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**STATE OF RHODE ISLAND  
AND PROVIDENCE PLANTATIONS**

**Independent Auditor's Report on Internal Control  
Over Financial Reporting and on Compliance**

**Schedule of Findings and Responses**

**JUNE 30, 2014 AUDIT**

Dennis E. Hoyle, CPA  
Auditor General

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

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# Office of the Auditor General

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

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March 31, 2015

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

We have audited the financial statements of the State of Rhode Island and Providence Plantations (the State) for the year ended June 30, 2014 and have issued our report thereon dated December 18, 2014. Our Independent Auditor's Report on the State's financial statements was included in the State's Comprehensive Annual Financial Report for fiscal 2014.

As required by *Government Auditing Standards*, we have also prepared a report, dated December 18, 2014 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.

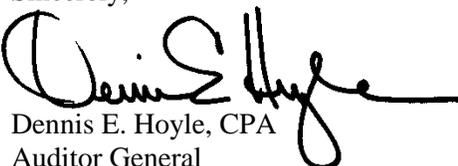
Our report includes:

- 18 findings that we considered significant deficiencies or material weaknesses in internal control over financial reporting or other matters required to be reported by *Government Auditing Standards*.
- 7 findings reported by the auditors of component units.
- 28 management comments – these are less significant findings, yet, in our opinion still warrant communication and the attention of the State's management.

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

Other findings and recommendations related to the State's administration of federal programs will be issued separately in the State's *Single Audit Report* for the fiscal year ended June 30, 2014.

Sincerely,



Dennis E. Hoyle, CPA  
Auditor General

# State of Rhode Island and Providence Plantations

## Schedule of Findings and Responses

JUNE 30, 2014 AUDIT

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We identified weaknesses in the State's internal control over financial reporting and made other recommendations to enhance controls or result in other operational efficiencies as part of our audit of the State of Rhode Island's financial statements for the year ended June 30, 2014. The State's management has responsibility for, and maintains internal control over, financial reporting. *Government Auditing Standards* require that we communicate deficiencies in internal control over financial reporting based on our audit.

Management has been responsive in addressing control deficiencies identified in prior audits – those that remain are generally conditions that have existed for several years and will likely require additional information technology (IT) investment. Developing new or enhancing existing systems demands significant monetary and technical resources. There are a multitude of operational benefits to be derived from these IT investments in addition to enhancing internal control over financial reporting.

The common thread underlying most of these control deficiencies is outdated or incomplete systems. RIFANS, the State's centralized accounting system is largely effective and reliable for the functionalities that are operational; however, there is substantial opportunity for further efficiencies through completion of the State's Enterprise Resource Planning (ERP) system. These functional gaps result in control deficiencies in specific areas. For example, RIFANS does not meet the State's needs in three important and interrelated areas – time reporting/payroll, grants management, and cost allocation – functions integral to overall State operations. The State needs to develop a strategic plan to complete the ERP system and address business continuity risks resulting from certain critical legacy systems.

The Division of Taxation's systems are antiquated and are currently being replaced with an integrated system that will enhance operations and address existing control issues.

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

Overall, the State has not sufficiently addressed IT security risks, an increasing concern given the State's very complex computing environment. Additionally, certain standard IT control processes, such as program change control, have not been implemented uniformly on an organization-wide basis.

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

We also reported 28 management comments, which are less significant findings that highlight financial-related operational, policy or accounting control matters. New fiscal 2014 management comments address adoption of the updated COSO internal control framework, accounting for DCYF trust funds, accumulating data for the disclosure of significant commitments, monitoring of internal service funds, federal reimbursements to the Veterans' Home, authorized bank signatories, and accounting for federal disaster declarations and recoveries. Management comments repeated from prior years address subrecipient monitoring, drawdown of federal funds, certain taxation processes, and other accounting and financial reporting issues.

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

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

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



# Office of the Auditor General

State of Rhode Island and Providence Plantations - General Assembly

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Rhode Island and Providence Plantations (the State), as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the State's basic financial statements and have issued our report thereon dated December 18, 2014. 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 2% of the assets and deferred outflows and 1% of the revenues of the governmental activities and 1% of the assets and 2% of the revenues of the aggregate remaining fund information;
- the Convention Center Authority, a major fund, which also represents 63% of the assets and deferred outflows and 2% of the revenues of the business-type activities;
- the HealthSource RI Trust, an agency fund, and the Ocean State Investment Pool, an external investment trust, which represents less than 1% of the assets and revenues of the aggregate remaining fund information; and
- all the component units comprising the aggregate discretely presented component units.

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

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

## Internal Control Over Financial Reporting

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

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

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the State's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: Findings 2014-004, 2014-005, 2014-007, 2014-008, 2014-011, 2014-013, 2014-014, 2014-015 and 2014-017. 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 2014-019, 2014-020 and 2014-021.

*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 2014-001, 2014-002, 2014-003, 2014-006, 2014-009, 2014-010, 2014-012, 2014-016 and 2014-018. 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 2014-022, 2014-023 and 2014-024.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests and those of the other auditors disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as Finding 2014-025.

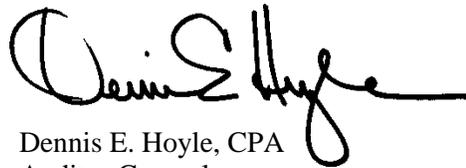
Finance Committee of the House of Representatives and  
Joint Committee on Legislative Services, General Assembly

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

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

### **Purpose of this Report**

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



Dennis E. Hoyle, CPA  
Auditor General

December 18, 2014

2014

*Schedule of  
Findings and Responses*

*Statewide Accounting Systems  
and Other Financial Reporting  
Matters*



Material Weaknesses and  
Significant Deficiencies in  
Internal Control over  
Financial Reporting

**Finding 2014-001***(significant deficiency - repeat finding)***STRATEGIC AND BUSINESS CONTINUITY PLANNING FOR CRITICAL FINANCIAL COMPUTER SYSTEMS**

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

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

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

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

The State's information technology environment is complex due to the scope and interrelationship of the multiple systems operating within State government. Additionally, there is a wide range in the "ages" of the technology employed – some critical systems utilize outdated technology which makes these operations vulnerable from a business continuity and systems security perspective. Certain of these legacy systems utilize software that is no longer supported and the availability of skilled personnel to work on the systems is limited. In other instances, the State has not timely implemented software upgrades which may limit vendor support and exposes the application to other vulnerabilities.

The State's payroll system is a key example of a critical computer system that results in business continuity risk. The payroll system processes payroll for over 14,000 employees totaling more than \$965 million in fiscal 2014 and meets the provisions of 100 separate collective bargaining agreements as well as contributions to health and pension benefit plans and other required withholdings. The payroll system utilizes outdated technology and is maintained by a very small group of employees. It still utilizes a legacy account structure that was replaced upon implementation of RIFANS. External support for the system, if required, would largely be unavailable. Documentation of the system has not been maintained consistent with current IT standards further challenging consideration of external support or development of a replacement system.

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

While RIFANS is largely effective and reliable for the functionalities that are operational, there is substantial need and opportunity for further efficiencies to be accomplished through completion of the ERP system. Inefficiencies result when departments pursue individual solutions to their needs, where a comprehensive ERP solution could yield a uniform, more efficient, and overall cost-effective solution. For example, the Executive Office of Health and Human Services is engaging a consultant to develop a cost allocation plan and process just for its Medicaid program operations. There are numerous cost allocation systems and vendor supported solutions throughout State government none of which is uniform or integrated into centralized accounting system.

Various subsidiary accounting systems (largely departmental cost allocation systems) which process material classes of expenditures have not been converted to the RIFANS account structure and continue to use an old account structure that was replaced in July 2001. Consequently, account conversion tables must be continually maintained which increases the risk that data may be misposted in the accounting system. This adds unnecessary complexity to the overall internal control structure and requires that certain employees remain knowledgeable about and even create new accounts (to match new activities or programs within RIFANS). These legacy systems also present business continuity risk since, like the payroll accounting system, they utilize outdated technology, are largely undocumented, and are maintained by a very small staff without backup and limited opportunities for external support.

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

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

A comprehensive strategic plan, consistent with the vision of an integrated ERP system, should be prepared. The strategic vision for the ERP system and other mission critical financial systems must resolve the continuing skepticism and uncertainty regarding whether completion of the ERP system by implementing additional Oracle modules is the desired solution. Regardless, the plan must ensure that the desired integration aspects of the ERP system can be met.

Many of the ERP functionalities pending implementation are interdependent. Consequently, implementing these functionalities is challenging and requires a coordinated timeline. Further, due to the significant scope of the remaining components, adequate resources must be identified and committed to the tasks.

### RECOMMENDATIONS

- |           |  |
|-----------|--|
| 2014-001a | Develop and implement a comprehensive strategic plan to address the completion of the State's ERP system and the business continuity risk presented by critical legacy financial systems.  |
| 2014-001b | Ensure that the strategic plan identifies the amount of resources (both State and/or contracted personnel) needed to either a) support a fully-integrated State ERP system or b) transition to and monitor systems or functions outsourced by the State. |

2014-001c Establish a timeline to migrate all systems currently using the legacy account structure that was replaced in 2001 to the RIFANS account structure.

Corrective action plan / auditee views:

*The Division of Information Technology (DoIT) in conjunction with the Office of Digital Excellence (ODE) is working to develop a comprehensive strategic plan for all critical business applications, including legacy financial systems. The plan will address the hierarchy of the systems, business continuity and disaster recovery plans, and the long-term approach to remediate findings for each major application. DoIT and ODE will also be working with the respective agencies and departments to determine the outstanding requirements and business needs over the next six months in preparation for a potential capital submission to address ongoing funding shortfalls.*

Anticipated Completion Date: September 30, 2015

Contact Person: Thom Guertin, Chief Digital Officer  
Phone: 401.222.2280

**Finding 2014-002**

(significant deficiency - repeat finding)

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

Appropriate controls over cash receipts and disbursements require segregation of duties. Specifically, the authorization and recording of transactions should be performed by individuals totally separate from those with responsibility for the actual disbursement and receipt of cash and subsequent reconciliation of bank and book balances. The Office of the General Treasurer's RIFANS system access allows certain employees to initiate and approve accounting transactions while also having responsibility for performing bank account reconciliations and initiating check printing and funds transfers from State bank accounts. During fiscal 2014, numerous journal entries recording receipts, adjustments, and allocations, were initiated and departmentally approved by Treasury personnel. Certain of these functions are less segregated than they should be resulting in weakened controls over the State's cash receipts and disbursements.

While the State has implemented various compensating controls to mitigate this risk, optimal financial control would fully segregate an organization's treasury and accounting functions to safeguard against asset misappropriation. Treasury should have responsibility for disbursing cash and executing funds transfer but have no responsibility for initiating or approving accounting entries. Segregation of duties could be enhanced through relocation of the revenue/receipt accounting transaction function from the General Treasurer's Office to the Office of Accounts and Control.

**RECOMMENDATION**

2014-002 Reorganize accounting responsibilities performed by the Office of the General Treasurer to ensure proper segregation of duties. Consider moving all functions relating to initiating, approving and recording transactions to the Office of Accounts and Control.

Corrective action plan / auditee views:

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

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

*Moving the initiation and approval of certain entries to the Controller's office (or to constituent agencies) may have substantial negative impacts on control and financial reporting. These impacts include but are not limited to a substantial increase in the number of reconciling variances (as the timely and accurate recording of entries by staff unfamiliar with the reconciliation process may not occur) and a dramatic delay in the completion of monthly bank account reconciliations.*

*The Office of the General Treasurer, in consultation with the Controller's office will review the current workflows and business practices to improve segregation where possible and to ensure compensating controls are as robust as possible given the systemic constraints.*

Anticipated Completion Date: Ongoing

Contact Person: Patrick Marr  
Chief Operating Officer / Deputy Treasurer  
Phone: 401.462.7664

**Auditor's response:**

We acknowledge that RIFANS system limitations have resulted in the Office of the General Treasurer having access to initiate and approve transactions in the accounting system. However, segregation of duties related to both treasury and accounting functions is a critical internal control component designed to prevent potential asset misappropriation from going undetected.

**Finding 2014-003***(significant deficiency – new finding)***COMPREHENSIVE GENERAL LEDGER CONTROLS OVER RECEIVABLES**

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

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

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

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

The Office of Accounts and Control is beginning a pilot implementation of the existing revenue/receivables module that is part of the Oracle E-Business Suite software with the aim of determining whether that module could be effective in enhancing controls over receivables. Other options may also need to be considered, specifically as part of the completion of the State's ERP system (as more fully discussed in Finding 2014-001) to enhance the State's controls over receivables, in aggregate, given the complicated and decentralized nature of revenue collection points throughout the State.

#### RECOMMENDATION

2014-003 Evaluate the effectiveness of the pilot Oracle E-Business Suite revenue/receivables module implementation and assess the need to explore other ERP integrated system options to enhance statewide general ledger controls over receivables.

#### Corrective action plan / auditee views:

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

*The classification of this new Fiscal 2014 finding as a significant deficiency in internal control over financial reporting is misleading to the reader. The reader should note that the auditors did not propose a financial reporting adjustment in this area as a result of existing controls. Certainly, there is always an opportunity to review and enhance accounting processes when manual tasks are involved; however, that fact alone should not lead to a significant deficiency classification in an audit report.*

*Considering the complex structure and myriad of systems that exist within a governmental environment, the auditor's recommendation is based more on conceptual theory than a practical solution. For example, the majority of net receivable balances are derived from the Division of Taxation (division) which currently tracks receivables at a detailed level in a separate system. Furthermore, the division is in the midst of a new integrated tax system project that will significantly enhance functionality in this area. Allocating resources to explore other ERP*

options (as stated in the recommendation) to exist between the new integrated tax system and the State's general ledger would be ill advised as it will create redundant and inefficient processes. Accordingly, the office is working with the division to post receivable balances periodically to the State's general ledger to improve tracking. Due to the enhanced processing capability of the integrated taxation system, it is a relatively straightforward change that does not require significant resources to implement.

It is also important to note that the office was already evaluating the possible use of the Oracle receivables module prior to this new finding. The office is working to identify non-tax related receivable types that may be recorded within this module without creating redundant processes.

Anticipated Completion Date: N/A

Contact Person: Marc Leonetti, State Controller  
Phone: 401.222.2271

**Auditor's response:**

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

**Finding 2014-004**

*(material weakness - repeat finding)*

**CONTROLS OVER FEDERAL PROGRAM FINANCIAL ACTIVITY**

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

Federal programs represented 39% of fiscal 2014 General Fund expenditures. Financial reporting risks include categorizing expenditures as federally reimbursable when grant funds have either been exhausted or the expenditures do not meet the specific program limitations. Further, the State can improve its overall centralized monitoring of federal program operations to ensure compliance with federal requirements.

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

Knowledge of grant requirements, spending authorizations, and limitations on reimbursable expenditures all rests with departmental managers who administer the federal grant programs. Accordingly, the Office of Accounts and Control, in preparing the State's financial statements, relies

primarily on the coding of expenditures (by funding source – federal) within the RIFANS accounting system. All expenditures recorded in federal accounts are considered reimbursable from the federal government and federal revenue is recorded to match those expenditures. From an overall statewide perspective, controls over financial reporting are ineffective to ensure that all federal expenditures are reimbursable and federal revenue is recognized appropriately.

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

### *Federal Grants Management and Cost Allocation*

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

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

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

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

The State's Office of Management and Budget (OMB) and the Office of Accounts and Control should coordinate statewide accounting and monitoring processes to enhance controls over federal program financial activity for financial reporting purposes but also to ensure compliance with federal program requirements.

### RECOMMENDATIONS

- |           |   |
|-----------|---|
| 2014-004a | Improve functionality with the statewide ERP system to facilitate federal grant administration (grants management, cash management, and cost allocation).                     |
| 2014-004b | Build statewide processes over federal grant administration within the Office of Management and Budget to supplement accounting controls within the RIFANS accounting system. |

Corrective action plan / auditee views:

2014-004a - In the last legislative session, the General Assembly approved the allocation of a share of anticipated receipts from a debt refinancing to the Information Technology Investment Fund to provide resources to support IT projects. The Governor's 2016 Budget proposes \$3.0 million for this purpose. Given the level of funding, projects will have to be prioritized. Other resources in future years should allow additional projects to be completed, but over a longer time frame than originally anticipated.

2014-004b - The OMB's Grants Management Office has made significant progress over the last two years with regard to federal grants administration.

To enhance management of federal funds statewide, OMB's Office of Grants Management instituted a systematic collection of federal award data from all State agencies into a Federal Award Catalog and State agencies update the catalog quarterly. As of July 1, 2015, agencies are required to report expenditures against awards and agencies were required to include a standardized federal award funding report as part of the FY2016 budget submission. The Office also works closely with the Budget Office and Accounts and Controls on federal funding issues.

In SFY2015, the Grants Management Office organized a training series on the new OMB Uniform Grant Guidance. The series is designed to improve all aspects of grants management including compliance with the new OMB Uniform grant Guidance.

The OMB's Grants Management Office will continue its effort to standardize, streamline, and improve the federal award business process. As part of this work, the Office will continue to provide training, technical assistance, and resources to agencies on grants administration.

Anticipated Completion Date: Ongoing

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

**Finding 2014-005***(material weakness - repeat finding)***MEDICAL ASSISTANCE PROGRAM – PROGRAM OVERSIGHT AND MONITORING**

The Executive Office of Health and Human Services (EOHHS) is responsible for the administration and oversight of the State's Medicaid program (and related State Children's Health Insurance Program which is operated as an expansion of the Medicaid program). Medicaid is the single largest programmatic activity of the State with more than \$2.3 billion in annual expenditures representing 38% of the State's General Fund expenditures for fiscal 2014.

EOHHS employs a fiscal agent and various other contractors to perform various program operations. This interplay of employees, consultants and vendors adds to the complexity of the control structure for the Medicaid program. EOHHS can enhance and formalize its overall monitoring of key controls over program operations to ensure contracted functions are performed as intended and to ensure compliance with State and federal laws and regulations. Federal regulations require non-federal entities to establish and maintain internal control designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements.

We noted significant control deficiencies relating to the effective administration and monitoring of the following critical aspects of the program:

- *Implementation of the federal Affordable Care Act (ACA) and Unified Health Infrastructure Project (UHIP)* – the State’s implementation of ACA, including the new UHIP computer system used to determine Medicaid eligibility, significantly modified the control environment over Medicaid eligibility determinations. Various vendors and consultants were engaged to develop and implement the new eligibility determination system and other new external parties (contracted contact call center) were involved in the eligibility determination process. We found that key data interfaces used to validate applicant self-attested data were not operational during fiscal 2014 thereby significantly weakening system controls over eligibility determinations.
- *Contracted program functions* – EOHHS, as the single State Medicaid agency, uses numerous consultants and contractors within the operation and administration of the Medicaid Program. However, EOHHS’s program oversight and monitoring responsibilities remain as the agency ultimately responsible for the administration of the program. EOHHS is responsible for the consideration and documentation of internal controls over significant program operations (i.e., program eligibility, contract compliance, and provider payments, as examples). Due to the size and complexity of the Medicaid program, the State should formalize its monitoring procedures relating to operations performed by contractors to ensure that all significant control risks are being mitigated through those procedures. Examples of significant program operations that were not adequately monitored in fiscal 2014 included: a) claiming to the State Children’s Health Insurance Program which is almost entirely determined through processes performed by consultants; and b) various settlements with managed care organizations (PCP Bump and Risk/Gain Share) delegated to EOHHS’s managed care consultants. In both examples, EOHHS did not perform any additional procedures to validate the accuracy of these expenditures claimed to federal programs.
- *Program operations administered by other State departments and agencies* – A significant volume of services are paid through Medicaid for (1) children in the State’s custody, (2) developmentally disabled adults, and (3) various CNOM programs (costs not otherwise matchable under Medicaid) operated by the Department of Children, Youth, and Families (DCYF), the Department of Behavioral Healthcare, Developmental Disabilities and Hospitals (BHDDH), and other State agencies. Significant control weaknesses have been identified over these program areas.
- *Controls over Eligibility* – EOHHS’s inability to conduct timely Medicaid Eligibility Quality Control (MEQC) reviews has weakened controls over recipient eligibility.
- *Surveillance Utilization Review Services (SURS)* - We observed that inadequate staffing at the fiscal agent’s SURS unit had caused many Level III cases, those with the potential to involve fraud and/or abuse, to remain unresolved for extended periods.
- *Comprehensive Information Technology Systems Security Reviews* – The Medicaid program operates through major information technology applications (MMIS, UHIP and INRHODES) that are supported/operated by vendors. These applications must be consistently monitored from a systems security perspective to ensure adherence to security objectives and to meet federal program requirements.

EOHHS should formalize specific monitoring procedures to ensure proper oversight and control over program expenditures that approximated \$2.3 billion in fiscal 2014. A formalization of its monitoring procedures should include identification of specific program activities determined significant to the related federal programs (Medicaid and SCHIP) as a whole and how defined monitoring and oversight procedures are designed to reduce the risk of program noncompliance going undetected in those areas.

RECOMMENDATION

2014-005 Enhance and formalize monitoring procedures over significant Medicaid and SCHIP program activities particularly those functions delegated to consultants and vendors to ensure performance and program compliance.

Corrective action plan / auditee views:

*EOHHS has taken significant steps over the last two years in order to improve its ability to administer and oversee the State's Medicaid Program. Among these are the developments of three new offices within EOHHS: the Office of Program Integrity; Office of Policy and Innovation; and in 2014, the Office of Operations. These new areas will have specific focus on the Medicaid Program as well as overall health and human services programs. EOHHS will address the critical program areas cited in the following ways:*

Implementation of the Affordable Care Act (ACA) and Unified Infrastructure Project (UHIP) – *When the issue was identified in June 2014, we took immediate steps to resolve the issue by correcting the interface issue and sending notices to the people who MAY have received MAGI Medicaid incorrectly. The Remediation steps are below:*

- *Code fixes were implemented to resolve the income interpretation logic and made available in the system on June 09, 2014 and June 16, 2014. DLT refresh was also initiated at this time. This prevented any further individuals from getting impacted by the issue.*
- *Remediation of individuals impacted by this issue followed a Multi-phase process. The goal was to allow individuals to provide supporting documentation and only terminate from Medicaid on failure to provide the information. A key decision made during on-going meetings was to effectuate changes prospectively due to the large population impacted and manual effort required by Health Plans to determine if claims were filed and paid.*
  - *Phase 1: Notify individuals to submit supporting documents that verify current income. Eligibility Status of individuals was changed to “Medicaid Pending” and they were requested to provide additional documentation to support reported Current Income (via the Additional Documentation Required notice). Notices were mailed to individuals from 7/11/2014-7/25/2014.*
  - *Phase 2: Terminate as required. Individuals who failed to provide the requested documentation within the 15 day period were sent a ‘Medicaid Termination Notice’ and terminated effective 08/31/2014.*
  - *Individuals in incorrect Aid Categories had application re-submitted from the system to move them in the correct Aid Category.*
  - *SWICA Data Access Strategy: DLT refreshes its State Wage Income Collection Agency (SWICA) data on a quarterly basis in its data base. Once data is refreshed by DLT, it is available to UHIP in real-time. To access income information about an individual in UHIP, a Database call is made from UHIP using the SSN and the income is returned by DLT.*

Contracted Program Functions – *In spring 2014, the Office of Policy and Innovation, Management Information Services Administrator hired two chiefs to be responsible for the oversight of the fiscal agent contract and the systems integrator vendor hired to build and*

implement the new eligibility system. The Management Information Services Unit now has six state FTEs as well as one consultant hired through the MPA list.

The Medicaid Program has traditionally been responsible for the oversight and monitoring of contracts with managed care organizations. While this oversight and monitoring is supported by contracted personnel, ultimate responsibility lies with state staff.

Program operations administered by other State departments and agencies – EOHHS has undertaken a review of the inter-agency service Agreements with each agency and will use the exercise to strengthen these agreements with other State departments and agencies. The newly appointed Deputy Secretary for Operations will be involved in ensuring that these agreements are fully implemented and will work with the other agencies to ensure compliance. The Deputy Secretary has already conducted several meetings on this subject and is in the process of reviewing all of the interagency agreements with the OHHS staff. The next step in this process is to meet with the other agencies to continue the dialogue that has occurred up to this point in order to strengthen these agreements. The development and work of the EOHHS Office of Program Integrity has greatly enhanced EOHHS ability to monitor other Departments' compliance with State and Federal requirements and that division will be reporting to the Deputy Secretary any and all issues that may affect compliance.

Controls Over Eligibility – Beginning with Federal Fiscal Year 2014, CMS notified states that the MEQC and the Payment Error Rate Measurement (PERM) eligibility reviews would be combined into the Eligibility Pilot Program (EPP) for Federal Fiscal Years 2014 – 2016. CMS reasoned that the method of determining Medicaid eligibility changed to Modified Adjusted Gross Income (MAGI) on October 1, 2013 and therefore the traditional eligibility audits no longer were adequate. CMS will issue new guidance covering eligibility audits for Federal Fiscal Year 2017 forward.

The MEQC unit is conducting the EPP reviews, beginning with eligibility determinations made beginning October 1, 2013. For the eligibility pilots, each state is required to submit sampling plans to CMS for approval for rounds 1 & 2, draw the samples, perform the reviews, and report the results to CMS. For round 3 eligibility reviews, MEQC and EOHHS will be working with CMS' Eligibility Support Contractor (ESC) during the audit process.

Surveillance Utilization Review Services (SURS) - The SURS team has made significant improvements towards addressing the backlog of Level III cases showing a 37 percent improvement. At the end of 2013 there were 69 Level III reviews pending. SURS closed 26 of those in 2014. Additionally, in November of 2015, SURS hired another nurse auditor who is actively reviewing cases and training on the MMIS. The addition of this position is expected to reduce the backlog significantly and to keep new cases current.

#### Comprehensive Information Technology Systems Security Review:

MMIS - The MMIS system underwent a comprehensive SOC audit regarding its security systems between the period of July 1, 2013 and June 30, 2014. No issues were identified as a result of this review. Medicaid Management Information System (MMIS) oversight and security activities follow guidelines outlined in 45 CFR 95.621. The State and its fiscal agent, HP Enterprise Services (HPES), conduct ongoing activities to ensure the security and privacy of the information housed in the MMIS.

Notable MMIS controls are:

- System Modification - All modifications to MMIS have a statement of work (SOW) and Business Design Document (BDD) associated with the project. Each element requires a sign off by the stakeholder before the project can move forward. Upon completion and before moving to production a walkthrough is conducted to demonstrate the results of testing and to demonstrate the modification works as designed. The walkthrough requires another sign off by the stakeholder.
- Quarterly Contract Monitoring - Quarterly contract monitoring meetings are held with the State to review system performance and various metrics from the preceding quarter.
- Disaster Recovery & Business Continuity Plan - These plans are reviewed annually, or as needed, by the State with HPES. The Disaster Recovery Plan is tested annually.
- Medicaid Account Privacy and Security Policies and Procedure Manual - The HPES security policies contained in the manual include, Security Management Process – Risk Analysis, Risk Management, Sanction Policy, Information System review, Workforce Security, Information Access Management, Security Awareness & Training Programs, Security Incident Procedures, Contingency Plan – Data Backup, Technical Safeguards, and Privacy.
- Annual SOC Audit (Formerly SAS 70 Type II) - Conducted annually by Ernst & Young, the SOC audit covers the nine (9) major topic areas. Audits in 2013 and 2014 did not contain any findings by Ernst & Young.
- Security Meeting - The security team meets quarterly to discuss and review any incidents in the previous quarter. If needed, corrective action plans are initiated to correct deficiencies.
- Project Meetings - Weekly project meetings are held with the State and HPES staff to discuss the status of all ongoing projects.
- Reporting - Annually HPES assembles all documentation for statements of work, business design documents, walkthroughs, quarterly meetings, Disaster Recovery Plan, System Security Plan, SOC audit report, etc. for review by the State and the Auditor General as part of the contract oversight and monitoring activities.

Unified Health Infrastructure Project (UHIP) - The Rhode Island UHIP (Unified Health Infrastructure Project) application's security measures follows the strict guidelines imposed by CMS and the IRS, based on NIST (National Institute of Standards and Technology) 800-53 standards and the IRS Publication 1075. Using the federal standards, Rhode Island has implemented protection in the security control areas such as physical access, configuration management, audits, contingency plans, technical security, incident response, maintenance, media controls, physical security, security planning, risk management, network/communications security. The security of the UHIP site has been directed by the State of Rhode Island with much of the work carried out by Deloitte Consulting, the system integrator chosen by the state for the integrated MAGI Medicaid and Exchange public web portal and the Administration portal. UHIP has certain federal requirements that mandate constant monitoring.

Among the many monitoring program documents employed are:

- Security Plan – CMS requires this plan that describes the system's security in its entirety. This extensive document outlines all security responsibility and controls. It is the main document for security controls and has been approved by CMS.

- Security Team – This multi-agency and technical stakeholder team meets once per week in order to review milestones for compliance with state and federal law along with up to date best practices for system security.
- Plan of Action and Milestones (POA&M) – This quarterly report is sent to CMS to report on scheduled milestone and how potential weaknesses are being addressed by the State.
- Privacy Impact Assessment (PIA) – This report describes how all data is stored and controlled relating to the privacy of citizens. CMS reviews this report and comments on security suggestions and system updates.
- IRS Safeguard Procedures Report (SPR) – This report explains compliance with all IRS mandated 1075 Requirements. This was sent to the IRS upon system start-up and was followed up with an audit in July of 2014 and had findings, separated into delivery timelines of three, six, nine, and twelve months from the time of the visit. Rhode Island, through its Chief Security Officer and other personnel, has been addressing the findings and will continue to work on the required changes to meet the IRS deadlines. The IRS has been monitoring Rhode Island's compliance with its regulations.

Anticipated Completion Date: On going

Contact Person: Wayne Hannon, Deputy Secretary - Administration  
Phone: 401.462.6005

**Auditor's response:**

While we acknowledge the actions outlined in EOHHS's corrective action plan, our finding focuses on the need for comprehensive consideration of how specific monitoring procedures are utilized and could be better integrated to mitigate the risks of noncompliance in critical program areas. Certain control activities may be delegated to contractors; however, validation of the performance of those activities remains with EOHHS and should be included within the recommended comprehensive monitoring plan.

**Finding 2014-006**

(significant deficiency - new finding)

**CONTROLS OVER ADVANCES TO MEDICAID PROVIDERS**

Medicaid provider payments are typically made after the underlying provider claims are processed through the Medicaid Management Information Systems (MMIS). In certain instances, an advance payment may be made for estimated amounts prior to formal claims adjudication. The advances should be tracked and recorded within the MMIS as prepayments (or provider receivables) to be offset against actual claims activity.

The Executive Office of Health and Human Services (EOHHS) authorized two advances approximating \$2.6 million to a hospital provider for fiscal 2014 services rendered but unbilled. The advances reimbursed the provider for neonatal intensive care unit services for newborns whose Medicaid eligibility processing was delayed in fiscal 2014.

EOHHS intended to recoup these provider advances when the newborn eligibility issue was resolved thereby allowing the claims to process. In order to defer immediate recoupment of the advance

from other payments to the provider, the advances were not recorded within the MMIS as advance payments or provider receivables. This resulted in the advance (receivable) being omitted from amounts reported at fiscal year-end for accrual within the State's financial statements.

EOHHS must enhance controls over provider advances to ensure that all such payments are accurately reflected in the MMIS. Procedures should be modified to automatically record advances through a system default but allow the timing of recoupment to be modified as necessary. This would ensure that all advances are appropriately reflected both within the MMIS and the State's financial statements.

### RECOMMENDATION

2014-006      Ensure all Medicaid provider advances are recorded by modifying MMIS system default accounting procedures.

#### Corrective action plan / auditee views:

*Although the circumstances surrounding the two advances cited were very unique, EOHHS agrees with the auditors finding and recommendation. The State's fiscal agent, HP Enterprise Services has now instituted improved procedures to manually record and track all advance payments including actual and prospective recoupments. The capability of this function to be handled in the MMIS does not currently exist.*

*EOHHS recognizes the advantage of an automated process and will investigate the technical and financial feasibility of making system modifications to the MMIS to enable the automatic recording and managing of all advances and recoupment schedules.*

Anticipated Completion Date:                      *Completed*

Contact Person:    *Wayne Hannon, Deputy Secretary - Administration  
Phone: 401.462.6005*

2014

*Schedule of  
Findings and Responses  
Information Systems Security*



Material Weaknesses and  
Significant Deficiencies in  
Internal Control over  
Financial Reporting

**Finding 2014-007***(material weakness - repeat finding)***COMPREHENSIVE INFORMATION SYSTEMS SECURITY POLICIES AND PROCEDURES**

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

The oversight and management of the State's information security program relies upon the implementation of DoIT's comprehensive information systems security plan that was finalized during fiscal 2006. The information systems security plan consists of detailed policies, procedures, standards, and guidelines that are designed to safeguard all of the information contained within the State's critical systems. As observed by an internal review performed by the Bureau of Audits, many of these policies require updating to current standards and other critical areas of the IT security plan need to be addressed which necessitate new policies.

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

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

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

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

**RECOMMENDATIONS**

- 2014-007a      Update existing policies and implement new policies where required to ensure DoIT's IT security policies and procedures conform to current standards and address all critical systems security vulnerabilities.

- 2014-007b Complete an initial assessment of compliance with systems security standards for the State’s mission critical systems.
- 2014-007c Consider contracting for the performance of IT security compliance reviews and accumulate and make use of available Service Organization Control reports, whenever available, to extend IT security monitoring of critical systems.
- 2014-007d Prepare a corrective action plan that prioritizes significant system security risks with the goal of achieving compliance of all significant State systems with DoIT’s formalized system security standards.
- 2014-007e Require systems security certification procedures to be performed by DoIT prior to any significantly modified application systems becoming operational.

Corrective action plan / auditee views:

*2014- 007a - DOIT is currently re-writing many of its current policies and also introducing new policies to address current standards. Over twenty re-written and new policies are currently under review by legal and other staff and once approved will be re-distributed.*

Anticipated Completion Date: December 31, 2015

*2014-007b - The Department of Administration under the direction of the Chief Information Security Officer (CISO) will continue to work on the initial assessment of compliance with system security standards for the State’s mission critical systems.*

Anticipated Completion Date: Ongoing

*2014-007c - DOIT will be adding additional MPA 230 security roles in the next MPA 230 RFP. These roles will allow for DoIT to procure additional security staff and also procure staff on fixed price deliverables to perform such audits. Funding would still have to be secured to proceed with having external organizations perform security audits.*

Anticipated Completion Date: Ongoing

*2014-007d – The Bureau of Audits performed an audit of internal procedures in this area. As a result of this audit, there are many recommendations that DOIT will be addressing and will incorporate as part of its internal security review.*

Anticipated Completion Date: TBD

*2014-007e - Currently, all new projects come through the PRC (Project Review Committee). Any new project that gets approved must provide the Chief Information Security Officer (CISO) a written security plan for review and approval.*

Anticipated Completion Date: Ongoing

*Contact Person: Kurt Huhn, Chief Information Security Officer  
Phone: 401.462.9292*

**Finding 2014-008***(material weakness - repeat finding)***INFORMATION TECHNOLOGY (IT) SYSTEMS - PROGRAM CHANGE CONTROLS**

The State does not follow uniform enterprise-wide program change control procedures for the various IT applications operating within State government. Program change controls are a critical IT control component to ensure that authorized changes are appropriately made to programs with testing and acceptance before being placed in production. Additionally, program change control procedures prevent and detect unauthorized program modifications from being made.

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

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

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

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

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

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

DoIT should implement a standardized formal enterprise program change control process for the application systems it supports. To assist this process, DoIT should evaluate enterprise software solutions to complement their program change process. Procedural guidance should be developed that provides detailing correct use of change management software and mandated internal control practices and

procedures, thus ensuring a documented, monitored, and repeatable process.

### RECOMMENDATIONS

- 2014-008a Reassess the use of a standard software package to determine the appropriate combination of operational, procedural and/or technical adjustments required to use the package in a manner that results in adequate program change control for the entire enterprise.
- 2014-008b Design, develop, formalize and implement procedural guidance manuals detailing specific requirements for program change control and disseminate and train DoIT support staff in its proper execution.

#### Corrective action plan / auditee views:

*2014-008a - Due to resource constraints, we have been unable to improve the current change management process. DOIT will be coordinating this effort with DLT and DOT as both agencies are also looking at a new change management process. DOIT will determine if another change management process, Revision Control System (RCS), currently used at another department, can be used to replace the current environment.*

Anticipated Completion Date: June 30, 2016

*2014-008b - This finding will be addressed when a new change management process is selected.*

Anticipated Completion Date: TBD

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

### ***Finding 2014-009***

*(significant deficiency- repeat finding)*

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

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

#### RIFANS "Super Users"

Activities of individuals with system administrator or "super user" roles are logged but not reported and reviewed. These individuals have unlimited access to RIFANS functions and data. Consequently, any RIFANS transactions or activity initiated by system administrators should be monitored. The Division of Information Technology's (DoIT) policies and procedures require the activities of privileged users (system administrators) to be logged by the system and reviewed for propriety by assigned personnel.

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

### Agency Hierarchies

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

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

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

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

### RIFANS Delegated Authority

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

### RECOMMENDATIONS

- |           |  |
|-----------|--|
| 2014-009a | Review activities of privileged users (system administrators) on a scheduled basis to ensure that additions, modifications, and deletions initiated by them are appropriate.   |
| 2014-009b | Improve controls over RIFANS access by developing the reporting functionality necessary to allow for periodic monitoring of user access for instances of unauthorized changes to user access and/or noncompliance with policies relating to delegated user access. |

Corrective action plan / auditee views:

2014-009a - DOIT consulted with an outside database administrator (DBA) for input on how to address this recommendation. The DBA recommended one of the following two procedures in Oracle 12 database to monitor certain system activities:

- *Standard Auditing.* Standard auditing provides basic auditing features for Oracle 12 system activities.
- *Fine-Grained Auditing (FGA).* This type of auditing provides very granular auditing of system activities.

Based on conversations with our DBA, the State will proceed with option 1, standard auditing. Auditing will be enabled for certain tables when updates, deletions, insertions and queries are performed against those tables. We feel this will address audit 2014-009a. We will ask for an increase in MPA 230 hours to have the outside MPA 230 DBA vendor implement this feature and work on the specifications.

Anticipated Completion Date: October 31, 2015

2014-009b - Part of the auditing recommended in 2014-009a includes notifications to certain personnel when certain functions are performed. The DBA has indicated this is possible. We will send out an email or other type of system notification when a change to a table or query is executed. The specifications will be developed with DOIT, Accounts and Control and the DBA. DOIT will ask for increased MPA 230 funding to implement this function.

Anticipated Completion Date: October 31, 2015

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

2014

*Schedule of  
Findings and Responses*

*Department of Revenue –  
Division of Taxation*



Material Weaknesses and  
Significant Deficiencies in  
Internal Control over  
Financial Reporting

**Finding 2014-010***(significant deficiency - new finding)***DEPARTMENT OF REVENUE – CONTROLS OVER CERTAIN TAXES RECEIVABLE**

The Division of Taxation should strengthen controls over certain taxes receivable balances that are maintained separately from the mainframe computer systems used for the larger tax categories. We found an erroneous tax receivable balance reported at June 30, 2014 - the taxpayer had paid the balance several years prior. The systems and procedures for these smaller tax categories are inadequate to ensure the accuracy of reported receivable balances. Tax payments are recorded when received but also require a separate recording to reduce the tax receivable balance for that taxpayer. In the instance found during our audit, the payment was recorded when received; however, the tax receivable balance was not reduced for the payment made.

Controls need to be enhanced to ensure the taxes receivable are accurately reported for operational and financial reporting purposes. The Division of Taxation is currently implementing a new computer system which is intended to improve controls particularly over these smaller non-mainframe tax categories.

**RECOMMENDATION**

2014-010      Improve controls over the non-mainframe tax receivable systems to ensure accurate reporting of tax receivable balances.

**Corrective action plan / auditee views:**

*The Division of Taxation questions the materiality of this finding given the volume of total receivables and the context of conversion of the non-mainframe tax databases to the new integrated tax system. The Division manages over 70,000 tax receivable balances and collects over \$3.0 billion annually, a finding outlining one incorrect balance resulting in an adjustment of less than \$200,000 seems immaterial.*

*The Division of Taxation is in the process of implementing an integrated tax system (STAARS) which will retire all of the non-mainframe tax databases. In July 2014, the Division of Taxation successfully implemented Release 1 which included 36 different non-mainframe taxes. As of February 27, 2014 all non-mainframe receivable, excluding cigarette receivables, have been converted to STAARS. The remaining cigarette tax receivables will be converted to STAARS by April 30, 2015.*

**Anticipated Completion Date:**                      April 30, 2015

**Contact Person:**    David Sullivan, Tax Administrator  
Phone: 401.574.8922

**Auditor's response:**

While the known misstatement detected by our audit procedures is not individually material, the error highlighted a control weakness over all non-mainframe taxes receivable which is the focus of the finding. We acknowledge that the Division's new STAARS system should address this weakness.

**Finding 2014-011***(material weakness - repeat finding)***DEPARTMENT OF REVENUE – CONTROLS OVER ELECTRONIC TRANSMISSION OF TAX PAYMENTS AND OTHER INFORMATION**

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

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

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

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

To ensure that the proper level of data protection is in place, Taxation, working with the Division of Information Technology (DoIT), performed a "data classification" review of these files during FY 2014. DoIT has policies requiring that all State data being captured, maintained, and reported by any agency or department be "data categorized" based upon three levels of availability and four levels of confidentiality (DoIT policy # 05-02 – *Data Categorization*). As a result of the "data classification" review, Taxation classified the data as "sensitive", therefore, requiring it to be encrypted using 256 bit or higher encryption strength. However, although Taxation has performed the "data classification" review, it does not currently have a mechanism to encrypt the data automatically (Taxation is in the process of implementing a new system that is designed to encrypt data automatically).

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

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

RECOMMENDATIONS

- 2014-011a Implement a mechanism to encrypt data classified as “sensitive” automatically consistent with DoIT Perform a “data classification” review consistent with DoIT policy # 05-02 – *Data Categorization*.
- 2014-011b Secure all electronic files containing taxpayer information residing on the Division of Taxation’s network to ensure data integrity.
- 2014-011c Control all electronic files that contain taxpayer information by requiring the file format to be secure and configured to the computer system in order to allow automatic transmission without any manual intervention.
- 2014-011d Develop monitoring and reporting procedures to ensure the proper upload of data files.

Corrective action plan / auditee views:

*2014-011a - In January 2014, the Division of Taxation requested information regarding how the Division can meet the encrypted data requirement. The Division of Taxation will continue to work with the Division of Information Technology to complete this task.*

Anticipated Completion Date: June 30, 2015

Contact Person: David Sullivan, Tax Administrator  
Phone: 401.574.8922

*2014-011b - Currently all files received by the Division of Taxation are received in encrypted format. The Division is in the process of encrypted all achieved (prior year EFT files) files on the internal servers.*

Anticipated Completion Date: June 30, 2015

Contact Person: Dan Clemence  
Phone: 401.574.8732

*2014-011c - In the new Division of Taxation system (STAARS) all electronic files will be processed through an encrypted file on our FTP server. Then it will be loaded into STAARS and all adjustment will be made after it is loaded into STAARS. However, certain payment types (Fed Wire) do not allow the Division complete control over what is sent, therefore the Division may have to manual adjust file prior to load to STAARS. The Division of Taxation will be collaborating with the primary and secondary financial institutions to enhance coordination regarding file layouts and unique processing requirements.*

Anticipated Completion Date: July 2016

Contact Person: Dan Clemence  
Phone: 401.574.8732

*2014-011d - The Division of Taxation has the ability to report on the total EFT payments received by the bank and the total amount to be processed by STAARS and the Mainframe system. During the STAARS reconciliation process, the Division is able to verify the total amount*

*deposited and process from EFT in STAARS by running specific reports to confirm the information needed.*

*Anticipated Completion Date: July 2014*

*Contact Person: David Sullivan, Tax Administrator  
Phone: 401.574.8922*

***Finding 2014-012***

*(significant deficiency - repeat finding)*

**DEPARTMENT OF REVENUE – PERSONAL INCOME TAX - W-3 RECONCILIATIONS**

Employers are required to file an annual W-3 reconciliation return comparing withholding payments due to actual amounts paid to the Division of Taxation (Taxation). While some employers file paper W-3 reconciliation returns, in most instances the reconciliation is calculated electronically by Taxation's mainframe system from the W-2 files submitted by employers and the record of employer withholding deposits.

There has been a significant backlog in posting/processing W-3 reconciliation returns. W-3 reconciliation returns for tax year 2013 were due February 28, 2014. During fiscal 2014, W-3 paper returns for tax years through 2013 were posted to the mainframe system. However, as of June 30, 2014, the system-generated W-3 reconciliation returns for tax years 2011, 2012, and 2013 had not yet been posted. The backlog in posting W-3 reconciliation returns delays identifying potential overpayments and underpayments of employer withholding taxes.

**RECOMMENDATION**

2014-012 Process W-3 reconciliation returns timely to identify any underpayment of employer withholding taxes.

**Corrective action plan / auditee views:**

*Effective January 2015, the Division of Taxation reassigned the function to review W-3 reconciliation returns to the Office Audit and Discovery unit. This unit will create automated processes to review and validate W-3 returns. The unit will work on reviewing tax year 2011 returns before April 2015 and process 2012 and 2013 returns over the next 6 months.*

*Anticipated Completion Date: April 2015*

*Contact Person: David Sullivan, Tax Administrator  
Phone: 401.574.8922*

**Finding 2014-013***(material weakness - repeat finding)*DEPARTMENT OF REVENUE – RECONCILIATION OF TAXATION RECEIPTS TO RIFANS

The Division of Taxation (Taxation) does not reconcile receipts posted to its systems with receipts reported in the RIFANS accounting system. Although Taxation reconciles their cash receipts ledger (subsidiary system) to RIFANS, controls would be improved if receipts reported within the mainframe system were reconciled to RIFANS. RIFANS data is the basis for much of the information utilized by the State for financial reporting and the reconciliation of that data with Taxation's systems (the official record for tracking tax payments and refunds) would provide enhanced control over the State's reporting of tax revenue.

RECOMMENDATION

2014-013      Develop the reporting capability to facilitate reconciliation of receipts reported by Taxation's systems with RIFANS.

Corrective action plan / auditee views:

*One of the major priorities of the Division of Taxation is the timely depositing of payments received. All payments received by Taxation are posted to various systems subsequent to their deposit. Currently the Division of Taxation has over 70 databases used to record payments and other taxpayer transactions (the mainframe system contains only 15 of these databases). As part of the Fiscal Year 2013 budget request, the Division of Taxation requested funding for an integrated tax system. This system will, among other things, overhaul the front end accounting systems and deposit systems. The system will also allow for real time posting of payments and transactions to taxpayer accounts, therefore any deposit made will be recorded in a more efficient manner. The release 1 implementation in July 2014 has; i) established better controls for non-mainframe tax types, ii) provided enhanced controls over non-mainframe taxes and iii) eliminated the need to enter the deposit in multiple databases. The Division is also implementing transitional processes to enhance controls; however, all issues will be resolved when the integrated tax system is fully implemented in September 2016.*

Anticipated Completion Date:                      *Release I-July 2014 (fully implemented September 2016)*

Contact Person:    *David Sullivan, Tax Administrator*  
*Phone: 401.574.8922*

**Finding 2014-014***(material weakness - repeat finding)*DEPARTMENT OF REVENUE – PERSONAL INCOME TAX - CONFIDENTIAL COMMUNICATION

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

2014

*Schedule of  
Findings and Responses*

*Department of Transportation –  
Intermodal Surface Transportation  
(IST) Fund*



Material Weaknesses and  
Significant Deficiencies in  
Internal Control over  
Financial Reporting

**Finding 2014-015***(material weakness - repeat finding)***FINANCIAL REPORTING – INTERMODAL SURFACE TRANSPORTATION FUND – USE OF RI DEPARTMENT OF TRANSPORTATION (RIDOT) FMS AND RIFANS ACCOUNTING SYSTEMS**

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

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

- ❑ RIDOT FMS and RIFANS each utilize separate and distinct account structures, which necessitates mapping to “crosswalk” the two charts of accounts. During our testing we identified a weakness over controls of the crosswalk; specifically all FMS accounts are not mapped to respective RIFANS accounts.
- ❑ Since no direct interface exists between the two systems, transmission files are utilized to transfer expenditure data between the RIDOT FMS and RIFANS to disburse vendor payments. Timing differences exist and have to be identified as part of the reconciliation process.
- ❑ RIDOT establishes and maintains purchase order balances on a detailed line item basis for the entire project duration; purchase order balances in RIFANS are in summary form and only for the amount expected to be expended during that fiscal year.
- ❑ Expenditures are recorded in the RIDOT FMS after disbursement in RIFANS; expenditures are recorded in RIFANS when entered and approved for payment.
- ❑ RIDOT FMS tracks activity at the project level as this is the level at which funding sources (e.g., federal, state and other) are determined and infrastructure or maintenance categorizations are made. RIFANS accumulates activity at the major program level (e.g., interstate highways).

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

Due to the use of two separate accounting systems, RIDOT has implemented a process of reconciling RIDOT FMS to RIFANS on a monthly basis, as a control, to ensure both systems accurately reflect RIDOT activity. Specific areas of the reconciliation process have been automated but the cause for differences must be manually identified and corrected in the appropriate system. In fiscal 2014, the

report used by RIDOT in the reconciliation process does not properly map all natural accounts between the two systems. This causes offsetting differences to exist in the reconciliation. Even though these differences are explainable, the control established to ensure the two systems are in sync is not working as originally intended.

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

### RECOMMENDATIONS

- 2014-015a      Reevaluate the continued operation of two separate accounting systems to support financial reporting for the IST Fund. Establish short and long-term goals to ensure reliable information is available to support timely financial reporting.
- 2014-015b      Ensure the reconciliation process includes fund balance accounts. At a minimum, ensure the control over the reconciliation of FMS to RIFANS is operating as intended by modifying the coding reconciliation report to properly map the natural accounts between the systems.
- 2014-015c      Improve controls over the FMS to RIFANS crosswalk by periodically comparing all FMS accounts to the crosswalk and ensuring all FMS accounts have an associated RIFANS account.

### Corrective action plan / auditee views:

*2014-015a - The Department will reevaluate the continued operation of two separate accounting systems to support financial reporting for the IST fund.*

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

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

Anticipated Completion Date:                      *To be determined*

*2014-015b - The former reconciliation report cannot be replicated until RIDOT's FMS system is upgraded to Oracle version 12.4. At that point, FMS will be operating on the same Oracle release as RIFANS. Only recently was funding identified to begin this update, which is scheduled to be completed by June 30, 2016. Notwithstanding this issue, the Department has continued to reconcile on a monthly basis using a manual process.*

Anticipated Completion Date: June 30, 2016

2014-015c - This condition was caused by retainage holding accounts with accounting strings that were not mapped. On a go-forward basis, RIDOT will review all retainage holding accounts to ensure that all accounting strings are accurate and mapped.

Anticipated Completion Date: June 30, 2015

Contact Person: Robert Farley, Chief Financial Officer  
401.222.6590

### **Finding 2014-016**

*(significant deficiency - repeat finding)*

#### INTERMODAL SURFACE TRANSPORTATION FUND - FINANCIAL REPORTING

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

#### Controls over the Preparation of Financial Statements

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

- ❑ The RIFANS hierarchy approvals for journal entries was not operating correctly during fiscal 2014. Although RIDOT instituted compensating controls by routing journals prepared by one individual to another for approval, the RIFANS control procedures, when operating appropriately, are more reliable and effective to prevent any one individual from initiating and approving a journal entry that could materially affect the financial statements.
- ❑ Multiple activities and funding streams are included within the IST Fund. Although combined for financial reporting purposes, each activity or funding stream requires separate analysis to ensure amounts are accurately reported. Classification of fund balance by category – nonspendable, restricted, committed, assigned, and unassigned - is dependent upon the analysis of each activity and/or funding stream. Our analysis discovered misclassifications of various fund balance categories. RIDOT should improve its controls over the reporting of fund balance by analyzing activity and funding stream components periodically throughout the fiscal year.
- ❑ There are several instances of transfers being incorrectly classified as payables and receivables for financial statement purposes when those transfers of funds should have been reported as either due to / due from other funds.

#### RECOMMENDATIONS

2014-016a Improve controls over financial reporting by updating the RIFANS hierarchy to include RIDOT in all journals posted to the IST Fund and lower the dollar threshold requiring journal entries to be reviewed and approved to an amount that could not materially misstate the financial statements. Ensure RIFANS is

requiring review and approval of journal entries in accordance with established hierarchies.

- 2014-016b Analyze each activity and/or funding source within the IST Fund to ensure activity is accurately recorded and to improve controls over the categorization and reporting of fund balance components. Perform the analysis periodically throughout the fiscal year.
- 2014-016c Improve controls over financial reporting to ensure transfers between funds are properly recorded in the State's accounting system and financial statements.

Corrective action plan / auditee views:

*2014-016a - Updating the RIFANS hierarchy is solely the purview of the Controller's Office, who historically have not been in favor of establishing this process, primarily because it would require RIDOT to approve journal entries and allocations that are not related to the IST Fund.*

Anticipated Completion Date: *To be determined*

*2014-016b - Financial Management has reformed this process and has dedicated significant staff resources towards resolving this recommendation. The one remaining hurdle is the primary FHWA federal account, which has an extremely high volume of activity.*

Anticipated Completion Date: *December 31, 2015*

*2014-016c - RIDOT will improve controls to ensure that the correct Natural account is used when posting GARVEE Gas Tax receipts.*

Anticipated Completion Date: *N/A*

Contact Person: *Robert Farley, Chief Financial Officer  
401.222.6590*

**Finding 2014-017**

*(material weakness - repeat finding)*

TRANSPORTATION INFRASTRUCTURE REPORTING

Transportation infrastructure is the most material capital asset category reported on the State's financial statements. Controls should be improved over the process used to accumulate reported transportation infrastructure amounts to ensure accurate reporting of such investments.

Process to Accumulate Infrastructure Outlays

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

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

We noted misstatements relating to the infrastructure balances initially reported for fiscal 2014. Certain completed projects totaling \$13.8 million were still included in construction in progress at June 30, 2014. Although corrected through audit adjustment, these misstatements indicate that controls should be improved to capitalize all infrastructure expenditures and more accurately identify when infrastructure assets are placed in service.

RIDOT was also not consistent in applying estimated internal design costs to overall project costs, which resulted in a potential misstatement of \$178,893. We also identified 97 projects totaling \$1.3 million excluded from RIDOT's infrastructure determination process.

#### Explore an Automated Approach to the Accumulation of Capitalized Infrastructure Outlays

The control deficiencies noted here are significantly interrelated to the issues detailed in Finding 2014-001 which describes the use of two incompatible accounting systems to prepare financial statements for the IST Fund. Due to the use of the two systems, accumulation of infrastructure outlays meeting the State's capitalization criteria is performed independent of both systems. Data is drawn from both systems into massive spreadsheets which eventually yield the amounts needed for financial reporting purposes. The design of RIDOT's FMS envisioned that system providing capital asset (infrastructure) financial reporting information; however, the use of the two systems in the current configuration leads to the inefficient and error-prone spreadsheet approach.

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

#### Asset Impairments

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

#### RECOMMENDATIONS

- |           |  |
|-----------|--|
| 2014-017a | Develop controls over the identification of project expenditures (to include construction costs, design costs, internal payroll, subtotalling of project expenditures, categorization of projects and reconciling between RIDOT FMS and RIFANS) to be recorded as infrastructure investment in the State's financial statements. |
| 2014-017b | Improve controls and the methodology for determining when infrastructure assets are placed in service.   |

- 2014-017c Explore ways that capitalized infrastructure outlays could be accumulated through an automated systems approach rather than the inefficient and error-prone spreadsheet approach currently used.
- 2014-017d Develop and document controls, policies and procedures to ensure inclusion of internal construction payroll costs in infrastructure investment in the State's financial statements.
- 2014-017e Evaluate and document the consideration of whether any of the State's transportation infrastructure has been impaired consistent with the criteria outlined in generally accepted accounting principles applicable to governmental entities.

Corrective Action / Auditee Views

*2014-017a - Financial Management will continue to improve controls over the identification of project expenditures to be recorded as infrastructure investment in the State's financial statements.*

Anticipated Completion Date: Ongoing

*2014-017b - For FY 2014, Financial Management utilized the date of substantial completion identified on RIDOT's "Substantial Completion and Request for Partial Acceptance / Final Inspection" form as the basis for determining when infrastructure assets are placed into service. This methodology has been agreed upon by both RIDOT and the Auditor General's Office.*

*RIDOT recognizes that, from time to time, traffic can already be utilizing infrastructure assets prior to the date of substantial completion identified on RIDOT's "Substantial Completion and Request for Partial Acceptance / Final Inspection" form. However, the department believes that utilizing this form provides both consistency and documentation of the date that infrastructure assets are substantially complete, as opposed to a more manually-intensive, and potentially more subjective, approach that would require tracking the date that the motoring public was first able to utilize the asset.*

*Additionally, Financial Management will ensure that expenditures related to CIP and capitalization are more accurately categorized during the preparation of infrastructure accounting entries.*

*2014-017c - The Department does not dispute the auditors' contention that a properly-aligned, automated systems approach would be a more efficient way to account for infrastructure assets. An internal RIDOT Asset Management Council meets regularly to continue implementing the department's comprehensive Asset Management initiative, including assessing information technology needs. One of the Council's standing subcommittees is charged with evaluating infrastructure accounting issues, and will evaluate an automated systems approach.*

Anticipated Completion Date: To be determined.

*2014-017d - The Department will enhance procedures to ensure inclusion of all project costs for the recording of transportation infrastructure investment in the State's financial statements.*

Anticipated Completion Date: N/A

2014-017e - This issue is currently being evaluated and has been discussed with the Department's Asset Management consultant. The resolution of this recommendation will require a high level of collaboration and coordination between Financial Management and various department units.

Anticipated Completion Date: To be determined.

Contact Person: Robert Farley, Chief Financial Officer  
401.222.6590

### ***Finding 2014-018***

*(significant deficiency - repeat finding)*

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

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

##### Progress Payment Data Files

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

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

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

##### Federal Billing

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

- ❑ The FMS does not have the capability to link multiple funding sources award numbers (FSAN) to one Federal Aid Project (FAP). The Federal Highway Administration links many FSANs to one FAP and requires RIDOT to draw down funds by the FSAN. Consequently, RIDOT after creating the drawdown file, manually splits draw requests between multiple FSANs.
- ❑ The file is in an open text format with no encryption. This open text format allows anyone who has access to the server directory to modify the file.
- ❑ There is no change management system in place tracking changes to the file, documenting who made the change, or requiring management approval of changes.

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

### RECOMMENDATIONS

- 2014-018a Review the progress payment file transfer process to identify critical points where automated controls could be implemented to eliminate the need for manual intervention.
- 2014-018b Create and implement appropriate approval hierarchies. Automatically identify RIFANS/FMS payment discrepancies for review.
- 2014-018c Improve controls over the RIDOT federal billing process to include transferring files without modification.
- 2014-018d Modify the Financial Management System to allow for multiple funding source award numbers (FSAN) to be linked to one Federal Aid Project.

#### Corrective action plan / auditee views:

*2014-018a - Discussions and analysis will continue regarding the potential implementation of automated controls in lieu of the manual intervention currently required in certain situations. Manual intervention can occur for a variety of reasons, and budgetary constraints are a limiting factor for the Department's ability to automate the process.*

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

Anticipated Completion Date: *To be determined*

Contact Person: *Loren Doyle, Administrator for Financial Management  
Phone: 401.222.6590*

*2014-018b - During the FMS system upgrade to Oracle Release 12.4, the issue of implementing Approval Hierarchies will be evaluated. Also, existing reports have been modified to determine discrepancies in invoice payment amounts between FMS and RIFANS.*

Anticipated Completion Date: *June 30, 2016*

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

*2014-018c - This issue has been discussed at length with Tom Lewandowski of DOIT and he has informed Financial Management that this cannot be accomplished with the current FMS system.*

Anticipated Completion Date: *To be determined*

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

*2014-018d - This issue has been discussed at length with Tom Lewandowski of DOIT and he has informed Financial Management that this cannot be accomplished with the current FMS system.*

*Anticipated Completion Date: To be determined*

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

2014

*Schedule of  
Findings and Responses*

*Component Units – Control  
Deficiencies and Material  
Noncompliance Reported by the  
Component Unit Auditors*



Material Weaknesses and  
Significant Deficiencies in  
Internal Control over  
Financial Reporting and  
Material Noncompliance

**Finding 2014-019***(material weakness - new finding)***METROPOLITAN REGIONAL CAREER AND TECHNICAL CENTER (THE MET) – INTERNAL CONTROLS**

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

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

- a. The monthly reconciliations of cash accounts during the 2014 fiscal year were not performed timely. Bank reconciliations of all bank accounts were provided to us after we requested them in June 2014. We became aware that certain of the reconciliations had not been reviewed prior to our receipts and as a result contained errors.
- b. The Met had difficulty in providing a detailed accounts payable schedule due to limitations in its financial management system. The detailed payable schedule as of June 30, 2014 was \$5,000 less than the balance in the general ledger.

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

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

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

**RECOMMENDATION**

2014-019      Policies and procedures should be development and implemented by the Met's management to ensure that appropriate internal controls are enforced.

**Corrective action plan / auditee views:**

- a. *The Met has implemented a process where which monthly reconciliations are performed by the Bookkeeper once bank statements for the prior month have been received. The Met will now also require that monthly reconciliations be signed off by both the Chief Accountant and Business Manager in order to insure timeliness and accuracy. Additionally, a staffing change was made in the Bookkeepers position.*
- b. *The Met is seeking to procure a new Financial Accounting and Management system and has worked in tandem with Rhode Island Department of Education and other municipal school districts to select the most appropriate and qualified vendor, through the State of Rhode Island's competitive procurement process which, can meet all required accounting standards*

and internal control requirements. It is anticipated that this new system will be fully implemented and operational during the 2016 fiscal year. Until then, The Met has created a query report within the current Financial Account and Management system, SunGard, to track accounts payable.

*Anticipated Completion Date:* Ongoing

*Contact Person:* Lucas Lussier  
401.752.2600

### **Finding 2014-020**

*(material weakness - repeat finding)*

#### CENTRAL FALLS SCHOOL DISTRICT – SEGREGATION OF DUTIES

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

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

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

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

#### RECOMMENDATION

2014-020 We recommend that the District establish a committee to review the current staffing of the finance department as well as the roles and responsibilities of all finance personnel. We further recommend that this committee be charged with developing formal policies and procedures governing the roles and responsibilities for all members of the finance department. The roles and responsibilities should focus on maintaining adequate segregation of duties and also rotation of those duties on a periodic basis so that all employees are properly cross trained. In addition, the policies should require that all bank reconciliations be reviewed and signed as approved on a monthly basis by the finance director or another management official if the reconciliations are being completed by the finance director.

#### Corrective action plan / auditee views:

*Due to continued turnover, the District has not been able to develop and implement new internal controls. The District will establish a committee to review the current staffing of the finance*

department and to review the duties of all finance staff inclusive of the Finance Director. Once this is completed, duties will be reassigned amongst the staff members as necessary to better segregate duties. More staffing changes may occur based on the internal control requirements. The committee will develop formal policies and procedures governing the roles and responsibilities for all members of the finance department. The Finance Director will complete deposits while the Staff Accountant performs bank reconciliations, the staff accountant will complete all journal entries while the Finance Director approves them, and finally, the Finance Director will sign off on all bank reconciliations.

Anticipated Completion Date: Ongoing

Contact Person: Maggie Baker, Business Director  
401.727.7700

### **Finding 2014-021**

*(material weakness - new finding)*

#### CENTRAL FALLS SCHOOL DISTRICT – JOURNAL ENTRIES

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

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

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

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

#### RECOMMENDATION

2014-021 We recommend that the District implement internal controls and policies and procedures for the posting of journal entries to the District's general ledger. We recommend the individual journal entries be approved by the Finance Director and/or another management official prior to posting and approval be documented on paper copy of entries filed in journal entry binders. We also recommend journal entries contain supporting documentation as well as affected account descriptions and purpose of entry. This will ensure a complete trail for transactions posted to the general ledger and ultimately the District's financial statements. In addition, we recommend that on a periodic basis a journal entry report be generated from the general ledger and that the report be provided to the Board of Trustees for review and approval. This approved report should be signed and maintained with the minutes to the Board meeting as evidence of the procedure being performed.

#### Corrective action plan / auditee views:

*As part of the new internal controls, the Staff Accountant will prepare all journal entries and the Finance Director will approve all journal entries. Proper backup will also be attached to all*

*journal entries for a complete audit trail. The District will review the option of providing journal entries to the Board of Trustees for review and approval.*

Anticipated Completion Date: Ongoing

Contact Person: Maggie Baker, Business Director  
401.727.7700

**Finding 2014-022**

*(significant deficiency - new finding)*

CENTRAL FALLS SCHOOL DISTRICT – COMPLETE GENERAL LEDGER

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

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

**Cause:** This was due to lack of management oversight and failure to ensure the completeness of the general ledger accounting records.

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

RECOMMENDATION

2014-022 We recommend that the District establish policies and procedures to ensure that all financial activity is properly reported in the general ledger accounting records. All periodic bank statements should be reconciled to the general ledger accounting records and signed by someone independent of the person preparing the reconciliation as evidence that the procedures were performed. Any bank or investment statement that is received by the District but which cannot be traced to the general ledger should be provided to the Superintendent of Schools for review.

Corrective action plan / auditee views:

*The District is in the process of adding all of the cash accounts to the general ledger. The District will also be developing new policies and procedures to ensure that any new District bank accounts are immediately added to the general ledger and to address steps to take when bank statements are received but do not tie back to the general ledger. As for the reconciliation process, the Staff Accountant will perform the reconciliation while the Finance Director will sign off on the reconciliation.*

Anticipated Completion Date: Ongoing

Contact Person: Maggie Baker, Business Director  
401.727.7700

**Finding 2014-023***(significant deficiency - new finding)*CENTRAL FALLS SCHOOL DISTRICT – CUT OFF PROCEDURES

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

**Condition:** During our audit we noted instances where the District did not properly report receipts and receivables as of June 30, 2014.

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

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

RECOMMENDATION

2014-023      We recommend that management review the current policies and procedures for recording the financial activity to ensure that all financial activity is recorded in a timely manner and in the proper period. Procedures should be implemented to ensure that all revenue, expenditures, and expenditure reimbursement activity is reported in the proper period.

Corrective action plan / auditee views:

*The Finance Director will develop policies and procedures for recording financial activity in the proper period. All cash receipts and disbursements subsequent to year-end will be closely reviewed by the Finance Director to ensure that all transactions are recorded in the proper accounting period.*

Anticipated Completion Date:

Ongoing

Contact Person:Maggie Baker, Business Director  
401.727.7700

**Finding 2014-024***(significant deficiency - repeat finding)*CENTRAL FALLS SCHOOL DISTRICT – CAPITAL ASSETS

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

**Condition:** The District does not currently have procedures for maintaining the capital asset records on a perpetual basis or for taking a physical inventory of these assets. In addition, the District does not have a system in place for identifying capital assets acquired with federal grant funds.

**Cause:** The District currently maintains the capital asset records utilizing an excel database which is updated on an annual basis. This database contains a complete listing of capital assets and related depreciation expense which is maintained for financial reporting purposes only. The listing currently does not include any information regarding the location of the asset or the source of the funds used to acquire the asset.

**Effect:** Failure to maintain the capital asset records on a perpetual basis increases the risk of potential misstatement of the capital assets at year end. In addition, failure to conduct a periodic inventory of capital assets, including controllable assets (assets not meeting the capitalization threshold but included in inventory due to their sensitive, portable, and/or theft prone nature) increases the risk of misuse and safeguarding of District assets.

RECOMMENDATION

2014-024      We recommend that the District implement an integrated software package that will enable capital assets to be recorded when the asset is acquired rather than being captured at year end. We further recommend that the capital asset inventory be updated to include the location of the asset and a code to identify all assets that are acquired with federal funds. Management should utilize this capital asset inventory listing, as well as the controllable asset listing, to conduct periodic inventories of the assets.

Corrective action plan / auditee views:

*The District engaged a third party to inventory all capital assets. Due to staff turnover, the data was not able to be incorporated into Infinite Visions before year-end. When this information is imported, we will use Infinite Visions exclusively for all capital asset activity in the District. All District assets will then be reviewed on a quarterly basis to account for asset additions and deletions, along with the recording of all necessary depreciation expense.*

Anticipated Completion Date:                      Ongoing

Contact Person:    Maggie Baker, Business Director  
401.727.7700

**Finding 2014-025***(material noncompliance - repeat finding)***CONVENTION CENTER AUTHORITY – MATERIAL NONCOMPLIANCE - FUNDING OF THE OPERATING RESERVE AND RENEWAL AND REPLACEMENT COMPONENTS OF ITS RESTRICTIVE COVENANTS**

During the fiscal year ended June 30, 2014, the Convention Center Authority was unable to fund the Operating Reserve and Renewal and Replacement components of its restrictive covenants pursuant to the bond indentures.

**Corrective action plan / auditee views:**

*The Authority will fund the Operating Reserve and Renewal Replacement components noted above provided there is sufficient cash flow.*

*Contact Person: James McCarvill, Executive Director  
Rhode Island Convention Center Authority  
Phone: 401.351.4295*

2014

*Schedule of  
Findings and Responses*

*Management Comments*



**Management Comment 2014-1***(new comment)*ADOPTION OF REVISED FRAMEWORK FOR COMPREHENSIVE DOCUMENTATION OF THE STATE'S INTERNAL CONTROL STRUCTURE

The State should apply the principles contained in recently issued internal control framework documents when evaluating and documenting the State's system of internal controls designed to safeguard public resources and provide accurate financial reporting.

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*. In 2013, COSO issued its revised framework, preserving an entity's responsibilities for the five components of internal control but expanding its guidance by setting 17 specific principles to be addressed for the five components, and updating the framework's discussion of the business and operating environment. In an effort to tailor this framework to the public environment, in September 2014, the federal Government Accountability Office (GAO) issued an update to its "Green Book", *Standards for Internal Control in the Federal Government*. The Green Book is required for federal agencies as a basis for establishing effective internal control systems; however, it can be useful to other governments when applying the principles contained within the COSO internal control framework.

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

The State should adopt the internal control framework prescribed in the revised Green Book, reassess its system of internal controls, and document the assessment with the aim of creating complete documentation of the State's internal control framework and related control procedures. Once established, the control structure should be communicated to ensure understanding by users of the State accounting system.

RECOMMENDATION

MC-2014-1      Apply the principles contained in recently issued internal control framework documents when evaluating and documenting the State's system of internal controls designed to safeguard public resources and provide accurate financial reporting.

Corrective action plan / auditee views:

*The Bureau of Audits has adopted the 2013 COSO revised framework within their risk based audit program. This ongoing audit program provides the State an opportunity to evaluate and document internal controls relative to the revised framework.*

Anticipated Completion Date:                      *Completed*

Contact Person:    *Dorothy Z. Pascale, Chief, Bureau of Audits  
Phone: 401.574.8170*

**Auditor’s response:**

Inclusion of the COSO principles within the State’s internal audit risk assessments and audit programs used by the State’s Bureau of Audits is appropriate. However, our comment and recommendation are directed towards using the internal control framework guidance contained in the Government Accountability Office’s “Green Book” as a basis for the State’s documentation of its internal control policies and procedures.

**Management Comment 2014-2***(new comment)***FINANCIAL STATEMENT DISCLOSURE OF SIGNIFICANT COMMITMENTS**

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

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

The Office of Accounts and Control along with the Division of Purchases must explore options to accumulate such information to better meet the State’s financial reporting needs. Additional consideration should be given to ensuring other commitments that are not evidenced by contracts are also adequately considered in the process.

**RECOMMENDATION**

MC-2014-2     Improve systems and procedures to enhance the disclosure of significant commitments within the State’s annual financial statements.

**Corrective action plan / auditee views:**

*The existing process regarding disclosure of commitments will be reviewed and enhancements made to provide greater assurance that the total dollar amount of all significant commitments is disclosed in the notes to financial statements.*

**Anticipated Completion Date:**                      August 31, 2015

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

**Management Comment 2014-3***(new comment)*DEPARTMENT OF CHILDREN, YOUTH AND FAMILIES - CHILDREN'S TRUST ACCOUNT

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

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

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

RECOMMENDATIONS

- MC-2014-3a Record the Children's Trust account cash and liability balances on the State's general ledger. Reconcile general ledger amounts to DCYF records to ensure the obligation for deposits held on behalf of children in the State's care is properly reflected in the State's accounting system.
- MC-2014-3b Transfer custody of the primary bank account used to receive the SSA funds to the Office of the General Treasurer.

Corrective action plan / auditee views:

*The Department of Children, Youth and Families (DCYF) will work with the Treasurer's Office and the Controller's Office to review the current process and make the necessary enhancements.*

Anticipated Completion Date: September 30, 2015

Contact Person: David Eaton, Acting CFO of DCYF  
Phone: 401.528.3590

**Management Comment 2014-4***(new comment)***MONITORING BILLING RATES AND OPERATIONS OF THE STATE'S INTERNAL SERVICE FUNDS**

One internal service fund (Assessed Fringe Benefits Fund) has had a negative net position for the three consecutive fiscal years. Ideally, internal service funds are intended to operate as close as possible to “break-even” - neither undercharging or overcharging the internal “customers” receiving fund services. Losses within an internal service fund signify that billing rates were inadequate to cover costs. Consequently, expenditures/expenses in other funds of the State should have actually been higher. Similarly, when rates are too high, excessive profits and net position accumulates signifying that “internal customers” have been overcharged.

Federal regulations (OMB Circular A-87) state that working capital reserve balances within internal service funds should not exceed 60 days of cash expenses for normal operating purposes. We noted two instances in which there was a working capital reserve significantly exceeding the 60-day expense reserve - the Central Warehouse and Correctional Industries funds each had working capital reserves exceeding 100 days of expenses at June 30, 2014.

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

**RECOMMENDATION**

MC-2014-4      Enhance internal service fund monitoring procedures to ensure that billing rates are appropriate to prevent significant losses or profits and to ensure compliance with federal regulations.

**Corrective action plan / auditee views:**

*The Budget Office has enhanced the monitoring process concerning billing rates and maintaining appropriate balances in the internal service funds. This includes periodic reviews throughout the year.*

**Anticipated Completion Date:**                      *Completed*

**Contact Person:**    *Elizabeth Leach, Supervising Budget Analyst*  
*Phone: 401.222.6422*

**Management Comment 2014-5***(new comment)***REVIEW ACCOUNTING PROCEDURES FOR STATE FLEET REPLACEMENT REVOLVING FUND (INTERNAL SERVICE FUND)**

The State Fleet Replacement Revolving Fund (SFRRF) – an internal service fund - was created to internally finance the acquisition of vehicles by the various departments and agencies within state government. The fund was capitalized by a transfer of \$7,350,000 from the State's General Fund in fiscal 2013.

In most instances, the department or agency acquiring the vehicle purchases it from their accounts and an expenditure credit is later processed to reimburse the expenditure from the internal service fund. This results in an unintended misstatement in the State's government-wide (full-accrual) financial statements as the fund level activity is collapsed and converted to the full-accrual accounting basis.

We also observed that the annual repayment terms (e.g., annual amount and term of repayment) for the vehicle-acquiring department or agency should be formalized through a memorandum of understanding. Responsibility for the fund's accounting procedures and records should be transferred from the Budget Office to the Central Business Office.

### RECOMMENDATIONS

MC-2014-5a Review the accounting procedures used to record the original vehicle acquisition and subsequent reimbursement from the SFRRF to eliminate the unintended misstatement within the State's government-wide financial statements.

MC-2014-5b Transfer responsibility for the SFRRF's accounting and record keeping from the Budget Office to the Central Business Office.

#### Corrective action plan / auditee views:

*MC-2014-5a - The accounting procedures for recording transactions in this fund will be reviewed and if any issues are identified that result in a material misstatement of the government-wide financial statements corrective action will be initiated.*

Anticipated Completion Date: June 30, 2015

Contact Person: Peter Keenan, Associate Controller  
Phone: 401.222.6408

*MC-2014-5b – The Budget office will determine if a transfer of responsibilities to the Central Business Office is viable from an operational perspective.*

Anticipated Completion Date: June 30, 2016

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

### **Management Comment 2014-6**

*(new comment)*

#### FINAL APPROVAL OF RIFANS JOURNAL ENTRIES

The RIFANS accounting system uses category codes to route journal entry transactions through a series of system workflows for approval of general ledger direct transactions. Departmental initiators approve transactions through agency approval hierarchies before most general ledger transactions are routed for central review by the Office of Accounts and Control for final approval and posting. While, as a matter of policy, the Office of Accounts and Control requires certain category codes be used for various purposes, there are no systemic functions restricting the individuals or departments from initiating using the category codes. Further, RIFANS does not systematically limit the accounts to which the

departmental initiator can record financial activity. The State's controls rely on the approval process to reject journal entry transactions that are not initiated properly.

During fiscal 2014, certain category codes for Lottery transfers and Electronic Benefit Transfer (TANF) funding transactions were initiated by the departmental users but were not routed for final approval by the Office of Accounts and Control. While the category code for Lottery transfers was modified prior to year-end, the fact that departmental users can initiate and approve journal entry transactions impacting other departments makes final approval by the Office of Accounts and Control a necessary control over the State's financial reporting.

#### RECOMMENDATION

MC-2014-6      Ensure that all journal entry transactions receive final approval by the Office of Accounts and Control prior to posting to RIFANS.

#### Corrective action plan / auditee views:

*As new journal entry categories are established in RIFANS, the Office of Accounts and Control carefully assesses the need for entries in that category to be subject to final review and approval by the office. In the vast majority of instance, entries are routed via the RIFANS workflow to our office for final approval.*

*The posting of Electronic Benefit Transfer/ TANF journal entries in RIFANS is very time sensitive. The work flow was intentionally created with the Chief Financial Officer of DHS as the final approver of the journal entries. No changes will be made to the existing workflow for this category of journal entry.*

Anticipated Completion Date:                      N/A

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

### **Management Comment 2014-7**

*(new comment)*

#### DEPARTMENT OF HUMAN SERVICES – VETERANS' HOME FEDERAL GRANT REIMBURSEMENTS

The RI Veterans' Home receives federal grant funds for the care and board of inpatient veterans. Amounts are received monthly in reimbursement of care provided to veterans in a previous month.

We found that the Department of Human Services (DHS) was not making timely accounting adjustments to recognize the federal revenue and reduce costs in the applicable general revenue funded accounts. We proposed an audit adjustment to recognize \$1.9 million in federal revenue at June 30, 2014. Accounting adjustments should be prepared timely to recognize federal revenue reimbursing the State for the care of veterans as the care is provided. DHS allowed funds to accumulate in the federal account and then made accounting adjustments, sometimes in a subsequent fiscal year, creating a mismatch between program revenues and related expenditures.

RECOMMENDATION

MC-2014-7 Prepare timely accounting adjustments to recognize federal revenue from the federal program reimbursing the State for the care of veterans as the care is provided.

Corrective action plan / auditee views:

*The Veterans Affairs Office will monitor federal balances more closely to be sure that expenditures are credited in the year they are incurred so there will be no additional federal carryforward funds.*

Anticipated Completion Date: June 30, 2015

Contact Person: Rick Baccus, Administrator  
Rhode Island Veterans Home  
Phone: 401.253.8000

**Management Comment 2014-8***(new comment)*BANK ACCOUNTS - AUTHORIZED SIGNATORIES

The Office of the General Treasurer can enhance procedures to ensure that authorized signatories for each bank account within the control of the General Treasurer is current and reflects active authorized personnel. We observed that two former Office of the General Treasurer employees continued to be listed as authorized signers on State deposit accounts with four banks well after their termination from State service. In addition, the Department of Health's financial management staff did not advise the Office of the General Treasurer that the Women, Infants and Children (WIC) bank account needed to be updated to remove terminated State employees listed as authorized signers on that account.

RECOMMENDATION

MC-2014-8 Maintain current lists of authorized signatories for all State bank accounts and make timely notifications and adjustments when personnel changes occur.

Corrective action plan / auditee views:

*The specific observation regarding former Treasury employees remaining as authorized signors may have been caused by the responsive financial institution providing the Auditor with an outdated signature card. The Office of the General Treasurer believes that at 06/30/2014 only duly authorized Treasury employees were signatories on State deposit accounts. In addition, it is important to note that there are substantial additional operational and technological controls in place that limit the ability of individuals to initiate transactions in state bank accounts.*

*Additionally, as of 3/20/2015 only duly authorized Treasury employees are signatories.*

*With respect to the imprest account at DOH for the WIC program, Treasury is unable to comment with respect to the access of their employees. When state agencies enter into banking relationships for imprest accounts that fall outside of Treasury's control, Treasury staff has no visibility into, or ability to manage, the named signors on these accounts.*

*Treasury does agree with the auditor that timely notifications and adjustments to account signatories are important. Treasury management will make enhancements to existing human resource practices to ensure the timely update of signatures upon a change in the employment status of Treasury employees.*

*Anticipated Completion Date: Ongoing*

*Contact Person: Patrick Marr  
Chief Operating Officer / Deputy Treasurer  
Phone: 401.462.7664*

### **Management Comment 2014-9**

*(new comment)*

#### **ESTABLISH A SEPARATE FUND AND BANK ACCOUNT FOR THE DEPARTMENT OF TRANSPORTATION'S MISSION 360 PROGRAM**

The Department of Transportation's (RIDOT) Mission 360 program provides loans to disadvantaged business enterprises using federal "seed" money. The program is administered by a vendor; however, financial activity, including program receipts and disbursements, are recorded in the State's accounting system. Accounting controls could be improved for this program by establishing a separate fund within the RIFANS accounting system and a separate bank account. This would segregate these sub-program transactions from the other significant activities of RIDOT thereby facilitating the timely reconciliation of cash and loan receivable balances with the vendor administering the program. For financial reporting purposes, the fund should continue to be reported as part of overall IST Fund activities.

#### **RECOMMENDATION**

MC-2014-9 Establish a separate fund and bank account for RIDOT's Mission 360 program to facilitate timely reconciliation of program activity thereby enhancing controls.

#### **Corrective action plan / auditee views:**

*A separate fund in RIFANS and a bank account will be established to account for activity relating to the Mission 360 program.*

*Anticipated Completion Date: June 30, 2015*

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

### **Management Comment 2014-10**

*(new comment)*

#### **NEW FEDERAL COST PRINCIPLES - ASSESS THE IMPACT ON FEDERAL REIMBURSEMENTS**

The federal government recently released new *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* which supersede federal cost principles (OMB Circular A-87), governing costs reimbursable under federal programs. The new uniform grant requirements have varying effective dates but some provisions become effective during fiscal 2015. The

State's Office of Management and Budget has commenced training for the departments and agencies regarding the new uniform grant requirements; however, a comprehensive review should be performed to determine if there are areas across multiple federal programs where changes in the cost principles would either restrict or expand costs currently reimbursed under federal programs.

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

#### RECOMMENDATION

MC-2014-10 Perform a comprehensive analysis to assess the impact of new federal uniform administrative requirements for federal awards.

#### Corrective action plan / auditee views:

*OMB's Grants Management Office (Office) is actively monitoring the impacts of the new Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards. Office staff participated in training sessions sponsored by the Council of Financial Assistance Reform, the National Grants Management Association, and Thompson Information Services. In these sessions, federal representatives characterized the changes to the cost principles (Section 200.4XX) as minimal.*

*The Office has organized a training series on the new Uniform Grant Guidance for state agencies including training on the cost principles. The training series will continue through the end of December 2015. The Office also is available to respond to questions from state agencies as needed.*

*The Office will continue to monitor implementation of the Guidance at the federal and state level, and will work with the state agencies to ensure that they are familiar with all provisions of the new Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards.*

Anticipated Completion Date: Ongoing

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

### **Management Comment 2014-11**

*(new comment)*

#### ACCOUNTING FOR FEDERAL DISASTER DECLARATION AID RECOVERIES

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

Recent official statements used to market the sale of the State's bonds included disclosure of the total amount reimbursable by the federal government for each disaster declaration. Upon inquiry, we found that information was not readily available to assess the amounts that were state and municipal

costs, amounts reimbursed to date and amounts still due from the federal government. Further, we observed that the accounting for such funds could be enhanced to allow for a better matching of expenditures and revenue. Due to the extended timeline for reimbursement, costs are often incurred in one period and the reimbursement is received in another period – sometimes years later. Typically, expenditure credits are processed in the agency, which had incurred clean-up costs, when the federal disaster recovery funding is actually received. This results in a misstatement of current year activity due to reimbursement of costs incurred previously reflected as expenditure reductions in the current period.

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

Information should be accumulated and reviewed by the Office of Accounts and Control in the preparation of the State’s financial statements to ensure federal disaster recoveries are appropriately and consistently reflected in the financial statements.

### RECOMMENDATION

MC-2014-11 Accumulate and review financial data relative to the status of federal disaster declarations for the purpose of preparing the State’s annual financial statements and to ensure appropriate and consistent accounting treatment of such recoveries.

#### Corrective action plan / auditee views:

*The Controller’s Office will work with the Emergency Management Agency to compile data related to amounts potentially receivable by the State related to federal disaster declarations and assess the need to record such amounts in the State’s financial statements.*

Anticipated Completion Date: June 30, 2015

Contact Person: Peter Keenan, Associate Controller  
Phone: 401.222.6408

## **Management Comment 2014-12**

*(repeat comment)*

### ACCOUNTING CONTROLS OVER CAPITAL PROJECTS

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

RECOMMENDATION

MC-2014-12 Implement an automated application to facilitate the accumulation and management of project costs for both financial reporting and project management purposes.

Corrective action plan / auditee views:

*The State currently utilizes an automated system of Excel spreadsheets to accumulate costs related to capital projects that meet the threshold for capitalization in the financial statements. Over the past several years significant time and effort has been expended to formalize and enhance the process for tracking capital projects and significant improvements in accuracy have resulted.*

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

Anticipated Completion Date: N/A

Contact Person: Peter Keenan, Associate Controller  
Phone: 401.222.6408

**Management Comment 2014-13***(repeat comment)*DEPARTMENT OF REVENUE – QUALITY CONTROL REVIEW OF DATA USED TO CALCULATE SIGNIFICANT ESTIMATES

The Office of Accounts and Control utilizes various Division of Taxation (Taxation) generated information to estimate financial statement revenue accruals including revenue refunds. Certain files and reports that were requested from Taxation, (which were not complete when provided), were used by the State to calculate the 2014 business corporation tax refunds payable amounts. Three audit adjustments were booked to correct the erroneous amounts recorded on the financial statements totaling approximately \$1.0 million.

Due to the incompleteness of the data included within the files, the estimates used in the preparation of the State's financial statements at June 30, 2014 were incorrect. Enhanced quality control procedures over the data supporting estimates used in preparing the financial statements should be employed. These should include verification of completeness of the data files extracted from Taxation's systems and independent files maintained by Taxation's accounting staff.

RECOMMENDATION

MC-2014-13 Enhance quality control procedures over data used to develop tax refund accrual estimates by verifying the completeness of all Taxation refund data received and used as part of the revenue taxes accrual calculations.

Corrective action plan / auditee views:

*As part of the Fiscal Year 2013 budget request, the Division of Taxation received funding for an integrated tax system. This system will, among other things, overhaul the front end data entry systems, accounting and processing systems. These improvements will streamline the Division's*

*data entry and return entry systems therefore improving the timeliness and accuracy of entering returns, corrections and adjustments to taxpayer accounts. The system will also allow for real time posting of payments and transactions to taxpayer accounts ensuring that taxpayer's accounts are updated, not only at fiscal year-end, but all throughout the year. The release 1 implementation in July 2014 has; i) established better controls for non-mainframe tax types, ii) provided enhanced controls over non-mainframe taxes and iii) eliminated the need to enter the deposit in multiple databases. The Division is also implementing transitional processes to enhance controls; however, all issues will be resolved when the integrated tax system is fully implemented in September 2016.*

*Anticipated Completion Date: Release 1 completed July 2014  
(fully implemented Sept 2016)*

*Contact Person: David Sullivan, Tax Administrator  
Phone: 401.574.8922*

**Management Comment 2014-14**

*(repeat comment)*

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

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

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

**RECOMMENDATION**

MC-2014-14 Develop and adopt a policy regarding the timing and recognition of refund liabilities for entities granted sales tax exemptions by the Rhode Island Commerce Corporation.

**Corrective action plan / auditee views:**

*The Division of Taxation and Office of Accounts and Control established a policy to timely recognize refunds liabilities relating to entities receiving sales tax exemption under RIGL §42-64-10. The Division of Taxation report the refunds issued and in process twice a year at the Revenue Estimating Conference and reported to the Office of Accounts and Control at year end.*

Anticipated Completion Date: N/A

Contact Person: David Sullivan, Tax Administrator  
Phone: 401.574.8922

**Management Comment 2014-15***(repeat comment)*ACCOUNTING FOR INDIRECT COSTS

General Law § 35-4-23.1 Indirect cost recoveries by state agencies encourages recovery of indirect costs from federal programs and provides that such amounts be recorded as restricted revenue for use within each department or agency subject to budget process approval. While part of the intent of the General Law was to “incentivize” departments to recover indirect costs wherever possible, the actual accounting process outlined in statute conflicts with appropriate financial reporting practices because it duplicates certain revenues and expenditures. Further, accounting for indirect costs is not uniform among the departments and agencies.

Many federal grants allow reimbursement of both direct and indirect costs. Typically, these include the pro rata share of agency administrative costs, which are allocated by (1) an approved indirect cost rate applied as a percentage of direct costs or (2) a departmental cost allocation plan. For accounting purposes, these costs need to be included in the total expenditures charged to and reimbursed by a federal grant. Since the indirect costs remain where originally incurred and are added to the costs reimbursable under the federal grant, there is a duplication of expenditures. Similarly, federal revenue is recognized when received as reimbursement of indirect costs and restricted revenue is recorded in essence to offset the effect of the duplicated expenditures. However, there is only one external revenue source – federal grant revenue. The “restricted revenue” is not an external resource but a cost allocation convention.

Instead, we recommend an indirect cost recovery expenditure credit account be established for each agency to reflect the amount of indirect costs recovered through federal programs. This would yield the same budgetary effect but without the financial misstatement of duplicating both revenues and expenditures. A department’s actual expenditures would accurately reflect the appropriate funding source.

As a result of prior recommendations, the Office of Accounts and Control assessed departmental methods for calculating and accounting for indirect costs which resulted in discovering accounting errors at two departments that understated federal revenues and expenditures. Federal revenues and expenditures were adjusted to align with federal reports.

The State needs to reexamine its approach to accounting for indirect costs charged to federal programs which may include recommending modification of General Law § 35-4-23.1. Additionally, accounting policies regarding indirect cost recovery should be communicated to the departments and agencies and monitored for consistent application and compliance.

RECOMMENDATIONS

- MC-2014-15a Reassess the State’s accounting procedures for indirect costs, including recommendations for amendment of the existing statutory provision.
- MC-2014-15b Develop and communicate accounting policies regarding indirect cost recovery and monitor for consistent application and compliance.

Corrective action plan / auditee views:

*Pursuant to Rhode Island General Law (RIGL) a restricted receipt account has been established for each affected agency to track indirect cost revenues recovered from Federal programs as well as the related expenses. The legislation was enacted to encourage agencies to maximize Federal reimbursement for indirect costs and enhance transparency over the amount of such funds actually recovered. Given this framework, during the past year the Office of Accounts & Control did an exhaustive review of how the present process is actually used by the affected agencies. During this review some non-substantive procedural inconsistencies were noted and corrective actions implemented.*

*It is management's opinion, that the financial misstatement referred to in the management comment is immaterial and in light of the provisions set forth in RIGL, the accounting office is following the appropriate policies.*

Anticipated Completion Date: N/A

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

**Management Comment 2014-16***(new comment)*IMPROVEMENTS TO THE FORMATS OF BUDGET AND ACTUAL COMPARISON SCHEDULES AND LEGISLATIVELY ENACTED BUDGETS

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

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

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

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

In addition, the while the format of the General Fund identifies variances, there is no explanation provided regarding significant variances between budgeted expenditures and actual disbursements. The

State should considered enhancing the usefulness of the report by providing additional explanations, when available, for significant variances from legally enacted amounts.

#### Intermodal Surface Transportation Fund

The State's annual budget appropriates certain Department of Transportation (RIDOT) expenditures, accounted for in the financial statements in the Intermodal Surface Transportation (IST) Fund. We observed that in some instances, the detail appropriation lines are so highly summarized (e.g. infrastructure engineering) that it precludes effective analysis of the budget compared to actual results. Additionally, the activities within RIDOT are now accounted for within three separate special revenue funds, which for financial reporting purposes, are now aggregated into the IST Fund. A budget is enacted by the General Assembly for activity recorded in only one of the three funds.

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

#### Lottery Division

The State includes estimated operational expenses for the RI Lottery in its annual appropriated budget. However, the amounts included in the budget are not inclusive of all expenses reported in the Lottery's financial statements. Specifically, the budget does not include estimated prize awards or required transfers to the General Fund. The Lottery is required by General Laws to transfer net proceeds of the Lottery games to the General Fund for funding of State operations. While the State projects estimated revenues to the General Fund as part of the Revenue Estimating Conference, net transfers are not included in the Lottery Division's budget. As such, the budgeted appropriations do not reflect the actual expenditures of the RI Lottery. In fiscal 2014, expenditures paid for prize awards, net of prize recoveries, totaled almost \$146 million and transfers to the General Fund totaled more than \$376 million.

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

#### Comprehensive, Multi-Fund Budgeting

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

#### RECOMMENDATIONS

- MC-2014-16a    Modify the current format of the detailed General Fund budget and actual comparison schedule to facilitate identification of relevant data at a departmental and unit level.

- MC-2014-16b    Reevaluate the presentation of the budget plan for the Department of Transportation and the related funds used to account for its activities. Consider changes in the level of detail and the inclusion of other items to facilitate comparison to actual results.
- MC-2014-16c    Consider modifying the level of detail included in the budget plan for the RI Lottery Division to include estimates for all expected expenses.
- MC-2014-16d    Explore the possibility of including fund information within the budget document to facilitate recording the budget in the accounting system and preparing budget to actual comparisons.

Corrective action plan / auditee views:

*The Budget Office will explore the feasibility of implementing the recommended changes to the budget format and presentation.*

Anticipated Completion Date:                      *June 30, 2016*

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

**Management Comment 2014-17**

*(repeat comment)*

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

The federal Affordable Care Act imposes an excise tax on high-cost health plans beginning in 2018. The excise tax, commonly referred to as the “Cadillac tax” is 40% on the cost of coverage for health plans that exceed an annual limit. The tax is paid by insurers or by employers when they are self-insured such as the State of Rhode Island.

While the excise tax is not effective until 2018, the State’s actuary, in performing the actuarial valuation of the State’s retiree health plans at June 30, 2013, calculated that the State would be subject to the 40% excise tax beginning in 2018 and included that cost in the development of the actuarial accrued liability for the retiree health plans.

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

RECOMMENDATION

- MC-2014-17    Explore options to determine if the excise or so called “Cadillac tax” on high-cost health plans could be avoided through changes in plan design for the State’s retiree health care plans.

Corrective action plan / auditee views:

*The State will be utilizing the service of its benefit consultant, Aon-Hewitt, to identify options and develop plan design changes for the State's retiree health plan(s) to enable the State to avoid the excise tax.*

*Anticipated Completion Date: December 31, 2015*

*Contact Person: Deborah Dawson, Director of Human Services  
Phone: 401.222.3454*

**Management Comment 2014-18***(repeat comment)***ASSESSMENT ON CONSULTANT PAYMENTS FOR TRANSFER TO THE RETIREMENT SYSTEM**

The State designed procedures to administer the requirements of RI General Law 42-149-3.1, which levies an assessment on State departments and agencies equal to 5.5% of the cost of services provided by nongovernmental persons or entities which are “substantially similar to and in-lieu-of services heretofore provided, in whole or in part, by regular employees” of the department or agency. The assessment is then paid to the retirement system on a quarterly basis. For fiscal 2014, \$414,958 was transferred to the Employee’s Retirement System pursuant to this General Law provision.

As written, the services subject to the assessment are open to interpretation since determining which services are substantially similar or in-lieu-of those provided by State employees is challenging. The State applied a narrow interpretation of the law – focusing only on certain master price agreements (MPAs) that clearly provide temporary services to departments and agencies with job vacancies. In many instances, these MPAs provide temporary services as long-term arrangements, when the State is unable to fill the position with qualified candidates.

In addition, the State opted to exclude consultant charges to federal expenditure accounts, to avoid noncompliance with federal cost principles since the assessment would not be considered eligible for federal reimbursement. However, there is no specific provision in the enacted legislation that allows the exclusion of contract services on other MPAs and purchase orders, nor is there a provision allowing the exclusion of charges to federal accounts.

Further legislative clarification of the services subject to the assessment would ensure that the intent of the law is being met. The State engages many contractors and delineating which of those services could be performed by state employees is subjective. Additionally, this is an administratively complex process to effect a relatively modest supplemental contribution to the Employees’ Retirement System. Actuarially required employer contributions by the State to the plans within the Employees’ Retirement System totaled approximately \$234 million for fiscal 2014. If the goal is simply to provide supplemental funding to the pension system, there are more administratively direct means to accomplish the same result.

**RECOMMENDATION**

MC-2014-18 Seek amendment of the RI General Law 42-149-3.1 to clarify the services subject to the assessment thereby facilitating compliance with the law.

Corrective action plan / auditee views:

*Management agrees that this law is subject to interpretation and requires a labor intensive, administratively complex process to comply. As a result, the possibility of an amendment will be explored and proposed if deemed achievable.*

Anticipated Completion Date: June 30, 2015

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

**Management Comment 2014-19***(repeat comment)*UNRECEIPTED FEDERAL FUNDS

At June 30, 2014, approximately \$2.6 million of federal grant receipts deposited in the State's bank accounts remained unidentified for accounting purposes. In general, this results from departments or agencies drawing federal funds, which are wired to the State's bank accounts, but failing to prepare required receipt accounting documentation. While the balance decreased by more than \$1.3 million in the last two fiscal years, the remaining unreceipted federal funds represent a significant number of receipts that were not recognized by departments responsible for administering federal programs.

The Office of the General Treasurer maintains a log of all unrecorded deposits and periodically requests State departments and agencies to review the listing in an effort to identify the appropriate federal program and properly record federal revenues. While the aggregate effect of the unidentified receipts was appropriately reflected on the State's financial statements, specific federal program balances are potentially misstated which impacts federal reporting and federal cash management requirements. Efforts to identify the origin and destination of the funds received have been enhanced to ensure timely recognition of federal revenues. Although the increased efforts has improved the balance in the current year, continued research of prior years' balances is required to resolve the remaining amounts. As more fully explained in Management Comment 2014-22, unidentified federal program receipts could be eliminated if the draw of federal funds was automated and centralized.

RECOMMENDATIONS

- MC-2014-19a Continue to enhance current procedures to resolve unrecorded deposits in a timely manner with the responsible State agencies.
- MC-2014-19b Improve coordination of the drawdown of federal funds by departments with the corresponding bank deposit and required receipt accounting transactions.
- MC-2014-19c Resolve unclaimed federal receipts from prior years by insuring the State agencies create required receipt documents.

Corrective action plan / auditee views:

*As of March 13, 2015, the balance of unidentified federal grant receipts has been reduced to \$1million.*

*As a matter of course, Treasury personnel expend substantial effort to identify unreceipted deposits and notify the state agencies responsible for administration and recognition of the funds. This effort includes agency outreach, phone calls to bank wire desks to elicit additional reference information, and, at times, calls to the transmitting federal entity.*

*Treasury is expending maximal effort to identify these deposits and believes that further progress will require process improvements within the agencies who receive federal disbursements. Management encourages the Auditor to recommend enhanced procedures to agency financial managers responsible for receipting federal deposits. In addition, the Auditor might consider recommending more stringent budgetary constraints (such as lowering red-balance limits), which may create incentives for agencies to properly record receipts for their deposits.*

*Anticipated Completion Date: Ongoing*

*Contact Person: Patrick Marr  
Chief Operating Officer / Deputy Treasurer  
Phone: 401.462.7664*

### **Management Comment 2014-20**

*(repeat comment)*

#### CHILD SUPPORT COLLECTIONS – RESOLUTION OF UNIDENTIFIED COLLECTIONS

Child support collections and distributions are processed through a separate computer system maintained by the Department of Human Services (DHS). Summary level data is also included in an escrow liability account within the State's General Fund. A long-standing unreconciled variance between the two systems has existed for what has traditionally been regarded as undistributed collections not identifiable to specific child support cases. As of June 30, 2014, this accumulated balance totaled \$402,620. While the variance has been, to a certain degree, consistent, fluctuations occurring during the last two fiscal years indicate that certain elements of current activity are not recorded consistently between the two systems

In response to prior year recommendations, in fiscal 2013 the State performed a review of certain receipt activity in the Child Support Collections escrow liability account. In response to this review, DHS has initiated changes to better record account activity in RIFANS although the balances between both accounts remain unreconciled. Continuing to review the activity in the account should aid in determining the cause of the inconsistencies. The State should continue to pursue measures to ensure that activity in the escrow liability account is reserved for child support collections and distributions, and that activity relative to the administration of the Child Support Enforcement program is recorded properly within the State accounting system. A permanent resolution to this long-standing variance should be obtained.

#### RECOMMENDATION

MC-2014-20 Resolve the balance of unidentified child support collections reported at year-end.

#### Corrective action plan / auditee views:

*As mentioned in the text of the finding, the Office of Child Support Services has taken significant steps to implement this recommendation and improve the recording of account activity. As a result of these steps, the variance has been reduced and the balance is being monitored.*

*Anticipated Completion Date:* Ongoing

*Contact Person:* Sharon Santilli, Associate Director  
Department of Human Services  
Phone: 401.458.4404

**Management Comment 2014-21***(repeat comment)***SUBRECIPIENT MONITORING – CENTRALIZED REVIEW OF SINGLE AUDIT REPORTS**

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

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

- ❑ Many subrecipients receive funding from multiple departments of the State – each is required to receive and review the same audit report.
- ❑ Specific agencies reviewing the audit reports do not consider noted deficiencies from the perspective of the risks that they pose to all state and federal funds passed through to the subrecipient. One large subrecipient of the State, which receives significant funding from multiple departments and agencies, has been very late in presenting its audit reports and those audit reports have highlighted serious deficiencies.
- ❑ There is no centralized database detailing which entities receive funding from the State, which are required to have a Single Audit performed, and the status of the audits.
- ❑ Effective subrecipient monitoring requires that individuals reviewing the audit reports be trained in governmental accounting and auditing requirements (specifically the Single Audit Act and OMB Circular A-133). This level of proficiency is difficult to achieve and maintain at all the departments and agencies now required to review subrecipient audits.

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

RECOMMENDATIONS

MC-2014-21a Centralize subrecipient monitoring procedures related to receipt and review of Single Audit Reports within one agency. This function should be staffed with individuals trained in governmental accounting and auditing matters to allow effective review of the Single Audit Reports.

MC-2014-21b Build a database of all subrecipient entities that receive state and/or federal grant funding.

Corrective action plan / auditee views:

2014-21a - OMB's Grants Management Office (Office) disagrees with the recommendation.

OMB Circular A-133 defines the responsibilities of pass through entities as it relates to sub-recipient monitoring. The Office believes it is appropriate for state agencies (pass through entities) to continue to be responsible for sub-recipient monitoring including the collection and review of the sub-recipient's single audit. State agencies, as the direct recipients of awards, are accountable for their programs and services.

In SFY2015, the Office organized a training series on the new Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (aka the Uniform Grant Guidance). Two recent sessions addressed sub-recipient monitoring and audit requirements. The training series will continue through the end of December 2015. In addition to the training sessions, the Office routinely responds to questions from state agencies regarding the circulars, the new Uniform Grant Guidance, and federal award requirements.

The Office will continue to develop and provide training, technical assistance, and resources to agencies on managing federal awards including sub-recipient monitoring. In the coming year, training will be provided on review of single audit reports and the Federal Audit Clearinghouse.

Anticipated Completion Date: N/A

2014-21b - In the last legislative session, the General Assembly approved the allocation of a share of anticipated receipts from a debt refinancing to the Information Technology Investment Fund to provide resources to support IT projects. The Governor's 2016 Budget proposes \$3.0 million the Information Technology Investment Fund. Given the level of funding, IT projects will have to be prioritized. Other resources in future years should allow additional projects to be completed, but over a longer time frame than originally anticipated.

The Office of Management and Budget will explore alternative methods for collecting this data until the grants management module is available.

Anticipated Completion Date: Plan for alternative system to build a sub-recipient database will be completed by July1, 2015.  
Training will be ongoing.

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

**Auditor’s response:**

We believe there are significant efficiencies to be obtained by centralizing the receipt and review of subrecipient audit reports. During fiscal 2014, two large departments, which pass-through a significant amount of federal funds, did not perform required subrecipient audit report reviews. A statewide, rather than department specific, perspective on aggregate federal funding passed through to any one subrecipient would allow the State to more effectively assess whether a Single Audit report was required for a subrecipient. As we envision, departments would still receive any finding(s) applicable to programs administered by their agency and issue federally required management decisions.

**Management Comment 2014-22***(repeat comment)***DRAWDOWN OF FEDERAL FUNDS**

Each agency administering a federal program is responsible for drawing federal funds for that program. Federal regulations govern the timing of these draws of federal cash – the federal government generally prohibits drawing cash before expenditures are actually made.

Federal grant revenue for the State approximated \$2.7 billion this year. Consequently, the timing of receipt of these funds has a significant impact on the State’s overall cash management. We have reported for many years that the State should enhance controls to ensure compliance with federal cash management requirements. In many instances, agencies do not draw federal cash as frequently as permitted by federal regulations thereby adversely impacting the State’s overall cash management.

We believe responsibility for the drawing of federal funds should be vested in the Office of the General Treasurer where cash management for federal programs could be integrated with other cash management objectives. The function of drawing federal cash should be automated as part of a comprehensive integrated accounting system. As allowable expenditures are recorded for federal programs in the State’s accounting system, cash would be drawn by electronic funds transfer into the State’s bank accounts.

**RECOMMENDATION**

MC-2014-22 Vest responsibility for drawing federal funds with the Office of the General Treasurer. Automate the drawing of federal funds as part of the implementation of a comprehensive integrated accounting system.

**Corrective action plan / auditee views:**

*Management agrees that the automation of the drawdown federal funds would be an excellent outcome of having a comprehensive integrated accounting system. However, moving responsibility for executing funds draw-down to Treasury would not be practicable for many federal grants. The financial management requirements/covenants of many federal grants require public program and grant-specific expertise in order to complete draw down transactions. This expertise is vested in the program and financial managers within the grantee agencies.*

**Anticipated Completion Date:**

N/A

Contact Person:

Patrick Marr  
Chief Operating Officer / Deputy Treasurer  
Phone: 401.462.7664

**Management Comment 2014-23**

(repeat comment)

IMPROVE CASH RECONCILIATION EFFICIENCY

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

Automated bank reconciliation functionality and related technology could be obtained through implementation of additional RIFANS (Oracle accounting system) modules.

RECOMMENDATION

MC-2014-23 Increase automation of the bank reconciliation process by exploring enhanced electronic transaction matching. Investigate the technology and functionalities provided by modules available within the RIFANS (Oracle) accounting system.

Corrective action plan / auditee views:

*The Treasurer's office has actively pursued automated account reconciliation for a number of years. An initial effort to determine how much benefit the department would receive for its largest account, the General Fund, yielded a match rate of less than 50%. In light of the poor automation rate and the high costs / lack of application support associated with implementing the Oracle modules, Treasury is pursuing other avenues. The office is presently implementing a low-cost, COTS (Commercial, Off-the-Shelf) Treasury workstation. This workstation product also has an automated reconciliation module that may prove cost-effective and help improve business processes.*

Anticipated Completion Date:

Ongoing

Contact Person:

Patrick Marr  
Chief Operating Officer / Deputy Treasurer  
Phone: 401.462.7664

**Management Comment 2014-24**

(repeat comment)

RIDOT – UNDOCUMENTED POLICIES AND PROCEDURES

RIDOT has not formally documented many policies and procedures that DoIT security policies require. Although unwritten, many RIDOT policies and procedures are understood by both management and personnel. However, unwritten policies and procedures increase the risk of misunderstandings and

tend to lead to inconsistencies in management enforcement of systems and security policy and procedures.

In 2006, DoIT finalized a comprehensive systems security plan detailing policies and procedures that provide the framework for managerial, operational, and technical guidance to agency management in order to safeguard the State’s data and mission critical systems. Among these are requirements that agency management formally document agency policies and procedures in order to define lines of authority, primary points of contact, range of responsibilities, requirements, procedures and management processes.

The following is a partial listing of areas where RIDOT has not documented policies consistent with DoIT requirements:

- System configuration policy and procedures
- Periodic review of baseline system configurations
- Periodic review of its system security plan
- Incident response or incident response training policy and procedure
- System and information audit and accountability policy and procedure
- Periodic review of security assessment and authorization
- Security alerts, advisories, and directives, and threats such as viruses, trojans, worms, spam -
- Risk assessment process

Formally documenting policies and procedures will enable RIDOT management to provide an effective systems security program.

#### RECOMMENDATION

MC-2014-24 Document agency policies and procedures to provide all RIDOT personnel with approved managerial, operational, and technical guidance and ensure compliance with DoIT published security policies.

#### Corrective action plan / auditee views:

*The Department will require RIDOT’s DoIT IT Manager and DoIT Technical Support Manager to work with the DoIT Office of the Chief Information Security Officer to ensure compliance with DoIT published security policies.*

Anticipated Completion Date: December 31, 2015

Contact Person: Thomas Lewandowski, Agency IT Manager  
401.222.6935

### **Management Comment 2014-25**

*(repeat comment)*

#### STATEWIDE CENTRALIZED COST ALLOCATIONS

The State discontinued use of certain internal service funds during fiscal 2007 and began budgeting and distributing costs for human resources, facilities and maintenance, and information technology services through centralized procedures within the Department of Administration (DOA). In order to obtain federal reimbursement for costs allocable to federal programs, the State created “mirror”

accounts (within DOA and other departments) for purposes of distributing the federal share of centralized costs to the other departments. Expenditures reported in federal accounts and linked to federal programs were expected to be claimed and drawn down by departments with the federal revenue being moved to reimburse DOA for costs allocable and recoverable from federal programs.

This new allocation method has resulted in a process that is inherently complex and not fully understood by many of the State’s departmental financial managers. The process also increased the risk that federal revenue and expenditures could be overstated.

Using internal service funds to distribute centralized shared costs to programs and activities is simpler, far less prone to error and subject to enhanced control and monitoring procedures. The State should reconsider the use of the “mirror” account allocation methodology in light of the unnecessary complexity it adds to the accounting system and related procedures.

### RECOMMENDATION

MC-2014-25    Reevaluate the current centralized cost allocation process for personnel, facilities and maintenance, and information technology services to ensure that these cost allocations comply with financial reporting and federal program requirements.

#### Corrective action plan / auditee views:

*The Central Business Office agrees with the recommendation to reevaluate the current cost allocation process. While the State has received approvals for each of the cost allocation methods developed for Human Resources, Information Technologies, and Facilities Management the accounting of these costs don’t provide departments with an effective reconciliatory process of Federal Expenditures. Maintaining a hybrid rotary billing system utilizing “mirror accounts” puts greater pressure on the department’s financial units to review financial data in two departments to reconcile their federal programs. The Department of Administration contends that the lack of transparency regarding what the departments are being billed for has been addressed with the use of a contractor to independently calculate each unit’s billable rates in accordance with federal guidelines. Therefore, the current cost allocation process will be reviewed and if all stakeholders agree, the process will be changed.*

Anticipated Completion Date:                      June 30, 2016

Contact Person:    Bernard Lane, Associate Director  
Financial Management  
Phone: 401.222.6603

## **Management Comment 2014-26**

*(repeat comment)*

### SURPLUS FURNITURE AND EQUIPMENT

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

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

#### RECOMMENDATION

MC-2014-26 Implement a statewide network or database of “surplused” furniture and equipment assets to facilitate notification and use by other state or local entities.

#### Corrective action plan / auditee views:

*The Department of Facilities Management agrees with the recommendation and will implement upon identification of proper staff to implement.*

Anticipated Completion Date: June 30, 2016

Contact Person: Marco Schiappa, Facilities Management  
Phone: 401.222.6200

#### **Management Comment 2014-27**

*(repeat comment)*

#### DEPARTMENT OF REVENUE - CONTROLS OVER TAX REVENUE RESULTING FROM DATA WAREHOUSE BILLINGS

The Division of Taxation (Taxation) utilizes a data warehouse to (1) collect data from Taxation systems and external sources for data analysis purposes, and (2) attempt to identify taxes potentially owed to the State of Rhode Island. During fiscal 2014, Taxation continued to use the enhanced analytical capabilities of the data warehouse to identify taxpayers that should have filed tax returns or potentially underreported and underpaid taxes to the State. Further, use of the data warehouse will increase with the Division’s migration to its new STAARS system.

“Notices” are generated from the data warehouse, which operates independently of the various mainframe tax systems. A 60-day threshold has been established before the notice results in recognition of a tax receivable balance within the mainframe tax systems. During this time, the data can be modified or adjusted if the taxpayer provides information indicating that the notice is in error or the balance potentially owed is less. However, these changes are not subject to the same control procedures that would apply to other adjustments or entries recorded in the mainframe systems.

New transaction codes detailing the original data warehouse notice total, tax amount, interest, and penalties were added to the mainframe to identify tax balances that resulted from analysis within the data warehouse. However, there are no codes that identify corrections or adjustments made to data warehouse notices. Consequently, correction or adjustment to tax amounts originating from the data warehouse cannot be readily identified within Taxation’s systems. Being able to segregate these amounts is necessary due to the inherently different collection characteristics of these notices versus known tax balances due. An allowance for uncollectible amounts, reflective of the unique characteristics of the data warehouse tax billings, should be developed and used for financial reporting purposes.

Further, Taxation should eliminate the 60-day waiting period before recognizing the tax assessments within the mainframe systems.

### RECOMMENDATIONS

- MC-2014-27a Identify corrected and adjusted tax amounts for transactions emanating from the data warehouse within the mainframe systems with unique codes to allow separate identification for analysis and collection purposes.
- MC-2014-27b Establish an allowance for uncollectible taxes receivable, which reflects the unique collection characteristics of the data warehouse notices/billings.
- MC-2014-27c Recognize all data warehouse generated receivables within Taxation's systems at the time of the notice creation, i.e. eliminate the 60-day waiting period.

#### Corrective action plan / auditee views:

*MC-2014-27a - Assessments created in the Data Warehouse which are transferred to the mainframe are coded with a special indicator. Any correction or adjustment made to these assessments can be separately identified and reported.*

Anticipated Completion Date: N/A

*MC-2013-27b - The Division of Taxation will continue to work with the Office of Accounts and Control to establish and modify the allowance for uncollectible tax receivables relating to assessments originating from the Data Warehouse. The Division of Taxation recently developed detail reports outlining the history of receivables and collections from the data warehouse notices.*

Anticipated Completion Date: June 2015

*MC-2013-27c - Any assessment created in the Data Warehouse is transferred to the Mainframe System within 48 hours. The assessments are held for 60-days to avoid duplicate billings and to afford the taxpayer their statutory 30-day right appeal the assessment. The Division of Taxation has reexamined the 60-day waiting period and feels it is important to maintain this waiting period.*

Anticipated Completion Date: N/A

Contact Person: David Sullivan, Tax Administrator  
Phone: 401.574.8922

### **Management Comment 2014-28**

*(repeat comment)*

### DEPARTMENT OF REVENUE – CONTROLS OVER THE RECORDING OF TAXES RECEIVABLE CORRECTION ADJUSTMENTS

The Division of Taxation (Taxation) should strengthen controls over Accounts Receivable Correction (ARC) transactions posted to its mainframe systems. Controls are not in place to ensure that the total of ARC transactions posted to each mainframe tax system matches the amount approved for data

entry. The lack of data entry “batch” controls could result in an ARC transaction being incorrectly posted to the mainframe system and not being detected.

### RECOMMENDATION

MC-2014-28 Improve data entry controls over ARC transactions.

#### Corrective action plan / auditee views:

*As part of the Fiscal Year 2013 budget request, the Division of Taxation received funding for an integrated tax system. This system will, among other things, overhaul the front end data entry systems, accounting and processing systems. These improvements will streamline the Division’s data entry and return entry systems therefore improving the timeliness and accuracy of entering returns, corrections and adjustments to taxpayer accounts. The system will also allow for real time posting of payments and transactions to taxpayer accounts ensuring that taxpayer’s accounts are updated, not only at fiscal year-end, but all throughout the year. The Division has also implemented training sessions to improve the accuracy of posting transactions entered into the mainframe system.*

Anticipated Completion Date: Release 1 implemented July 2014 (fully implemented September 2016)

Contact Person: David Sullivan, Tax Administrator  
Phone: 401.574.8922

### **Other Management Comments**

**Our audits of the Rhode Island Lottery and the Employees’ Retirement System for fiscal 2014 (which are included within the State’s financial statements) also included management comments, which are not repeated in this document. Those reports are available on our website [oag.ri.gov](http://oag.ri.gov).**

**Auditors of the component units may have also communicated management comments, in addition to the material weaknesses or significant deficiencies in internal controls, which are included herein.**