State of Rhode Island

Findings and Management Comments

Resulting from the Audit of the State of Rhode Island's Fiscal 2023 Financial Statements

David A. Bergantino, CPA, CFE
Auditor General

General Assembly
State of Rhode Island
Office of the Auditor General

Office of the Auditor General
State of Rhode Island - General Assembly
David A. Bergantino, CPA, CFE - Auditor General

oag.ri.gov

33 Broad Street • Suite 201 • Providence, RI • 02903-4177
tel: 401.222.2435 • fax: 401.222.2111

March 6, 2024

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

We have audited the financial statements of the State of Rhode Island for the year ended June 30, 2023 and have issued our report thereon dated February 27, 2024 in the State's Annual Comprehensive Financial Report for fiscal 2023.

As required by *Government Auditing Standards,* we have also prepared a report, dated February 27, 2024, 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. That report includes identification of control deficiencies that are significant deficiencies or material weaknesses in internal control over financial reporting as well as instances of material noncompliance. Our findings related to the financial statements are categorized below:

- 28 findings considered significant deficiencies or material weaknesses in internal control over financial reporting; including findings reported by the auditors of component units (legally separate entities included within the State's financial statements).

- 1 findings concerning compliance or other matters required to be reported by *Government Auditing Standards.*

This communication also includes 7 management comments resulting from our audit of the financial statements which are less significant issues that still warrant the attention of management.

Our *Single Audit Report* for fiscal 2023 is in progress and is scheduled to be completed later this year. That report will include findings related to controls over compliance with federal program requirements and the administration of federal programs.

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

Sincerely,

David A. Bergantino, CPA, CFE
Auditor General

FINDINGS AND MANAGEMENT COMMENTS

AUDIT OF THE STATE OF RHODE ISLAND's FISCAL 2023 FINANCIAL STATEMENTS

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EXECUTIVE SUMMARY

Executive Summary

Management's responsibility for implementing and maintaining a system of internal control is foundational to ensuring complete and accurate financial reporting, compliance with federal regulations, and safeguarding assets of the State. This responsibility is defined in State statute and federal requirements. A variety of internal control frameworks exist that define the elements of a system of internal control to aid entities in considering and documenting internal controls. RI General Law section 35-14-3, *Agency Responsibilities*, under the State's Financial Integrity and Accountability statutes, mandates that "State agency heads are responsible for the establishment and maintenance of a system or systems of internal accounting and administrative control within their agencies. This responsibility includes: (1) Documenting the system; (2) Communicating the system requirements to employees; and (3) Assuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions."

Management focus, training, and implementation resources have been insufficient to ensure that departments and agencies are assessing and documenting internal control consistent with management's overall responsibility for the adequacy of its design and operation. Internal controls safeguard public resources and support accurate financial reporting. The State should commit to providing additional training and implementation materials to assist departments and agencies in documenting their internal control. An internal control assessment and documentation effort should be implemented.

The State's current accounting and financial reporting system lacks the integration, functionality, and controls of a comprehensive Enterprise Resource Planning (ERP) system. The lack of integration has led to various manual processes being implemented over time which are prone to error and lack compensating controls to ensure accurate and complete financial reporting.

The multi-year implementation of a new ERP system will require substantial resources and planning to ensure a successful outcome. It is critical that the State remain committed to the selected software vendor to ensure a fully integrated system capable of addressing the current internal control deficiencies, business continuity risks, and inefficient processes inherent in the State's current financial and administrative systems.

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, 2023. 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 and material noncompliance based on our audit. Findings repeated from prior years are identified.

The complexity of Medical Assistance (Medicaid) program operations adds to the challenge of accurately accounting for all Medicaid financial activity within the State's financial statements. This complexity increases each year through new federal regulations, complex managed care contract settlement provisions, new State initiatives, and continued challenges relating to the State's integrated human services eligibility system (RIBridges). Medicaid is the State's single largest activity - representing nearly 38% of the State's General Fund expenditures. The State will need to ensure that the design of the next Medicaid Management Information System will provide the functionalities needed to enhance controls over program operations and fiscal oversight.

Controls are lacking to ensure the completeness and accuracy of reported Medicaid accruals in conjunction with the State's fiscal closing. Material audit adjustments were required to ensure the completeness and accuracy of reported program accruals.

The accumulation of significant deficits and surpluses in internal service funds must be avoided to ensure accurate financial reporting and compliance with federal regulations. Significant deficits and surpluses in internal service funds are not allowed by generally accepted accounting principles (GAAP) and federal regulations as such amounts represent the understatement (deficits) or overstatement (surpluses) of expenditures in other funds included in the State's financial reporting.

The State can improve controls over recording federal revenue to ensure (1) amounts are consistent with the limitations of grant awards from the federal government and (2) federally claimed expenditures are consistent with amounts recorded in the State's accounting system.

Controls over the preparation of the Schedule of Expenditures of Federal Awards (SEFA) can be enhanced to ensure all program activity is accurately reported to the proper Assistance Listing Number and amounts passed through to subrecipients are appropriately classified and reported.

The State can continue to improve its consideration of controls over functions performed by external parties by enhancing the use and documentation of Service Organization Control (SOC) reports. These improvements are necessary and consistent with management's responsibility for the overall adequacy of the design and operation of internal control.

A significant number of material audit adjustments were required during our audit of the State's fiscal 2023 financial statements. Material audit adjustments are indicative of weaknesses in controls over the preparation of financial statements.

The complexity of Treasury operations has increased substantially over the years without significant modifications to the State's investment in technology and personnel to support those efforts and to ensure internal control best practices are maintained.

There is an excessive volume of journal entries recorded within the accounting system. This volume weakens controls over the appropriate authorization and classification of expenditures and limits transparency regarding the underlying transactions.

Within the Intermodal Surface Transportation Fund, controls can be enhanced over the presentation of financial statements to ensure consistent and accurate reporting of fund activity in accordance with GAAP.

Controls over the identification of transportation infrastructure assets have been improved but can be further enhanced to ensure the accuracy of such amounts. Controls should be improved to record the disposal of infrastructure assets when retired or replaced.

The State updated its current cybersecurity readiness and has begun to identify risk mitigation priorities and the resources needed to implement necessary corrective action. The State does not currently have sufficient resources dedicated for the size and complexity of State operations and risk mitigation is not progressing quickly enough.

The State's current practices for periodic logical access and privilege reviews at both the application and network levels need improvement. Practices for database logging and monitoring at the database level also need improvement.

The State has not performed disaster recovery testing of critical applications since fiscal 2021. The State should formalize identification of major systems, standardize application testing, and incorporate business continuity planning within its overall disaster recovery policy and testing.

In addition to findings that impact Statewide controls over financial reporting and information security, our report includes findings specific to the Employees' Retirement System of Rhode Island, and Rhode Island State Employees' and Electing Teachers OPEB System.

Our report includes control deficiencies and material noncompliance reported by the independent auditors of the discretely presented component units included within the State's financial statements. Their accounting and control procedures are generally independent of the State's control procedures.

Our report also includes 7 management comments that highlight opportunities for enhancement of financial-related operational, policy or accounting control matters.

The scholarship disbursement function of the RI Division of Higher Education Assistance does not merit administration as a separate financial reporting entity and these activities should be accounted for within the State's General Fund rather than as a discretely presented component unit.

The Tobacco Settlement Financing Corporation should periodically update its projected debt service requirements to reflect operating and other economic factors.

Agency specific policies to conduct periodic physical inventories of capital assets should be formalized to improve controls over capital assets. Agency procedures and accountability has become especially important with the increase in mobile technology (i.e., laptops and tablets) use in recent years to support hybrid work schedules.

Management's response to the findings and comments, including planned corrective actions, are detailed in our report.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

Office of the Auditor General
State of Rhode Island - General Assembly
David A. Bergantino, CPA, CFE – Auditor General
oag.ri.gov
33 Broad Street • Suite 201 • Providence, RI • 02903-4177
tel: 401.222.2435 • fax: 401.222.2111

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

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 (the State), as of and for the year ended June 30, 2023, and the related notes to the financial statements, which collectively comprise the State's basic financial statements and have issued our report thereon dated February 27, 2024. 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 less than 1% of the assets and deferred outflows and the revenues of the governmental activities and less than 1% of the assets and 2% of the revenues of the aggregate remaining fund information;
- the Convention Center Authority, a major fund, which represents 26% of the assets and deferred outflows and less than 3% of the revenues of the business-type activities;
- the Ocean State Investment Pool - an investment trust fund, and the HealthSource RI, Rhode Island Higher Education Savings, and ABLE private-purpose trust funds, which collectively represent 24% of the assets and 22% of the revenues, including additions, 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.

Report on 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) as a basis for designing 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 described in the accompanying schedule of findings and responses, we and the other auditors did identify 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 2023-001, 2023-003, 2023-004, 2023-005, 2023-006, 2023-008, 2023-009, 2023-010, 2023-014, 2023-015, and 2023-017. 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 2023-027 and 2023-029.

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 2023-002, 2023-007, 2023-011, 2023-012, 2023-013, 2023-016, 2023-018, 2023-019, 2023-020, 2023-021, 2023-022, and 2023-023. 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: 2023-025, 2023-026, and 2023-028.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free from 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 financial statements. 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. Other auditors of the discretely presented component units disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as Finding 2023-024.

State's Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on the State's responses to the findings identified in our audit and described in the accompanying schedule of findings and responses. The State's responses were not subjected to the other 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.

David A. Bergantino

David A. Bergantino, CPA, CFE
Auditor General
February 27, 2024

SCHEDULE OF FINDINGS AND RESPONSES

INTERNAL CONTROL OVER FINANCIAL REPORTING - STATEWIDE

AUDIT STANDARD:

Management is responsible for a.) the preparation of the financial statements in accordance with the applicable financial reporting framework, and b.) the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Finding 2023-001	***(material weakness - repeat finding – 2022-005)***

COMPREHENSIVE DOCUMENTATION OF THE STATE'S INTERNAL CONTROL STRUCTURE

Management focus, training and implementation resources have been insufficient to ensure that departments and agencies are assessing and documenting internal control consistent with management's overall responsibility for the adequacy of the design and operation of internal control. Internal controls safeguard public resources and support accurate financial reporting.

Background: The State's management has responsibility for the design and operation of internal control. The Committee of Sponsoring Organizations (COSO) has 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*. The Government Accountability Office's "Green Book" - *Standards for Internal Control in the Federal Government* tailors this conceptual framework to the public environment. The "Green Book" is required for federal agencies and is useful to other governments when applying the principles of an internal control framework.

Criteria: RI General Law section 35-14-3, *Agency Responsibilities*, under the State's Financial Integrity and Accountability statutes, mandates that "State agency heads are responsible for the establishment and maintenance of a system or systems of internal accounting and administrative control within their agencies. This responsibility includes: (1) Documenting the system; (2) Communicating the system requirements to employees; and (3) Assuring that the system is functioning as prescribed and is modified, as appropriate, for changes in conditions."

An internal control framework, such as COSO and/or the Green Book, provides an overall structure for management to design, document, and monitor its internal control policies and procedures. Both within and outside government, management has responsibility for the adequacy of design and operation of an entity's control structure. A complete consideration of internal control, in addition to documenting control policies and procedures, must also include how the policies are communicated, documentation of risks associated with financial reporting and operations, and monitoring of those documented controls to ensure their effectiveness. Federal regulations require the establishment and maintenance of effective internal controls when administering federal awards.

Condition: The majority of agency and Statewide policies and procedures are not documented and administered in the manner that is required by statute or professional standards (COSO, Green Book). While certain control policies and processes have been documented, there is a lack of formalized documentation and comprehensive internal control structure throughout State government that complies with an accepted framework such as COSO and/or the Green Book. To meet the intended standards for internal control, internal control (policies and procedures) must be documented, periodically evaluated and revised based on updated risk assessments, effectively communicated to employees (through training if necessary) and monitored for effectiveness by the agency. More formalized documentation of Statewide internal controls is a needed first step that will allow agencies to expand on and supplement with their agency-specific policies and procedures relating to critical program functions. Since each State agency has unique programs and procedures that supplement Statewide functions (i.e., accounting, procurement, centralized payroll), internal control consideration and documentation must be performed at the agency level, as required by statute.

An opportunity exists for a coordinated effort to implement an internal control framework and to reassess the design of its current control structure (both statewide and at the individual agency level) with emphasis on risk assessment and monitoring - both essential components of internal control. With the State implementing an integrated ERP system, which will require substantial modification of certain processes and related controls, opportunities exist to evaluate and document control procedures consistent with the internal control framework. Such an exercise will be vital to ensure that the new ERP and its related configuration and workflow processes ensure adequate internal controls over the core functions of the new system (i.e., human resources, procurement, accounting and financial reporting, disbursements, etc.).

Cause: Management focus, training and implementation resources have been insufficient to ensure that departments and agencies are adequately documenting their internal control structures inclusive of all elements.

Effect: Control weaknesses could exist and go undetected either through inadequate design or through noncompliance resulting from insufficient monitoring. Continued noncompliance with statutory requirements for agency documentation of internal control.

RECOMMENDATIONS

2023-001a: Commit additional resources to training and implementation materials to ensure that departments and agencies are adequately documenting their internal controls to reflect an understanding of its required elements in accordance with an acceptable framework such as COSO or the Green Book.

2023-001b: Implement an internal control assessment and documentation effort to coincide with the implementation of a fully integrated ERP system.

Management's Views and Corrective Actions:

As stated in prior fiscal years, management agrees the State lacks formalized documentation and a comprehensive internal control structure statewide that complies with an accepted framework. Unfortunately, the Office of Accounts and Control does not have the resources to provide training to agency management about documenting internal controls. The Office has published internal control best practice guidance in the past in conjunction with the Office of Internal Audit. Further, the Office makes itself available for specific questions from the agencies.

The Office of Accounts and Control will try a phased approach to address this finding. The first step will involve the work underway with the ERP system. The ERP implementation brings an opportunity to embed internal controls within the software application. The Office of Accounts & Control (A&C) will highlight with the ERP vendor the need to train and provide documentation to State financial management about the automated system of internal controls.

Anticipated Completion Date: *Ongoing*

Contact Person: *Alex Herald, Administrator of Financial Management, Department of Administration, Office of Accounts & Control*
alexander.herald@doa.ri.gov

Finding 2023-002 ***(significant deficiency - repeat finding - 2022-006)***

EVALUATION OF CONTROLS OVER FUNCTIONS PERFORMED BY EXTERNAL PARTIES

The State can continue to improve its consideration of controls over functions performed by external parties by enhancing the use and documentation of Service Organization Control (SOC) reports. These improvements require State agencies (the "user entities") to document and review user entity controls designated in those SOC reports which the service organization assumes are in place and operating effectively for proper and secure use of the contracted entity's services. This consideration is necessary and consistent with management's responsibility for the overall adequacy of the design and operation of internal controls.

Background: SOC reports are provided by service organizations to assure customers/clients that controls are sufficiently designed and in operation over relevant activities. Management of the user entity should use these reports as part of their overall consideration and documentation of the adequacy of the design and operation of internal control. Management should also ensure that their user entity controls are documented and reviewed to ensure that they are operating effectively. Ineffective user entity controls limit the usefulness of SOC reports when documenting an entity's financial and operational controls as those reports assume that user entity controls are operating effectively.

To provide an example of the significance of financial operations involving service organizations, benefit disbursements by the State's Medicaid fiscal agent and human services eligibility and benefits system, RIBridges, represent approximately 40% of the State's General Fund expenditures. Service organizations are currently involved, to some degree, in most finance-related functions of State government. The use of service organizations has increased over time, and will likely continue to, as more services are being administered through cloud-based applications.

Criteria: Management has responsibility for the adequacy of the design and operation of an entity's control structure including functions performed by external parties. This responsibility also includes documenting and reviewing designated user entity controls which the service organization assumes are in place and operating effectively for the proper and secure use of the contracted entity's services.

Condition: The State has made progress by training employees and implementing a uniform SOC report assessment tool to document the consideration of controls at its service organizations. Centralized monitoring by the Office of Accounts and Control has improved agency compliance with obtaining and evaluating SOC reports to ensure that cited deficiencies of the service organization's internal control are being followed-up on and understood. The next step in utilizing SOC reports within the internal control structure of significant State operations requires:

- User agency documentation of key SOC controls within that agency's internal control documentation. As indicated in Finding 2023-001, most State agencies lack formalized documentation of internal controls thus management consideration and documentation of how SOC reports are utilized to mitigate operational risks is equally deficient.
- More robust documentation and testing of the complimentary user entity controls (user entity controls) that are being assumed by the auditor of the service organization when providing an opinion on the effectiveness of the entity's internal controls. Each agency must ensure that relevant user entity (agency) controls identified by service organizations are also in place and operating effectively. Our audit has frequently noted instances where user entity controls have not been documented and reviewed by the State agencies with direct responsibility for those identified controls. Such control considerations should be included in the documentation and evaluation of internal controls discussed in Finding 2023-001.

When SOC reports identify exceptions, evaluation of such matters must be timely and thorough. Any highlighted deviations in control testing that may result in a qualified opinion regarding the design and effectiveness of certain control procedures at the service organization, as well as complementary user entity control considerations should be documented, reviewed, and thoroughly vetted. For fiscal 2023, documentation obtained from State agencies utilizing the service organization was incomplete or insufficient regarding the evaluations of the exceptions and the impact on the State's overall operational controls.

Cause: The lack of comprehensive documentation and consideration of (1) service organization controls and (2) user entity controls by agencies that rely on service organizations that perform critical functions for State government represent a weakness in internal control over financial reporting. In addition, insufficient documentation and review of user entity controls limits the related assurance that can be placed on control objectives reported within SOC reports.

Effect: Many functions performed by external parties are material to the State's overall operations. Deficiencies in the design or operation of controls at service organizations could materially impact the State's overall controls over financial reporting and compliance.

<u>RECOMMENDATIONS</u>

2023-002a: For complementary user entity (State agency) controls identified within SOC reports, document and evaluate the agency controls to ensure that they are in place and operating effectively. These controls should be included in each agency's documentation of internal control over program operations when placing reliance on SOC reports provided by service organizations.

2023-002b: Document and review the user entity controls designated in SOC reports which the service organization assumes are in place and operating effectively for proper and secure use of the entity's services.

Management's Views and Corrective Actions:

A&C has educated and provided training and resources to the State agencies to address this finding in prior fiscal years. A&C will provide relevant documentation to the Office of Internal Audit which will allow them to incorporate the review and testing of the controls within the audits they perform.

<u>Anticipated Completion Date</u>: *Ongoing pending a coordinated effort with the Office of Internal Audit.*

<u>Contact Persons</u>: *Training: Alex Herald, Administrator of Financial Management Department of Administration, Office of Accounts & Control alexander.herald@doa.ri.gov*

Audit Review: Andrew Manca, Chief Financial Officer III, Office of Management and Budget, Office of Internal Audit Andrew.M.Manca@audits.ri.gov

Finding 2023-003	***(material weakness – repeat finding – 2022-001)***

<u>IMPLEMENTATION OF AN ENTERPRISE RESOURCE PLANNING (ERP) SYSTEM TO ADDRESS THE STATE'S CRITICAL FINANCIAL AND ADMINISTRATIVE FUNCTIONS</u>

The multi-year implementation of an ERP system will require substantial resources and planning to ensure a successful outcome. It is critical that the State remain committed to the selected software vendor to ensure a fully integrated system capable of addressing the current internal control deficiencies, business continuity risks, and inefficient processes inherent in the State's current financial and administrative systems.

Background: The State's current systems supporting key financial and administrative functions lack integration and represent risks to the State's business continuity due to their age and dwindling technical support. The lack of integration and functionality has also created several deficiencies in internal control over financial reporting and inefficiencies throughout financial and administrative processes. The State began its implementation of a new Workday ERP system in fiscal 2023 focusing on project planning, business process analysis, and system configuration design relating to the human capital module (payroll, human resource management, etc.) which has a planned implementation for calendar year 2025. In total, the State anticipates that the ERP project, which will incorporate the finance and human capital modules, will take several years to implement.

Criteria: Management needs well-designed financial systems that support comprehensive internal controls over financial reporting, enable organization-wide efficiencies, and promote business continuity. Integrated functionalities support appropriate internal controls and eliminate inefficiencies resulting from multiple systems, duplicate data entry and ineffective communication between systems.

Condition: Important functionalities are minimally met through legacy systems, the existing statewide accounting system, and multiple departmental processes without intended integration and efficiencies. This results in business continuity risk, decreased efficiency and effectiveness, and control weaknesses. 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 these systems is limited. Many of the needed financial functionalities are interdependent and, consequently, the risk of failed integration is increased absent appropriate strategic planning and sequencing.

The design and limitations of the State's current financial system have resulted in numerous control deficiencies, collectively representing a material weakness over financial reporting. These control deficiencies are largely due to ineffective manual procedures being implemented in place of systemic integration that minimizes the risks of errors. The following control deficiencies most significantly impact the State's controls over financial reporting:

- *General ledger access* – Effective accounting systems restrict general ledger access to those individuals knowledgeable about the State's accounting and financial reporting. The current system allows wide access to the general ledger which results from recording cash receipts through journal entries rather than a cash receipts module. This significantly increases the risk of accounting errors being made and not being detected in a timely manner. This design also creates a large volume of journal entry transactions which is difficult to manage with the State's limited centralized accounting and financial reporting staff.
- *Recording accruals during the fiscal close* – The State currently relies on the manual accumulation of accruals (except for system generated accounts payable) as part of their fiscal closing process. These manual processes are more likely to omit or misstate the recording of accruals as the process lacks effective controls to ensure the completeness and accuracy of recorded amounts.
- *Recording financial activity from subsidiary systems* – Financial activity processed (and in certain situations disbursed) by subsidiary systems often prevents detailed transaction data from being reported in the

accounting system. In addition, reconciliations of subsidiary systems to the State accounting system is a lacking compensating control needed in response to the decentralized use of multiple financial systems.

- *Federal revenue and expenditure reporting* – With the majority of the State's expenditures being funded by federal grants, controls over their reporting are material to the State's financial reporting. The State's accounting system does not meet the State's needs in three important and interrelated areas relating to the reporting of federal revenue and expenditures – time reporting/payroll, grants management, and cost allocation – all functionalities that are integral to the management of federal programs. These functions are currently performed independent of RIFANS and generally through multiple departmental systems - most of which are duplicative and utilize old and sometimes unsupported technology. Because these systems and processes are decentralized, they do not ensure that federal expenditures are only reported when available grant award authority exists and that federal expenditures are recorded in the proper period due to delays in cost allocation results being reflected in the accounting system.
- *Capital projects reporting* – The State currently tracks capital projects using Excel. Project costs are accumulated in Excel and reported as construction in progress before being reclassified to the proper capital asset category upon completion. This process is inefficient and lacks the controls that a fully integrated capital projects module would provide.
- *Payroll / Personnel Administration* – The State still utilizes carbon-copy paper-based forms to administer payroll for its employees. Forms require manual input into multiple systems which is inefficient and prone to error. During our audit, a high percentage of payroll forms authorizing current employee pay levels could not be located to support the current salary amounts paid during the year.

Cause: The State's current accounting and financial reporting system lacks the integration, functionality, and controls of a comprehensive ERP system. The lack of integration has led to various manual processes being implemented over time which are prone to error and lack compensating controls to ensure accurate and complete financial reporting.

Effect: Business continuity risks, deficiencies in internal control over financial reporting, and the lack of organization-wide efficiencies exist and are exacerbated due to the lack of an integrated ERP system.

RECOMMENDATIONS

2023-003a: Manage the business process re-engineering required to align the State's processes to the software-as-a-service functionalities within the ERP system.

2023-003b: Ensure sufficient subject matter experts are involved in the implementation process to ensure a high likelihood of success.

2023-003c: Ensure that the new ERP system addresses identified internal control deficiencies relating to financial reporting.

Management's Views and Corrective Actions:

The State has engaged a system integrator, an independent validation and verification third party partner, and a data conversion specialist, in addition to our own subject matter experts to reduce the risks associated with control deficiencies and standardization of business processes across the stakeholder environment. Further, the State has augmented with external staffing to allow our subject matter experts to devote time to this project unobstructed. There are 48 state resources and 65 system integrator staff dedicated to this project.

Anticipated Completion Date: *July 1, 2025*

Contact Persons: *Brian Tardiff, Chief Digital Officer / Chief Information Officer, Department of Administration, Enterprise Technology Strategy and Services*
brian.tardiff@doit.ri.gov

Dorothy Pascale, State Controller Department of Administration, Office of Accounts & Control
dorothy.z.pascale@doa.ri.gov

Jennifer Wilson, Personnel Administrator, Office of Human Resources
Jennifer.Wilson@hr.ri.gov

Finding 2023-004 ***(material weakness – new finding)***

MONITORING BILLING RATES OF THE STATE'S INTERNAL SERVICE FUNDS TO PREVENT FINANCIAL STATEMENT MISSTATEMENTS AND FEDERAL NONCOMPLIANCE

The accumulation of significant deficits and surpluses in internal service funds must be avoided to ensure accurate financial reporting and compliance with federal regulations.

Criteria: 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. Generally accepted accounting principles (GAAP), GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, requires that if the charge by an internal service fund (when administering risk financing activities such as health insurance costs) to the other funds fails to recover the full cost of claims over a reasonable period of time, any deficit fund balance in the internal service fund should be charged back to the other funds and reported as an expenditure/expense of those funds.

Condition: The State reports 15 internal service funds in its financial statements that allocate the costs of centralized services across the financial reporting entity. We noted one instance in which there was a working capital reserve significantly exceeding the 60-day expense reserve - the Assessed Fringe Benefits internal service fund had working capital reserves exceeding 150 days of expenses at June 30, 2023, per the draft financial statements. Once identified during our audit, the State recorded the required adjustment to reduce the reported surplus within the reserve level mandated by federal regulations.

We also noted an instance where a significant deficit ($24 million per the June 30, 2023 draft financial statements) was reported in the Health Insurance – Active Employees internal service fund. Once identified, the State recorded the required adjustment to reduce the reported deficit to a level more in accordance with GAAP, ensuring that other funds of the State recognized their respective share of health insurance costs incurred in fiscal 2023.

The above adjustments demonstrate the need for improved monitoring of internal service fund activity and periodic billing rate adjustments, as required, to ensure compliance with federal regulations and accurate financial reporting.

Cause: Insufficient monitoring and adjustment of internal service fund billing rates.

Effect: Potential noncompliance with federal regulations and GAAP.

RECOMMENDATION

2023-004: Enhance internal service fund monitoring procedures to ensure that billing rates are appropriate to prevent significant deficits and surpluses from accumulating to ensure compliance with federal regulations and GAAP.

Management's Views and Corrective Actions:

Management agrees with this recommendation. The State has started a Finance Council to discuss best approaches to financial functions that cross over multiple divisions. One of the focuses of this group was to define the roles and responsibilities of the oversight, monitoring, rate setting, and billing for the internal service funds. Further, A&C has hired an Administrator of Financial Management to document procedures and oversee the internal service funds. A&C will work to ensure monitoring of the internal service funds is completed on a timely basis, that billing rates are appropriate to prevent significant deficits and surpluses from accumulating and will communicate the necessary changes to respective parties.

Anticipated Completion Date: *June 30, 2024*

Contact Persons: *Xiomara Soto, Administrator, Financial Management and Reporting*
xiomara.c.soto@doa.ri.gov

Tara Mello, Associate Controller, Department of Administration, Office of Accounts & Control
tara.m.mello@doa.ri.gov

Dorothy Pascale, State Controller, Department of Administration, Office of Accounts & Control
dorothy.z.pascale@doa.ri.gov

Finding 2023-005	***(material weakness – repeat finding – 2022-003)***

MEDICAID PROGRAM COMPLEXITY AFFECTS FINANCIAL REPORTING AND OVERALL PROGRAM CONTROLS

The continued and growing complexity of Medicaid program operations adds to the challenge of accurately accounting for all Medicaid program related financial activity within the State's financial statements.

Background: The complexity of the Medicaid program increases each year through new federal regulations, complex managed care contract settlement provisions, new State initiatives, and continued challenges relating to the State's integrated human services eligibility system, RIBridges. Medicaid is the State's single largest program activity - representing just under $3.7 billion in expenditures or approximately 38% of the State's General Fund expenditures. Consequently, the financial aspects of this program are material to the State's financial reporting objectives. Expenditures for individuals covered under managed care approximated $2.1 billion, representing the majority of benefit expenditures reported for Medicaid.

Criteria: Management of the Executive Office of Health and Human Services (EOHHS) is responsible for establishing and maintaining internal control over financial reporting to ensure accurate and complete reporting of transactions in accordance with generally accepted accounting principles.

Condition: Significant Medicaid program activity is currently being accounted for external to the systemic controls and processes designed within the Medicaid Management Information System (MMIS). The MMIS was developed as a claims processing system over 30 years ago and was not designed to meet the current processing and reporting needs of the State's managed care programs. Managed care requires a system that can handle capitation adjustments and a more robust adjudication of encounter data submitted by the State's contracted managed care organizations (MCOs). While the MMIS has been modified over time to handle the disbursement of capitation and the submission of encounter data, it lacks the functionality to completely process and account for managed care activity.

Risks relating to inaccurate financial activity and federal compliance have increased due to the length of settlement periods, eligibility discrepancies between the claims payment system and the State's integrated eligibility system, retroactive capitation adjustments, and the volume of transactions being accumulated and evaluated independent of regular program controls.

The following were examples of control deficiencies which led to a significant number of audit adjustments to correct financial reporting:

- Receivables and liabilities relating to the Medicaid Program at year-end each totaled in excess of $200 million. The estimation, calculation, and reporting of year-end accruals is an entirely manual process involving no systemic controls to ensure the accuracy and completeness of reported amounts;
- Payments to and recoupments from providers and managed care organizations totaling more than $150 million and $140 million, respectively, were made through system and manual transactions made by the fiscal agent with authorization by the State Medicaid Agency. These payments are not subjected to the claims processing controls of the MMIS and often require substantial off-line manual calculations to determine the transaction amounts. These transactions are often netted within the normal claims processing cycle activity and the MMIS system lacks sufficient reporting capability for these transactions. During fiscal 2023, the volume of payment transactions was significant (more than 700 transactions) and individual disbursements often exceeded $100,000 (approximately 210 individual payments in 2023);
- Managed care contract or rate adjustment settlements represented the largest system and manual payments. These transactions often totaled millions and resulted in the final capitation rate actually disbursed not being

reflected in the MMIS, further complicating the final contract settlements which are performed manually by Medicaid staff and contract employees; and

- The MMIS's limited ability to process capitation adjustments and to process and report on encounter data makes it very difficult to estimate accruals relating to managed care. The State Medicaid agency currently relies on plan reporting from the MCOs to estimate final contract settlements requiring accrual at year-end. The accuracy of the data provided, the run-out period for providers to continue submitting claims, and the lack of complete encounter data reported in the MMIS remain challenges in accruing accurate managed care settlements at year-end.

While EOHHS's manual procedures are making every attempt to accurately and completely settle and account for its managed care activities, systemic controls do not currently support those efforts and control deficiencies exist that continue to impact the State's financial reporting. With the State currently exploring procurement for a new MMIS, significant focus should be placed on ensuring that controls over managed care capitation and claiming activity are significantly improved. In the near term, the State should look to utilize federally required audit procedures to improve controls over segments of the managed care settlement process that are currently not being validated.

Cause: Ensuring all financial activity is properly and completely recorded in the State's financial statements is an increasingly complex task. The State does not currently have a system that can process retroactive capitation rate changes and/or changes in participant enrollment category. The current MMIS performs limited edits in encounter data submitted by the plans that are no longer adequate for the size and volume of medical claims covered under capitation. Insufficient system reporting for system payouts and recoupments increases the risk that material transactions are not identified that require reporting as prior period activity on federal reports and for financial reporting. The extent to which system payouts are not individually recorded in the State accounting system increases the risk that these transactions are not accounted for properly for financial reporting as they bypass the State's centralized review procedures designed to ensure that transactions are recorded in the correct accounts and reflected in the correct fiscal period.

Effect: Potential effects of this control deficiency include unrecorded or inaccurately recorded financial transactions, incorrect reimbursements to providers or managed care organizations, and noncompliance with federal regulations.

RECOMMENDATIONS

2023-005a: Develop specific objectives for managed care data processing (i.e., premium and encounter data processing functionality) that will be required of and included in the specifications for the next MMIS.

2023-005b: Minimize instances where material financial activities are reliant on manual processes to ensure proper financial reporting.

2023-005c: Develop comprehensive reporting for system payouts, manual disbursements, and system recoupments to improve the transparency of these transactions processed by the Medicaid fiscal agent.

2023-005d: Improve controls over non-claims based financial transactions in the next MMIS to provide for individual reporting and proper financial accounting treatment.

Management's Views and Corrective Actions:

EOHHS concurs with this finding and acknowledges that the continued and growing complexity of Medicaid program operations adds to the challenge of accurately accounting for all Medicaid program related financial activity within the State's financial statements.

2023-005a: EOHHS has, in conjunction with our MES Planning Vendor, documented the existing MMIS processes for premium payments, capitations, and encounters as well as the "To Be" state of these processes related to the assessment of business needs. Additionally, a Gap Analysis was prepared to ensure needs were identified and incorporated accordingly into the procurement(s) for replacement systems that will perform in alignment with Rhode Island-specific needs and have the flexibility to achieve the Programs' objectives in these areas.

2023-005b: EOHHS is aware of many of the risks facing the program's financial reporting, including manual payments, and has taken steps to simplify Medicaid-related financial activities and improve oversight as outlined below. The steps taken to-date and future steps to improve oversight are outlined below:

1. *Risk Share Settlements*
    a. *MCO risk share settlements are based on MCO submitted reporting and validated against accepted encounter claims in the MMIS. In FY20, the state implemented a requirement that the MCOs report quarterly through a new "Financial Data Cost Report" (FDCR) their membership, benefit expenses, including general ledger adjustments, sub-capitated arrangements, reinsurance arrangements, reserves, benefit expense recoveries and administrative costs for each Premium Rating Group. These expenses are reported at either the rate cell and category of service level, or at the product level (Rite Care/Expansion, etc.). This allows for the risk share reporting to be validated against other financial reporting and in alignment with rate setting activities.*
        - *Annually, the MCOs must reconcile the information in its FDCR to their NAIC financial statements.*
        - *EOHHS utilizes this FDCR data in rate setting as well as to monitor MCO financial performance throughout the year.*
        - *EOHHS began utilizing the FDCR reporting for risk share settlement beginning with the final reconciliation for FY 2019.*

2. *Stop Loss Programs*
    a. *EOHHS recognizes that stop loss payments result in additional manual payments, creating risk of error. As a result, in FY22, EOHHS eliminated its Hepatitis C stop loss program and its organ transplant stop loss program, eliminating manual payments made by the state to the MCOs. However, stop loss programs will remain where necessary; for example, through FY23, there was a COVID vaccine administration "non-risk" stop loss program where the state paid the full amount of vaccine administration reimbursement back to the MCO using 100% federal funds.*
    b. *The state eliminated the COVID-19 vaccine administration "non-risk" payment, and subsequent manual payment, in FY24, by incorporating this payment into rates.*

3. *Limiting Manual Capitation Payments*
    a. *EOHHS recognizes that retroactive capitation payments can result in additional manual payments, creating risk of error. For premiums paid monthly, the MMIS can systematically correct payments made within a three-month window – retroactively for the prior month, the current month, and prospectively for the future month. For capitation paid daily (RiteCare), corrections can only be systematically made within a two-month window – for the current month and prospectively for the future month. However, new processes were incorporated into the MMIS to allow for systematic adjustments to payments retroactively in two scenarios: 1) based on a Newborns Date of Birth and 2) based on a recipients Date of Death. These two scenarios contributed to the highest number of retroactive adjustments aside from rate changes. Any corrections outside of the systematic adjustment windows or aside from the Newborn and Death causes must still be processed manually unless additional system modifications are implemented.*

To limit system modifications, but further reduce manual payments, throughout FY20, EOHHS developed an internal MCO contract project charter and workgroup with the express goal of ensuring that our contract amendments and MCO capitation rates would be completed timely and ensure that MCO rates are in the system at the start of the year, or soon thereafter to minimize any manual payments.

However, in recent FYs, including for FY22, FY23, and FY24, budget initiatives impacting rates in the enacted budgets passed at the end of June have led to a delay in the final rates or required retroactive rate adjustments to prior fiscal years. This process is out of EOHHS' control and has resulted in large manual payments. Some states input new fiscal year rates without final state budgets or signed contracts, but EOHHS has assessed that this creates its own risk and that the current approach is preferred.

As EOHHS works to modernize and modularize the current MMIS to the new MES, we have incorporated into our planning activities steps to ensure that updates made to the current MMIS to address the items noted *above are then carried over into the MES. Additionally, any work to address this finding that has not yet been incorporated into the MMIS at the time of procurement of the new MES module(s) related to financial management will be included into the requirements of the solicitation(s) for that module(s).*

<u>2023-005c</u>: In December 2019, EOHHS and the fiscal agent implemented a monthly report recapping all Fiscal Agent Control Notes (FACNs) processed that month. EOHHS Finance also maintains a monthly log of all FACNs it approves, capturing all pertinent data, and reconciles this log with the fiscal agent's monthly FACN report. Any discrepancy is promptly researched and resolved. EOHHS is also reviewing the documentation required when FACNs are submitted for payment or recoupments, including how requests document Federal authorities in place. EOHHS intends to issue updated guidance to ensure consistency across all FACNs.

EOHHS has implemented "ServiceNow" with their fiscal agent for the purpose of more formally tracking system issues, incidents, password resets. The fiscal agent is in the process of testing functionality for non-financial FACNs, and the financial FACN and system modification request will be implemented at a later date. This tool will eliminate the FACN process as it is defined presently. To the extent that additional codes are needed to clarify the nature of various transactions, EOHHS will work with the fiscal agent to establish and utilize these new codes on a go-forward basis within the new ServiceNow tool. Due to the complexity of having a one stop "ServiceNow" center, this project is still in progress. Remaining ServiceNow functionality should be implemented by June 2024.

<u>2023-005d</u>: EOHHS, in conjunction with our MES Planning Vendor, is evaluating the existing non-claims based MMIS financial transactions and reason codes, and has documented the current business processes related to this work as well as the "To Be" state of those processes in the MES. In order to ensure these business needs are met, a Gap Analysis has been prepared related to the Financial Management work and that analysis will be incorporated accordingly into the procurement(s) for replacement systems that will perform in alignment with Rhode Island-specific needs and/or have the flexibility to achieve the Programs' objectives in these areas.

<u>Anticipated Completion Date</u>:	*Ongoing (unless specified above)*
<u>Contact Persons</u>:	*<u>2023-005a</u>: Maria Dawson, Interdepartmental Project Manager, Medicaid Enterprise Systems Planning & Implementation Executive Office of Health and Human Services maria.dawson@ohhs.ri.gov*
	<u>2023-005b</u>: Maria Dawson, Interdepartmental Project Manager, Medicaid Enterprise Systems Planning & Implementation Executive Office of Health and Human Services maria.dawson@ohhs.ri.gov
	Chaz Plungis, Chief of Strategic Planning, Monitoring, and Evaluation, Medicaid Finance Executive Office of Health and Human Services charles.plungis@ohhs.ri.gov
	<u>2023-005c</u>: Allison Shartrand, Assistant Director Financial and Contract Management Executive Office of Health and Human Services allison.shartrand@ohhs.ri.gov
	<u>2023-005d</u>: Maria Dawson, Interdepartmental Project Manager, Medicaid Enterprise Systems Planning & Executive Office of Health and Human Services Implementation maria.dawson@ohhs.ri.gov

Finding 2023-006 ***(material weakness – repeat finding – 2022-004)***

CONTROLS OVER ACCRUALS RELATING TO THE MEDICAL ASSISTANCE PROGRAM

Controls are lacking to ensure the completeness and accuracy of reported accruals relating to the Medicaid program in conjunction with the State's fiscal closing.

Criteria: Management is responsible for establishing and maintaining internal control over financial reporting to ensure accurate and complete reporting of transactions in accordance with generally accepted accounting principles. Generally accepted accounting principles require that expenditures are recorded in the correct financial period and, when necessary, estimates can be recorded by management to ensure the completeness of financial reporting.

Condition: Accruals for certain benefit expenditures and recoveries associated with the Medical Assistance Program were omitted from the State's financial reporting at June 30, 2023. In addition, certain accruals recorded at June 30, 2023 required adjustment due to the use of incomplete data or errors in estimation. Material audit adjustments were required to:

- Record $10.5 million in Medicaid reimbursement owed for fiscal 2023 services provided by Eleanor Slater Hospital and State-operated group homes that were not recorded by the Department of Behavioral Healthcare, Developmental Disabilities, and Hospitals;
- Record $8.3 million in Medicaid reimbursement owed to the Department of Children Youth and Families for Medicaid eligible services provided to children in the State's custody that were not recorded by the department;
- Reduce managed care expenditures by $23 million for net gain share settlements associated with managed care contracts that were understated due to the use of incomplete data available at year-end;
- Reduce the drug rebate receivable recorded at June 30, 2023 by $2.5 million for an error in estimation; and
- Reduce expenditures for services provided by privately operated providers of services to developmentally disabled individuals by $9 million relating to an overstated estimate of the accrual.

Cause: Management made no attempt to estimate and record amounts for certain year-end accruals associated with costs incurred but not reimbursed at year-end and final cost settlements relating to fiscal 2023. Management did not properly estimate the accruals proposed due to error or use of incomplete data.

Effect: The potential omission in accrual recording could result in material misstatement of the financial statements.

RECOMMENDATIONS

2023-006a: Estimate and record expenditures at year-end to ensure the completeness of financial reporting.

2023-006b: Reevaluate and refine estimation methods that are prone to error or resulting in misstated accruals at year-end.

Management's Views and Corrective Actions:

2023-006a: EOHHS concurs with the findings related to the missing year-end accruals for BHDDH and DCYF. We acknowledge that there were omissions in our financial reporting as of June 30, 2023, and we are committed to rectifying these issues. EOHHS will partner with its sister agencies to ensure all year-end accruals affecting the Medicaid program are entered in a timely manner. This will include collaborating with each agency at year-end on the status of any anticipated accruals, offering staff assistance with preparation of these accruals, and inclusion in EOHHS' interagency service agreements (ISAs) with each sister agency.

2023-006b: EOHHS is committed to improving our financial reporting and internal controls to ensure the completeness and accuracy of reported accruals relating to the Medicaid program. We will continue to work to address these issues. While EOHHS uses the most complete data available at year-end to prepare its accrual entries, certain expenditure categories inherently contain significant uncertainty. EOHHS believes the errors cited in the finding are due to a lack of data and not the estimation methods themselves. It is because of this known limitation with data availability that EOHHS partners with the OAG and Accounts *and Control in the months following fiscal close to propose revisions to its accruals that incorporate more recent available data.*

Two such areas are highlighted in the finding:

Pharmacy Rebates: As of 6/30, EOHHS's fiscal intermediary has just issued invoices to drug manufacturers for pharmacy claims with service dates through 3/31. This delay stems from the time required for health plans to adjudicate claims, transmit them to EOHHS via the encounter data submission process, and have them accepted into the State's MMIS. Only after MMIS acceptance can our fiscal intermediary invoice manufacturers for rebates. Consequently, EOHHS must estimate:

- *Outstanding collections for invoices issued through 3/31.*
- *Invoiced and collection amounts for the quarter ending 6/30 for pharmacy claims with service dates between 4/1 and 6/30.*

Note: The run-out of pharmacy claims is generally faster than other provider types, as reflected in the short three-month delay between the end of a fiscal quarter and when EOHHS's fiscal intermediary issues invoices to pharmacy manufacturers based on claims data received from the plans.

Risk Share: Complete expenditure data for risk share arrangements is not available at year-end. As of 6/30, health plans have not paid and are unaware of all claims for dates of service through 6/30. As a result, the accrual for risk share tends to be the most volatile and challenging to predict with certainty given the potential changes between what the health plans expect and assume for reserves in their quarterly reporting to EOHHS and what eventually transpires.

EOHHS will explore ways to reduce this volatility in future accruals, which may include applying discounts to plan-reported IBNP reserves to attempt to control for conservatism in health plan-reporting.

EOHHS acknowledges the importance of issuing financial statements that comply with generally accepted accounting principles and thus welcomes suggestions for improvements to its methodological approaches to reduce the volatility in these areas.

Anticipated Completion Date: *Ongoing*

Contact Persons:

Chaz Plungis, Chief of Strategic Planning, Monitoring, and Evaluation, Medicaid Finance, Executive Office of Health and Human Services
charles.plungis@ohhs.ri.gov

Allison Shartrand, Assistant Director Financial and Contract Management, Executive Office of Health and Human Services
allison.shartrand@ohhs.ri.gov

Finding 2023-007 ***(significant deficiency – repeat finding – 2022-007)***

CONTROLS OVER PREPARATION OF THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Controls over the preparation of the Schedule of Expenditures of Federal Awards (SEFA) can be enhanced to ensure all program activity is accurately reported to the proper Assistance Listing Number and amounts passed through to subrecipients are appropriately classified and reported.

Criteria: 2 CFR 200.510(b) states "The auditee must also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements which must include the total Federal awards expended as determined in accordance with §200.502".

The preparation of an accurate SEFA is critical to ensuring the proper recording of federal revenue and expenditures in the financial statements and to ensure that the State can comply with federal Uniform Guidance when submitting the State's Single Audit Report required by federal regulations.

Condition: While federal expenditures are reported accurately in the State accounting system based on disbursements for most federal programs and the State as a whole, adjustments are still needed, especially for a statewide Single Audit that also includes federal expenditures of component units, to ensure that expenditures are accurately reported on the SEFA. We noted several instances in which adjustments to the SEFA were necessary to accurately report the federal expenditure activity for fiscal 2023:

- *Coronavirus State and Local Fiscal Recovery Fund (SLFRF) (21.027)* - Amounts disbursed to municipalities from the State non-entitlement and county distribution amounts which federal regulations define as direct assistance to those entities. In accordance with federal guidance, these funds should be reported as direct assistance by the municipalities and not reported on the State's SEFA. Accordingly, expenditures were reduced by $132 million.
- *Disaster Grants – Public Assistance (administered by the Federal Emergency Management Agency) (97.036)* – Under generally accepted accounting principles, disaster grant federal revenue cannot be recognized until the underlying expenditures are approved by FEMA. The FEMA approval is deemed to be the underlying requirement for revenue recognition. Thus, recognition of the federal expenditures can lag the actual fiscal period in which the expenditures are incurred. Expenditures had to be increased by $271 million for amounts awarded by FEMA in fiscal 2023 relating to expenditures incurred in prior periods. Additionally, amounts received by the RI Emergency Management Agency and passed through to municipalities and other subrecipients, totaling approximately $50 million, were not initially recorded as expenditures of federal awards.
- *Medical Assistance Program (93.778)* – In accordance with provisions in the State's section 1115 waiver, the State receives federal match for certain Designated State Healthcare Program (DSHP) expenditures when incurred. Those proceeds must be utilized by the State to fund the State match for certain Healthcare Systems Transformation Programs (HSTP). HSTP expenditures from restricted DSHP funding totaled $12.8 million in fiscal 2023 and required addition to reported federal expenditures in the SEFA.
- *Social Services Block Grant (SSBG) (93.667)* – In accordance with federal regulations, certain expenditures for the SSBG program can be funded through the State's *Temporary Assistance to Needy Families (TANF) Program (93.558)*. For SEFA reporting purposes, this required reclassification of $4.9 million between the programs in fiscal 2023.

Adjustments of reported pass-through amounts were also required. In addition to adjustments for the primary government's federal expenditures, the State does not adequately review and monitor reported federal expenditures of the discretely presented component units. Such monitoring and oversight is necessary to ensure proper reporting as Rhode Island submits a Single Audit Report for the entire financial reporting entity.

Cause: There is a disconnect between the agency personnel responsible for accurate recording of federal expenditures in the SEFA and the Office of Accounts and Control, the agency that prepares the SEFA from the accounting system.

Effect: Without correction, the SEFA would not accurately present federal expenditures in accordance with the Uniform Guidance.

<u>RECOMMENDATION</u>

2023-007: Ensure policies and procedures for presenting the SEFA are consistent with Uniform Guidance requirements.

Management's Views and Corrective Actions:

We agree with this finding.

Over the last three years, significant progress has been made related to the accurate recording of federal expenditures at the state agency level, however as noted there is additional work to do to ensure compliance with Uniform Grant Guidance and for the ability for Accounts and Controls to monitor this activity to ensure compliance – ultimately resulting in an accurate SEFA report.

We expect steps like the implementation of a statewide grant management system (12/2022) and a modern ERP Finance system to replace RIFANS (expected 7/2025) will have a major impact on the ability of Accounts and Controls to monitor the accurate recording of federal expenditures. The current state financial system, RIFANS, lacks grant identification information making the direct connection between expenditure data and a federal grant challenging. The new grant management system has helped with this issue by *generating a unique grant ID (RIGID) and pushing it to RIFANS, but it will not be until RIFANS is replaced that we will have the ability to monitor federal expenditures at the desired level.*

In the interim period, we will continue to focus on agency adoption of the grant management system and reinforce compliance with Uniform Grant Guidance as we believe this puts the state in the best possible position, leading up the implementation of the new financial system, to address the issues outlined in this finding.

Anticipated Completion Date:	*Ongoing*
Contact Person:	*Steve Thompson, Chief of Strategic Planning, Monitoring, and Evaluation, Grants Management Office, Office of Accounts and Control* *steve.thompson@doa.ri.gov*

Finding 2023-008 ***(material weakness – repeat finding – 2022-008)***

CONTROLS OVER FEDERAL PROGRAM FINANCIAL ACTIVITY

The State must 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.

Background: Federal programs represented 51% of fiscal 2023 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 requirements. Further, the State can improve its overall centralized monitoring of federal program operations to ensure compliance with federal regulations.

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.

Criteria: Federal revenue and expenditures recorded by the State must be consistent with the limitations of grant awards from the federal government and claimed expenditures on federal reports must be consistent with amounts recorded in the State's accounting system.

Condition: Knowledge of grant requirements, spending authorizations, and limitations on reimbursable expenditures all rest with departmental managers who administer the federal grant programs. 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. In addition, procedures designed to ensure the consistency of federal expenditures reported in RIFANS (the source of the State's SEFA) with those reported on federal reports were deemed ineffective and discontinued.

With the longer-term solution residing with a fully integrated ERP system with the functionalities outlined in Finding 2023-003, the State needs to implement the following near-term solutions to improve controls over federal reporting:

- Interface RIFANS with the separate Grants Management System (GMS) to provide controls ensuring that federal expenditures are recognized only if the GMS reports sufficient federal grant authority at the time of the transaction. The effectiveness of this interface will be limited since some agencies are unable to delineate the applicable grant period when processing transactions in RIFANS.
- Ensure that agencies complete quarterly cost allocations and that related adjustments of reported expenditures are completed in a timely manner.
- Improve monitoring to ensure that agencies are drawing down federal funds in a timely manner.
- Utilize reporting functionality of GMS to require reports showing availability of funds as supporting documentation for manual journal entries to post federal program activity.

- The State needs to implement a new process to monitor the consistency of federal expenditures reported by RIFANS with those reported by agencies on federal reports. Differences often arise due to timing, federal disallowance, reporting basis (i.e., accrual versus cash basis), etc., which require reconciliation to determine if adjustments are needed in RIFANS or on federal reports. The State should implement a monitoring process that highlights variances between RIFANS and federal reports to ensure that adjustments are made in a timely manner to correct reporting.

The State will need to carefully consider whether the interface of the current GMS with the ERP system, currently in the implementation stages, will ensure sufficient functionality to address the above deficiencies.

Cause: Sufficient controls have not been implemented within the statewide accounting system to ensure amounts are consistent with the limitations of grant awards from the federal government and claimed expenditures on federal reports are consistent with amounts recorded in the State's accounting system.

Effect: Federal revenue could be overstated and not detected for financial reporting purposes. The share of program costs allocable to funding sources (e.g., general revenue vs. federal) could be misstated.

<u>RECOMMENDATIONS</u>

2023-008a: Utilize the GMS to improve monitoring of federal program financial activity.

2023-008b: Implement a monitoring process that highlights variances between RIFANS and federal reports to ensure that adjustments are made in a timely manner to correct reporting.

2023-008c: Ensure that the interface of the current GMS with the ERP system, currently in the implementation stages, will ensure sufficient functionality to address the above deficiencies.

Management's Views and Corrective Actions:

We agree with this finding.

The statewide grant management system was implemented at the end of 2022. State regulation 220-RICR-20-00-2 requiring all new subawards to be issued through the grant management system took full effect on 07/01/23, since then we have seen a continued increase in state agencies using the grant system to manage their federal awards. As of early 2024 there are over 900 federal awards in the system and over 350 subawards have been issued from the system. We believe the most efficient way to address issues outlined in this finding is to increase state agency adoption of the grant management system and to integrate that system with the new modern ERP finance system that is currently being developed.

The lack of grant identification information (grant ID) in the current state financial system, RIFANS, makes the tracking of grant transactions extremely complicated and contributes to the difficultly in effectively implementing necessary internal controls. As noted in the finding, care must be taken to ensure the integration of the grant management system and the new ERP finance system is done in such a fashion to ensure the necessary internal controls are in place to accurately track revenue and expenditures on federal awards.

Specifically related to the issue of overstated federal revenue, Accounts & Controls issued the Interagency Agreements with Federal Funds (IAA-FF) Policy on 05/29/23. The policy provides detailed guidance on reporting of federal revenue when one agency passes federal funds to another state agency. It is intended to reduce the risk of federal revenue being overstated.

We anticipate significant progress on this finding after the ERP Finance system is live (expected 07/25) and integrated with the grant management system.

<u>Anticipated Completion Date</u>: *Ongoing*

<u>*Contact Person*</u>*:*	*Steve Thompson, Chief of Strategic Planning, Monitoring, and Evaluation, Grants Management Office, Office of Accounts and Control* *steve.thompson@doa.ri.gov*

Finding 2023-009 ***(material weakness – repeat finding – 2022-009)***

<u>MATERIAL AUDIT ADJUSTMENTS</u>

Material audit adjustments were proposed and accepted during our audit of the State's fiscal 2023 financial statements.

Background: Generally accepted auditing standards require the need for material audit adjustments to be considered a control deficiency.

Criteria: Material audit adjustments are indicative of weaknesses in controls over the preparation of financial statements.

Condition: We proposed multiple material audit adjustments deemed necessary to fairly present the State's financial statements in accordance with generally accepted accounting principles. Common reasons for proposed audit adjustments were to correct the financial statements to ensure the:

- Alignment and consistency amongst funds and/or for proper financial reporting classification (i.e., ensuring that transactions were reported consistently in the financial statements);
- Completeness and accuracy of accrual transactions;
- Recording of accounting adjustments pending information not provided timely by State agencies; and
- Proper reporting of custodial activity in the State's financial statements.

Cause: The Office of Accounts and Control has responsibility for the State's financial reporting but is reliant on agency personnel to accurately record financial activity in conjunction with the State's fiscal close. In addition, risks exist that information impacting the State's financial statements could be omitted from or incorrectly accounted for in the State's financial statements if not disclosed to or identified by the Office of Accounts and Control. While the State has implemented manual processes in response to these risks, material adjustments were still required to adjust or record financial activity during the audit.

Effect: The State's financial statements would have been misstated without the required audit adjustments.

<u>RECOMMENDATIONS</u>

2023-009a: Consider additional oversight over agency financial closing procedures to ensure completeness and accuracy of recorded transactions.

2023-009b: Improve documentation of the State's policies and procedures relating to financial reporting.

2023-009c: Financial reporting training should be considered for State agency finance personnel to increase awareness of governmental financial reporting.

Management's Views and Corrective Actions:

Management agrees with the finding. In response to the recommendations:

<u>*2023-009a*</u>*: Additional oversight of agency financial closing procedures to ensure the completeness and accuracy of recorded transactions would require system hierarchy changes at the agency level. This additional oversight will be improved in the implementation of the ERP system with improved business process alignment and approval process.*

2023-009b: The Office of Accounts and Control has worked to document State policies and procedures relating to financial reporting as well as hold regular meetings with the agency financial management to educate on such policies.

2023-009c: A&C will communicate the upcoming Government Finance Officers Association (GFOA) trainings to the State Chief Financial Officers so they may assign to their respective finance staff to attend applicable trainings. Agency management should hold themselves and their financial staff accountable to attend the applicable government financial reporting training to improve awareness of governmental financial reporting. The Office of Accounts and Control requires CPE annually from its staff and encourages GFOA training to the extent the budget allows for it.

Anticipated Completion Dates:	*2023-009a: October 2025* *2023-009b: Completed* *2023-009c: First communication April 1, 2024, and then ongoing.*
Contact Persons:	*2023-009a: Louise Sawtelle, Associate Controller, Office of Accounts and Control* *Louise.Sawtelle@doa.ri.gov* *2023-009b&c: Tara Mello, Associate Controller, Department of Administration, Office of Accounts & Control* *tara.m.mello@doa.ri.gov*

Finding 2023-010 **(material weakness - repeat finding – 2022-010)**

INVESTMENT NEEDED FOR MODERNIZATION OF THE STATE'S TREASURY FUNCTIONS

The complexity of Treasury operations has increased substantially over the years without significant modifications to the State's investment in technology and personnel to support those efforts and to ensure internal control best practices are maintained.

Background: The Office of the General Treasurer (Treasury) is responsible for the State's cash management functionality which includes oversight of deposit balances with multiple financial institutions, investment of cash balances, maintaining liquidity to meet obligations, and ensuring the safety of deposits and short-term investment balances.

At June 30, 2023, the State's short-term deposit, investment portfolio (exclusive of pension and OPEB related investments), and funds on deposit with fiscal agent (State debt proceeds, which are held in trust by fiduciaries but subject to the State's monitoring of permitted investments and other contract requirements) totaled in excess of $4 billion. Organizations of similar size and complexity would typically have sophisticated and integrated information technology systems to facilitate daily cash management operations and ensure compliance with deposit and investment guidelines.

The Office of the General Treasurer has utilized various applications to facilitate its cash management functionalities, but none have been integrated with the State's accounting system. The State has begun implementation of an ERP system which includes integrated cash management functionalities within the project scope. The ERP system implementation is expected to take several years before its complete functionality is operational.

Criteria: Management is responsible for ensuring internal controls over Treasury operations are well designed and effective. Most important within Treasury operations is ensuring segregation of duties. Treasury is also responsible for ensuring the safety and liquidity of the State's deposits and for ensuring compliance with the deposit and short-term investment guidelines of the State Investment Commission.

Condition: While Treasury meets its daily cash management responsibilities, mostly through the continuity of "key" personnel, these activities are not adequately supported by current technology that accesses and integrates data from multiple sources (e.g., accounting system, banks, custodians, investment counterparties). Accordingly, data is independently gathered from a variety of sources, which is time consuming and inefficient. Additionally, given the current configuration of non-integrated applications, there is an insufficient number of staff assigned to these functions to allow adequate segregation of duties. The systems and processes used to manage the deposit and short-term portfolio present the following control deficiencies:

- Difficulties in ensuring segregation of duties relating to the transfer of funds and the recording and reconciling of investment activity.
- The State is currently utilizing Excel to record the purchase and sale of investments. The program is used to journalize summary investment activity into the State's accounting system. While functional, the lack of transaction level detail being recorded in the State's accounting system, coupled with the lack of controls that a more substantial software application would include, is not ideal.
- Managing compliance with investment diversification policies (promulgated by the State Investment Commission) and statutory collateralization requirements mandated for the State's cash deposits requires continual monitoring to ensure compliance. The Treasury currently lacks a modern cash management system that would facilitate compliance monitoring, requiring those functions to be performed by personnel already depended on for various other Treasury functions. During our audit, we noted two investment accounts totaling $13 million that were uncollateralized and not detected timely by monthly reconciliation processes.
- Periodic confirmation of authorized signatories on the State's deposit and investment accounts is an additional monitoring procedure currently lacking in Treasury operations. Our audit noted instances where authorized signatories required update.
- The Treasury lacks dedicated internal audit and information system (IS) security functions common in most state Treasury operations to ensure that financial and IS security controls are in place and operating effectively.

In response to this finding, when reported for fiscal 2022, the newly elected Treasurer obtained budgetary approval for a Deputy Cash Manager position and reassigned duties to create a Director of Strategic Planning position to begin efforts to address the issues cited above. The Deputy Cash Manager started in fiscal 2024 and strategic planning initiatives include the development of a request for proposal as an initial phase of a multi-phase project to identify and address the strategic needs of the Treasury.

Cause: The current systems do not contribute to segregation of duties, and staffing is insufficient to adequately segregate the functions with the required redundancy needed in various positions. Current use of Excel lacks required access, data integrity, and other systemic controls to safeguard the recording of the State's short-term investment activity. There is a lack of sufficient technology and personnel resources needed to manage compliance with investment diversification policies and statutory collateralization requirements.

Effect: There is an inability to (1) maintain proper segregation of duties in key Treasury operations, (2) evaluate and monitor financial and operational controls, and (3) effectively monitor compliance with diversification and permitted investment requirements, as well as collateralization policies, for the State's cash and investments.

<u>RECOMMENDATIONS</u>

2023-010a: Contract for a study of Treasury operations to identify potential modern technological and contract service solutions consistent with the size and complexity of current operations.

2023-010b: Ensure the State's ERP system implementation includes the State's treasury function and the resources that will be needed to integrate the cash management functionality within the System.

2023-010c: Consider the personnel resources necessary to enhance internal controls (i.e., segregation of duties, financial, operational, and IS security controls), and reduce business continuity risks associated with current personnel levels.

Management's Views and Corrective Actions:

<u>2023-010a</u>: Treasury staff have formulated and released an RFP seeking a consultant to inventory and assess cash related activity and to provide recommendations on technology and processes to improve this activity. Additionally, the consultant will analyze and offer recommendations regarding collateralization monitoring, banking relationships, and due diligence related to banking institution stability. It is expected that this work

will begin in May/June 2024 and extend through fiscal year 2025, with the possibility of extending the engagement further.

2023-010b: To ensure effective integration of Treasury activity into the ERP system, a staff person has been assigned as the Banking/Settlement workstream lead with the ERP project team. The workstream lead participates in the array of meetings and activity associated with the project and engages with subject matter experts in various Treasury departments as needed to ensure domain expertise.

2023-010c: The Auditor General noted the General Treasurer's successful effort to obtain budgetary authority and hiring a Deputy Cash Manager for the team. This positive contribution shall require additional effort as the Cash Manager resigned in February 2024. The individual hired as the Deputy Cash Manager is being tasked with acting as the interim Cash Manager in the immediate future. It is anticipated that the opening created by the Cash Manager's departure shall be permanently filled early in fiscal year 2025. The cash team is also being relocated to the DOA facility in Providence, on a hybrid basis, to bring them in closer contact with Accounts and Controls and the Treasury investment team.

Anticipated Completion Date: *Ongoing*

Contact Persons: *Chris Civittolo, Director of Strategic Planning, Office of the General Treasurer*
Chris.Civittolo@treasury.ri.gov

Eric Baggesen, Chief Investment Officer, Office of the General Treasurer
Eric.Baggesen@treasury.ri.gov

Finding 2023-011 ***(significant deficiency – repeat finding - 2022-011)***

VOLUME OF ACCOUNTING SYSTEM JOURNAL ENTRIES

There is an excessive volume of journal entries recorded within the accounting system. This volume weakens controls over the appropriate authorization and classification of expenditures and limits transparency regarding the underlying transactions.

Background: More than 11,000 journal entries were processed during fiscal 2023 in the accounting system. An additional 36,000 journal entries were used to record receipts/revenues.

Criteria: Initiation and approval of journal entries is typically restricted to a small number of higher-level accounting staff to record specific financial reporting related entries or to make corrections.

Condition: A significant volume of journal entries is required due to the lack of a fully integrated ERP system. For example, journal entries are utilized to:

- Allocate costs to multiple programs and activities. These journals primarily adjust expenditures based on the results of various disparate federal cost allocation systems and agency time reporting systems that are utilized throughout the State;
- Record receipts due to the lack of a revenue and receivable module in the current State accounting system; and
- Adjust natural accounts of expenditures recorded in governmental funds to facilitate capital asset recording in the government-wide financial statements.

Journal entries typically are considered higher risk from an internal control perspective as approval level controls require understanding and appropriate review of complex transactions to be effective. As the volume increases, the time to adequately review and approve what are often material transactions also increases, threatening the effectiveness of control procedures.

Cause: Insufficient cost allocation functionality in the current accounting system necessitates a high volume of journal entries to allocate administrative costs. Since accounting personnel in all departments and agencies need to process receipts through journal entries, the ability to initiate and approve journal entries is more widespread than would be typically seen in most large accounting systems. In addition, while agency finance personnel are knowledgeable about program and agency activities, they are often less familiar with governmental accounting and financial reporting requirements.

Effect: Controls are weakened through the large volume of high-dollar transactions that are recorded through journal entries, which increase the possibility that a misstatement could occur and not be detected in the normal course of operations.

RECOMMENDATIONS

2023-011a: Ensure the statewide ERP system includes appropriate cost allocation functionality, including payroll distributions, and an integrated revenue/receipt functionality to significantly reduce the volume of journal entries needed to maintain the accounting system and support financial reporting.

2023-011b: Enhance review and oversight of material journal entries to ensure appropriate recording of transactions and avoid misstatement of the financial statements.

Management's Views and Corrective Actions:

Management agrees with the recommendations. The recommendation regarding system capabilities to allocate costs will be addressed with the implementation of a new ERP system. The new system will be required to have functionality to allocate costs. A&C will continue to work on its review and oversight of material journal entries to ensure appropriate recording of transactions.

Anticipated Completion Date: *July 1, 2025 for ERP system*

Contact Persons: *Tara Mello, Associate Controller, Department of Administration, Office of Accounts & Control*
tara.m.mello@doa.ri.gov

Martires Mullins, Administrator – Financial Management & Reporting Department of Administration, Office of Accounts & Control
martires.hernandez@doa.ri.gov

Finding 2023-012 ***(significant deficiency – repeat finding - 2022-012)***

PREPARATION OF THE GOVERNMENT-WIDE FINANCIAL STATEMENTS

The State needs to minimize manual processes required to prepare the government-wide financial statements.

Background: The State accounting system maintains distinct accounting records to support the preparation of the government-wide (full accrual) financial statements. The full accrual set of books is populated through consolidation entries of the monthly activity from the modified accrual set of books, capital asset transactions throughout the fiscal year, and conversion entries to record noncurrent assets and liabilities and to reclassify fund-level activity as needed. A significant amount of manual processing, mostly in Excel workbooks, is required to compile data needed to post consolidation entries.

Criteria: Trial balances from the accounting system should not require significant modification to generate accurate financial statements. Controls should be operational to ensure that all transaction activity is recorded consistently in both sets of books and required updates to account mappings are made when needed. Preparation of the government-wide financial statements should include adequate review to ensure results are consistent with expectations.

Condition: While the fiscal 2023 draft government-wide financial statements required several audit adjustments to ensure proper and accurate presentation, the financials were significantly improved over the prior year with staff at the Office of Accounts and Control having more experience. Reconciliations, included as a required component of the basic financial statements, to identify and explain the differences between the government-wide and fund-level financial statements required some adjustment but were also improved. Adjustments in fiscal 2023, were largely attributed to (1) net position reclassifications, (2) revenue categorization differences between operating and capital grants, (3) misstatements in reported capital assets, and (4) reporting long-term liabilities and receivables.

Cause: Most misstatements related to errors in process or classification which occur in conjunction with manual processes inherent in the State's current preparation of the government-wide financial statements.

Effect: Possible material misstatement of the State's financial statements.

RECOMMENDATIONS

2023-012a: Enhance procedures for preparing the government-wide financial statements to ensure consistent and accurate recording of transaction activity. Minimize manual processes to the extent possible when preparing the financial statements.

2023-012b: Expand training in governmental financial reporting for Accounts and Control staff to continue enhancing staff development in this specialized area.

Management's Views and Corrective Actions:

A&C agrees with these recommendations. A&C continues to work on improving its documentation of government-wide financial reporting policies and procedures. As policies and procedures are formalized, they are communicated and trained to the respective staff. Further, the process for preparing the government-wide financial statements will change with the ERP implementation and additional training will inform A&C staff of the improved business process.

Anticipated Completion Date: *Ongoing*

Contact Persons: *Martires Mullins, Administrator – Financial Management & Reporting*
Department of Administration, Office of Accounts & Control
martires.hernandez@doa.ri.gov

Tara Mello, Associate Controller, Department of Administration,
Office of Accounts & Control
tara.m.mello@doa.ri.gov

INTERNAL CONTROL OVER FINANCIAL REPORTING -

INTERMODAL SURFACE TRANSPORTATION FUND

Finding 2023-013	*(significant deficiency – repeat finding – 2022-014)*

DIVISION OF MOTOR VEHICLES – CONTROLS OVER REVENUE COLLECTIONS

Controls can be improved over the recording of license, registration and surcharge fees collected by the Division of Motor Vehicles (DMV) and deposited in the Intermodal Surface Transportation (IST) Fund.

Background: In fiscal 2023, the DMV collected $106.5 million in revenues (excluding sales taxes) of which $85.6 million was remitted to the IST Fund's Highway Maintenance Account.

Criteria: DMV must have controls in place to ensure the completeness of revenue reflected within the IST Fund. RI General Law chapter 39-18.1 designates certain fees to be deposited in the IST Fund for transportation purposes.

Condition: DMV lacks effective controls to ensure that all revenues collected by the DMV for deposit within the IST Fund have been recorded. RI Department of Transportation (RIDOT) should have procedures in place to provide reasonable assurance that the appropriate fees have been earmarked for the IST Fund and have been received and recorded as revenue. This should include documentation of the fee structure identified by the RI General Laws, the surcharge amount being applied to each DMV transactions code, and how the DMV computer system, RIMS, is programmed to identify such amounts for the IST Fund. RIDOT and the DMV should periodically assess the reasonableness of the actual revenue recognized for recording in the IST Fund. We identified the following control deficiencies:

- There is no crosswalk of the fee structure identified by the RI General Laws for licenses, registrations, surcharges, etc. and how RIMS is programmed to identify such amounts.

- The current reconciliation performed between the State accounting system (RIFANS) and RIMS does not include all fees collected by the DMV.

- Manual write offs are not recorded in RIMS; they are maintained outside of the system. Manual write offs should be recorded within RIMS to maintain a log of the adjustments and to facilitate RIMS/RIFANS reconciliation.

- Identifying an estimated deposit date for DMV proceeds within RIMS reports will assist in fully reconciling RIMS reported activity with the State accounting system.

DMV began working through the recommended reconciliations requested in prior years, however, corrective action was not completed in fiscal 2023 and remains in progress. To be an effective control over financial reporting, the department reconciliation needs to be completed prior to the fiscal closing by the State.

Cause: Controls to ensure the completeness of the DMV revenues earmarked for transportation purposes within the IST Fund require improvement. DMV should consider ways that the RIMS system can enhance monitoring of compliance with statutory revenue requirements and assist the agency in completely reconciling with RIFANS.

Effect: Potential for misstatements in the financial statements not being detected in a timely manner.

RECOMMENDATIONS

2023-013a: Ensure the timely completion of monthly and annual reconciliations between RIFANS and RIMS to ensure that recorded revenue is supported by RIMS data.

2023-013b: Create a crosswalk between the fees charged in RIMS and the section of the Rhode Island General Laws authorizing the fee.

Management's Views and Corrective Actions:

2023-013a: The DMV agrees that a reconciliation of the revenues collected is needed and will work to reconcile the revenues collected on an annual basis, there are too many variables outside of the DMV's control which prevent us from reconciling monthly. The DMV in in the process of reconciling all funds collected during FY 2023.

2023-013b: The DMV agrees that a crosswalk is a beneficial document to have. The DMV is in the process of completing a crosswalk of fees charged in RIMS and the section of the Rhode Island General Laws.

Anticipated Completion Date:	*March 31, 2024*
Contact Persons:	*Paul Dombrowski, Administrator Financial Management, Division of Motor Vehicles* *Paul.Dombrowski@dmv.ri.gov* *Roger Demers, Chief of Legal Services, Division of Motor Vehicles* *Roger.Demers@dmv.ri.gov*

Finding 2023-014 **(material weakness - repeat finding - 2022-015)**

INTERMODAL SURFACE TRANSPORTATION (IST) FUND – FINANCIAL REPORTING

Controls can be enhanced over the presentation of IST Fund financial statements to ensure consistent and accurate reporting of fund activity in accordance with generally accepted accounting principles.

Background: The IST Fund accounts for transportation related activities of the State, including the federal highway construction program, transportation bond proceeds, and designated revenues collected by the Division of Motor Vehicles. The IST Fund financial statements, although generated by the State accounting system, are the responsibility of the RI Department of Transportation (RIDOT).

Criteria: Controls over the preparation of financial statements should ensure consistent and accurate financial reporting. RIDOT management is responsible for ensuring that controls over financial reporting are in place and operating effectively.

Condition: We identified several misstatements in the 2023 IST Fund financial statements that required adjustment. Those misstatements related to the reporting of fund balance, federal revenue and expenditures, and accounts payable. In addition, adjustments were also required to correct several account classifications on the IST Fund financial statements to ensure consistent presentation with GAAP. Account reconciliations are currently lacking to ensure accurate reporting of federal revenue and expenditures in the IST Fund. In fiscal 2023, federal revenue and expenditures were overstated by $20 million and $24 million, respectively, at the fiscal close, requiring adjustment.

Cause: Identified misstatements resulted from deficiencies in current financial reporting processes relating to manual procedures designed to compensate for deficiencies in the accounting system. Examples include the allocation of fund balance and the accumulation of accounts payable transactions from the RIDOT Financial Management System (FMS). These manual processes can be prone to error and lack controls to ensure completeness. In addition, most of these accounting processes are performed by the more experienced accounting staff at RIDOT, reducing the likelihood that independent reviews will be performed. Most of the exceptions noted may have been identified if RIDOT had been performing a more detailed review of account balances in conjunction with the fiscal close.

Effect: Account balances within the IST Fund financial statements could be misstated.

RECOMMENDATIONS

2023-014a: Ensure the transactions identified through the reconciliation of each activity and/or funding source within the IST Fund result in the appropriate categorization and reporting of revenue, expenditures, and fund balance components on the financial statements.

2023-014b: Implement controls, including account reconciliations and more detailed supervisory review of financial statement accounts, to ensure the accuracy of recorded amounts in the financial statements. Management reviews of financial statements should also be performed to ensure proper classification and presentation.

Management's Views and Corrective Actions:

2023-014a: RIDOT will implement continuous checks throughout the fiscal year to ensure accurate reporting of the IST Fund, adhering to GASB Standards, and using proper Generally Accepted Accounting Principles. IT has developed a more in depth and detailed reporting of the Fund Balance to ensure a more accurate reporting and preparation through the year leading up to fiscal close.

2023-014b: General Ledger will meet continuously with Senior Management to implement new controls in the current financial systems to ensure proper identification and reconciliation during fiscal close. Developing new standards of these reconciliations will allow RIDOT to properly identify any misstatements prior to journal entry.

Anticipated Completion Date:	*December 31, 2024*
Contact Person:	*Loren Doyle, Chief Operating Officer, Department of Transportation* *loren.doyle@dot.ri.gov*

Finding 2023-015	***(material weakness – repeat finding – 2022-016)***

TRANSPORTATION INFRASTRUCTURE REPORTING

Controls over the identification of transportation infrastructure assets have been improved but can be further enhanced to ensure the accuracy of such amounts. Controls should be improved to record the disposal of infrastructure assets when retired or replaced.

Background: RIDOT enhanced its process to identify transportation infrastructure assets which use the RIDOT Financial Management System (FMS) to identify each project and ensure that total project costs (e.g., design and construction costs) are included in the capitalized amount. Since the source of the information used to identify capitalized infrastructure is FMS and the financial statements are based on RIFANS (as recorded by the Office of Accounts and Control), the data used must be reconciled between the two systems.

Projects are assigned to one of nine infrastructure codes established to identify the type (road, bridge, etc.) and the estimated useful life of the asset which drives depreciation expense.

Criteria: Generally accepted accounting principles (GAAP) require recording the State's investment in infrastructure assets to be reflected on the government-wide financial statements. Such amounts should be capitalized and depreciated consistent with the State's adopted accounting policies. Amounts are recorded as construction in progress until placed in service, at which time depreciation commences. Infrastructure disposals should be recorded when assets are replaced or permanently taken out of service.

GAAP also requires 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.

Condition: The cost and related accumulated depreciation associated with infrastructure assets that have been replaced or are no longer in service have not been removed from reported infrastructure amounts. The State asserts that these assets are fully depreciated thus not resulting in a significant misstatement of reported net infrastructure, however, a process for removal to support that assertion by management needs to be implemented. A reasonable process to identify and record infrastructure disposals is also needed to ensure accurate note disclosure of infrastructure assets.

RIDOT utilizes a report from its FMS to report infrastructure additions to the Office of Accounts and Control annually. The FMS report does not reflect accrued expenditures, while RIFANS reported amounts include accruals reported for financial reporting purposes. The impact of the prior year accrual reversals in RIFANS was not properly accounted for when recording infrastructure additions for fiscal 2023 and resulted in construction in progress being overstated by $59.8 million. Material adjustments were recorded to correct balances at June 30, 2023. RIDOT needs to properly account for accruals reported in RIFANS when recording infrastructure additions for financial reporting.

In conjunction with its review of asset disposals, RIDOT should consider whether it has current transportation infrastructure assets recorded that may be impaired and require proper accounting recognition in accordance with government accounting standards.

Cause: Controls over RIDOT's infrastructure asset identification and disposal processes are not sufficient to ensure accurate reporting of capitalized infrastructure amounts.

A process to evaluate and remove estimated costs relating to retired/replaced infrastructure has not been implemented. The consideration and documentation of impaired infrastructure assets should also be performed.

RIDOT does not review infrastructure assets reported in the State's financial statements to ensure that balances are consistent with supporting documentation and RIFANS.

Effect: Infrastructure assets and related depreciation expense may be materially misstated.

RECOMMENDATIONS

2023-015a: Enhance controls over the recording of infrastructure assets by reconciling RIDOT departmental records of construction in progress and infrastructure assets to amounts reported in the State's financial statements.

2023-015b: Implement a process to remove estimated infrastructure assets and related accumulated depreciation when assets have been replaced or taken out of service. Include in that process consideration of whether any of the State's recorded transportation infrastructure has been impaired consistent with GAAP criteria.

Management's Views and Corrective Actions:

2023-015a: RIDOT will continue to reconcile the infrastructure assets along with construction in progress through RIDOT's Financial Management System (FMS) to match the State's financial statements.

2023-015b: In previous fiscal year of 2022 and continuing into 2023 and beyond, RIDOT's Financial Management and Bridge Maintenance Divisions developed a method to determine the assets that were impaired, replaced and/or taken out of service. RIDOT will continue to work with the RI Department of Administration's Office of Accounts and Control to determine the proper life cycle depreciation of the assets in question.

Anticipated Completion Date: *December 31, 2024*

Contact Person: *Loren Doyle, Chief Operating Officer, Department of Transportation*
loren.doyle@dot.ri.gov

INTERNAL CONTROL OVER FINANCIAL REPORTING -

STATEWIDE INFORMATION SYSTEMS SECURITY

AUDIT STANDARD:

Auditing standards defines the risk of the use of information technology (IT) as the susceptibility of information processing controls to ineffective design or operation, or risks to the integrity of information in the entity's information system, due to ineffective design or operation in the entity's IT processes.

Finding 2023-016	*(significant deficiency – repeat finding – 2022-018)*

COMPREHENSIVE INFORMATION SYSTEMS SECURITY – ADDITIONAL RESOURCES NEEDED TO ADDRESS CURRENT RISK ASSESSMENT

The State updated its current cybersecurity readiness and has begun to identify risk mitigation priorities and the resources needed to implement necessary corrective action.

Background: The Division of Enterprise Technology Strategy and Services (ETSS) 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) is critically important to ensure that information technology (IT) dependent operations continue uninterrupted, and that sensitive data accumulated within State operations remains secure with appropriately controlled access.

Periodic comprehensive technology risk assessments are key to uncovering underlying vulnerabilities in the environment as well as providing guidance on where to best spend limited assets to reduce risk. The State's most recently updated assessment of its cybersecurity readiness was completed in June 2022. The assessment noted improvements by the State in several areas and also identified and prioritized a significant number of critical improvements required to mitigate current security risks. Critical improvements will require substantial resources to be devoted by the State.

During our audit we focused on the following mission critical systems due to their impact on the State's financial reporting: RIFANS, STAARS, RIBridges, MMIS, DMV- RIMS, and DLT benefit and revenue systems. We also reviewed the IS over the State's network environment which is critical to the State's operations and negatively impacts application security if not maintained at an acceptable industry level standard. Our detailed findings, in most instances, mirrored the findings of the recent cybersecurity assessment.

ETSS has continued to implement a variety of system and network improvements that will enhance management capabilities (e.g., policy enforcement) and improve overall IS. Unfortunately, the State does not have sufficient resources dedicated for the size and complexity of State operations and risk mitigation is not progressing quickly enough.

Criteria: IT risk assessment policies and procedures must be documented (National Institute of Standards and Technology – NIST RA-1). Risk assessments should be performed every three years or whenever there are significant changes (e.g., new system or network implementations) (NIST RA-3). Risk assessments are vital to managing and mitigating risks, maintaining compliance (i.e., IRS and HIPAA requirements), prioritizing IT spending, and supporting business continuity.

The oversight and management of the State's IS relies upon the implementation of ETSS's comprehensive information IS plan, which includes detailed policies and procedures that are designed to safeguard all systems and data contained within the State's IT environment.

Assessments of compliance to IT policies and procedures for all critical IT systems and data should be performed on a periodic basis as part of the risk assessment.

Condition: The State has continued to update and enhance its IS policies and procedures which is a continuous effort for any large entity. Ensuring effective communication and implementation of these policies will continue to require additional IS resources and training. Evaluating compliance with policies and procedures across the entity to identify and mitigate risks remains a significant challenge due to a lack of resources. While the State has improved technology in recent years to identify and report on specific risks, the personnel needed to respond to the increased volume of risks reported has remained insufficient. The updated IT cybersecurity assessment provided validation of the State's improvements in several areas when compared to previous assessments, however, it also validated that the pace of improvement is too slow and resources are insufficient to mitigate current risks.

The State needs a comprehensive plan to identify the amount of dedicated IS resources appropriate to the State's size and complexity. The plan should include a formalized risk assessment to identify the risks deemed most critical to operations and security. The plan should identify the resources necessary (additional or repurposed positions to address current operational needs) and the mechanism to ensure proper funding of those resources over time. The State should consider IS to be an operational cost rather than something that requires only periodic investment.

A formalized plan should include risks by priority level, a corrective action or remediation plan, and anticipated costs and resources so that State management can adequately plan to address critical areas in a timely manner. The State should consider external resources to expedite the completion of this formalized assessment. Layering this effort on the State resources responsible for maintaining current operations and security is not practical.

During fiscal 2023, the State contracted with a firewall and networking service provider to bring additional resources to these vital IS functions. These contracts supplement resources dedicated to the implementation, support, and maintenance of the critical IS functions. As with all contract functions, the State is still responsible for oversight and monitoring of these functions which is resource dependent.

Cause: Current resources are insufficient to maintain IS over the State's IT infrastructure, systems, and data for an entity the size of the State.

Without a formal risk-based prioritization approach, ensuring that resources (funding and personnel) required to support the number of system implementations, network improvements, and security monitoring and improvements in process concurrently will be difficult to manage. Further, insufficient resources will increase the chances of project delay and failure as well as impacting the State's ability to manage the continuity and security of existing IT operations.

Effect: Critical systems and data may be exposed to security vulnerabilities and cyberattacks when comprehensive information security risk assessments are not performed routinely. This could impact the State's ability to ensure continued operation of mission critical systems and the security and integrity of the data within those systems.

<u>RECOMMENDATIONS</u>

2023-016a: Using the recent cybersecurity assessment and existing audit recommendations, develop a comprehensive plan to address the current IS risks to State operations. This plan should be risk-based and include the necessary resources, corrective actions, and prioritization needed to ensure timely mitigation by the State.

2023-016b: Continue to update formalized risk assessments periodically (with annual updates to adjust security priorities) with the results documented and communicated to management. These assessments should include consideration of IS issues resulting from audits, reviews of Service Organization Control reports, and internal assessments to include IS concerns for all of the State's critical systems.

Management's Views and Corrective Actions:

This activity is ongoing and cyclical in nature. Requests for funding for a Governance, Risk, and Compliance tool will be submitted for implementation in FY2024 which will support the maturation of the risk assessment and formal planning process. GRC Application has been procured and has working environment. Access is currently being refined and implemented with build out of risk module.

<u>Anticipated Completion Date</u>: *Ongoing*

<u>Contact Person</u>: *Nathan Loura, Chief Information Security Officer, Department of Administration, Division of Enterprise Technology Strategy and Services*
nathan.loura@doit.ri.gov

Finding 2023-017	*(material weakness – repeat finding – 2022-019)*

PROGRAM CHANGE CONTROLS

The State does not follow uniform enterprise-wide program change control procedures for the various IT applications operating within State government. This increases the risk that unauthorized or inappropriate changes could be made to IT applications without detection.

Background: Program change controls are a critical component of any system development life cycle. These controls ensure that only authorized changes are made to programs (along with user acceptance testing) before being promoted into the production environment. Additionally, program change control procedures prevent and detect unauthorized program modifications from being made. Almost all custom-developed computer applications require changes and/or updates throughout their production lifecycles. Consequently, these customized, home-grown applications require a formalized change management system to ensure that only authorized changes are made.

While some agencies have formally implemented program change controls, a standardized statewide approach has not been implemented.

Criteria: The State's change management process should be standardized so that all movement of code, modifications, testing, acceptance, and implementation provide management with a tracking history and record of approvals. This leads to consistent outcomes, efficient use of resources, auditability, and enhanced integrity of the application systems. Automated tools facilitate control over the change management process, reduce human error, and allow the process to be consistent, predictable, and repeatable.

ETSS should develop procedural guidance to detail the correct use of change management software and mandate internal control practices and procedures, thus ensuring a documented, monitored, auditable, and repeatable process.

Condition: The State lacks a uniform enterprise-wide program change control management process for the various IT applications operating within State government. This leads to inconsistent methods, as well as noncompliance and circumvention of ETSS's change control policies and procedures. For many of the State's critical systems, automated change control procedures were lacking to substantiate that only authorized and proper changes had been implemented.

While the State's implementation of standardized technology within program change controls remained lacking, the State did implement a Change Advisory Board (CAB) to oversee new projects and major changes. The CAB represents an improvement in the consideration, approval, and management of program changes previously lacking.

Cause: Various methods are used to control program change management which rely mostly upon manual and semi-automated procedures that incorporate emails, memoranda, and other paper-based forms to document application changes.

Effect: A lack of a uniform enterprise-wide program change control management process increases the risk that unauthorized or inappropriate changes could be made to IT applications without detection.

RECOMMENDATIONS

2023-017a: Develop and implement procedures detailing specific requirements for program change control and disseminate and train ETSS support staff in its proper execution.

2023-017b: Determine the appropriate combination of operational, procedural and/or technical adjustments required to use change management software to result in adequate program change control for the entire enterprise.

Management's Views and Corrective Actions:

ETSS continues to rollout JIRA for statewide IT projects. We have purchased additional licenses and now require all ETSS employees to attend mandatory training on the use of JIRA. In addtion ETSS has implemented weekly change review meetings as part of the rollout.

Anticipated Completion Date: *June 2024*

Contact Person: *Arul Rangaraju, Chief of IT, Portfolio and Project Management, Department of Administration, Division of Enterprise Technology Strategy and Services*
arulanandan.rangaraju@doit.ri.gov

Finding 2023-018	***(significant deficiency - repeat finding – 2022-020)***

PERIODIC SYSTEM ACCESS AND PRIVILEGE REVIEWS

The State's current practices for periodic logical access and privilege reviews at both the application and network levels need improvement.

Background: Within information systems security, identity, credential, and access management represents the programs, technologies, and personnel used to create trusted digital identity representations of individuals and other entities to provide authorized access to entity resources.

Criteria: While it is critical to set initial system access for an employee to the minimum necessary to perform the job function, it is also crucial to ensure that their access level remains current and appropriate over time since job functions may change.

Per NIST 800-53, "The need for certain assigned user privileges may change over time to reflect changes in organizational mission and business functions, environments of operation, technologies, or threats. A periodic review of assigned user privileges is necessary to determine if the rationale for assigning such privileges remains valid. If the need cannot be revalidated, organizations take appropriate corrective actions."

Condition: Periodic review of granted system access (privileges) is not consistently or uniformly performed for the majority of applications utilized throughout State government. Special attention should be paid to review system access for individuals granted administrator or "super user" access to ensure that such access is required and terminated in a timely manner. State network access should also be reviewed to ensure timely termination when system users leave employment (State or Contractor), are transferred to a new position, or no longer require system access.

During fiscal 2023, ETSS organized identity access management separately under its governance structure to facilitate a more consistent management approach across the entity.

Cause: Lack of consistent and uniform review of system access (privileges) across most State applications.

Effect: Improper or unauthorized access to State systems or networks which could impact service availability, data integrity, and/or security.

RECOMMENDATIONS

2023-018a: Implement periodic, verifiable privilege reviews for all applications and networks. Prioritize critical financial applications and those that contain sensitive data.

2023-018b: Communicate policies and procedures for privileged user access reviews to be performed by assigned agency IT staff periodically (no less than annually). Implement specific training in conjunction with the communication of policies and procedures to ensure conformity across the entity.

Management's Views and Corrective Actions:

ETSS access policy is drafted noting privileged account access and on-going project with CyberArk as our Privileged Access Monitoring (PAM) platform solution. The project is within final closure and documentation will be delivered into location available to all required users.

Anticipated Completion Date: *Ongoing*

Contact Person: *Nathan Loura, Chief Information Security Officer, Department of Administration, Division of Enterprise Technology Strategy and Services*
nathan.loura@doit.ri.gov

Finding 2023-019	***(significant deficiency - repeat finding – 2022-021)***

DATABASE LOGGING AND ACTIVITY MONITORING

The State's current practices for database logging and activity monitoring at the database level needs improvement.

Criteria: Just as it is essential to have logging and monitoring at the application level for key financial and sensitive data to guard against unauthorized transactions and errors, it is equally important to have database logging and monitoring in place to help guard against unauthorized changes occurring at the database level outside of the scope of application controls.

Proper database logging, monitoring, and alerting is identified as an important step in securing the database by both the Information Systems Audit and Control Association (ISACA) and other IT security professionals as an industry best practice.

Condition: Database logging and monitoring for most State applications is not adequate across the entity. While the State has begun implementing processes to improve in this area, consistent application of controls and additional resources are needed.

Cause: Lack of an implemented uniform practice for database logging and activity monitoring.

Effect: The lack of database logging and monitoring for improper activity makes it more likely that key databases will be vulnerable to malicious attacks without detection. Risk to data integrity may result from unauthorized database changes that go undetected.

RECOMMENDATIONS

2023-019a: Complete implementation of a consistent and effective database logging and monitoring process across all major State applications. Prioritize applications/databases that contain critical financial and sensitive data.

2023-019b: Communicate policies and procedures for database logging and monitoring to assigned agency IT staff. Implement specific training in conjunction with the communication of the policies and procedures to ensure consistent application across the entity.

Management's Views and Corrective Actions:

The state will continue to review remaining databases and options to encrypt, including the HCI environment which also encrypts data at rest and our cloud environments which encrypts at rest. We are currently onboarding a new member of security team to replace a recent departure to address this finding.

Anticipated Completion Date: *Ongoing*

Contact Person: *Alan Dias, Chief of IT, Agency and Enterprise Applications, Department of Administration, Division of Enterprise Technology Strategy and Services*
alan.dias@doit.ri.gov

Finding 2023-020	*(significant deficiency – repeat finding – 2022-022)*

DISASTER RECOVERY TESTING

The State should formalize identification of major systems, standardize application testing, and incorporate business continuity planning within its overall disaster recovery policy and testing.

Background: Periodic tests of the disaster recovery plan are a vital component of an overall business continuity plan to increase the likelihood that critical systems can be restored should a disaster disable or suspend operations at the State's data center. ETSS has a designated disaster recovery facility in New Jersey (operated by a vendor). During fiscal 2023, the State continued the process of modernizing its disaster recovery hardware and procedures. While this represents progress that will benefit the State going forward, no disaster recovery testing was performed during the fiscal year.

Criteria: Industry best practices stipulate that disaster recovery testing be performed twice a year to accommodate the ever-changing IT systems environment. The State should perform a full disaster recovery test for critical applications at least annually.

Condition: A list of major systems has been developed and the restoration priority has been established. In addition, further progress is needed to test all critical functionality of major systems and their applications. With the State continuing its modernization of disaster recovery hardware and procedures, no testing was performed during fiscal 2023 with the most recent test of disaster recovery procedures being partially completed in fiscal 2021. The State completed its planned infrastructure modernization in July 2023 which should allow for disaster recovery testing to resume in fiscal 2024.

Cause: The State's current modernization of its disaster recovery hardware and procedures in fiscal 2023 limited its disaster recovery testing. The State's last disaster recovery test in fiscal 2021 did not fully validate the system functionality, a necessary requirement of a successful disaster recovery exercise.

Effect: Incomplete disaster recovery testing reduces the assurance that all mission critical systems can be restored, should a disaster disable or suspend operations.

RECOMMENDATION

2023-020: Establish a repeatable level of system restoration and incorporate business continuity planning within periodic disaster recovery testing.

Management's Views and Corrective Actions:

We have continued to improve and add to our SharePoint Online DR Document repository, which contains all relevant DR materials in a secure cloud-based location, accessible from anywhere with an internet connection for maximum resiliency. Once complete, this will provide us with a much more efficient, resilient and quicker method of recovery for all systems on the platform and provide us with a much more realistic and repeatable process to recovery all production physical and virtual systems we support. We have a system priority restore list that is updated at least annually now and have also created a standard BCP template that all ETSS supported agencies will use, as well as the Enterprise I&O team for our Enterprise Operations Center that will be created in the same time frame.

Anticipated Completion Date: *April 2024*

Contact Person: *Cesar Mendoza, Chief of IT, Infrastructure and Operations, Department of Administration, Division of Enterprise Technology Strategy and Services*
cesar.mendoza@doit.ri.gov

Finding 2023-021	***(significant deficiency - repeat finding – 2022-023)***

INCIDENT RESPONSE TRAINING

The State needs to further enhance its coordination and training to improve its incident response capabilities in the event of a data breach.

Criteria: A strong and well-designed incident response program is required for the State to effectively respond to incidents such as a data breach initiated from outside the State network or an insider attack on agency infrastructure and systems. Per NIST 800-61, a key step in establishing an incident response capability includes "staffing and training the incident response team". This includes designated agency staff as well as ETSS personnel.

ETSS has an Incident Response Plan and has trained their staff on their various responsibilities, but also requires the agencies to be involved depending on the nature of the incident. This coordination is required under the shared services IT security model (ETSS and individual agencies) employed by the State which requires both parties to be prepared. Depending on the nature of the incident, the agency response may need to include business continuity plan activation.

Condition: During the fiscal 2023 audit, we noted that agency level incident response training still varies widely from implemented and verifiable, to not occurring. Formal incident response training is essential so that all staff are clear on their roles and responsibilities in the event of an IT security incident (e.g., data breach).

Cause: Additional focus is needed to ensure that all designated agency personnel are properly trained and prepared to respond in the event of an incident affecting agency systems.

Effect: The lack of consistent statewide incident response training increases the risk that the State will not properly respond, in a coordinated manner, to an IT security incident. Proper response to detected IT security incidents is critical to safeguarding the State's data and continuity of operations.

RECOMMENDATION

2023-021: Identify all agency personnel roles relating to incident response and implement verifiable training for all agency personnel based on their respective roles.

Management's Views and Corrective Actions:

Need to identify additional information requested by Sr. AIMs to better determine who will need training. Met with Sr. AIMs to provide audit findings and determine Agency personnel that will need training because of their role, as it pertains to being an escalation point for a data breach. These individuals will be added to the list of individuals currently identified as needing Incident Response training. I will also meet with our CISO to review the current Incident Response process, prior to developing training that will then be delivered to each individual.

Anticipated Completion Date: *Ongoing*

Contact Person: *Nathan Loura, Chief Information Security Officer, Department of Administration, Division of Enterprise Technology Strategy and Services*
nathan.loura@doit.ri.gov

INTERNAL CONTROL OVER FINANCIAL REPORTING -

OTHER FUND SPECIFIC FINDINGS

Rhode Island State Employees' and Electing Teachers OPEB System

Employees' Retirement System of Rhode Island

Finding 2023-022	*(significant deficiency – repeat finding – 2022-024)*

RHODE ISLAND STATE EMPLOYEES' AND ELECTING TEACHERS OPEB SYSTEM - ASSESS THE RESOURCES AND SYSTEMS NECESSARY TO EFFECTIVELY ADMINISTER THE OPEB SYSTEM

The resources necessary to effectively manage and administer the OPEB System to ensure all System functions are met and adequately controlled should be assessed. This would improve controls over the administration of the benefit programs and the process to accumulate data necessary for periodic actuarial valuations of the OPEB plans for both funding and accounting purposes.

Background: The Rhode Island State Employees' and Electing Teachers OPEB System (the System), acts as a common investment and administrative agent for post-employment health care benefits provided by six plans covering state employees and certain employees of the Board of Education. In fiscal 2023, required employer and employee contributions to OPEB plans approximated $47 million, with $31 million in retiree benefits paid. OPEB assets totaled more than $587 million at June 30, 2023.

When the State began to advance fund its retiree health benefits, OPEB trusts were established for each of the plans and a formalized governance structure was established by statute; however, no dedicated personnel were specifically tasked with administering the System and no administrative systems were implemented at that time, or subsequently, to capture and control membership data for the various OPEB plans. Instead, membership data, the determination of eligibility for benefits and any required retiree copays are administered through a variety of processes which largely lack the controls needed to administer plans of this size and complexity.

The System's functions are managed through various units within State government. The Department of Administration's Office of Employee Benefits (OEB) currently determines eligibility and manages member benefits for the State Employees, Teachers, Judges, State Police and Legislator plans. The Human Resources Department at the University of Rhode Island separately determines eligibility, calculates benefits, and manages member subsidy receivables for the Board of Education plan. The Office of Accounts and Control handles the accounting and financial reporting aspects of the System and coordinates the actuarial valuations. The Office of the General Treasurer oversees the investment activity of the System.

Census data for each plan is provided to the System's actuary to prepare required actuarial valuations of the plans. Each plan has unique benefit eligibility and healthcare coverage provisions.

Criteria: As the System grows and matures, the administrative infrastructure supporting the System should be assessed to ensure adequate resources and systems with appropriate controls are in place to manage the System effectively.

Maintaining membership data and determining the eligibility for benefits and required co-pays should be managed through systems and processes with adequate controls to ensure that membership data is reliable, benefits are accurately and consistently determined in accordance with plan provisions, and census data is maintained to facilitate extraction for actuarial valuations. Duties should be appropriately segregated to ensure that no one individual is responsible for determining eligibility and required copays, enrolling the individual for coverage, collecting and accounting for copay amounts, and maintaining plan census data.

The State improved certain reporting on OPEB enrollment by ensuring that all pre-65 retirees were registered in the State's Workterra software platform which the State also utilizes to administer active employee benefits. This improvement provides systemic reporting of pre-65 enrollees and assists in ensuring their timely transition to Medicare and post-65 OPEB benefits. State employees, once enrolled in Medicare, are enrolled in Via Benefits which establishes a health savings account (HSA) for the retiree. The State funds a predetermined amount for the retiree who can utilize the funds to pay health claims or purchase Medicare gap insurance coverage. The State, however, lacks a complete system that it considers to be the official record of System enrollment.

Condition: We identified control deficiencies over the various disjointed processes used to administer the OPEB plans as follows:

- Insufficient resources have been allocated and centralized to administer the System effectively. Knowledge of key System benefit provisions, administrative operations and operating procedures are dispersed amongst too many separate units of State government without effective coordination.

- The accumulation of census data provided to the actuary for plan valuation purposes is derived from multiple sources and requires analysis of other external source data to establish the active and retiree plan members for each plan. Controls are inadequate to prevent duplicate or inaccurate census data from being provided to the actuary. The State lacks a documented comprehensive reconciliation of all System members and retirees that ensures completeness and accuracy of reported census data to the State's actuary.

- Inadequate segregation of duties exists between eligibility determinations, benefit calculations, copay receivable billings and collections, healthcare plan enrollment, and maintenance of the plan census information.

- Periodic reconciliations between the plans' records and healthcare providers enrollment data are not documented.

- Procedures for identifying and terminating coverage for deceased members, spouses and dependents are inconsistent and can be improved.

- Documentation and monitoring of user entity controls relating to functions contracted to service organizations (health insurance provider (Blue Cross / CVS Caremark), health benefits administration system (WORKTERRA), Health Savings Account (HSA) Administrator (VIA Benefits)).

- Monitoring and analysis on OPEB liabilities reported for retirees over age 65 – requires determining estimate of percentage of HSA commitment that is ultimately utilized by retirees over the course of their retirement.

Cause: The State and System have not implemented System specific administrative processes and computer applications to effectively support the overall administration of the OPEB System, accumulate plan census data, manage and control the eligibility, copay determination, and plan enrollment functions. Existing processes used to support healthcare plan enrollment for active employees have generally been used to support the OPEB System but lack certain functions and controls that are unique to and requisite for the administration of the OPEB System.

Effect: Inadequate controls over key plan administrative functions could impact the reliability of amounts (e.g., member co-pays and member benefits) reported on the System's financial statements as well as the accuracy of census data used by the actuary to determine each plan's annual actuarially determined contribution amount and the net OPEB liability or asset for each plan.

RECOMMENDATIONS

2023-022a: Assess the resources necessary to effectively manage and administer the OPEB System to ensure all System functions are met and adequately controlled.

2023-022b: Implement a member benefit computer application to accumulate and manage plan membership data to support the overall administration of the OPEB System with enhanced controls.

2023-022c: Evaluate assigned responsibilities for key functions and segregate certain responsibilities for incompatible functions to enhance controls over critical plan administrative functions.

2023-022d: Establish consistent procedures to identify deceased plan members and prompt timely termination of coverage.

Management's Views and Corrective Actions:

Management reviewed the recommendations and agrees that it is appropriate to consider administrative review and operational enhancements such as those described in the recommendations. During fiscal year 2023, steps were taken to address the finding, including the posting of a Request for Information (RFI) to solicit OPEB system assessment and software solutions. Additionally, the process to document procedures for deceased plan members began.

Anticipated Completion Date: *Ongoing*

Contact Persons: Office of Accounts and Control
Xiomara Soto, Financial Reporting Manager,
Xiomara.C.Soto@doa.ri.gov

Dorothy Pascale, State Controller,
Dorothy.Z.Pascale@doa.ri.gov

Joseph Codega, State Budget Officer, OPEB Chair,
Joseph.Codega@omb.ri.gov

Finding 2023-023 ***(significant deficiency – repeat finding – Finding 2022 - 026)***

EMPLOYEES' RETIREMENT SYSTEM OF RHODE ISLAND (ERSRI) - OVERSIGHT OF THE DEFINED CONTRIBUTION PLAN

Background: The Employees' Retirement System of the State of Rhode Island (System) oversees a defined contribution (DC) plan for members which is part of the overall "hybrid" pension benefits, in conjunction with defined benefit plan benefits, for most covered employees. The DC plan is administered totally by the Teachers Insurance and Annuity Association of America (TIAA) and the System is reliant on information provided by TIAA for financial reporting purposes. No independent records are maintained by the System for the DC plan activities.

As expected, total assets of the DC plan have grown considerably since plan inception and members are beginning to withdraw funds to meet their retirement objectives. Total assets in the DC plan at June 30, 2023 totaled $1.7 billion.

Criteria: The System should have sufficient information to support effective compliance monitoring and financial reporting for the DC plan. Management is responsible for the accuracy of the System's financial reporting.

Condition: The System does not receive information on the employer remittances of employer and employee contributions to the DC plan and therefore has limited information to ensure employer compliance with the DC plan provisions. Contribution compliance monitoring should be included within the risk-assessment process to determine effective controls are in place.

Our testing in fiscal 2023 continued to note limited instances where employer remittances to the plan administrator incorrectly coded employer and employee contribution amounts in reverse. Since the System utilizes reporting by the plan administrator for financial reporting, incorrect employer coding results in misstatements in the financial statements. While we noted some improvement over fiscal 2022, the exceptions noted continue to support a deficiency in internal control over financial reporting for the DC plan.

As the plan matures and investment assets continue to grow, the System should assess and strengthen their oversight of the DC plan to ensure (1) compliance by the plan administrator with contracted plan provisions, (2) employer compliance with plan provisions, and (3) the accuracy of reported DC plan activity in the financial statements. This should include consideration of relevant risks and the development and formalization of an oversight/monitoring plan to meet this objective. The monitoring plan should include how the plan administrator's annual Service Organization Control (SOC) Report is utilized by the System as oversight of critical defined contribution plan activities. Ensuring documentation of critical user entity controls (i.e., reviewing plan reports and ensuring reconciliation to internal records and/or plan documents) and how those controls are performed should also be documented within the plan.

Additionally, consideration should be given to modifying the existing contribution and benefit system for the defined benefit plans to also include the employer data for the DC plan before transmission to TIAA. This would facilitate monitoring of contribution data and provide independent corroboration of amounts reported by TIAA as employer and employee contributions to the plan. In the short-term, requiring employers to provide more data elements (i.e., employee wages subject to contribution) in their submissions to the plan administrator coupled with additional reporting by the plan administrator could enhance the System's monitoring of employer compliance with DC plan provisions.

Other plan administration areas that should be addressed in the plan to strengthen internal controls include periodic (at least monthly) analytical reviews of investment growth and performance, contributions to and distributions from the plan and fees paid. The analytical reviews should include documentation of follow-up and resolution when actual results differ from expectations.

Cause: At the inception of the DC plan, the plan design, enacted by legislation, provided for employer and employee contribution data to flow directly from the employer to TIAA without any data capture by ERSRI.

Effect: The System lacks sufficient accounting and contribution data to monitor compliance with contribution requirements and to validate reporting by TIAA.

RECOMMENDATIONS

2023-023a: Perform a risk assessment for the DC plan and identify areas where internal controls and oversight can be strengthened.

2023-023b: Consider modifying the existing contribution and benefit system for the defined benefit plans to capture employer (employee and employer contributions) data for the DC plan or implement other procedures to enhance monitoring of employer compliance with the plan provisions.

2023-023c: Formalize a DC monitoring plan to protect member plan balances, ensure compliance by the plan administrator, and enhance controls over financial reporting of the plan within the System's overall financial reporting.

Management's Views and Corrective Action Plan:

A public RFP was issued in 2023 for the State of Rhode Island Defined Contribution Retirement Plan. The Defined Contribution Plan maintained its existing relationship with TIAA. Included in the RFP were specific requirements to provide tools to ERSRI with the ability to monitor contribution processing and add internal controls. ERSRI is currently working with TIAA to develop these internal controls. A formalized DC monitoring plan will be developed upon completion of discussions.

With regard to investment activity, the State Investment Commission (SIC) contracts with a vendor that serves to monitor the investment activities of the DC plan. This vendor communicates with the Investments team regularly and reports to the SIC on a quarterly basis. ERSRI and Treasury feel confident the oversight functions performed with the vendor, the Investments team and the SIC serve as a strong monitoring process related to the investment activities of the DC plan.

While ERSRI has a robust wage and contribution processing system for the defined benefit (DB) plan, configuration to accommodate the defined contribution (DC) plan processing would require significant technical and personnel resources that cannot be funded through the DB administrative allocation consistent with R.I. Gen. Laws § 36-8-10.1. Administrative funding for the DC plan is insufficient to cover such a change.

Anticipated Completion Date: *Ongoing*

Contact Person: *Stacey Whitton, Chief Financial Officer, ERSRI*
Stacey.Whitton@ersri.org

DISCRETELY PRESENTED COMPONENT UNITS

Finding 2023-024	*(material noncompliance – repeat finding – 2022-030)*

RHODE ISLAND CONVENTION CENTER AUTHORITY – RESTRICTIVE COVENANTS

Criteria: Bond indentures require that the Authority fund the Operating Reserve requirement of the restrictive covenants for the RI Convention Center (RICC) and the Amica Mutual Pavilion (AMP).

Condition: During the year ended June 30, 2023, the Authority was unable to fund the Operating Reserve requirement of the restrictive covenants for the RICC and the AMP pursuant to the indentures.

Context: The Authority is currently in violation of certain debt indentures with respect to the Operating Reserve requirement.

Cause: The Authority does not have sufficient cash flow to fund the Operating Reserve.

Effect: As a result of this fund not being funded, the Authority is in noncompliance with certain bond indentures.

RECOMMENDATION

2023-024: The auditors recommended that the Authority fund the Operating Reserve.

Management's Views and Corrective Actions:

The Authority will fund the Operating Reserve provided there is sufficient cash flow or if an alternative means of security, such as a letter of credit, is available.

Given that the Authority continues to make timely and complete debt service payments, it would make little sense for the trustee to declare a default for reserve fund noncompliance. In fact, this has been the practical practice over several years as the Authority has failed to maintain adequate reserves due to insufficient State appropriations. If a default was declared, the Authority would have 90 days to cure and would seek a legislative appropriation to remedy the default. Of course, annual appropriations in excess of debt service requirements would assist in building reserves and reaching the requirements. The Authority and its advisors are actively in search of a viable resolution to this matter.

Anticipated Completion Date: *Undetermined*

Contact Person: *Daniel McConaughy, Executive Director*
Rhode Island Convention Center Authority
Daniel.McConaghy@riccauth.com

Finding 2023-025	*(significant deficiency – repeat finding – 2022-035)*

RHODE ISLAND PUBLIC TRANSIT AUTHORITY – CASH RECONCILIATIONS

Criteria: Management is responsible for (1) establishing and maintaining effective internal controls, including internal controls over compliance, and for evaluating and monitoring ongoing activities; to help ensure that appropriate goals and objectives are met; (2) following laws and regulations; (3) ensuring that there is reasonable assurance that government programs are administered in compliance with compliance requirements; and (4) ensuring that management and financial information is reliable and properly reported. Management is also responsible for implementing systems designed to achieve compliance with applicable laws, regulations, contracts, and grant agreements.

Condition: During the performance of audit procedures on the Authority's cash reconciliations, the auditors noted that the operating cash account had a continuing variance between the reconciliation and the general ledger for all of fiscal year 2023.

Cause: Cash reconciliations were not being done on a timely basis.

Effect: Monthly reconciliations with the operating cash account showed continuing variances for all of fiscal year 2023.

RECOMMENDATION

2023-025: The auditors recommended that the Authority develop as part of its internal control process to include a set of controls to require the operating account be reconciled within a few days of the end of the month and all variances to be researched and resolved.

Management's Views and Corrective Actions:

Operating cash is continually being reviewed to find the discrepancies and make any changes necessary. RIPTA is having INIT re-train individuals to make sure the wave transactions are properly being recorded. This was a repeat finding during the review of the FY 2023 financial statements. A new staff member has been hired and has been given this as a priority task. Significant progress has been made and it is expected that the issue will be fully resolved by 6/30/2024.

Anticipated Completion Date: *Immediately*

Contact Person: *Christopher Durand, Chief Financial Officer*
Rhode Island Public Transit Authority
CDurand@ripta.com

Finding 2023-026 ***(significant deficiency – repeat finding – 2022-036)***

RHODE ISLAND PUBLIC TRANSIT AUTHORITY – FARE REVENUES

Criteria: The Rhode Island Public Transit Authority should reconcile the daily farebox report and GFI Software daily summary report, as well as deposits to the related documentation.

Condition: During our current year testing of fare revenue policies and procedures, we noted all the days selected had variances (some immaterial and some more than 1% of revenue) between the daily farebox report and GFI daily summary report. We also noted immaterial variances between deposits and the related documentation and discrepancies in the coin deposits to the bank.

Cause: The Authority's did not have adequate policies or procedures in place to ensure the reconciliation of records timely and reviewing reporting from GFI system in comparison to deposits to correct these variances going forward.

Effect: Daily reconciliations with the farebox reports and the GFI daily summary are consistently showing variances which, if not corrected going forward, could result in material variances.

RECOMMENDATION

2023-026: The auditors recommended that the Authority enhance internal control policies and procedures ate policies and procedures to correct this process going forward.

Management's Views and Corrective Actions:

All farebox revenue which has a difference of +- 1% percent is reviewed by Security. All variances exceeding stated threshold are reviewed by security. This finding has been resolved.

Anticipated Completion Date: *Immediately*

Contact Person: *Christopher Durand, Chief Financial Officer*
Rhode Island Public Transit Authority
CDurand@ripta.com

Finding 2023-027 **(material weakness – new finding)**

RHODE ISLAND RESOURCE RECOVERY CORPORATION – CONFLICT OF INTEREST

Criteria: Employees of Rhode Island Resource Recovery Corporation (the "Corporation") are provided a copy of the Corporation's employee handbook and conflict of interest policy and are required to sign to acknowledge their receipt of both documents. In addition, public officials and employees of the State of Rhode Island are required to abide by the State's code of ethics policy. These policies and procedures state that in the case of a related party transaction occurring, it should be documented, in writing, with the appropriate level of management and an affected employee should recuse themselves from voting or participating in any ongoing business with the related party.

Condition: The Corporation's employee handbook, conflict of interest policy, and State ethics policy are part of the Corporation's internal control framework. During our inquires of management and those charged with governance, it was discovered that there was a related party transaction that violated the Corporation's conflict of interest policies and procedures, and the State's code of ethics policies and procedures. This transaction occurred in a prior audit period.

Cause: Management was not aware of their responsibilities to document the existence of the related party relationship or recuse themselves from ongoing business with the related party.

Effect: The internal control procedures designed and implemented for related party transactions were not effective in the circumstance described above.

RECOMMENDATION

2023-027: The auditors recommended that the Corporation review and improve the standard operating procedures for conflicts of interest and perform formal training for existing employees and include the training as part of on-boarding for new employees.

Management's Views and Corrective Actions:

The Corporation agrees with the finding. Management has reviewed and improved the standard operating procedures and controls related to conflicts of interest. These actions include the deployment of enhanced conflict of interest policies, new standard operating procedures for management and employees, as well as guidelines for identifying potential conflicts of interest. All effected management and employees received in person training which included how to identify potential conflicts of interest and the necessary steps to ensure compliance. This enhanced training curriculum has been included as part of the annual employee handbook signoff and training for existing employees as well as a standard part of the on-boarding training curriculum for all new employees. These changes have been implemented as of the financial statement issuance date.

Anticipated Completion Date: *Immediately*

Contact Person: *Lou Vergato, Interim Executive Director*
Rhode Island Resource Recovery Corporation
Lvergato@rirrc.org

Finding 2023-028 **(significant deficiency – new finding)**

RHODE ISLAND COLLEGE – INTERNAL CONTROL OVER FINANCIAL REPORTING

Criteria: Rhode Island College ("College") is responsible for financial reporting in the form of financial statements that present fairly, in all material respects, the respective financial position, changes in financial position, and, statement of cash flows.

Condition: The College made an error in recording the lease receivables and deferred inflows of resources in FY22. The College believed that the amendment to the lease was in place during FY22. The original lease from 2009 preceded most members of management and the College became aware of the modification of lease terms after the issuance of the FY22 audit report and should not have recorded this lease.

Cause: The College did not have a formal process in place to review executed contracts to determine if the contracts were expired or amended.

Effect: The delays of implementing the new accounting standard led to delays in the financial reporting process.

RECOMMENDATION

2023-028: The College should implement a formal policy regarding expiring contracts and amended contracts to mitigate issues similar to this in the future.

Management's Views and Corrective Actions:

Management agrees with the finding and recommendation.

Anticipated Completion Date: *June 30, 2024*

Contact Person: *Nelia Kruger, Chief Financial Officer*
Rhode Island College
nkruger@ric.edu

Finding 2023-029	***(material weakness – repeat finding – 2022-027)***

CENTRAL FALLS SCHOOL DISTRICT – LACK OF CONTROLS OVER FINANCIAL REPORTING

Criteria: Management of the District is responsible for the preparation and fair presentation of the financial statements in accordance with generally accepted accounting principles. This includes the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement.

Condition: The District did not reconcile many general ledger accounts throughout the year on a timely basis. Material adjustments to year- end balances and current year activity were necessary for the financial statement to be fairly presented in accordance with generally accepted accounting principles.

Cause: The District does not have policies and procedures in place to ensure for accurate and timely recording of daily transactions to reconcile general ledger accounts on a periodic basis to provide for the accurate and timely preparation of the financial statements and related disclosures.

Effect: The District's financial statements required significant adjustments at year end in these financial statement area. The lack of policy and procedures increases the risk of material misstatement in the financial statements, either due to error or fraud.

RECOMMENDATION

2023-029: The District should develop policy and procedures to reconcile its activity and accounts on a monthly basis. Specifically, the general ledger cash accounts should be reconciled to their related bank accounts including deposits in transit and outstanding checks. Receivables due from federal and State governments should be reconciled to the individual grant records on a monthly basis. This plan should include the development of a comprehensive policies and procedures manual; appropriate controls related to authorization and review of recorded transactions; timely recording of transactions, reconciliation and reviews of reconciliations so as to detect and correct errors in a timely manner, and a comprehensive review of the District's organizational structure to ensure adequate levels of supervision and clear reporting paths for all staff involved.

Management's Views and Corrective Actions:

The District agrees with the finding. The District also agrees with the recommendation, please see below for action plan.

The District is compiling its policies and procedures into a comprehensive manual to ensure every area of responsibility; accounting, payroll, accounts receivable, grants, accounts payable, procurement and fixed assets to eliminate-reduce errors, create efficiencies. The steps of the process will be included but not limited to ensuring all financial data is captured in the system monthly (cash receipts/disbursements in accordance to funding source as well as, deposits, salaries, and all other encumbrances). The information would thereafter be verified and then reconciled to the bank statement by the accountant and then reviewed by the Deputy Director of Finance for first review and the Chief Financial Officer for final review. The third step is to ensure that all fixed asset transactions have been properly recorded. Step four is to produce Budget-To-Actual Projections and file monthly reports when necessary or quarterly. The Finance department is creating a sub org chart of the District to ensure proper process flow and checks and balances between Team Members, and the departments it serves.

Anticipated Completion Date:	*Ongoing*
Contact Person:	*Keree J. Simmons, Director of Finance* *Central Falls School District* *SimmonsK@cfschools.net*

Management Comments

Management Comment 2023-01 ***(repeat comment – 2022-01)***

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE (RIDHEA)

The remaining activities of the RI Division of Higher Education Assistance should be accounted for within the State's General Fund rather than as a discretely presented component unit.

In prior years, the predecessor Rhode Island Higher Education Assistance Authority had multiple activities including acting as the guaranty agency for federally insured student loans. With federal changes to those programs some years ago, a Division of Higher Education Assistance (RIDHEA) was created within the Office of the Postsecondary Commissioner (OPC). While the operational and financial aspects of the guaranty agency wound down, the Division continued to be reported as a discretely presented component unit with separately issued and audited financial statements. What now remains is essentially the disbursement of scholarship funds which originate from the State. Scholarship resources spent down significantly in fiscal 2023 and will soon be disbursing approximately $5 million annually in scholarships funded by the annual revenue stream from the State's 529 college saving plan.

This activity could easily, and more appropriately, be reported within the State's General Fund rather than as a separate financial reporting entity. This would eliminate the additional accounting and financial reporting requirements currently maintained for the Division's operations and allow OPC to administer the scholarship program through a restricted receipt account in the General Fund. In addition, accounting for the scholarship and grant program within the State's General Fund would bring those operations under the State's centralized control processes (i.e., disbursements, bank reconciliations), significantly improving the segregation of duties over program operations that are currently limited within the Division.

RECOMMENDATION

MC-2023-01: Account for the scholarship and grant activities of the Division of Higher Education Assistance – Office of Postsecondary Commissioner within the State's General Fund and eliminate the Division of Higher Education Assistance within the Office of the Postsecondary Commissioner.

Management's Views and Corrective Actions:

The Office of the Postsecondary Commissioner concurs with the Auditor General and that organizational changes of the Division merit a review of the current operations and financial reporting requirements. A structural change of this nature will need to be reviewed by legal counsel to determine if any of the Council on Postsecondary Education's liabilities, obligations, and all other responsibilities related to the operations of the Division will need to be amended. Any findings from this review will need to be presented to the Council on Postsecondary Education for approval. In addition, the Office would request that the Auditor General provide guidance from legislative council to assist in determining the legislative changes, if any, that may require approval from the General Assembly.

Anticipated Completion Date: *Ongoing*

Contact Person: *Zachary J. Saul, Chief Financial Officer, Office of the Postsecondary Commissioner*
zachary.saul@riopc.edu

Management Comment 2023-02 ***(repeat comment – 2022-02)***

TOBACCO SETTLEMENT FINANCING CORPORATION

The Tobacco Settlement Financing Corporation should update its projected debt service requirements to reflect operating and other economic factors that may impact the State's ability to meet future debt service obligations.

The Tobacco Settlement Financing Corporation (TSFC) is a blended component unit of the State. The TSFC is unique in that it has limited dedicated staff resources and meets its administrative and financial reporting responsibilities through staff within the Budget Office and Office of Accounts and Control. The Office of Attorney General manages specific legal issues related to the compliance and enforcement of the multi-state tobacco settlement agreement. TSFC engages a CPA firm to prepare its annual financial statements. While this is necessary, that firm cannot step into the role of management for the TSFC and serves only to compile the annual financial statements. Similarly, the TSFC's external auditor role does not extend to managing the entity or providing other administrative support. While TSFC's administrative needs are minimally met through these decentralized processes, management's most critical role is monitoring the entity's ability to meet future debt service requirements (with projected tobacco settlement revenues) which totaled $2.3 billion at June 30, 2023 with more than $1.6 billion due at the end of the current debt service schedule in year 2052.

The Corporation does not accumulate resources for future debt repayment – tobacco settlement amounts received in excess of required debt service are used for "turbo" or early redemptions. Additionally, review of the TSFC's financial statements highlights the need to obtain an independent financial analysis of the TSFC's ability to support long-term debt service, specifically the deep discount debt that matures at the end of the payment schedule when $1.4 billion in accreted interest comes due. While projections of future tobacco settlement revenues have been prepared and used to support recent refinancing of certain tobacco bonds – an updated comprehensive analysis is necessary to provide board members and other State leaders with a current projection of the likelihood that sufficient resources will be available to support that future debt service. The analysis should integrate the projections for U.S. tobacco consumption and related settlement revenues with projections of the impact of turbo principal reductions and the amounts needed to service all TSFC debt.

RECOMMENDATION

MC-2023-02: Perform periodic analyses of projected debt service requirements reflecting actual operating experience, turbo maturity redemption experience, and other economic factors.

Management's Views and Corrective Actions:

This matter was discussed at a meeting of the Board which took place in December 2023. The Board noted that while the Corporation is considered a blended component unit of the State, it has a legal existence distinct from the State, and bonds issued by the Corporation shall not constitute a debt of the State. Board members were unaware of a study of debt capacity being conducted in other similarly situated tobacco settlement financing entities in other jurisdictions, outside the context of an initial securitization or refinancing. The outstanding debt of the Corporation is monitored and receives credit ratings from S&P Global Ratings, which monitors industry trends, economic conditions, and updates from the National Association of Attorneys General (NAAG), in addition to applying various ratings tests to each bond maturity. The Board directed staff to organize additional educational opportunities to be featured at an upcoming board meeting to inform the board on best practices and emerging trends related to administration of tobacco settlement securities. This review may include an examination of whether such studies are commissioned by other similarly tobacco settlement financing entities. Following this review, the Board will reassess what, if any, action is warranted in response to this Management Comment.

Anticipated Completion Date: *Ongoing*

Contact Person: *Joseph Codega, TSFC Chair,*
Office of Management & Budget
Joseph.Codega@omb.ri.gov

Management Comment 2023-03	***(repeat comment – 2022-04)***

UNRESOLVED BALANCE IN THE PUBLIC SERVICE CORPORATION TAX ESCROW ACCOUNT

Efforts should continue to resolve the unidentified remaining balance in the public service corporation tax escrow account.

Telecommunication companies annually declare the net book value of their tangible assets located in Rhode Island to the Division of Municipal Finance in accordance with Rhode Island General Law § 44-13-13. The Division of Municipal Finance calculates and collects the tax due and distributes the proceeds (net of a 0.75% administrative fee) to the municipalities based on percentage of population.

The collection and disbursement of the tax proceeds are accounted for in an escrow liability account. The telephone tangible tax escrow account continues to show an unresolved variance of $6.5 million in the account at June 30, 2023. This variance has existed and remained unresolved for an extended period of time.

Efforts continued during fiscal 2023 to determine the underlying cause of the balance without resolution. A portion of the balance can be attributed to the 0.75% administrative fee which has not been transferred from the account for multiple years.

RECOMMENDATION

MC-2023-03: Determine the cause of the unresolved account balance in the Public Service Corporation Tax escrow account and make any required adjustments or distributions.

Management's Views and Corrective Actions:

Municipal Finance is continuing to review past balances associated with the public service corporation tax escrow account. We are working in coordination with Taxation to resolve past balances and better document changes within the account.

Anticipated Completion Date: *Ongoing*

Contact Person: *Steve Coleman, Chief of Municipal Finance, Department of Revenue*
steve.coleman@dor.ri.gov

Management Comment 2023-04	***(new comment)***

STANDARDIZED AGENCY CAPITAL ASSET INVENTORY POLICIES

The State should formalize annual capital asset inventory procedures for all agencies.

The Office of Accounts and Control requires departments to perform agency-specific inventory verification for capital assets on a three-year cycle. Inventory results are reported to the Office of Accounts and Control which prompts any required accounting adjustments. While this process has improved controls over financial reporting of capital assets, it has continued to highlight capital assets that could not be located or accounted for by State agencies. While some of these reported items represent the continued required clean-up of older assets likely disposed from the State's accounting records, several items reported were purchased in recent years and could not be located or documented by the respective agencies.

Such findings support ineffective tracking of capital assets by State agencies. The State should mandate requirements for the annual performance and documentation of capital asset inventories. This has become especially important with the increase in laptop and tablet use in recent years to support hybrid work schedules. The mobility of these items necessitates more frequent and thorough accountability of capital assets at the agency level.

RECOMMENDATION

MC-2023-04: Formalize and implement policies and procedures for annual capital asset inventories by State agencies.

Management's Views and Corrective Actions:

Management reviewed the recommendations and agreed that it is appropriate to perform regular physical inventory of assets and have clear policy and procedures. During fiscal year 2024, steps were taken to address the finding, including the engagement of a vendor to perform a physical inventory of all assets. It is management's intention to have a vendor perform this duty every five years. Additionally, steps are being taken to update and document fixed asset policies and procedures to align with the new ERP system.

Anticipated Completion Date: *Physical Inventory: July 10, 2024*
Policies and Procedures: July 2025

Contact Persons: *Jonathan Rodriguez, Deputy Director of Security and Risk Management, Office of Accounts and Controls*
Jonathan.Rodriguez@doa.ri.gov

Dorothy Pascale, State Controller, Department of Administration, Office of Accounts and Control
Dorothy.Z.Pascale@doa.ri.gov

Management Comment 2023-05 ***(new comment)***

UNEMPLOYMENT BENEFIT SYSTEM – BUSINESS CONTINUITY RISKS

The mainframe system utilized by the RI Department of Labor and Training (DLT) to process unemployment benefits has reached end-of-life and poses significant business continuity risks to unemployment insurance benefit operations.

The State's unemployment insurance (UI) program administration is a critical function of State government. The State disbursed over $150 million in unemployment benefits in fiscal 2023 during a period of low unemployment. UI benefits during the pandemic, however, exceeded $2 billion in fiscal 2021 during the peak of federal pandemic unemployment assistance. Benefit fraud within the pandemic assistance programs was widespread and required the application of new technologies applied in the front-end cloud-based application component of the system to handle the significant increase in application volume and required fraud prevention procedures necessitated by the pandemic. The front-end application process has functioned well but ultimately still transmits data to a very old COBOL based mainframe system that has limited system support options.

With the current mainframe already facing limited support options, the State (RI Department of Labor and Training (DLT) and Division of Information Technology) should formalize, with a strategic plan, the needs of the unemployment program and the complete modernization of DLT's systems, including the UI Benefit Claims processing system. The future modernization project will need to include benefit fraud detection safeguards, modern information security protocols, and system capacities that will meet citizens needs during periods of significant unemployment.

RECOMMENDATION

MC-2023-05: Develop a strategic plan for the modernization of DLT's systems, including the UI benefit claims processing system.

Management's Views and Corrective Actions:

This finding is resolved. RI DLT and Enterprise Technology Strategy and Services have completed the process of working with IBM to develop a strategic plan to address the modernization of DLT's systems, *including the UI Benefit Claims processing system. Implementation will occur in many stages and is dependent on staff and financial resources.*

Anticipated Completion Date: *February 29, 2024*

Contact Person: *Jessica Johnson, Assistant Director, Unemployment Insurance, Department of Labor and Training*
Jessica.Johnson@dlt.ri.gov

Management Comment 2023-06	**(repeat comment – 2022-010)**

THIRD-PARTY INSURER RECOVERIES FOR COVID TESTING

Third-party insurance reimbursements for COVID testing totaling $11 million at June 30, 2023 are pending (1) credit to the federal government for previously reimbursed costs or (2) recognition as general revenues.

In conjunction with statewide COVID-19 testing in response to the public health emergency, the State billed and received reimbursement from health insurers for covered individuals. These reimbursement efforts were identified and tracked manually. Receipts from third-party insurers for COVID testing were deposited in an escrow account pending research and a decision regarding how to credit the federal government for their proportionate share and the criteria to record general revenues, if any. COVID testing costs were reimbursed through at least three separate federal awards during the pandemic and consequently, determining the appropriate amounts to credit to each program was challenging. The State's net reimbursement submission to FEMA for testing costs included an estimate of insurer receipts which also complicates the final reconciliation and accounting for FEMA reimbursements.

The balance in the escrow account still pending proper accounting recognition at June 30, 2023 totaled $11 million. GAAP requires costs and expenditures to be recognized net of applicable credits. When recoveries are obtained for costs previously reimbursed by federal awards, amounts should be credited back to the federal government for its applicable share. The State should complete its analysis and properly recognize these reimbursements as general revenue or as a reduction of federal program expenditures and a return of federal revenue to the related federal program.

RECOMMENDATION

MC-2023-06: Complete the proper accounting recognition for prior period COVID-19 testing health insurer reimbursements in accordance with GAAP.

Management's Views and Corrective Actions:

Journal entry will be booked in FY2024.

Anticipated Completion Date: *March 31, 2024*

Contact Person: *Brianna Ruggiero, Chief of Staff, Pandemic Recovery Office*
brianna.ruggiero@doa.ri.gov

Management Comment 2023-07	**(repeat comment – 2022-09)**

PRIVATE ENTITY USAGE OF STATE PROPERTIES

Complete an inventory of leases or arrangements where the State has approved private entities to utilize space within State buildings. Ensure that all such arrangements are formalized, approved, and centrally administered by the State.

The State, on occasion, has provided space in State buildings to private entities for a host of purposes. This situation has evolved over time as the Division of Capital Asset Management and Maintenance (DCAMM) has been either requested or directed to provide such space by various State authorities. Instances range from non-profit entities deemed to provide important public services to office space for private contractors providing services to the State (i.e., system maintenance and operation). The State does not currently have a complete listing of these arrangements and in some instances, the use arrangements have not been documented in a formal lease agreement.

In addition, the process for the granting of facility use by private entities is not formalized in statute or policy to ensure consistent application across State government. Whether such arrangements would require approval of the State Properties Committee is unclear. There are also procurement considerations based on whether the State is providing space at a no-cost or reduced cost basis to the successful bidder that would impact the development of a competitive bid proposal. In instances where the use of State properties relates to a procurement of services by the State, such considerations should be formalized within the request for proposal to ensure the consistency of bid proposals submitted by interested entities.

The DCAMM – Department of Administration should:

- Identify all arrangements where private entities utilize State property, the nature of the required usage (i.e., statutorily required, contractually required, public service), and any existing agreements documenting the usage with the private entity.

- Develop a formalized request process for State agencies to request the use of State property by a vendor/grantee/non-profit entity including justification and specific usage purposes and space requirements proposed for the entity.

- Adopt specific policies as to how such requests will be vetted and approved (e.g., is State Properties Committee approval necessary).

- Develop standardized lease arrangements that specify all costs and requirements of the private entity using the property.

- Adopt policies that require initial and periodic updates of agreements with the private entities utilizing State properties including the appropriate legal review of such agreements.

- Ensure that all agreements are centrally managed within the Department of Administration to ensure that all operational risks associated with that property are addressed based on the nature of the usage awarded. Assess the adequacy of existing insurance coverage in light of building use contemplated by the vendor/grantee/non-profit entity.

Generally accepted accounting principles require the State to consider and account for all lease arrangements and will be negatively impacted by any arrangements that lack proper and current documentation. Further, the current practice does not provide adequate centralization to ensure that operational risks (i.e., insurance coverage, public health and safety) are well managed by the State.

The above improvements will allow the State to better manage its properties and ensure that such arrangements are properly considered from a financial reporting and operational standpoint. Implementing a more formalized application and approval process will also provide the necessary transparency and consistency for such arrangements that is needed for an organization the size of the State that has centralized management of its properties.

RECOMMENDATIONS

MC-2023-07a: Identify all arrangements where private entities utilize State property, the nature of the required use (i.e., statutorily required, contractually required, public service), and any existing agreements documenting the usage with the private entity.

MC-2023-07b: Formalize policies and procedures to ensure the consistent application, approval, documentation, and centralized administration of all State property lease arrangements with private entities.

Management's Views and Corrective Actions:

DCAMM agrees with the recommendations. The State of Rhode Island's audit of the Fiscal 2022 financial statements resulted in similar findings concerning private entity usage of State properties. As a result, the State and responsible agencies are actively identifying properties for which there is no current lease agreement and reaching out to the occupying entities to initiate an agreement.

As acknowledged in FY 2022, many of the impacted properties described in the finding are under the control of BHDDH. As part of a comprehensive set of policy and process reforms related to State-owned group home facilities, DCAMM and BHDDH are working toward increasing coordination, clarifying responsibilities, and establishing sustainable sources of funding for these properties. Both agencies share a focus on providing safe and well-maintained properties for operation by service providers. In service of this, several legislative proposals also seek to align the funding and resources available for the ongoing monitoring, upkeep, and maintenance of State-owned properties leased by BHDDH. More specifically, the following actions have been taken:

- *A service level agreement was executed by BHDDH and DCAMM to codify responsibilities as it relates to the ongoing administration of State-owned group home facilities;*
- *Coordinated legislative proposals were submitted to ensure the effective management of these processes and properties, including funding for personnel and unmet needs at the properties that will deepen cooperation between service providers and BHDDH; and*
- *Soliciting a vendor to produce a facility condition assessment that will also include a benchmark for baseline rent rates at each State-owned property that BHDDH leases for group home services.*

These measures ensure that DCAMM And BHDDH consider provider equity when contemplating lease renewals going forward.

Anticipated Completion Date: *June 30, 2024*

Contact Person: *Marco Schiappa, DCAMM Director, Department of Administration*
marco.schiappa@doa.ri.gov