation of the 2017 account changes, a process will be developed to assist the agencies operating federal programs in the identification of a sub-recipient and the proper natural account for sub-recipient payments. Appropriate guidance and instruction will then be given to the appropriate agency personnel.*

Anticipated Completion Date:    June 30, 2017

Contact Person:                            Laurie Petrone, Director, Office of Federal Grants  
Administration  
Phone: 401.574.8423

**Management Comment 2015-2**

(repeat comment)

FINANCIAL STATEMENT DISCLOSURE OF SIGNIFICANT COMMITMENTS

Generally accepted accounting principles require the disclosure of significant commitments within the State’s annual financial statements. The State’s significant commitments include, among others, contractual obligations for infrastructure maintenance and construction, information technology development and implementation, and other vendor contracts for program operations.

Despite a centralized purchasing and procurement process within the State, the accumulation of the information necessary to disclose commitments is challenging since the recording of encumbrances (purchase orders issued resulting in a budgetary reservation of appropriations) is done consistent with the annual budget process. Therefore, an encumbrance is recorded only for the amount estimated to be expended in the budget year. While the RIFANS purchasing module captures certain balances for control purposes, there is no existing system or process that readily accumulates total contract or other commitments at the time of award or subsequently as payments reduce the total commitment.

In fiscal 2015, the Office of Accounts and Control implemented new procedures for identifying significant commitments – a hybrid approach of extracting long-term contract balances from the purchasing module supplemented by information from project managers at various State departments and agencies. These procedures yielded better information but highlighted the need to further enhance the processes and sources of the data.

The State should continue to explore options to accumulate such information from its systems thereby minimizing the amount of data collection and analysis.

**RECOMMENDATION**

MC-2015-2     Improve systems and procedures to enhance the disclosure of significant commitments within the State’s annual financial statements.

Corrective action plan / auditee views:

*The existing process regarding the disclosure of commitments was thoroughly reviewed and extensively enhanced during the fiscal year ending 6/30/2015. This provided much improved assurance that the total dollar amount of all significant commitments was disclosed in the notes to the financial statements. There are some incremental improvements that will be made to the process in the current financial reporting cycle for certain categories of commitments.*

Anticipated Completion Date:    December 1, 2016

Contact Person:                             Jennifer Findlay, Financial Reporting Manager  
 Phone: 401.222.5771

**Management Comment 2015-3** *(repeat comment)*

**DEPARTMENT OF CHILDREN, YOUTH AND FAMILIES - CHILDREN’S TRUST ACCOUNT**

The Department of Children, Youth and Families (DCYF) receives Social Security Administration (SSA) payments as the trustee for eligible children in State custody. These funds are used to (1) reimburse the State, in part, for the cost of care and (2) provide funds for the child’s personal needs. The Social Security payments are deposited into two separate bank accounts within the custody and control of DCYF. Disbursements are made from the accounts, independent of the State accounting system, by DCYF personnel. The bank balances and liability for undistributed funds are not recorded within the State’s accounting system.

On a quarterly basis, the cost of care for children receiving SSA payments is calculated. DCYF issues a check drawn on the DCYF Children’s Trust bank account to reimburse the State for the costs of care. These amounts are recorded as restricted revenue in the State accounting system. DCYF makes other disbursements for the personal needs of the children receiving the SSA payments. DCYF maintains

an internal system to record the receipt and disbursement of funds for each child.

Control over these funds can be enhanced by recording all such activity in the State’s accounting system. The initial receipt of SSA payments on behalf of children in the State’s custody should be recorded in an escrow liability account within the State’s General Fund. The funds in the existing bank accounts, now used to receive the deposit of the SSA payments, should be transferred to the custody of the State’s General Treasurer. A separate bank account should be established as an imprest account and funded from the primary bank accounts. This imprest account can remain in the custody of DCYF to facilitate disbursement of amounts for children’s personal needs.

**RECOMMENDATIONS**

- MC-2015-3a Record the Children’s Trust account cash and liability balances on the State’s general ledger. Reconcile general ledger amounts to DCYF records to ensure the obligation for deposits held on behalf of children in the State’s care is properly reflected in the State’s accounting system.
  
- MC-2015-3b Transfer custody of the primary bank account used to receive the SSA payments to the Office of the General Treasurer.

*Corrective action plan / auditee views:*

*DCYF has made progress by meeting with representatives of Accounts and Control and the Treasurer’s Office. We have established the RIFANS escrow liability accounts and developed the process and procedures for the transfer of the bank accounts to the Treasury. DCYF will transfer the bank account to Treasury no later than April 1, 2016.*

*Anticipated Completion Date: April 1, 2016*

*Contact Person: David Alves, DCYF Chief Financial Officer  
Phone: 401.528.3630*

**Management Comment 2015-4 (repeat comment)**

**MONITORING BILLING RATES AND OPERATIONS OF THE STATE’S INTERNAL SERVICE FUNDS**

One internal service fund (Assessed Fringe Benefits Fund) has had a deficit net position for four consecutive fiscal years. Despite a mid-year rate increase during fiscal 2015, the deficit increased by \$500,000 to \$1.9 million at June 30, 2015.

Ideally, internal service funds are intended to operate as close as possible to “break-even” - neither undercharging or overcharging the internal “customers” receiving fund services. Losses within an internal service fund signify that billing rates were inadequate to cover costs. Consequently, expenditures/expenses in other funds of the State should have actually been higher. Similarly, when rates are too high, excessive profits and net position accumulates signifying that “internal customers” have been overcharged.

Federal regulations (*Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*) state that working capital reserve balances within internal service funds should not exceed 60 days of cash expenses for normal operating purposes. We noted two

instances in which there was a working capital reserve significantly exceeding the 60-day expense reserve - the Central Warehouse and Correctional Industries funds each had working capital reserves exceeding 100 days of expenses at June 30, 2015.

Monitoring procedures should be enhanced to ensure that billing rates are appropriate to prevent significant losses or profits and to ensure compliance with federal regulations. An analysis at the mid-point in the fiscal year would be beneficial to adjust billing rates for the remainder of the fiscal year when warranted. When losses or excessive profits are realized, corrective action and rate adjustments should eliminate such amounts within the next fiscal year.

**RECOMMENDATION**

MC-2015-4 Enhance internal service fund monitoring procedures to ensure that billing rates are appropriate to prevent significant losses or profits and to ensure compliance with federal regulations.

*Corrective action plan / auditee views:*

*The financial staff at each of the respective agencies that manage internal service funds are responsible for ensuring that billing rates are sufficient to cover costs. As an added control measure, the Office of Accounts & Control will periodically evaluate the financial condition of internal service funds that are at risk of operating at a deficit. In instances where Accounts & Control discovers issues, the agencies will be contacted to ensure an action plan is developed to address any emerging deficits on a timely basis.*

*Anticipated Completion Date: June 30, 2016*

*Contact Person: Peter Keenan, Associate Controller  
Phone: 401.222.6408*

**Management Comment 2015-5**

*(repeat comment)*

**FINAL APPROVAL OF RIFANS JOURNAL ENTRIES**

The RIFANS accounting system uses category codes to route journal entry transactions through a series of system workflows for approval of general ledger direct transactions. Departmental initiators approve transactions through agency approval hierarchies before most general ledger transactions are routed for central review by the Office of Accounts and Control for final approval and posting. While, as a matter of policy, the Office of Accounts and Control requires certain category codes be used for specific purposes, there are no systemic functions restricting the individuals or departments from using the category codes.

During fiscal 2015, we noted two separate category codes that resulted in journal entries not routed to the Office of Accounts and Control for final approval. First, the category code for Electronic Benefit Transfer (TANF) funding transactions allowed those transactions to be initiated by the departmental users without being routed for final approval to the Office of Accounts and Control. In addition, we found that a second category code, generally reserved for use by personnel within the Office of Accounts and Control, was erroneously used by the Department of Business Regulation. Because the second category code was, by policy, limited to certain centralized accounting staff, there was no systemic workflow routing the transactions to final approval at the Office of Accounts and Control.

RIFANS does not systematically limit the accounts to which the departmental initiator can record financial activity. Additionally, system controls do not currently exist that either prevent or detect circumvention. As a result, departmental users can initiate and approve journal entry transactions impacting other departments, making final approval by the Office of Accounts and Control a necessary control over the State’s financial reporting.

RECOMMENDATION

MC-2015-5      Ensure that all journal entry transactions receive final approval by the Office of Accounts and Control prior to posting to RIFANS.

Corrective action plan / auditee views:

*We have requested that DOIT incorporate a systemic control in RIFANS to prevent staff outside the Office of Accounts & Control from using the referenced Journal Entry category (“Transfers”).*

Anticipated Completion Date:    June 30, 2016

Contact Person:                                Peter Keenan, Associate Controller  
Phone: 401-222-6408

**Management Comment 2015-6**

*(repeat comment)*

BANK ACCOUNTS - AUTHORIZED SIGNATORIES

The Office of the General Treasurer can enhance procedures to ensure that authorized signatories for each bank account within the control of the General Treasurer are current and reflect active authorized personnel. The lists of authorized signatories obtained from the State’s various bank institutions at June 30, 2015 included individuals no longer employed by the State.

RECOMMENDATION

MC-2015-6      Ensure authorized signatories for all State bank accounts are current. Make timely notifications and adjustments when personnel changes occur.

Corrective action plan / auditee views:

*Immediately after the change of administration in January 2015, Treasury Management notified all banks of the updated signors for the State’s bank accounts. These instructions indicated that all current signors should be removed and an entirely new roster, which was supplied to the banks, should be assigned.*

*Despite these clear instructions, one of the state’s banks did not fully execute on this task, failing to fully update account information on twelve of the state’s accounts. It is important to note that additional electronic security measures remained in place and would have precluded incorrectly listed signors from executing actual transactions.*

*Treasury Management has confirmed that the error has been corrected and has verified that all current account signors are correct.*

Treasury policy was to update the list annually, as well as upon the departure of any signor or the hiring of newly authorized personnel.

Going forward, Treasury Management will perform a quarterly review of all authorized signors on state bank accounts. This review will be in addition to the aforementioned policy.

Anticipated Completion Date: Fiscal 2016

Contact Person: Vincent T. Izzo, Jr.  
Cash Manager  
Phone 401.462.7650

**Management Comment 2015-7**

(repeat comment)

NEW FEDERAL COST PRINCIPLES - ASSESS THE IMPACT ON FEDERAL REIMBURSEMENTS

The federal government recently released new *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* which superseded federal cost principles (OMB Circular A-87), governing costs reimbursable under federal programs. The new uniform grant requirements have varying effective dates but some provisions became effective during fiscal 2015. The State's Office of Management and Budget has commenced training for the departments and agencies regarding the new uniform grant requirements; however, a comprehensive review should be performed to determine if there are areas across multiple federal programs where changes in the cost principles would either restrict or expand costs currently reimbursed under federal programs.

A comprehensive analysis should be performed and coordinated with the various departments and agencies to avoid any unexpected budgetary impact resulting from disallowed or unreimbursable costs.

RECOMMENDATION

MC-2015-7 Perform a comprehensive analysis to assess the impact of new federal uniform administrative requirements for federal awards.

Corrective action plan / auditee views:

*The Council on Financial Assistance Reform (COFAR) completed a comprehensive analysis of the changes under the new uniform administrative requirements. The analysis can be viewed at <https://cfo.gov/cofar/#RUUG>. The Office of Management and Budget has adopted this analysis and uses it as the basis for determining priorities for training and/or policy development.*

*The Grants Management Office actively monitors the impact of the new Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (aka as the Uniform Grant Guidance) through a variety of grants professional organizations such as National Grants Management Association, Thompson Interactive, and the national Grant Directors' working group.*

*The Grants Management Office continues to offer training on the new Uniform Grant Guidance for state agencies including training on the cost principles. The Thompson Interactive training series will continue in 2016. The following upcoming webinars include content related to the cost principles under the new Uniform Grant Guidance:*

- *Uniform Guidance Changes to Grants Allowability and Select Items of Cost*
- *When the Auditor Comes Knocking*
- *Improper Payments Under the Uniform Grant Guidance*

*Training dates will be scheduled with state agencies on these topics and on-demand information viewing will be provided to agency chief financial officers to ensure appropriate staff have access to this information should they not be able to participate in the in-person session. Additional training will be scheduled as announced by Thompson Interactive.*

*Anticipated Completion Date: Ongoing*

*Contact Person: Laurie Petrone, Director, Office of Federal Grants  
Administration  
Phone: 401.574.8423*

**Management Comment 2015-8**

*(repeat comment)*

**ACCOUNTING FOR FEDERAL DISASTER DECLARATION AID RECOVERIES**

Accounting for federal disaster assistance presents some unique challenges due to the State’s role as a conduit for funds flowing to municipalities and the length of time between the disaster, the incurrence of clean-up and other remediation costs, and the actual reimbursement from the federal government.

Data exists to assess the amounts that were state and municipal costs, amounts reimbursed to date and amounts still due from the federal government; however, uncertainty regarding the allowability of the reimbursable costs complicates efforts to account for these amounts. The accounting for such funds could be enhanced to allow for a better matching of expenditures and revenue. Due to the extended timeline for reimbursement, costs are often incurred in one period and the reimbursement is received in another period – sometimes years later. Typically, expenditure credits are processed when the federal disaster recovery funding is actually received – resulting in a understatement of current year.

Efforts should be made to better match revenues for reimbursement of allowable costs in the same period that costs are incurred. When not practical, recoveries in a subsequent period should be recorded in a manner that avoids distortion of current year activity.

**RECOMMENDATION**

MC-2015-8      Accumulate and review financial data relative to the status of federal disaster declarations for the purpose of preparing the State’s annual financial statements and to ensure appropriate and consistent accounting treatment of such recoveries.

*Corrective action plan / auditee views:*

*In fiscal 2015 the Controller’s Office worked with staff at the RI Emergency Management Agency to develop a process to identify and compile material amounts potentially receivable by the State from FEMA. This process was successfully used in preparing the State’s financial statements at June 30, 2015 and will be used again in ensuing years. No further actions will be taken.*

*Anticipated Completion Date: N/A*

*Contact Person: Peter Keenan, Associate Controller  
Phone: 401-222-6408*

**Management Comment 2015-9**

(repeat comment)

ACCOUNTING CONTROLS OVER CAPITAL PROJECTS

The largest capital asset additions, from a dollar perspective, are project-based rather than single item acquisitions. The RIFANS capital asset module is programmed to flag expenditures in designated natural account codes as potential capital asset additions. This works well for single capital items but not as effectively for projects that involve multiple categories of expenditures and span more than one fiscal year. Independent processes have been developed which include accumulation of project costs on spreadsheets external to RIFANS. This process is manually intensive and can lead to error or omission of capital projects if system coding or system query is not performed accurately. Implementation of the capital projects module or another application with similar functionality would facilitate accumulation and management of project costs for both financial reporting and project management purposes.

RECOMMENDATION

MC-2015-9 Implement an automated application to facilitate the accumulation and management of project costs for both financial reporting and project management purposes.

Corrective action plan / auditee views:

*The State utilizes an automated system of Excel spreadsheets to accumulate costs related to capital projects that meet the threshold for capitalization in the financial statements. Over the past few years significant resources have been invested in formalizing and enhancing this capital project tracking process. These efforts have resulted in significant improvements in the accuracy of cost information included in the State’s financial statements.*

*If resources are allocated to implement the Oracle Project Module, we will then assess if that module would be a more effective tool to track capital projects.*

Anticipated Completion Date: N/A

Contact Person: Peter Keenan, Associate Controller  
Phone: 401-222-6408

**Management Comment 2015-10**

(repeat comment)

DEPARTMENT OF REVENUE – QUALITY CONTROL REVIEW OF DATA USED TO CALCULATE SIGNIFICANT ESTIMATES

The Office of Accounts and Control utilizes various Division of Taxation generated information to estimate financial statement revenue accruals, revenue refunds, and allowances for uncollectible and unavailable amounts. The data and assumptions underlying significant estimates should be reassessed periodically to ensure they are valid and appropriate for the circumstances. For example, the allowance for uncollectible and unavailable amounts for certain smaller dollar collection taxes should be developed based on collection history data specific to that tax rather than using the average of other taxes. Certain other tax filing statistics used to build the estimates of refund liabilities should similarly be updated on recent filing data.

RECOMMENDATION

MC-2015-10 Enhance quality control procedures over data used to develop significant tax revenue and refund accrual estimates by updating data periodically and ensuring the data used is tailored to the specific tax where possible.

Corrective action plan / auditee views:

*The Division of Taxation has been meeting with the Office of Accounts and Controls to review various information generated by the Division to estimate financial statement revenue accruals, revenue refunds, and allowances for uncollectible and unavailable amounts as well as other reports provided to the Office of Accounts and Controls. Given the transition of the Division's off-line and mainframe tax types into the integrated tax system, the Division will continue to meet with the Office of Accounts and Controls to review the information in STAARS (its integrated tax system) and develop quality control procedures over the data.*

Anticipated Completion Date: *Incrementally for all reports during implementation of STAARS throughout 2016 with the goal of being fully compliant by June 30, 2017.*

Contact Person: *Neena S. Savage, Acting Tax Administrator  
Phone: 401.574.8922*

**Management Comment 2015-11**

*(repeat comment)*

DEPARTMENT OF REVENUE – RECOGNITION OF REFUND LIABILITY FOR BUSINESSES  
GRANTED SALES TAX EXEMPTIONS BY THE RHODE ISLAND COMMERCE  
CORPORATION

The Rhode Island Commerce Corporation administers an economic development program where a qualifying business entity may seek an exemption from sales taxes on certain materials used to construct new facilities. Application and approval are made to and by the Commerce Corporation. However, the Division of Taxation reviews and approves documentation of the amount of qualifying sales tax to be refunded to the business entity. The time from application and award of the sales tax exemption to eventual refund of the sales tax to the taxpayer can span multiple years.

Starting in fiscal 2013, the Division of Taxation and the Office of Accounts and Control began estimating and accruing sales tax refunds payable to business entities that had received Commerce Corporation approval for a sales tax waiver on a qualifying project. Due to the multi-year time span from approval of the project to the eventual refund of qualified sales tax amounts, the Division of Taxation should adopt a policy delineating at which point in the project timeline a State liability should be recorded for the sales tax to be refunded to the taxpayer. This would facilitate consistent accounting recognition of such liabilities when preparing the State's annual financial statements and for developing revenue projections for biannual Revenue Estimating Conferences.

RECOMMENDATION

MC-2015-11 Develop and adopt a policy regarding the timing and recognition of refund liabilities for entities granted sales tax exemptions by the Rhode Island Commerce Corporation.

Corrective action plan / auditee views:

*It is difficult to adopt a consistent policy regarding the timing and recognition of such refund liabilities because the refund requests the projects span several years, may not be completed on time, are subject to audit, and there is a hearing process (and appeal thereof) that may be initiated if the refunds are disallowed. The Division will work with its Revenue Accounting and Field Audit sections to come up with a policy for recognition of the refund liability; however, it may be difficult to implement consistently given the variables effecting timing.*

Anticipated Completion Date: June 30, 2016

Contact Person: Neena S. Savage, Acting Tax Administrator  
Phone: 401.574.8922

**Management Comment 2015-12**

*(repeat comment)*

**IMPROVEMENTS TO THE FORMATS OF BUDGET AND ACTUAL COMPARISON SCHEDULES AND LEGISLATIVELY ENACTED BUDGETS**

The State's current formats of various budget and actual comparison schedules could be enhanced to provide more effective annual financial plan and monitoring tools. Budgetary comparison schedules are included in the State's financial statements which compares budget to actual results. These schedules are prepared based on the detail included in the legislatively enacted budget.

*Basic Format of the Detailed General Fund Budget and Actual Schedule*

The detailed General Fund Budget and Actual Schedule comprehensively documents the budgeted expenditures and projected revenues for all financial transactions except for those required to be reported in separate funds. As a result, the schedule is broad and provides information about most departments and agencies within the State's reporting entity. The schedule further, reflective of the format of the legislatively enacted annual budget, breaks departmental expenditures into individual offices and units within each department.

The current format of the General Fund schedule does not facilitate the identification of budgeted, actual or variance totals by department, unit, or function. Totals by function or department are not emphasized to enable users to identify and monitor variances from budget projections that will aid in planning. Further, the current format does not separately identify totals by revenue source on a departmental or functional level. The lack of inclusive data by revenue source limits the effectiveness of the budget and actual schedule in determining the impact of individual budget deficits or surpluses on the State's available funds.

In addition, while the format of the General Fund identifies variances, there is no explanation provided regarding significant variances between budgeted expenditures and actual disbursements. The State should consider enhancing the usefulness of the report by providing additional explanations, when available, for significant variances from legally enacted amounts.

*Intermodal Surface Transportation Fund*

The State's annual budget appropriates certain Department of Transportation (RIDOT) expenditures, accounted for in the financial statements in the Intermodal Surface Transportation (IST) Fund. We observed that in some instances, the detail appropriation lines are so highly summarized (e.g.

infrastructure-engineering) that it precludes effective analysis of the budget compared to actual results. Additionally, the activities within RIDOT are now accounted for within four separate special revenue funds, which for financial reporting purposes, are now aggregated into the IST Fund. A budget is enacted by the General Assembly for activity recorded in only one of the three funds.

The primary sources available to fund RIDOT operations are the Gasoline Tax, federal funds, debt proceeds, and amounts appropriated within the RI Capital Plan Fund which are now used to provide the “State match” for federally funded highway projects. Because the State’s legislatively enacted budget is prepared on a comprehensive basis, extracting a complete budget plan that corresponds with activity reported in the IST Fund financial statements is not possible.

Lottery Division

The State includes estimated operational expenses for the RI Lottery in its annual appropriated budget. However, the amounts included in the budget are not inclusive of all expenses reported in the Lottery’s financial statements. Specifically, the budget does not include estimated prize awards or required transfers to the General Fund. The Lottery is required by General Laws to transfer net proceeds of the Lottery games to the General Fund for funding of State operations. While the State projects estimated revenues to the General Fund as part of the Revenue Estimating Conference, net transfers are not included in the Lottery Division’s budget. As such, the budgeted appropriations do not reflect the actual expenditures of the RI Lottery. In fiscal 2015, expenditures paid for prize awards, net of prize recoveries, totaled almost \$147 million and transfers to the General Fund totaled almost \$382 million.

The existing method of budgeting for the Lottery’s expenses does not, as a result, represent the full range of disbursements required by the Lottery, therefore reducing the value of the appropriated budget as a tool for long-term planning.

Comprehensive, Multi-Fund Budgeting

The State’s annual budget enacted by the General Assembly encompasses multiple funds (General, IST, University and Colleges, TDI, Unemployment Insurance) in a comprehensive format by governmental function. Generally accepted accounting principles require expenditures to be reported in distinct funds and, as such, the budget must be recorded within the accounting system segregated by distinct fund. The State should explore the possibility of including the fund information within the budget to facilitate recording the budget within the accounting system and preparation of budget to actual comparisons for financial reporting purposes (which are prepared on a fund basis).

RECOMMENDATIONS

- MC-2015-12a    Modify the current format of the detailed General Fund budget and actual comparison schedule to facilitate identification of relevant data at a departmental and unit level.
- MC-2015-12b    Reevaluate the presentation of the budget plan for the Department of Transportation and the related funds used to account for its activities. Consider changes in the level of detail and the inclusion of other items to facilitate comparison to actual results.
- MC-2015-12c    Consider modifying the level of detail included in the budget plan for the RI Lottery Division to include estimates for all expected expenses.
- MC-2015-12d    Explore the possibility of including fund information within the budget document to facilitate recording the budget in the accounting system and

preparing budget to actual comparisons.

Corrective action plan / auditee views:

*MC-2015-12a - We will review the format of the existing General Fund Budget and Actual Comparison Schedule and identify and implement improvements in the format of the Schedule. Such improvements may include incorporating totals by program and agency, as well as revenue source, on the Schedule.*

*Also, we will work with the Budget Office to develop a method for reporting the reasons for the most significant departmental general revenue variances between the budgeted and actual amounts on the Schedule or an attachment.*

Anticipated Completion Date: December 31, 2016

Contact Person: Peter Keenan, Associate Controller  
Phone: 401-222-6408

*MC-2015-12b, c, and d- The Budget Office will work with the State Controller and Auditor General to identify and submit changes to the budget format and presentation that would useful from a reporting perspective.*

Anticipated Completion Date: June 30, 2017

Contact Person: Thomas Mullaney, State Budget Officer  
Phone: 401.222.6414

**Management Comment 2015-13**

*(repeat comment)*

EXCISE OR “CADILLAC TAX” ON RETIREE HEALTHCARE BENEFITS INCLUDED IN OPEB ACTUARIAL VALUATION

The federal Affordable Care Act imposes an excise tax on high-cost health plans beginning in 2020. The excise tax, commonly referred to as the “Cadillac tax” is 40% on the cost of coverage for health plans that exceed an annual limit. The tax is paid by insurers or by employers when they are self-insured such as the State of Rhode Island.

While the excise tax is not effective until 2020, the State’s actuary, in performing the actuarial valuation of the State’s retiree health plans at June 30, 2013, calculated that the State would be subject to the 40% excise tax beginning in 2020 and included that cost in the development of the actuarial accrued liability for the retiree health plans.

The State should explore options to determine if the excise tax could be avoided through changes in plan design. If the applicability of the tax could be avoided, the State’s actuarially determined contribution could be lowered thereby providing budgetary savings.

RECOMMENDATION

MC-2015-13 Explore options to determine if the excise or so called “Cadillac tax” on high-cost health plans could be avoided through changes in plan design for the State’s retiree health care plans.

Corrective action plan / auditee views:

*The State has retained Segal Consulting as its employee benefits consultant. The State will work with Segal to identify options and develop plan changes for the State's pre-65 retiree health plan(s) that will enable the State to avoid the excise tax.*

Anticipated Completion Date: December 31, 2016

Contact Person: Paula Cofone, Deputy Personnel Administrator  
Phone: 401.574-8505

**Management Comment 2015-14**

*(repeat comment)*

SUBRECIPIENT MONITORING – CENTRALIZED REVIEW OF SINGLE AUDIT REPORTS

Subrecipients assist the State in carrying out various programs funded with state and/or federal monies and include such entities as municipalities, community action programs and local educational agencies. Monitoring of subrecipients, which is required when the State passes through federal funds to another entity, varies depending on the nature of the program or activity but always should include review of subrecipient audit reports. Federal regulations (currently OMB Circular A-133; “Super Circular” thereafter) require any entity that expends \$500,000 or more in federal assistance [direct or pass-through (e.g., State)] have a Single Audit performed. Copies of the Single Audit Reports must be provided to the pass-through entity and the federal government.

Receipt and review of subrecipient audit reports is now performed on a decentralized basis as responsibility is vested in numerous departments. The State can improve its subrecipient monitoring practices by centralizing the audit report review function for the reasons outlined below:

- ❑ Many subrecipients receive funding from multiple departments of the State – each is required to receive and review the same audit report.
- ❑ Specific agencies reviewing the audit reports do not consider noted deficiencies from the perspective of the risks that they pose to all state and federal funds passed through to the subrecipient. One large subrecipient of the State, which receives significant funding from multiple departments and agencies, has been very late in presenting its audit reports and those audit reports have highlighted serious deficiencies.
- ❑ There is no centralized database detailing which entities receive funding from the State, which are required to have a Single Audit performed, and the status of the audits.
- ❑ Effective subrecipient monitoring requires that individuals reviewing the audit reports be trained in governmental accounting and auditing requirements. This level of proficiency is difficult to achieve and maintain at all the departments and agencies now required to review subrecipient audits.

We have reported various deficiencies in the process used to review subrecipient audit reports. Considerable advantages can be gained by centralizing the subrecipient monitoring function within one unit of State government. This will raise the level of assurance that subrecipients comply with applicable laws and regulations and both state and federal funds are spent as intended. It will also reduce the amount of resources devoted to this effort and achieve other efficiencies.

RECOMMENDATIONS

MC-2015-14a Centralize subrecipient monitoring procedures related to receipt and review of Single Audit Reports within one agency. This function should be staffed with individuals trained in governmental accounting and auditing matters to allow effective review of the Single Audit Reports.

MC-2015-14b Build a database of all subrecipient entities that receive state and/or federal grant funding.

Corrective action plan / auditee views:

*MC-2015-14a - The OMB's Grants Management Office disagrees with the recommendation. The Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (aka Uniform Grant Guidance) defines the responsibilities of pass through entities as it relates to sub-recipient monitoring. The OMB's Grants Management Office believes it is appropriate for state agencies (pass through entities) to continue to be responsible for sub-recipient monitoring including the collection and review of the sub-recipient's single audit. State agencies, as the direct recipients of awards, are accountable for their programs and services.*

*The OMB's Grants Management Office will continue to develop and provide training, technical assistance, and resources to agencies on managing federal awards including sub-recipient monitoring. In an effort to better manage the risks associated with single audit report findings and information, the Grants Management Office is exploring the feasibility of a self-service model for entities applying for sub-awards, including a feature which would require entities to submit a Single Audit report prior to being considered for grant funding. The single audit report document would be an upload through the system at the time of application as well as subsequent fiscal years as required by the Uniform Grants Guidance.*

Anticipated Completion Date: September 2017

Contact Person: Laurie Petrone, Director, Office of Federal Grants Administration  
Phone: 401.574.8423

*MC-2015-14b- The Grants Management Office is working with the Division of Accounts and Controls to refine RIFANS so that agencies can designate federally-funded sub-recipient relationships in the system using a dedicated natural account number. The Grants Management Office will develop and implement a tool to assist agencies in determining the nature of the relationship that exists with the entity (sub-recipient or contractor relationship). Once operational, an automated sub-recipient report can be generated from RIFANS.*

*In addition, the Office of Management and Budget's Grants Management Office is embarking on a process to identify and implement a technology solution that automates the grants management business processes across state agencies. The end-to-end grants management system will turn disparate systems, data sources, files, and processes into a single, centralized system for use by all state agencies. The system will systematically track and report sub-recipient activity within and across awards.*

Anticipated Completion Date: RIFANS Solution – July 1, 2016.  
Grants Management System – September 2017.

Contact Person: Laurie Petrone, Director, Office of Federal Grants  
Administration  
Phone: 401.574.8423

**Management Comment 2015-15**

(repeat comment)

IMPROVE CASH RECONCILIATION EFFICIENCY

The General Treasurer’s Office should continue to explore options to further automate the cash reconciliation process between the RIFANS accounting system and its financial institutions. Current technology allows much of the bank reconciliation process to be performed automatically. Electronic matching could be further facilitated by aligning transaction detail between the bank and the State’s accounting system to minimize any differences.

RECOMMENDATION

MC-2015-15 Increase automation of the bank reconciliation process by exploring enhanced electronic transaction matching.

Corrective action plan / auditee views:

*Treasury Management has actively pursued automated account reconciliation for a number of years. An initial effort to determine how much benefit the department would receive for its largest account, the General Fund, yielded a match rate of less than 50%. In light of the poor automation rate and the high costs / lack of application support associated with implementing the requisite RIFANS modules, Treasury is pursuing other avenues.*

*Treasury recently implemented a low-cost, COTS (Commercial, Off-the-Shelf) Treasury workstation. The vendor that supplies this workstation product also offers an automated reconciliation module. Treasury is in discussions with the vendor to explore purchase and deployment of this module. We anticipate this to occur during FY 2017.*

*Additionally, Treasury personnel are exploring opportunities to further pool cash resources with the goal of improving efficiency for both reconciliation efforts and overall cash management.*

Anticipated Completion Date: Fiscal 2017

Contact Person: Maria Demelo-Olsson  
Chief Fiscal Manager  
Phone 401.462.7668



**Management Comment 2015-17**

(repeat comment)

SURPLUS FURNITURE AND EQUIPMENT

The State disposes of and replaces various capital assets during the normal course of operations. State departments and agencies are required to report assets deemed surplus to the Office of Accounts and Control (for accounting purposes) and ultimately to the “surplus property officer”. The intent is that capital assets declared surplus by one agency could potentially be used by another State agency, municipality, or local school district, etc.

While the surplus property reporting process is in place, there is no practical means for other State agencies, municipalities, or school districts, etc. to learn of the availability of assets deemed surplus that are now available for potential use. Clearly, not all assets declared surplus are usable and, particularly in the case of computer equipment, may be outdated technologically. However, establishing a searchable database of surplus assets would greatly increase the likelihood that still useful assets could be matched to those with a potential need.

RECOMMENDATION

MC-2015-17 Implement a statewide network or database of “surplused” furniture and equipment assets to facilitate notification and use by other state or local entities.

Corrective action plan / auditee views:

*The Division of Capital Asset Management and Maintenance agrees with the recommendation and will implement upon identification of proper staff.*

Anticipated Completion Date: June 30, 2017

Contact Person: Marco Schiappa, Facilities Management  
Phone: 401.222.6200