State of Rhode Island
and Providence Plantations

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*

Schedule of Findings and Responses

JUNE 30, 2010 AUDIT

Dennis E. Hoyle, CPA
Acting Auditor General

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

DENNIS E. HOYLE, CPA
ACTING AUDITOR GENERAL
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STATE of RHODE ISLAND and PROVIDENCE PLANTATIONS

GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

- *INTEGRITY*
- *RELIABILITY*
- *INDEPENDENCE*
- *ACCOUNTABILITY*

March 9, 2011

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, 2010 and have issued our report thereon dated December 30, 2010. We issued our Independent Auditor's report on the State's basic financial statements as part of the State's Comprehensive Annual Financial Report.

In conjunction with our audit of the State's financial statements, we have also prepared a report, dated December 30, 2010 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 *Government Auditing Standards*. Our report includes 37 findings that we believe meet the criteria to be considered material weaknesses and/or significant deficiencies in internal control over financial reporting and one finding deemed to be non-compliance with certain provisions of laws, regulations, contracts, or grant agreements.

This report also includes twelve management comments, which are less significant findings than those considered significant deficiencies, 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, 2010.

Sincerely,

Dennis E. Hoyle, CPA
Acting Auditor General

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State of Rhode Island and Providence Plantations

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JUNE 30, 2010 AUDIT

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Our audit of the State's financial statements, performed in accordance with *Government Auditing Standards*, requires that we communicate deficiencies in internal control over financial reporting. 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.***

Our audit, which includes consideration of the audit results of certain component units which were audited by other auditors, identified 17 material weaknesses and 20 significant deficiencies in internal control over financial reporting. These control deficiencies can be broadly categorized as follows:

- ***accounting system inadequacies*** *– (2 findings)*
  - full implementation of the planned statewide accounting system (RIFANS) has stalled
  - design of the accounting system used by the Department of Transportation is incompatible with the RIFANS system resulting in control weaknesses and various inefficiencies

- ***weaknesses in general accounting and financial statement preparation controls*** *- (9 findings)*

- ***controls over federal program revenue*** *- (2 findings)* - stronger centralized control procedures are needed over federal programs which are largely administered by departments

- ***weaknesses in information technology controls*** *- (12 findings)*
  - monitoring of comprehensive information system security policies and procedures
  - program change controls
  - secure transmission of financial data to external parties

- ***capital asset accounting issues*** *- (2 findings)*

- ***controls over tax revenue and related processing*** *- (6 findings)*
  - controls over tax payments received electronically
  - adjustment of taxpayer balances
  - consistent revenue recognition and data warehouse billings
  - personal income tax administration

- ***weaknesses in controls for separate component units of state government*** *– (4 findings)*

Based on our tests of the State's 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, we reported one instance of noncompliance identified by the auditors of the Convention Center Authority.

We have also included twelve management comments, which we do not consider significant deficiencies or material weaknesses, yet in our opinion, still warrant communication and the attention of the State's management. These include recommendations concerning subrecipient monitoring, drawdown of federal funds, year-end tax accrual calculations, and guidance on implementing a new accounting pronouncement effective in the next fiscal year.

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STATE of RHODE ISLAND and PROVIDENCE PLANTATIONS

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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 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, 2010, which collectively comprise the State's basic financial statements and have issued our report thereon dated December 30, 2010. Our report was modified to include a reference to other auditors. We conducted our audit in accordance with 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. As described in our report on the State's financial statements, other auditors audited the financial statements of:

- certain component units which represent 2% of the assets and 1% of the revenues of the governmental activities and 1% of the assets and 3% of the revenues of the aggregate remaining fund information;

- the Convention Center Authority, a major fund, which also represents 63% of the assets and 1% of the revenues of the business-type activities; and

- component units which represent 100% of the assets and 100% of the revenues of 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.

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Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed in the accompanying schedule of findings and responses, we and the other auditors identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be 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 entity'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 2010-1, 2010-2, 2010-5, 2010-6, 2010-9, 2010-15, 2010-17, 2010-18, 2010-20, 2010-22, 2010-23, 2010-24, 2010-32, 2010-35, 2010-36, 2010-37, and 2010-38.

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 the attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies in internal control over financial reporting: Findings 2010-3, 2010-4, 2010-7, 2010-8, 2010-10, 2010-11, 2010-12, 2010-13, 2010-14, 2010-16, 2010-19, 2010-21, 2010-25, 2010-26, 2010-27, 2010-28, 2010-29, 2010-30, 2010-33, and 2010-34.

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 the reports of the other auditors disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as Finding 2010-31.

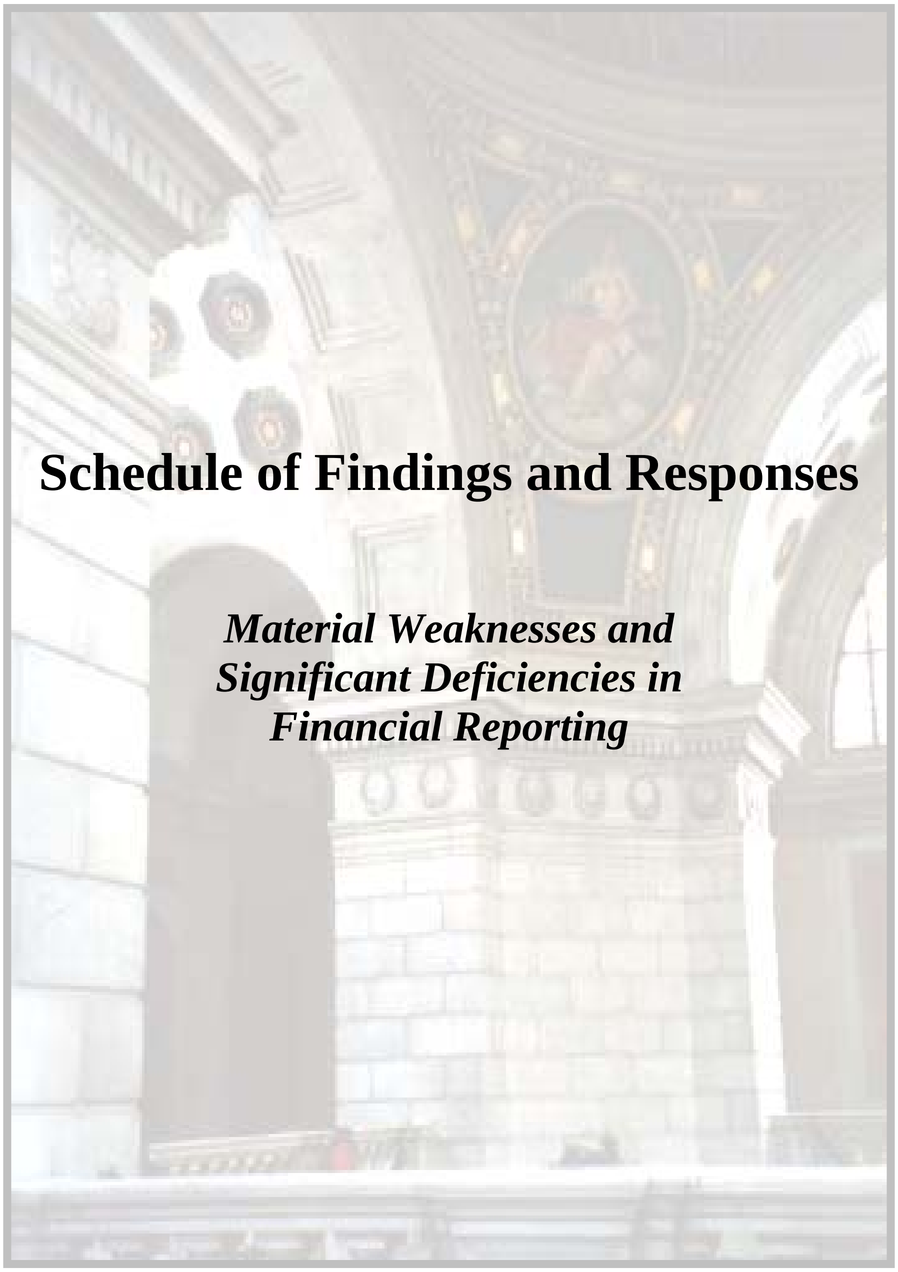
We also noted certain matters described as Management Comments 2010-1 through 2010-12 in the schedule of findings and responses that we consider to be less significant findings than those considered to be significant deficiencies, yet, in our opinion still warrant communication and the attention of the State's management.

The State's response to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the State's response and accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Finance Committee of the House of Representatives, the Joint Committee on Legislative Services, the Governor and management of the State, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Dennis E. Hoyle, CPA
Acting Auditor General

December 30, 2010



Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Financial Reporting

Finding 2010-1

COMPLETE IMPLEMENTATION OF A COMPREHENSIVE FULLY-INTEGRATED STATE ACCOUNTING SYSTEM

The Rhode Island Financial and Accounting Network System (RIFANS) is used to meet the State's accounting and financial reporting responsibilities. Originally envisioned as a multi-module, integrated accounting system, full implementation has stalled and various functionalities are not operational. Consequently, many of the intended benefits for improved efficiency, enhanced management information, and reduced incompatibility and redundancy of accounting applications throughout state government have not been achieved. This weakens overall controls over financial reporting due to necessary, but nonetheless undesirable, procedures to utilize incompatible accounting systems for certain transactions or use RIFANS system capabilities in unintended ways.

Continued progress is needed to achieve the intended goal of a comprehensive, integrated accounting system for the State. At a minimum, the following functionalities must be included within RIFANS:

- *revenue/receivables* – receipts/revenue are currently recorded via journal entry transactions (directly to the general ledger) instead of through a revenue/receivables module as part of the fully integrated Oracle accounting system. This weakens controls by providing numerous individuals the access to initiate and approve general ledger transactions that would otherwise not need such access. This further weakens controls over financial reporting because receivables are tracked by numerous departmental accounting systems that cannot be integrated into RIFANS. A revenue/receivables module would improve control over the recording of revenue and receivables and improve information available to management.

- *human resources* (personnel/payroll) – this module should be implemented to automate, standardize and streamline employee time and effort reporting and perform various payroll related processing functions.

- *grants management* – this module should be implemented to improve the State's controls over the administration of numerous federal grant programs which are a critical component of State operations. The State uses multiple departmental cost allocation systems, many of which are outdated, cannot be upgraded, and cannot be integrated into RIFANS. Cost allocation among grant programs, as currently performed, is labor intensive, prone to error and lacks appropriate statewide controls.

- *cash management* – this module is necessary to integrate the cash management, investing, and accounts payable functions which is critical to improving the efficiency and effectiveness of the State's overall cash management process.

- *budget preparation* – annual budget preparation should be integrated into the accounting system to reduce the time and effort devoted to this process.

- *capital projects* – the State accumulates its construction in progress component of capital assets external to RIFANS. With the implementation of a capital projects module, controls over this significant component of capital outlay could be enhanced as well as facilitate preparation of the annual capital budget.

Current budgetary challenges will likely impact the pace with which additional functionalities (modules) can be implemented. However, control weaknesses over financial reporting and deferred realization of operational efficiency and effectiveness will result if complete system implementation is further delayed.

RECOMMENDATION

2010-1 Complete installation of remaining modules necessary to achieve a comprehensive fully-integrated accounting system.

Corrective action plan / auditee views:

The Department of Administration has implemented certain modules of its Oracle E-Business Suite called RIFANS. These modules include I-Procurement, Sourcing, Contracts, General Ledger, and Fixed Assets. The Department has been requesting funding to continue the installation of the remaining modules. Those remaining modules include Projects and Grants, Time and Attendance, Cash Management and Asset Manager. Due to budget constraints, funding has not been available to implement these modules.

The Department will continue to request further funding to implement the remaining modules. But the installation of these modules will remain resource and funding dependent. We note that in FY 2011, funding was available to implement the I-Supplier module.

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

Finding 2010-2

ACCOUNTING CONTROLS – 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 movement of cash and subsequent reconciliation of bank and book balances. Over time, responsibility for what should be separate functions has become less distinct, largely due to the incomplete implementation of the RIFANS accounting system (which is more fully described in Finding 2010-1). This results in weakened controls over the State's cash receipts and disbursements.

System limitations have necessitated that the Office of the General Treasurer be provided certain RIFANS system access that is inconsistent with appropriate segregation of duties. The Office of the General Treasurer's system access allows certain employees to initiate and approve accounting transactions while also having responsibility for performing account reconciliations, and initiating transfers from State accounts. Such access was deemed necessary to meet stringent timelines for required movement of cash or to ensure that transactions generated by a myriad of subsidiary systems were recorded timely within the accounting system.

Recording of Payments made from Subsidiary Accounting Systems

Treasury posts expenditures to RIFANS for certain payments (Medicaid provider payments, Unemployment Insurance and TDI benefit payments, TANF benefits, etc.) processed and issued through subsidiary payment systems of the State. These payments are normally made through checks or ACH payments issued by other departments and agencies, or through fiscal agents on behalf of the State. These expenditures are subsequently recorded in RIFANS by journal entry. In certain instances, the journal entries also record the movement of cash to the fiscal agent.

Treasury currently initiates, departmentally approves, and final approves most of these payment transactions. Additionally, Treasury is responsible for the movement of cash and the bank reconciliation process. In the past, the time sensitivity of the required cash movement prompted Treasury's involvement in the entire process rather than segregating certain duties consistent with effective control procedures. As noted above, Treasury should have responsibility for executing funds transfer but have no responsibility for authorizing accounting entries.

The State should evaluate the types of transactions that are currently recorded through this process to restore segregation of duties while ensuring that the cash is moved on a timely basis as required. Moving the recording function for these transactions from the General Treasurer's office is one possible solution.

RECOMMENDATION

2010-2 Improve controls over cash receipts and disbursements by better segregating certain duties currently performed by the Office of the General Treasurer.

Corrective action plan / auditee views:

The Office of the General Treasurer will improve the control over cash receipts and disbursements by developing a process improvement that either wholly segregates certain duties or by creating compensating controls while meeting the required cash movement timelines.

Anticipated Completion Date: June 30, 2011

Contact Person: Chris Feisthamel, Chief Operating Officer
Office of the General Treasurer
401.222.8550

Finding 2010-3

PAYROLL ACCOUNTING SYSTEM – SYSTEMS DOCUMENTATION AND MONITORING

The State's payroll information system, for fiscal 2010, calculated payroll expenditures for 14,000 employees totaling more than $878 million. This system has been programmed for a multitude of distinct contract provisions outlined in agreements with approximately 100 separate bargaining units of the State as well as administration of payroll related benefit plans and required withholdings.

For years, the State has relied on the institutional knowledge of key employees to maintain the operations of the payroll system and has focused less on ensuring that the systems documentation was formalized in a manner consistent with strong internal control. Complete and comprehensive documentation and understanding of the State's payroll system is a critical tool in the State's ability to monitor and assess data inputs utilized within the calculations performed by the system. In addition to allowing for better review and analysis of data inputs utilized by the State payroll system, formalized system documentation would be important in the event of employee turnover or when the State upgrades or replaces its legacy payroll system with newer technology.

Audit procedures relating to the State's calculation of employee payroll have noted instances, in recent years, where improper coding and/or system programming has not accurately determined proper withholdings from employee payroll. Although the State remedied these problems upon identification, these instances suggest that the State needs to implement improved documentation and monitoring of its payroll system processing to identify and correct errors. Implementing monitoring procedures that ensure that such errors are detected and corrected in a timely manner is an essential part of internal control over payroll processing.

RECOMMENDATIONS

2010-3a Improve formalized documentation of the State's payroll system.

2010-3b Implement monitoring procedures over the State's payroll system designed to identify and correct any payroll processing errors in a timely manner.

Corrective action plan / auditee views:

2010-3a

The State's payroll system is a legacy application written in COBOL in an IBM mainframe environment. The payroll system handles payroll for the executive branch of government. It also handles payroll for the other branches of State government, including the colleges and universities. The system does rely on institutional knowledge. The documentation in place is more of a technical nature and relies on understanding the computer code. Since this system is a major system and there are limited resources to undertake a major system documentation effort, DoIT will prioritize which documentation occurs first. The first effort in addressing this audit finding will be to focus on documenting the technical codes for the payroll processing file and to provide an overview and explanation of this file. This will facilitate a better understanding of how the payroll process works for non-technical staff.

2010-3b

DoIT will work with the Office of Accounts and Control to identify better monitoring procedures over changes to the State's payroll processing. These procedures may include additional report changes to current payroll change requests.

Anticipated Completion Date: March, 2012

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

Finding 2010-4

COMPREHENSIVE INFORMATION SYSTEMS SECURITY POLICIES AND PROCEDURES

The Division of Information Technology (DoIT), within the Department of Administration (DOA) has been charged with the safe and secure operation of the State's mission critical information systems (i.e., RIFANS, Personnel, Payroll, Taxation, Division of Motor Vehicles, etc.). The information contained within these systems, is now accessible through either departmental or statewide networks as well as the Internet. As the State opens these systems to greater user (i.e., employees, vendors, citizens, etc.) interaction, the possibility that access security may be compromised increases, thereby exposing the State to potential losses and other risks.

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. The plan is comprehensive in its coverage of all security issues and reflects the security needs of the State's diverse information systems. The information security plan also includes appropriate consideration of disaster recovery/business continuity planning aspects as well.

Although the development of a comprehensive information systems security plan was a significant accomplishment, the State is still deficient in ensuring that all of its critical information systems are compliant with these formalized policies and procedures. In addition to information systems within the Department of Administration, DoIT should also ensure that critical information systems within other State agencies and departments (i.e., MMIS (DHS), RICHIST (DCYF), INRHODES (DHS), etc.) also comply with the State's mandated information systems security policies and procedures.

During fiscal 2009, the State started a process of evaluating each mission critical information system's compliance with formalized system security standards. DoIT has been unable to complete this evaluation due to a lack of personnel resources. The State must complete this process to 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. In addition, new information systems or significant system modifications should be subjected to a formalized systems security certification by DoIT prior to becoming operational.

RECOMMENDATIONS

2010-4a Complete an initial assessment of compliance with recently promulgated systems security standards for the State's mission critical systems.

2010-4b 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.

2010-4c Require systems security certification procedures to be performed by DoIT prior to any significantly modified application systems becoming operational.

2010-4d Consider additional information system security personnel resources to assist in the daily information systems security operational and monitoring procedures.

<u>Corrective action plan / auditee views</u>:

2010-4a

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. The security group has worked with departments in addressing auditing needs. For example, the security group recently worked with the IRS and the Department of Revenue and DHS to address auditing needs. However, these activities are not proactive at this point in time. Audit finding 2010-4a is resource dependent and DoIT is working on obtaining additional resources for the security group.

<u>Anticipated Completion Date</u>: To be determined.

Contact Person: Ernest Quaglieri, Chief Information Security Officer
Phone: 401.462.9292

2010-4b

The preparation of a corrective action plan is resource and funding dependent.

<u>Anticipated Completion Date</u>: To be determined.

Contact Person: Ernest Quaglieri, Chief Information Security Officer
Phone: 401.462.9292

2010-4c

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.

DoIT now requires that all new systems and major changes require signoff by the CISO. However, due to limited staff, we are unable to retroactively review systems already in place and provide a certification.

<u>Anticipated Completion Date</u>: To be determined.

Contact Person: Ernest Quaglieri, Chief Information Security Officer
Phone: 401.462.9292

2010-4d

Currently, DoIT has one Chief Information Security Officer (CISO) and one FTE assisting the CISO. DoIT is requesting an additional FTE for the security group in FY2011. DoIT will fill this position once approved.

Anticipated Completion Date: September 30, 2011

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

Finding 2010-5

CONTROLS OVER THE PREPARATION OF GOVERNMENT-WIDE FINANCIAL STATEMENTS

Governmental financial reporting involves two perspectives: the fund perspective, which for governmental funds focuses on current available resources, and the government-wide financial statements, which are full-accrual entity-wide financial statements. The State has developed a full-accrual set of financial records within RIFANS that accumulates fund level transactions and records capital outlays as asset additions. Long-term asset and liability balances, not recorded for the fund perspective, are reported by RIFANS; however, fiscal year activity and changes in those balances are not accumulated through the system. Instead, balances are adjusted at year-end to reflect activity accumulated on off-line spreadsheets or subsidiary systems (e.g., DBC Debt Manager System). This current process lacks control, is manually intensive, provides only limited financial reporting information during the fiscal year, and is prone to error.

We noted a significant number of misstatements that required adjustment within the government-wide financial statements. Most misstatements were caused by staff utilizing incorrect formulas, prior year financial data, or incorrect amounts in the computations supporting the government-wide accounting entries. Controls over the preparation of the government-wide financial statements would be improved by supervisory review of the government-wide accounting entries including the underlying support and computations. The State should also consider whether more automated processes can be utilized in the preparation of the government-wide financial statements.

RECOMMENDATIONS

2010-5a Improve controls over the preparation of the government-wide financial statements by implementing a supervisory review of government-wide accounting entries and supporting documentation.

2010-5b Consider whether more automated processes can be utilized within the preparation of the government-wide financial statements.

<u>Corrective action plan / auditee views</u>:

2010-5a

The Office of Accounts and Control will enhance the controls related to government-wide accounting entries by implementing a comprehensive review process.

<u>Anticipated Completion Date</u>: November 30, 2011

Contact Person: Peter Keenan, Associate Controller-Finance
Phone: 401.222.6408

2010-5b

The Office of Accounts and Control is currently reviewing external software that would significantly enhance the government-wide financial statement preparation process. If there is a viable software option available, a funding request will be submitted by the end of fiscal year 2011.

<u>Anticipated Completion Date</u>: June 30, 2011

Contact Person: Marc Leonetti, Controller
Phone: 401.222.6731

Finding 2010-6

<u>ACCOUNTING CONTROLS OVER FEDERAL REVENUE AND EXPENDITURES</u>

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. Federal revenue within the governmental activities totaled $2.5 billion for fiscal 2010.

Generally, federal revenue is recognized as reimbursable expenditures 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.

Expenditures could be recorded in a specific federal program account yet not be reimbursable from the federal government either because grant funds have been exhausted or the expenditures do not meet the specific program limitations. Further, official claims for reimbursement from the federal government as documented on federal reports should be reconciled to amounts considered reimbursable per the RIFANS accounting system. During our audit, we noted $7 million in federal expenditures that were erroneously recorded in RIFANS. This error, if uncorrected, would have caused federal expenditures in two federal programs to be misstated in the State's Schedule of Expenditures of Federal Awards. This error would have been detected in a timely manner if the above described reconciliations were being performed.

We noted the following control deficiencies over federal revenue and expenditures:

- Federal programs are administered at the department level. Knowledge of grant requirements, spending authorizations, and limitations on reimbursable expenditures all rests with departmental managers. Accordingly, the Office of Accounts and Control, in preparing the State's financial statements, relies solely on the coding of expenditures 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.

- Departments and agencies administering federal programs are responsible for monitoring expenditure amounts compared to grant awards and preparing federal reports detailing this information. In some instances, agencies are making necessary adjustments on federal reports but not adjusting the State's accounting system. Timely recording of such adjustments in the RIFANS accounting system is necessary to ensure that federal program expenditures recorded in the accounting system are consistent with amounts reported to the federal government and do not exceed federal grant awards.

- For fiscal 2010, the Office of Accounts and Control required departments and agencies to complete an automated Federal Grants Information Schedule (FGIS) that was developed as a standardized RIFANS report. The goal of this revised FGIS process was to provide agencies with the required revenue and expenditure information from the State accounting system to efficiently reconcile expenditures reported on federal reports. Our results found that few departments actually completed the schedule and required reconciliation. In addition, the Office of Accounts and Control did not validate the accuracy of information for departments that attempted completion of the schedule. The State needs to reconsider its FGIS process or another process to ensure the reconciliation of:

    - federal expenditures reported in RIFANS with federal expenditures reported on federal reports (cash-basis);
    - federal revenue reported in RIFANS with cash basis drawdowns made during the fiscal year; and
    - deferred revenue or federal receivable balances recorded at year-end by the Office of Accounts and Control utilizing revenue and expenditure amounts recorded for the fiscal year.

  Internal controls, as well as coordination between the departments administering federal programs and the Office of Accounts and Control, need to be enhanced to ensure federal revenue is recorded appropriately.

- In fiscal 2010, the Office of Accounts and Control established natural accounts to be used specifically to record prior period adjustments; however, departments have rarely used these codes to record prior period activity for federal grants. The federal government often adjusts federal grant amounts relating to prior fiscal years or disallows expenditures that were already claimed and reported on the State's financial statements. In most instances, current period federal activity is adjusted in the State's accounting system to reflect these changes to prior period claimed expenditures. This practice can cause the current federal period activity to be misstated and result in non-compliance relating to period of availability requirements for federal grants. Segregating prior period adjustments in the accounting system would facilitate reconciliation of current period claimed expenditures to RIFANS amounts as well as improve financial reporting by isolating amounts that may warrant consideration of restatement of prior periods financial statements.

The potential impact of these control weaknesses on federal revenue and expenditures within the State's financial statements requires that statewide controls be improved through allocating more resources within the Office of Accounts and Control. Specifically, an additional senior level position should be added to coordinate accounting and statewide control procedures for federal programs, oversee cash management, and serve as a liaison to the departments and agencies directly administering federal programs.

<u>RECOMMENDATIONS</u>

2010-6a Improve the design and utilization of the Federal Grants Information Schedule (FGIS) or implement other processes to ensure that reported federal program expenditures, amounts due from the federal government, and available grant awards are consistent with amounts recorded within the State accounting system.

2010-6b Ensure that variances identified on the FGIS are fully resolved prior to the preparation of draft financial statements.

2010-6c Enforce accounting procedures that distinctly identify adjustments to prior period federal activity in the State's accounting system.

2010-6d Create an additional senior level position within the Office of Accounts and Control to enhance statewide controls over the financial reporting aspects of federal programs.

<u>Corrective action plan / auditee views</u>:

2010-6a

The Office of Accounts and Control completely redesigned the Federal Grants Information Schedule (FGIS) for the fiscal 2010 financial closing. To further improve this process, we will explore enhancements that include providing pre-populated Oracle information to agencies on either a cash or accrual basis, depending on how they prepare federal reports.

<u>Anticipated Completion Date</u>: June 30, 2011

Contact Person: Peter Hodosh, Assistant Director of Special Projects
Phone: 401.222.6404

2010-6b

In conjunction with the redesign of the FGIS, procedures were also developed to enhance the review of the report. We will continue to evaluate our procedures, enhance them where appropriate, and use the improved procedures in FY2011.

Anticipated Completion Date: June 30, 2011

Contact Person: Peter Keenan, Associate Controller-Finance
Phone: 401.222.6408

2010-6c

A communication will be sent to all agencies reminding them of the existence of the natural account that was created for this purpose.

Anticipated Completion Date: April 30, 2011

Contact Person: Peter Keenan, Associate Controller-Finance
Phone: 401.222.6408

2010-6d

The creation of an additional senior level position is subject to budgetary constraints. However, if there is an opportunity to obtain additional funding, Accounts and Control will establish a position to enhance statewide controls.

Anticipated Completion Date: June 30, 2012

Contact Person: Marc Leonetti, Controller
Phone: 401.222.6731

Finding 2010-7

RIFANS LOGICAL ACCESS CONTROLS

Access roles are assigned to all RIFANS users and controlled through unique passwords. These roles, which are assigned based on job function and responsibility level, permit or limit access to various system capabilities. Access is further controlled by permitting only the viewing of data or the actual entry or changing of system information.

Transaction level controls are also affected through agency hierarchies, which define specific functionalities and dollar authorization limits by individual within each department. Other transaction specific authorization controls are managed through workflow directories within RIFANS.

We found that activities of individuals with system administrator roles were recorded but not reviewed. These individuals have access to all critical areas in RIFANS and their activities are not required to be approved by another user. Additions, modifications, and deletions of critical data initiated by system administrators must be reviewed by authorized personnel.

The Division of Information Technology (DoIT) has formalized policies and procedures to secure logical access over the RIFANS accounting system. These policies require the activities of privileged users (system administrators) to be logged by the system and reviewed for propriety by assigned personnel.

RECOMMENDATION

2010-7 Review activities of privileged users (system administrators) on a scheduled basis to ensure that additions, modifications, and deletions initiated by them are appropriate.

Corrective action plan / auditee views:

DoIT has implemented certain changes to the responsibilities of privileged users in RIFANS. These changes included creating a new responsibility with additional restrictions to limit functions performed. DoIT will also implement logging of certain critical database changes to critical system tables.

RIFANS provides auditing features of system users. To address this finding, we will configure the auditing features to produce system reports of system changes by privileged users. DoIT will work with Accounts and Control to determine the review process of these reports.

Anticipated Completion Date: September 30, 2011

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

Finding 2010-8

LEGACY SYSTEMS – ACCOUNT STRUCTURE CONVERSION

Various subsidiary accounting systems (e.g., employee payroll and departmental cost allocation) which process material classes of expenditures have not been converted to the current account structure used within the RIFANS accounting system. These subsidiary accounting systems continue to use an old account structure that has not been utilized since 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) in an account structure that was discontinued nearly ten years ago.

RECOMMENDATION

2010-8 Complete conversion of subsidiary accounting systems using the legacy account structure to the new RIFANS account structure.

Corrective action plan / auditee views:

The Department of Administration has started the conversion of the subsidiary accounting systems. The two major systems are payroll and human resources (HR). System changes have been made on the payroll system with HR currently undergoing system changes.

This project has been ongoing since 2006 and is resource dependent. Other major changes to payroll in FY11 have impacted the completion date of this finding. In FY11, we determined that a major change also had to occur for this change to be made. That change is a rewrite of our security login procedures. Due to the additional payroll accounts that need to be accessed for historical purposes, this module is being re-written and scheduled to be released in the spring of 2011. This must be released prior to doing the conversion. The security login procedure is currently in test.

Anticipated Completion Date: September 30, 2011

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

Finding 2010-9

ACCOUNTING AND PHYSICAL CONTROL OVER CAPITAL ASSETS

During fiscal 2010, we continued to note control weaknesses which collectively impact the State's financial reporting of capital assets. While the State has improved its recording of capital assets in recent years, RIFANS' current system limitations has made it difficult to effectively eliminate these control deficiencies.

Accounting for Capital Projects

The State's capital asset reporting module within RIFANS has provided a more integrated process of identifying capital assets by isolating transactions charged to specific natural accounts designated for capital asset acquisitions. These "flagged" transactions are then analyzed and added to the State's capital asset inventory consistent with the State's capitalization policies. The lack of a capital projects module within RIFANS, however, still causes the Office of Accounts and Control to accumulate costs outside of RIFANS for project-related capital additions.

Capital assets totaling in excess of $5.7 million, most of which were building improvement projects in the implementation or construction phase at June 30, 2010, were not recorded in the capital asset accounting records. In some of these instances, significant project expenditures relating to multi-year building improvement projects were not capitalized because the magnitude and scope of the project was not understood through the analysis of only the current period's expenditures. This results from a weakness in the State's accumulation of expenditures for project-based capital assets. Project-based capital asset acquisitions are tracked manually, independent of the automated process employed within RIFANS. Functionality to track project-based expenditures involving multiple transactions that could span more than one accounting period should be integrated into the RIFANS accounting system. This could be accomplished by "flagging" transactions as potential capital asset additions by designated line item (for project-based capital assets) as well as by natural account.

Periodic Physical Inventories

Periodic physical inventories of the State's capital assets should be performed to ensure the accuracy of the State's capital asset accounting records and to serve as an important element of physical control over capital assets. During fiscal 2010, the State performed physical inventories of three large State agencies. The results of those inventories, however, were not completed and reflected in the State's accounting records at June 30, 2010. Although improved in fiscal 2010, a significant number of State agencies have still not been inventoried in several years. Physical inventories should be performed on a cyclical basis such that each agency is visited every three years.

The State will need to address missing data elements relating to its reported capital assets to ensure that the correct asset location information is present in RIFANS. This process will allow developed capital asset inventory reports to accurately report the location of capital assets and enhance the efficiency of physical inventory inspections being conducted. Other additional refinements in the inventory process should also be considered to ensure that physical inventory results are reflected more timely in the State's accounting records.

Capital Assets Acquired with Federal Funds

Office of Management and Budget (OMB) Circular A-102 requires States to use, manage, and dispose of equipment acquired with federal funds in accordance with state laws and procedures. The RIFANS system does not currently have reports designed to identify capital assets by funding source. Additionally, the State's weaknesses in accounting and physical controls over capital assets impacted its ability to identify equipment purchased with federal funds and to ensure compliance with its own procedures regarding the use, management and disposition of all equipment.

Capital Leases

The State does not have adequate controls in place to identify capital assets (mostly machinery and equipment) acquired through capital leases. The State's RIFANS accounting system and established capital asset policies and procedures do not provide an effective means to identify and properly record capital assets and the related capital lease obligations. Further, the State has not routinely recorded capital lease transactions in accordance with generally accepted accounting principles (GAAP). GAAP require that capital lease transactions, in which the government is the lessee, be accounted for as though the capital acquisition had, in fact, been financed through a third party lender. That is, GAAP require that a governmental fund report, at the inception of the capital lease, both an "other financing source" and an "expenditure" equal to the net present value of the future minimum lease payments. The State currently does not record such amounts and instead only records lease payments made annually as expenditures in governmental funds. Additionally, the State does not have processes in place to accumulate the information necessary to identify capital lease obligations and related capital assets for financial reporting purposes. Revised control procedures should be implemented to prompt identification of potential capital lease transactions and result in the appropriate financial reporting for such transactions. These new control procedures should be integrated into accounting policies and procedures for the RIFANS capital asset module.

Impairment of Capital Assets

Governmental Accounting Standards 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. The Office of Accounts and Control requested information regarding the impairment of capital assets from all State agencies as part of its annual fiscal closing procedures. For fiscal 2010, all responding agencies reported no knowledge of capital asset impairments.

Our audit procedures included inquiry of State officials responsible for the management of the State's properties and infrastructure to evaluate the impact of capital asset impairment on amounts reported in the State's financial statements. Our inquiry resulted in the accumulation of a listing of State buildings no longer in use due to physical deterioration. Although the carrying value of these properties was not material to the State's financial statements, the inability of the State's process to identify these instances of impairment suggest that more effective processes are needed to ensure compliance with these accounting standards. The State should implement guidance and reporting processes to ensure the proper financial reporting consideration of capital asset impairments.

<u>RECOMMENDATIONS</u>

2010-9a Develop procedures to improve the tracking of capital projects within RIFANS.

2010-9b Enhance controls over furniture and equipment disposals by performing physical inventories of capital assets utilized by the State's departments and agencies on a cyclical basis.

2010-9c Improve accounting controls to ensure the identification of federal funds utilized to purchase or construct capital assets.

2010-9d Implement procedures to ensure that all capital lease activity is identified and recorded in accordance with GAAP in the State's financial statements.

2010-9e Implement guidance and reporting processes that properly consider capital asset impairment within the State's financial reporting.

<u>Corrective action plan / auditee views</u>:

2010-9a

The existing capital project tracking process, which is spreadsheet based, will be reviewed to identify areas that can be improved. However, to address this issue fully, the Oracle projects module should be implemented.

<u>Anticipated Completion Date</u>: November 30, 2011

Contact Person: Peter Keenan, Associate Controller-Finance
Phone: 401.222.6408

2010-9b

Physical inventories are now being performed on a regular basis. There are twelve agencies scheduled to be inventoried in FY2011 and the balance of the agencies within the executive branch will have an inventory in FY2012.

<u>Anticipated Completion Date</u>: June 30, 2012

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

2010-9c

For all assets purchased since the implementation of the Oracle Fixed Asset module in 2007, the funding source is available in the data tables. As a result, the data is currently available by a query function. The Office of Accounts and Control will request that a standard report be developed in RIFANS.

Anticipated Completion Date: June 30, 2011

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

2010-9d

An internal procedure related to this process exists. This procedure will be used as the basis to formalize a statewide policy which will provide guidance related to the identification and reporting of capital lease activity.

Anticipated Completion Date: June 30, 2011

Contact Person: *John Lewis, Supervisor Financial Management and Reporting*
Phone: 401.222.6302

2010-9e

The Office of Accounts and Control will review the current process and make enhancements where appropriate. This includes incorporating information compiled by the Risk Management Office.

Anticipated Completion Date: June 30, 2011

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

Finding 2010-10

CONTROLS OVER EMPLOYEE PAYROLL SYSTEM

Payroll data for the majority of State employees is entered via on-line access to the payroll system at the department or agency level. We reviewed the controls over data entry for the employee payroll system and found that established procedures now mandate the assignment of unique passwords for each user to control and restrict access to the system. However, the existing password control system does not record user identification information within the data files to identify individuals making specific file changes, thereby preventing a clear audit trail. System access controls need to be improved by utilizing the user identification to track all transactions initiated by an individual user. Management may decide to identify key data fields to track transactions by specific user identification.

In June 2006, a new payroll sub-system was implemented to capture and log selected data changes within the "Employee Time Keeping / Attendance Reporting" system. While this action improved control over this component of the payroll system, changes in the payroll master file, which contains a multitude of data elements that have a direct effect on payroll for State employees, are not similarly captured and logged. Logging these data element changes should be implemented to provide adequate control over changes to the payroll master file.

RECOMMENDATION

2010-10 Identify critical data elements to be tracked as changes occur. Capture and maintain the unique user identification for each transaction resulting in changes to critical payroll master file data elements.

Corrective action plan / auditee views:

The Division of Information Technology will assign a team to implement this capability using current available technology. This corrective action will be implemented after audit finding 2010-8 is addressed.

Anticipated Completion Date: May 30, 2012

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

Finding 2010-11

INFORMATION TECHNOLOGY (IT) SYSTEMS - PROGRAM CHANGE CONTROLS

Procedural Issues

Program change management controls are a critical IT control component to maintain highly reliable systems that meet the defined service levels of the organization. Almost all custom developed computer programs require changes or updates during their production lifecycle. Users may encounter errors, seek new programmable features, or require adaptations to accommodate changes in operation.

The primary goal of formalized program change management policies and procedures is to accomplish IT application changes in the most efficient manner while minimizing the business impact, costs, and risks. Strong change management controls are needed to ensure that standardized methods and procedures are used for efficient handling of all application specific changes and are a required component within formal departmental level IT policies and procedures.

DoIT Program Change Management Control - Policy Directives

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".

These policy directives are designed to be a component of a high level overall plan that embraces the general goals and directives of DoIT. These directives are general in the description of their subject matter and are designed as a statement of principles. Detailed standards, practices and procedural guides governing the actions of DoIT personnel should be developed from these general policy directives.

DoIT Program Change Management Control - Procedural Guidance

Procedural guidance provides detailed information pertaining to the specific activities that need to be implemented to accomplish the stated goals and directives of a related policy statement. This type of guidance would provide DoIT personnel with detailed instructions pertaining to the development and correct use of mandated internal control practices and procedures, thus ensuring compliance with the corresponding policy directive.

Within its published policies directives, DoIT makes numerous references to DoIT personnel using "best practices" concerning program change control procedures, yet it offers no specific procedural guidance regarding what it considers to be the required "best practices."

DoIT should design and develop formal procedural guidance manuals detailing specific requirements for program change control. Standard, uniform practices and procedures need to be developed to control the process of requesting, analyzing, approving, developing, tracking, implementing, and reviewing all application program changes. Published reference manuals, specific to this area of control, are available from various nationally recognized IT professional organizations. Once developed, these DoIT guidance manuals would need to be reviewed and periodically updated and readily available to all DoIT personnel.

Program Change Control – Current Operational Issues

In response to prior audit recommendations, DOA/DoIT purchased two software packages designed to better maintain and control IBM mainframe application program change requests. The ClearQuest package provides change request tracking, process automation, reporting, and lifecycle traceability. ClearCase provides version control, workspace management, parallel development support and version 'build' auditing. These packages offer processes designed to utilize newer, more stringent controls over the application's program change process. Taxation and the Employee Payroll systems were the first two DoIT applications to utilize the new program change control protocols beginning in fiscal 2007.

During fiscal 2010, we found that the ClearQuest package was still working to expectations but our previously reported concerns regarding the use of ClearCase had not been addressed. Users of ClearCase reported that instead of making the program change process more efficient and productive, the process was extremely cumbersome and time consuming. Software/hardware problems, improper installation/configuration and slow download speeds contributed to product dissatisfaction and resulting nonuse. Further, application programmers were able to circumvent DoIT's change control process thereby rendering the controls ineffective.

DoIT should review its use of the ClearCase software package to determine what combination of operational, procedural and/or technical adjustments are required to use the package in a manner that results in adequate program change control. Further, DoIT should implement a formal program change control process for its mainframe applications.

<u>RECOMMENDATIONS</u>

2010-11a DoIT needs to design, develop, formalize and implement procedural guidance manuals detailing specific requirements for program change control.

2010-11b Assess use of the ClearCase software package to determine what combination of operational, procedural and/or technical adjustments are required to use the package in a manner that results in adequate program change control.

<u>Corrective action plan / auditee views</u>:

2010-11a

The current procedures and policies do need to be upgraded and improved upon. The original procedures and policies to be used with the version control and application tracking system, ClearCase/ClearQuest, were put into place in June 2006. Most of the staff that originally put these systems in place have left state service. DoIT acknowledges that procedures and policies in place need to be upgraded and improved to reflect best practices. However, these improvements are resource and funding dependent. Our primary goal will be to first address 2010-11b to ensure future support of the environment.

<u>Anticipated Completion Date</u>: June 30, 2012

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

2010-11b

DoIT acknowledges that improvements need to be made to the original software implementation to better improve the program change control originally put into place. In 2010, DoIT continued to maintain support on the product and determined that we must upgrade in the very near future to be supported. The initial rollout of ClearCase was in 2006. The product offers many features. Many of the issues that we face may be due to a lack of knowledge and internal resources that are familiar with the product. We will seek additional training on the product. DoIT will also contract to acquire resources to upgrade the environment.

The completion of this finding is funding dependent for the outside resources and we have limited staff knowledge of the product at this time.

<u>Anticipated Completion Date</u>: June 30, 2012

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

Finding 2010-12

FUNDS ON DEPOSIT WITH FISCAL AGENT

Funds on Deposit with Fiscal Agent on the Statement of Net Assets – Governmental Activities totaled more than $250 million at June 30, 2010. These assets result from the issuance of certain debt (Grant Anticipation Revenue Vehicle (GARVEE) Bonds, Motor Fuel Revenue Bonds, Certificates of Participation, and Historic Preservation Tax Credit Financing Bonds) by the State. Unlike the issuance of general obligation bonds of the State where the proceeds are received by the General Treasurer and disbursed through the State accounting system for authorized purposes, these debt proceeds are retained by a trustee. A trust agreement entered into at the time of issuance governs (a) the establishment of various trust accounts and restrictions on their use, (b) permitted investments, (c) documentation required to release the funds for valid project expenditures and (d) various other legal and operational matters.

Because these debt proceeds are not actually "received" directly by the State, the manner in which they are accounted for, monitored, and invested differs from other funds of the State. Aside from the trustee holding the assets, it is unclear who within State government has responsibility for monitoring the investments held within the various trustee accounts. The importance of this responsibility was highlighted during fiscal 2009 when the credit ratings assigned to a corporate issuer of certain investment agreements were downgraded causing the State/trustee to opt out of the investment agreement and request return of the funds.

Because of the dollar significance of these assets, compliance monitoring, and controls over financial reporting should be enhanced. We observed the following weaknesses:

- Once the debt is issued, the State Investment Commission or the Office of the General Treasurer has no role in investing, monitoring or disbursing the funds on deposit with the fiscal agent. Generally, the State Investment Commission and Office of the General Treasurer have statutory authority for the custody and investment of state funds. Consequently, the control procedures in place over the investment and disbursement of state funds (employed by the Office of the General Treasurer and Office of Accounts and Control) do not apply to these amounts. Responsibility for monitoring investments made with unexpended debt proceeds is unclear and should be clarified. The State Investment Commission, which establishes investment policy and the General Treasurer's Office do not appear to have responsibility and control for these investments but it is not clear who does.

- Control over funds on deposit with fiscal agent is not centralized – some trustee activity and reporting is controlled at the department level while other activity is controlled at the Office of Accounts and Control.

- Trustee activity statements are not all stored in a central area under common control.

- Duties related to recording and reconciling trustee activity with balances in the State accounting system are not sufficiently segregated.

- The role of the trustee should be clarified to assess whether the trustee has responsibility to monitor various compliance features (e.g., permitted investments – credit quality of corporate issuer of investment agreements) or provide various reports and disclosure information.

RECOMMENDATIONS

2010-12a Enhance controls over funds on deposit with fiscal agent by centralizing oversight responsibilities, segregating certain duties, and clarifying the role and responsibilities of the trustee.

2010-12b Clarify State responsibility for oversight and monitoring of investments held by fiscal agents resulting from the issuance of debt.

Corrective action plan / auditee views:

2010-12a

Working with the Office of Accounts and Control, the Office of the General Treasurer will create an enhanced centralized control structure. The Office of the General Treasurer will provide reconciliation services for those funds which the Office of Accounts and Control has accounting and oversight responsibilities for.

2010-12b

Neither the State Investment Commission nor the Office of the General Treasurer have any authority over or contractual privity with the trustees holding these funds. A work group will be formed to review the responsibilities related to investments held by fiscal agents as a result of issuance of debt.

Anticipated Completion Date: June 30, 2011

Contact Persons: *Chris Feisthamel, Chief Operating Officer*
Office of the General Treasurer
401.222.8550

Marc Leonetti, State Controller
401.222.6731

Finding 2010-13

ADMINISTRATION OF THE STATE'S DEPOSIT COLLATERALIZATION PROGRAM

The General Laws require financial institutions to collateralize public deposits if they represent time deposits greater than 60 days or if an institution fails to maintain their minimum capital standing as required by their federal regulator. In addition to this statutory requirement, during fiscal 2009, the Office of the General Treasurer instituted a policy requiring collateralization of the uninsured balance of all deposits held by financial institutions on behalf of the State. The State's collateralization policy was further formalized through adoption by the State Investment Commission in 2010.

The Office of the General Treasurer made significant improvements in its administration and monitoring of the collateralization program during fiscal 2010; however, further improvement is needed to enhance security of the State's deposits and to provide the information needed for financial statement disclosure. The following areas should be enhanced:

- Effective monitoring of each institution's compliance with the collateralization policy requires identification of the bank balance at each financial institution subject to the State's policy. Some institutions have provided a comprehensive list of accounts for which collateral is pledged and access to daily balances while others have not.

- Some institutions have interpreted the policy to require collateralization of only "collected balances" in an account rather than the entire bank balance. The State's policy should be specific to avoid inconsistency or lack of compliance.

- The applicability of the policy to accounts that are not in the custody of the General Treasurer should be clarified. There are a number of accounts (e.g., various Court accounts) that are not in the custody of the General Treasurer. Generally, the financial institutions are grouping accounts subject to the State's collateralization policy based on the federal identification number listed for the account and not by official custodian. The Office of the General Treasurer has been working with the Judicial branch to resolve these issues.

- At June 30, 2010, not all collateral was held by an independent custodian in the State's name and in some instances security agreements had not been executed to perfect the State's interest in the collateral.

The Government Finance Officer's Association has adopted "best practice" guidance on the collateralization of public deposits, which includes written agreements with depositories, third party custody of collateral, periodic marked to market of collateral and an overall monitoring process.

<u>RECOMMENDATIONS</u>

2010-13a Enhance the deposit collateralization monitoring process to ensure compliance with the State Investment Commission's collateralization requirement.

2010-13b Modify the collateralization policy adopted by the State Investment Commission as required to clarify various implementation issues.

<u>Corrective action plan / auditee views</u>:

The Office of the General Treasurer has a formal collateralization policy approved by the State's Investment Commission.

Daily monitoring – We currently have daily balance reporting for all accounts. We also receive monthly spreadsheets recapping balances from the two biggest providers. Further, we have the ability to access collateral information from the third party custodian, wealth management department or the Federal Reserve System. Our providers and collateral method are as follows: Bank of America, Citizens Bank, Sovereign Bank and Webster Bank use BNY Mellon as a third-party custodian. Washington Trust uses their Wealth

Management Division; a separate unit of the bank. BankRI uses the Federal Reserve System. All of the providers give us daily access to our collateral information, with the exception of BankRI, which uses the Federal Reserve System for monthly reporting, or when a change to collateral takes place.

Collected Balances – as of 2/25/11, all banks are using the deposited balance as the basis for collateral.

Funds outside of our control – We have worked with the agencies, mainly the Judicial Branch, and the banks to give us sufficient data to verify that we are properly collateralized. We receive balance reports which include the balances that we do not have control over, but which still use the State's Tax ID. Working with the agencies is an integral part of our overall campaign to improve banking services throughout State government.

Independent Custodian – At this time, the majority of our deposits have collateral on deposit with a third party. BankRI uses the Federal Reserve System for its collateral, while Washington Trust uses its Wealth Management Division to hold the collateral. The collateral is in the name of the State of RI and both of these institutions comply with our collateralization policy.

Anticipated Completion Date: Completed

Contact Person: Ken Goodreau, Chief Investment Officer
Office of the General Treasurer
401.222.8578

Finding 2010-14

TRANSMISSION OF CASH DISBURSEMENT DATA FILES AND WIRE TRANSFERS

Certain cash disbursements are made via ACH transactions where the State transmits a data file containing payee information to a financial institution for electronic transfer to the payee's designated bank account. Other large State disbursements are made via wire transfer of funds by the Office of the General Treasurer. Controls over these disbursement types should be enhanced as described below.

Temporary Disability Insurance (TDI) Program ACH Disbursements

Three data files representing TDI program disbursements are transmitted by the Department of Labor and Training (DLT) to a financial institution (direct deposit data, positive pay data and refunds positive pay data). We found that the data files are transmitted in an open text format rather than encrypted. The major risk in transmitting sensitive data in an open text format is that if the data were to be received or intercepted by anyone other the intended recipient, this data is easily read by any computer system. We also noted that the files are transmitted from a personal computer rather than directly from the mainframe computer system. This increases the risk of potential interception and corruption since the same computer is used for other internet access.

DLT's IT personnel indicated that they are aware of this situation and are planning to resolve this weakness by implementing the needed software and operational changes.

RECOMMENDATION

2010-14a Secure the TDI data files that are currently being transmitted in an unsecure format by implementing encryption and originating the transmission from a dedicated secure PC or directly from the mainframe computer system.

Wire Transfers - Office of the General Treasurer

The Office of the General Treasurer is responsible for daily wire transfer of funds to external parties (vendors and investment purchases) and between various State accounts. The dollar amount of these wire transactions is significant. The wire transfers are effected through web-based applications of the various financial institutions holding State funds. In this environment, controls are enhanced when the personal computers which are used to initiate the web-based wire transfers are used solely for these transactions with no other internet or other use permitted. This reduces the risk of unintentional access to critical data that could compromise the controls over the wire transfer process. Personal computers dedicated solely for wire transfer transactions are not used by the General Treasurer employees who are responsible for initiating wire transfers.

RECOMMENDATION

2010-14b Dedicate secure personal computers for the initiation and transfer of wire transfer information via web-based applications of the State's various financial institutions.

Corrective action plan / auditee views:

2010-14a

The Division of Information Technology (DoIT) plans to use Linoma's "Go Anywhere" software for the current TDI transmissions sent to Citizens Bank. The files will be sent via secure file transfer protocol directly from a dedicated secure computer, the TDI I-Series. DoIT has notified Citizens Bank and plans to implement this new process during fiscal year 2011.

Anticipated Completion Date: June 30, 2011

Contact Person: Diane Gagne, Assistant Director, Financial and Contract Management
Phone: 401.462.8147

2010-14b

The Treasury staff has reviewed the industry literature provided by the Office of the Auditor General. Current procedures mirror the suggested controls related to the risk of wire transfers executed via a web-based application, and, where different, offer compensating controls.

Our processes employ physical, electronic and procedural safeguards to prevent unauthorized access or misuse. While specific protocols vary from bank to bank, access to *the bank's system generally require a user name, password and a hardware authenticator (which generates a random, time limited, single use password). Additionally, some banks also require installation of a user-and-machine specific public key certificate. All data transmitted to and received from the banks is 128 bit encrypted. Additionally two of our banks require a telephone confirmation prior to executing a transfer.*

Treasury employs an active endpoint antivirus and antimalware software solution. This software is centrally managed and updates to definition files are processed a minimum of four times per day. All computers within Treasury are secured by this software and managed centrally. Treasury also utilizes an automatic Windows Update Service which ensures that all PC's on the Treasury network receive critical security updates in a timely fashion.

Additionally, Treasury's network sits behind the State's enterprise network infrastructure. This ensures that Treasury is protected by the State's firewall and is also the beneficiary of the State's outbound Web-access filter. This prevents users from accessing a wide variety of sites that are not related to our business purpose or could potentially host various forms of malware. Software downloads are completely blocked. Overall network activity is monitored, and Treasury staff notified in the event of aberrant activity.

A dedicated workstation would desegregate the initiation, approval and report gathering functions that are currently independent. Bringing these functions to the same machine creates a potential single point of failure, operational inefficiency and eliminates the unique network credentials used to audit user and machine activity. The use of a dedicated workstation not connected to the Treasury's infrastructure would require unique security and control issues, manual software updates and continual manual antivirus and malware updates.

In the unlikely event that Treasury systems were to be compromised by malware, it is possible that a dedicated workstation could easily be impacted via various network or operating vulnerabilities.

After contacting our three biggest vendors we learned that none of their collective clients have a dedicated workstation to execute wire transfers. Treasury staff believes that current user and transaction authentication procedures represent an appropriate control of security risk for transmission of electronic payments that is consistent with the industry recommendations and practice.

Anticipated Completion Date: Completed

Contact Person: Ken Goodreau, Chief Investment Officer
Office of the General Treasurer
401.222.8578

Finding 2010-15

DEPARTMENT OF REVENUE – CONTROLS OVER ELECTRONIC FUNDS TRANSFER (EFT) OF TAXES

The majority of the taxes (based on dollars) are received electronically. Funds are deposited automatically in the State's bank accounts and electronic files are transmitted to the Division of Taxation (Taxation) by the State's banks that contain abbreviated tax payment data (taxpayer identification number, payment amount, tax type, tax period). These electronic files are in an open text format that allows, rather than restricts, manipulation of data prior to recording in Taxation's computer systems.

Near the close of fiscal 2006, Taxation, in coordination with the Division of Information Technology (DoIT), implemented an automated system that can log all changes made to these files and maintains version control over each individual data file. This type of automated system is required to ensure that all changes made were required, authorized, and available for management review or audit. For example, this effort revised the EFT process to the extent that the tasks of downloading, processing, and uploading payment detail files were placed under the control of the automated system that monitors and records the movement and processing of these payment files. However, not all files processed by Taxation's systems are controlled or logged by this automated system.

A select group of Taxation personnel are assigned responsibility for downloading electronic files, reconciling the 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 Taxation mainframe computer systems. Taxation has taken steps to segregate duties regarding the processing of these files; however, certain individuals still have access that allows them to perform multiple functions.

All electronic files that contain tax payment data and are processed by Taxation's systems should be encrypted at all times (during transmission and at rest) and fully controlled by the automated logging system prior to entering the systems. These electronic files should be in a file format that is ready for uploading to Taxation's systems without the need for manual intervention.

Additionally, DoIT personnel need to develop a monitoring and reporting process for the automated logging system to identify and report any operational problems that occur. No formal reporting system has been developed to audit/review the changes made to the data files. Such a system should be used to ensure that all transactional changes were required, authorized, and properly applied.

All of the electronic files described above contain taxpayer specific data transmitted from a number of sources and in various formats. To ensure that the proper level of data protection is in place, Taxation working with DoIT, needs to perform a "data classification" review for the data contained within these files. DoIT has polices requiring that all State data being captured, maintained and reported upon by any agency or department is to be "data categorized" based upon three levels of availability and four levels of confidentiality (DoIT policy *# 05-02 – Data Categorization).* If the data is considered confidential or sensitive, then the data must be protected by an acceptable method of data encryption.

RECOMMENDATIONS

2010-15a Control all electronic files that contain tax payment by the automated logging system from the time of receipt through upload to the taxation mainframe systems to ensure data integrity.

2010-15b Develop monitoring and reporting procedures for the automated logging system control process over data files. These procedures should identify and report any problems within the system's daily production cycle to ensure the control process remains operational.

2010-15c Develop a formal reporting system to audit/review changes made to the EFT data files to ensure that all changes were required, authorized, and properly applied.

2010-15d Perform a data categorization review consistent with DoIT Policy *# 05-02 Data Categorization*, to ensure the proper level of data protection (e.g. encryption) is in place.

Corrective action plan / auditee views:

As part of the fiscal year 2012 budget request, the Division of Taxation requested funding for an integrated tax system. This system will, among other things, overhaul the front-end entry systems, accounting systems and processing systems. These improvements will address many of the Auditor General's findings and meet their recommendations.

2010-15a

The electronic payment files that are currently under "version control" contain only a portion of the EFT payments received (EFT Credit only). The remaining electronic files come from various sources both inside and outside of the Division of Taxation. These files are collected and then combined to create one "optical character recognition" (OCR) file that is manually uploaded to the tax mainframe.

- *OCR – originate in Primary Processing and are payments by check that are processed by the NCR machines.*

- *WEBSTER – originate at Webster Bank and are payments processed through the "lockbox" and transmitted via secure FTP to a site inside the state firewall where they are retrieved by the EFT section for processing. These files are "zipped" and must be extracted before being combined with remaining files. A copy of the ACH credit file is manually loaded into the ClearCase "version control" for reference. It is not part of the automatic process.*

- *PORTAL – These are payments processed through the State portal (RI.gov) and include direct debits for personal income tax payments as well as EFT debit files. They are retrieved manually by the EFT section directly from the RI.gov site.*

- *CREDIT CARD – These are payments processed through Official Payments. Official Payments notifies the Division via email when a file is available for download. The files are then retrieved by the EFT section for processing.*

The current "version control" is not a solution for these files because of their disparate sources. Taxation will contact DoIT to explore an appropriate solution.

2010-15b

The current system (ClearCase) issues notification regarding problems with data files, but these notifications are not received until the following day. Taxation will work with DoIT to explore alternative options to resolve this issue.

2010-15c

The current system (ClearCase) contains customizable reports for various uses. Taxation will submit a request to DoIT to create custom reports to review/audit changes to data files.

2010-15d

Taxation will work with DoIT to establish a plan for proper data categorization and encryption of these files.

<u>Anticipated Completion Date</u>: June 30, 2011

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

Finding 2010-16

<u>DEPARTMENT OF REVENUE – PERSONAL INCOME TAX ADMINISTRATION</u>

<u>W-3 Reconciliations</u>

Employers are required to file an annual W-3 reconciliation between the withholding payments due compared to the actual amounts paid to the Division of Taxation. Some employers file paper W-3 reconciliation returns, but in most instances the reconciliation is calculated electronically by Taxation's computer 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 reconciliations for tax year 2009 were due February 28, 2010. During fiscal 2010, W-3 paper returns for tax years 2000 through 2009 were posted to the Taxation mainframe system. However, as of June 30, 2010, the system-generated W-3 reconciliations for tax years 2008 and 2009 had not yet been posted. During fiscal 2010, the Division posted W-3 system generated returns for 2006 and 2007. The backlog in posting W-3 reconciliation returns delays identifying overpayments and underpayments of employer withholding taxes.

<u>RECOMMENDATION</u>

2010-16a Process W-3 reconciliations more timely to identify any underpayment of employer withholding taxes.

Management Review of Overpayment Carryforwards

The Division of Taxation's "Management Refund Report" is used to highlight high-dollar tax refunds requiring review prior to payment and to select other refunds for review. When a taxpayer elects to apply the refund to next year's tax liability rather than request a refund, the carry-forward is not subject to the same review procedures. Overpayment carry-forwards should be subject to the same management review procedures as returns requesting immediate refund of overpayments.

RECOMMENDATION

2010-16b Include refund carry-forward returns within the management refund review control procedures.

Tax Returns Remaining on the Error Register

Personal income tax returns that cannot be processed completely (due to data entry errors or taxpayer error) are placed on an "error register" pending investigation. We noted a significant backlog of returns on the error register that are pending resolution. As of June 30, 2010 there were 40,816 returns dating from 1990 thru 2010. Approximately, 20,000 returns include requests for refunds totaling more than $19 million.

The impact of the large number of returns on the error register includes the inability to offset current taxes owed against prior refunds that remain unpaid and the failure to bill taxpayers for amounts that may be owed.

RECOMMENDATION

2010-16c Investigate and resolve returns on the error register in a timely and efficient manner. Apply refund offsets and bill additional taxes receivable where indicated.

Withholding Tax Filing Frequency

Taxpayers are required to remit personal income tax withholding payments on a frequency as determined by past dollar amounts paid. Larger taxpayers are required to remit more frequently. The Division of Taxation has not run specific reports (WT9074 and WT9075) since March 2009 to update taxpayer information and ensure that each taxpayer is filing at the required interval. Some taxpayers may not be filing as frequently as required thereby impacting the timing and availability of tax receipts to the State.

RECOMMENDATION

2010-16d Review and update taxpayer information to ensure taxpayers are remitting tax withholdings on the required frequency.

<u>Corrective action plan / auditee views</u>:

As part of the fiscal year 2012 budget request, the Division of Taxation requested funding for an integrated tax system. This system will, among other things, centralize all data received by the Division of Taxation. These improvements will allow Taxation to process returns faster and more efficiently. In addition, the system will allow Taxation the ability to change/modify return processing procedures without major programming changes.

2010-16a

Due to a lack of staffing in the past, this function was drastically delayed. Over the past year, the Processing Sections dedicated a Revenue Agent position to focus some of their time to reconciling and processing W-3s. During the past few months, the Processing Section has generated over 1,000 notices in an attempt to reconcile the W-3s for tax year 2008.

During the next few months, Taxation will focus on developing a comprehensive compliance program for employers, utilizing the data warehouse to match various data sources. This program will expedite the processing of W-3s and ensure that employers are complying with all Rhode Island tax laws.

2010-16b

Taxation will submit a request to DoIT programming to add carryovers of income tax refunds to the management report similar to refunds.

2010-16c

Over the past year, returns were being added to the error report faster than the staff could remove them. Over the next few months, the Division of Taxation will review all error codes to determine if they can be modified to reduce the number of errors. The Division will also study if the data warehouse can be used to prescreen returns, therefore creating fewer errors and improving processing time of personal income tax returns and refunds.

2010-16d

Due to lack of staffing, the Division of Taxation opted to defer this project. However, on January 19, 2011, Taxation requested the report from DoIT. The report highlighted several instances of incorrect filings affecting collections. Totals indicated the following: 348 potential weekly filers (presently monthly), and 461 potential monthly filers (presently quarterly). The Division of Taxation will contact these taxpayers to notify them of their correct filing method and continue this project on an annual basis.

<u>Anticipated Completion Date</u>: June 30, 2011

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

Finding 2010-17

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 their mainframe systems. Taxation currently requires supervisory approval of all ARC transactions for sales, withholding, and corporate taxes before they are posted to those respective systems. However, ARC transactions relating to personal income taxes do not require supervisory review prior to posting. Over $90 million in ARC transactions were posted to the personal income tax system in fiscal 2010. There were nine individual ARC transactions over $1 million each, totaling $14.8 million. While it would be impractical for a supervisor to review each ARC posted to the system due to the number of ARC transactions processed, a supervisor should at least review all ARCs over an established threshold.

In addition, 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 controls could result in an ARC transaction being incorrectly posted to the mainframe system and not being detected by management.

RECOMMENDATIONS

2010-17a Establish a threshold for supervisory review of accounts receivable corrections of personal income tax accounts.

2010-17b Improve data entry controls over ARC transactions.

Corrective action plan / auditee views:

As part of the fiscal year 2012 budget request, the Division of Taxation requested funding for an integrated tax system. This system will, among other things, overhaul the front end entry systems, accounting systems and processing systems. These improvements will allow Taxation Revenue Agents and Revenue Officers the ability to make on-line corrections to taxpayer accounts. Depending on the type and amount of the correction, the system will require supervisor approval(s) and also maintain an audit trail of these corrections.

2010-17a

The Division will review the total number of ARCs and the various types of ARCs. Over the next two months, the Division will issue formal procedures on an approval process for ARCs over an established threshold.

2010-17b

The approval process established as a result of Finding 2010-17a will improve controls over ARC transactions. Currently, ARCs are processed by either a data entry supervisor or a data control clerk. Taxation will work with DoIT programming staff to create mainframe reports to ensure that all ARCs were entered correctly and timely.

Anticipated Completion Date: June 30, 2011

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

Finding 2010-18

DEPARTMENT OF REVENUE – CONTROLS OVER TAX REVENUE RECOGNITION

Controls over tax revenue recognition should be strengthened by improving procedures for fiscal year-end cutoff and calculation of estimates (allowance for uncollectible amounts and refunds). Taxes receivable and the corresponding tax revenue are recorded in the State's accounting system at fiscal year-end based upon the receivable balances reported in Taxation's systems. We found that the receivable balances reported in these systems at fiscal year-end did not always reflect the most current taxpayer information. We found instances where receivable balances did not reflect taxpayer payments correctly or timely and payments were applied to the wrong tax year or wrong account. While Taxation is attentive to cutoff procedures for cash receipts, there is less attention to recording all taxpayer changes (field audit, hearings, accounts receivable corrections, etc.) in the detail tax systems. Consequently, timing differences were identified when we confirmed balances with taxpayers or performed other detail testing of account balances.

Taxation was aware of these situations before fiscal year-end, but the receivable balances were not adjusted prior to providing the balances to the Office of Accounts and Control for financial reporting purposes. An audit adjustment was proposed but not booked to decrease taxes receivable by $6.1 million, with a related allowance of $5 million, for a net decrease in taxes receivable of $1.1 million.

The Office of Accounts and Control estimates tax refunds payable at June 30 based on the July refunds paid in the subsequent fiscal year. Due to staff shortages, Taxation has not been able to process all prior period adjustments by July of the following fiscal year. Therefore, processing of certain refunds has been delayed with processing occurring in August or later. An audit adjustment of $1 million was proposed (but not booked) to increase tax refunds payable and decrease tax revenue. The Office of Accounts and Control should revise its method for estimating refunds that is based on payment history instead of refunds paid immediately after fiscal year-end.

RECOMMENDATIONS

2010-18a Improve controls over processing taxpayer data (i.e., returns, payments, etc.) to ensure timely and accurate posting to taxpayer accounts particularly at fiscal year-end.

2010-18b Revise the methodology for estimating tax refunds payable which is based on an analysis of tax refund payment history rather than refunds paid immediately after fiscal year-end.

Corrective action plan / auditee views:

As part of the fiscal year 2012 budget request, the Division of Taxation requested 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.

2010-18a

The current systems in the Division of Taxation are inadequate and extremely manual. Over the past ten years, the staffing in the data entry section has drastically decreased due to retirements and budget restrictions. Over the past year, the Division of Taxation has partnered with Webster Bank to improve processing of payments and vouchers. The partnership allows for checks to be deposited faster and allows for the data to be automatically and securely uploaded to the mainframe. Over the next few months, the Division of Taxation will explore additional methods to improve controls and expedite the entry of taxpayer information.

Anticipated Completion Date: June 30, 2011

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

2010-18b

The Office of Accounts and Control will revise the methodology regarding refunds payable and base the estimate on payment history for the fiscal 2011 financial closing.

Anticipated Completion Date: August 31, 2011

Contact Person: Peter Keenan, Associate Controller-Finance
Phone: 401.222.6408

Finding 2010-19

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

The Department of Revenue – Division of Taxation implemented a data warehouse to (1) collect data from Division of 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 2010, the Division used 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. While the effort to identify unreported tax liabilities to the State is noteworthy, use of the data warehouse affected the State's recognition of tax revenue during fiscal 2010.

Notices are generated from the data warehouse, which operates independently of the Division of Taxation's various mainframe tax systems. These tax systems are the official record of tax revenues and receivables for financial reporting purposes. Upon generation of the tax notice from the data warehouse, data is uploaded to the respective tax system(s). A 60-day threshold has been established before the "notice" information results in recognition of a tax receivable balance within the Division's tax systems. It is Taxation's representation that the 60-day waiting period reflects the nature of a notice as being a high likelihood but yet uncertain claim of taxes owed. The notice is in essence a request for additional information from the taxpayer to either file and pay or explain the filing discrepancy.

During fiscal 2010, use of the data warehouse affected controls over recognition of tax revenue as follows:

- The 60-day waiting period before notices generated from the data warehouse are officially recognized as tax revenue/receivables results in arbitrary and inconsistent recognition of tax revenue. For example, notices sent before May 1st would all be recognized as revenue/receivables in the fiscal year ending June 30 – no amounts would be recognized for those sent after May 1st regardless of the underlying time-period related to the tax balance or the validity of the claim against the taxpayer. While the notice data is within Taxation's systems, the data is held in a "suspense" mode until the 60-day period elapses. 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 system. During fiscal 2010, the Division of Taxation included the billings in suspense at June 30, 2010 in the accounts receivable balance by booking a manual adjustment to the financial statements.

- 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 (these codes are only effective for mainframe transactions processed after 8/14/2009). 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 theses notices versus a 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. In fiscal 2010, determination of the allowance for uncollectible taxes receivable did not reflect the unique characteristics of these balances.

Due to the age and inflexibility of certain mainframe tax systems, the Division intends to use its data warehouse more extensively. Policies should be reviewed to ensure that tax receivable information emanating from the data warehouse is recognized as revenue consistent with the Office of Accounts and Control's policies and that an appropriate allowance for uncollectible amounts is established which reflects the unique nature of these receivable balances. Further, the Taxation mainframe systems should be enhanced to be consistent with the posting of accounts receivable balances to the financial statements. Elimination of the 60-day waiting period will result in Taxation's compliance with their established accounts receivable control policies.

<u>RECOMMENDATIONS</u>

2010-19a Identify corrected and adjusted tax amounts for transactions emanating from Taxation's data warehouse within the tax systems with unique codes to allow separate identification for analysis and collection purposes.

2010-19b Establish an allowance for uncollectible taxes receivable, which reflects the unique collection characteristics of the data warehouse notices/billings.

2010-19c 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.

<u>Corrective action plan / auditee views</u>:

2010-19a

The original bill on the mainframe is assigned a special code identifying it as a data warehouse bill. If a subsequent adjustment or correction is performed on this bill, the codes are consistent with other adjustments or corrections. At the end of the fiscal year, Taxation was able to perform an analysis reporting all of the adjustments and corrections posted to data warehouse bills. Due to the age and inflexibility of the mainframe system, it is our position that new correction and adjustment types are unnecessary and would cause a great deal of programming time to create.

2010-19b

During fiscal year 2010, the Division of Taxation used history from other states to create an allowance for uncollectible taxes relating to the data warehouse assessment. Given that the Division now has almost two years of history, the Division of Taxation will work with Accounts and Control to establish an accurate estimate for uncollectible taxes relating to data warehouse billings.

2010-19c

Currently, when a notice is generated through the data warehouse, a transaction (bill) is posted to the taxpayer account. Rhode Island General Law §44-30-81 allows the taxpayer 30 days to appeal any notice of deficiency. Any notice of deficiency created in the mainframe system does not become a receivable until at least 30 days after the creation of the notice to give the taxpayer ample time to appeal the deficiency. To remain consistent with the mainframe process and to adhere to RI law and to allow for delays in processing responses from taxpayers, the notices generated from the data warehouse are held for 60 days before they become a receivable. It is our opinion that the 60 day delay from the time a notice becomes a receivable is fulfilling a statutory requirement.

<u>Anticipated Completion Date</u>: June 30, 2011

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

Finding 2010-20

<u>DEPARTMENT OF REVENUE – PERSONAL INCOME TAX – CONFIDENTIAL COMMUNICATION</u>

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

Finding 2010-21

CONTROLS OVER THE IDENTIFICATION AND RECORDING OF YEAR-END PAYABLES

The State has implemented statewide fiscal closing procedures designed to allow the State's accounting system to accurately report accounts receivable and payable balances at year-end. These procedures require agencies to record all transactions (deposits and payment documents) relating to a fiscal year by a specified closing date. In addition, agencies must submit payment documents with an "effective date" equal to the fiscal year-end date in order for that transaction to be accrued as a liability at year-end. Agencies also have the option of reporting receivables and payables directly to the Office of Accounts and Control using certain standard forms and procedures. Failure to use the correct "effective date" or to submit transactions or required forms by the designated closing date will result in transactions not being properly recorded (accrued) in the correct fiscal year. The Office of Accounts and Control also performs a review of expenditure transactions greater than $250,000 recorded in the beginning of the next fiscal year to identify any transactions that should have been accrued in the previous fiscal year.

We conducted audit procedures to identify unrecorded revenues and expenditures to evaluate whether these transactions were reported in the appropriate fiscal period. Despite the above detailed control procedures performed by the State, we identified unrecorded liabilities (individually greater than $250,000) in the General Fund and capital projects funds approximating $1.5 million and $2.5 million, respectively. In addition, our audit procedures noted approximately $1 million in accounts receivables that required accrual in fiscal 2010. Audit adjustments were subsequently recorded to reflect these transactions within the State's financial statements. Controls should be improved to ensure that significant accounting transactions are accurately accrued at year-end.

RECOMMENDATION

2010-21 Evaluate and improve controls to identify and record accrual transactions at year-end.

Corrective action plan / auditee views:

The Office of Accounts and Control will review the existing control processes and improve them as warranted. Notwithstanding control enhancements, the process requires manual review and, as such, will continue to be subject to manual error.

Anticipated Completion Date: June 30, 2011

Contact Person: Peter Keenan, Associate Controller-Finance
Phone: 401.222.6408

Finding 2010-22

FINANCIAL REPORTING – INTERMODAL SURFACE TRANSPORTATION AND GARVEE FUNDS – USE OF RIDOT FMS AND RIFANS ACCOUNTING SYSTEMS

Financial statements for the IST and GARVEE funds 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 these two funds is unduly complex.

The RIDOT FMS is an integrated multi-module system intended to meet RIDOT's entire project accounting needs, including purchasing, billing, construction management and general ledger functions. While the majority of RIDOT financial transactions originate in the FMS, the FMS is dependent on the State's accounting system to process cash disbursements to vendors, and for payroll processing. A significant interrelationship exists between the two systems requiring each system to generate transmission files to pass transaction data back and forth 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 necessitate a mapping scheme to "crosswalk" the two charts of accounts.

- Since no direct interface exists between the two systems, transmission files are utilized to transfer expenditure data between the RIDOT FMS and RIFANS to disburse vendor payments. Timing differences exist and have to be identified as part of the reconciliation process.

- RIDOT establishes and maintains purchase order balances on a detailed line item basis for the entire project duration; purchase order balances in RIFANS are in summary form and only for the amount expected to be expended during that fiscal year.

- Expenditures are recorded in the RIDOT FMS after disbursement in RIFANS; expenditures are recorded in RIFANS when entered and approved for payment.

- RIDOT FMS tracks activity at the project level as this is the level at which funding sources (e.g., federal, state and other) are determined and infrastructure or maintenance categorizations are made. RIFANS accumulates activity at the major program level (e.g., interstate highways).

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

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 and GARVEE funds. 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 longer-term goals to ensure reliable information is available to support timely financial reporting.

<u>RECOMMENDATION</u>

2010-22 Re-evaluate the continued operation of two separate accounting systems to support financial reporting for the IST and GARVEE funds. Establish short and long-term goals to ensure reliable information is available to support timely financial reporting.

<u>Corrective action plan / auditee views</u>:

Regarding short-term goals, RIDOT has identified implementing a unified chart of accounts as a desired outcome. Preliminary discussions with Oracle have indicated that transitioning from the FMS account number strings to RIFANS will present both cost and logistical challenges.

RIDOT will obtain estimates from Oracle as to the estimated cost, projected time line, and level of RIDOT and DoIT staff resources needed to implement this project. Based upon this data, RIDOT will assess the likelihood of how quickly this major undertaking can be achieved.

Regarding long-term goals, RIDOT has met with the State Controller to discuss the feasibility of using the FMS system data for financial statement purposes. We will continue to assess the costs and risks of using FMS as the stand-alone accounting system of record for financial reporting, including an analysis of the efficiencies that can be achieved.

<u>Anticipated Completion Date</u>: To be determined.

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

Finding 2010-23

<u>INTERMODAL SURFACE TRANSPORTATION AND GARVEE FUNDS - FINANCIAL REPORTING</u>

The Intermodal Surface Transportation (IST) Fund has been established as a special revenue fund to account for transportation related activities of the State including the highway construction program. The GARVEE fund, a capital projects fund, accounts for 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. Debt service on the bonds is repaid with federal funds and a dedicated portion of the State's gas tax. Bond proceeds held by a trustee pending disbursement for eligible project costs totaled $176 million at June 30, 2010.

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

Controls over the Preparation of Financial Statements

Several account balances reflected in the fiscal 2010 draft financial statements required material adjustment due to weaknesses in controls over financial reporting.

Accounts payable and amounts due from the federal government **–** Controls over the reporting of accounts payable and amounts due from the federal government can be improved to ensure all material amounts are included in the financial statements. These financial statement line items required numerous adjustments. Additionally, RIDOT's process to record the legal claims and settlements can be improved to better identify those amounts that are fund liabilities based on amounts to be liquidated within the next year.

Fund balance reservation **–** Weaknesses in control over financial reporting required audit adjustments to classify fund balance components appropriately within the funds:

- Fund balance within the IST fund includes general obligation bond proceeds transferred in prior years in excess of the required state match to federal funds. Such amounts were not reported as a reserved component of fund balance to reflect legal limitations on their use for only voter approved transportation projects. Review of this fund balance revealed unrecorded amounts due from the Bond Fund requiring adjustment by Accounts and Control after the draft financial statements were presented for audit.

- Fund balance within the IST fund includes federal revenue as a reserved component of fund balance to reflect limitations on their use for FHWA approved transportation projects. Review of this fund balance activity revealed unrecorded federal receivables requiring adjustment by RIDOT after the draft financial statements were presented for audit. Additionally, the department was unable to explain changes in net assets caused by federal funding sources when it was different from expectations.

- Fund balance within the GARVEE fund includes Reserved for Debt and Unreserved for Capital Projects. The Reserved for Debt component of Fund Balance is not available for project expenditures. Amounts reserved for future debt service include a required debt service reserve fund created at the time of issuance of the bonds, and any amounts available from the dedicated portion of the State's gas tax that were not required to meet current debt service. GARVEE fund balance components required audit adjustment to properly reflect balances reserved and unreserved at June 30, 2010.

Reconciliation between the GARVEE Trustee, RIDOT FMS and RIFANS

GARVEE project disbursements originate in the RIDOT FMS; however, disbursement is made by the trustee and the transactions must also be recorded in RIFANS. Periodic reconciliation between all three sources is necessary to ensure that all GARVEE project disbursements have been recorded in RIFANS which serves as the basis for the fund financial statements.

RIDOT's reconciliation focused on asset balances rather than specific transaction types or accounts (e.g., gas tax transfers in, expenditures, investment income, and debt service). RIDOT's reconciliation process can be further improved to include reconciliation by transaction type to ensure the financial statements accurately reflect all trustee activity.

RECOMMENDATIONS

2010-23a Strengthen control procedures over financial reporting to ensure accurate identification of accounts payable, accounts receivable and reservations of fund balance.

2010-23b Analyze the change in fund balance by funding source to ensure the results are consistent with the programs being administered through the IST Fund.

2010-23c Expand the reconciliation between the trustee and the State accounting system to encompass transactions at the account level to ensure the financial statements accurately reflect all trustee activity.

Corrective action plan / auditee views:

Financial Management will continue to strengthen the control procedures over financial reporting to ensure accurate identification of accounts payable and reservations of fund balance. In particular, Financial Management will implement the following corrective actions:

- *Run the Schedule of Revenues, Expenditures and Changes in Net Assets in early June every year to identify and resolve material variances;*
- *Compare (a) revenues received per the federal FMIS report to (b) receipts booked in RIFANS and resolve any differences;*
- *Institute revised procedures to ensure that all involved parties agree upon and sign off on the amounts to be reported for likely settlements of legal claims before these liabilities are recorded on the draft financials;*
- *Work closely with Accounts and Control to ensure that the general obligation fund balance issue is resolved in FY 2011;*
- *Ensure that a revised report to track changes in EBUB is implemented for FY 2011;*
- *Amend the fiscal year close schedule to include a step for processing the Gas Tax journal entry required for GARVEE; and*
- *Include transactions at the account level as part of the GARVEE reconciliation process.*

Anticipated Completion Date: August 15, 2011

Contact Person: Robert Farley, Chief Financial Officer
401.222.6590

Finding 2010-24

TRANSPORTATION INFRASTRUCTURE REPORTING

Amounts reported as capitalized infrastructure are derived from project-level data contained in the RIDOT Financial Management System (FMS). Controls should be improved over this process to ensure accurate reporting of infrastructure expenditures including related design costs. Controls can also be improved to accurately identify when infrastructure assets are placed in service thereby commencing depreciation.

The process performed by RIDOT to determine the amounts to be reported in the financial statements is manually intensive and requires reconciliation to the State's accounting system. The project information obtained from FMS can approximate 18,000 lines of data that must be sorted, subtotaled, categorized and reconciled. This volume of transactions and required data manipulation increases the risk of error.

RIDOT's process to accumulate infrastructure capital outlays utilizes actual construction expenditures but includes estimated amounts for design costs. The current methodology is to identify large construction projects and apply actual design costs incurred related to those projects. Remaining design costs are allocated during the fiscal year to all other construction projects based on the project costs incurred during the year. This methodology results in a timing mismatch since the design costs are not occurring in the period when they are being capitalized. Design costs are not linked to the accumulation of total project costs within the RIDOT FMS. For larger projects, actual design costs should be accumulated and linked to the total of all project costs which are capitalized as infrastructure. Estimates may be appropriate for smaller projects.

Certain misstatements relating to the State's reporting of infrastructure were noted during fiscal 2010. The most significant misstatements related to the State's failure to recognize the completion of infrastructure projects totaling $76.3 million from its reported construction in progress. The State also misstated infrastructure currently under construction by $3.9 million (net) when it reclassified these amounts to infrastructure and began depreciating the assets prior to the project being placed in service.

Identifying and recording infrastructure disposals also continues to be a significant weakness in RIDOT's financial reporting for infrastructure assets. The department has not disposed of any infrastructure assets which included approximately 30 years of infrastructure investment by the State at June 30, 2010. RIDOT needs to develop policies and procedures to begin identifying and recording infrastructure asset disposals to ensure that the State's investment in infrastructure assets is fairly recorded in all material respects in future years.

RECOMMENDATIONS

2010-24a Improve controls over the recording of infrastructure investment and disposal in the State's financial statements.

2010-24b Improve the methodology to determine whether infrastructure assets are placed in service to ensure projects identified as substantially complete are properly categorized as infrastructure.

2010-24c Accumulate and link actual design and construction costs related to an individual project. Identify and record project costs to be included as infrastructure from design through project completion.

Corrective action plan / auditee views:

Financial Management will continue to improve controls over the recording of infrastructure investment and disposal. Regarding the identification and recording of infrastructure asset disposals, a control procedure will be implemented for FY 2011 to make the determination based upon useful life codes. This will require increased levels of coordination between RIDOT Financial Management, Accounts and Control, and other RIDOT divisions.

Additionally, Financial Management will improve its methodology of determining when infrastructure assets are placed into service. For FY 2010, Financial Management utilized its historic methodology of basing this determination upon whenever 80 percent of the contract amount had been expended. Going forward, Financial Management will use the date of substantial completion identified on RIDOT form "Substantial Completion and Request for Partial Acceptance / Final Inspection" as the basis. This methodology has been agreed upon by both RIDOT and the Office of the Auditor General.

Regarding the issue of linking actual design and construction costs to projects, RIDOT Financial Management dedicated significant time and personnel resources to revamp the past practice of calculating design costs by using 19 percent of the total construction costs incurred during the fiscal year for each project. For FY 2010, Financial Management determined the total design costs incurred and linked specific design costs for three large-dollar projects, while the remaining design costs were allocated based upon construction costs incurred by each respective smaller-dollar project. The Department concurs that this methodology results in timing issues, and will examine further refinement for linking design and construction costs on a go-forward basis.

Anticipated Completion Date: August 15, 2011

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

Finding 2010-25

RIDOT - DISASTER RECOVERY AND CONTINGENCY PLAN

There is no formally documented or periodically tested disaster recovery and contingency plan specific to the two major applications used by RIDOT for its financial management operations - the Project Management Portal (PMP) and RIDOT Financial Management System (FMS).

Both of these systems have periodic backups performed and restore procedures in the event of a localized system failure. However, these systems and all other RIDOT application systems and operations have not been included in the DoIT enterprise disaster recovery and contingency plan/testing. Maintaining sufficient backups of system data addresses only part of the disaster recovery equation. RIDOT management indicated that they are in the process of formally addressing their disaster recovery policies and procedures to be more aligned with accepted best business practices.

An appropriate disaster recovery/contingency plan should focus on: (1) the timely recovery of mission critical systems and data and (2) the continuation of business functions and services until the recovery is complete. As DoIT ultimately has authority over RIDOT Systems and has published security policies state that all State IT systems require contingency plans *(Policy 10-05: Management Controls, §5*, RIDOT should coordinate with DoIT for assistance in developing a disaster recovery/contingency plan. Upon development, the disaster recovery/contingency plan must be tested and reviewed on a periodic basis (yearly) and updated whenever a major change occurs to ensure its continued adequacy and viability.

<u>RECOMMENDATION</u>

2010-25 Develop and implement a formal written disaster recovery/contingency plan for all of its systems (including the PMP and FMS). Upon approval, the plan must be periodically tested and reviewed in accordance with DoIT published policies to ensure its continued adequacy and viability.

<u>Corrective action plan / auditee views</u>:

RIDOT will work with DoIT Operations to develop a disaster recovery/contingency plan by September 30, 2011. Implementation of the plan depends upon the availability of staff, hardware, and financial resources.

<u>Anticipated Completion Date</u>: September 30, 2011

Contact Person: David Ahlijanian, Chief Technology Officer
Phone: 401.574.9203

Finding 2010-26

<u>RIDOT – CONTROLS OVER DATA MODIFICATION</u>

Manual intervention is needed to continue the processing of construction financial data within RIDOT's Construction Management System ((CMS). For example, during the transfer of CMS data files from the PMP to the FMS, some data elements within the file are manually modified prior to being posted to the FMS. While the need for the data modifications were sufficiently explained, any time system data is modified manually or opportunities exist for modification represents a threat to data reliability. Appropriate controls should be incorporated into the system to ensure the accuracy of processed data.

File modifications should be automated (to the extent that technology allows), eliminating the potential for manual errors. If after reviewing the entire file transfer process, management determines that manual modifications are still warranted, an automated log of all changes made should be maintained and periodically reviewed by appropriate supervisory personnel (not the individual making the change) to ensure that only authorized changes have been made.

RECOMMENDATION

2010-26 Review the PMP to FMS file transfer process to determine the feasibility of fully automating all instances of manual data modifications. If deemed necessary, logs of all manual data modifications data must be saved and periodically reviewed by RIDOT management to ensure the accuracy of the changes.

Corrective action plan / auditee views:

Financial Management staff will meet with IT staff to determine the feasibility of fully automating all instances of manual data modifications.

Anticipated Completion Date: September 30, 2011

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

Finding 2010-27

RIDOT - DEVELOPER ROLE – SEGREGATION OF DUTIES AND CHANGE MANAGEMENT

We noted a lack of segregation of duties regarding the "Developer" role and its ability to both develop and promote PMP source code changes into production. In addition, we found that there are no automated IT-based controls in place to detect unapproved PMP code changes made by staff who have been assigned the "Developer" role.

The PMP Technical group has granted the developer role to four individuals; three developers and one lead programmer manage and coordinate all development work on source code. All source code version changes are logged within SourceSafe version control software. Typically, code development is initiated in the development environment and subsequently advanced to the test environment where the code is tested and evaluated by the entire PMP Technical group, both individually and as a team. The process of promoting the code to production always involves the lead programmer – regardless of which team member is actually promoting the code. RIDOT management stated that a quality assurance process such as this ensures that production code releases are adequately reviewed.

Although Active Directory groups have been created to limit access to the test/production environments and SourceSafe was implemented to track code changes, the developer role has been granted administrator super user access rights that allows full access to all PMP resources. Therefore, all four developers have sufficient access rights allowing them to develop and promote their own code into production – regardless of lead programmer involvement. To further add to the concern, SourceSafe log reviews are not performed on a regular basis and there are no automated IT-based controls in place to prevent PMP code changes that are not reviewed by the lead programmer from being implemented. This increases the risk that system and data integrity could be compromised.

The application change management process is critical and requires appropriate controls in order to maintain the accuracy and integrity of the system and its data. Best business practices regarding the segregation of duties limits application developers to code development and/or changes and do not allow for access to live data or for the promotion of changes to the production environment. In granting system access, RIDOT management should apply the principles of segregation of duties and least privilege. Additionally, best business practices maintain that audit trail logs (SourceSafe logs) should be reviewed on a periodic basis and performed by an individual who has not made code changes. In the absence of such practices, a segregation of duties risk occurs and there is also an increased risk to system and data integrity. DoIT provides policy and guidance regarding audit trails and logs that including individual accountability, mitigating segregation of duties risks, reconstructing events, intrusion detection and problem identification *(Policy 10-07: Technical Controls, §1.3.4).* DoIT provides policy and guidance on minimum implementation requirements concerning the staffing of positions that interact with all IT system resources, the administration of system users and special considerations regarding contractors and other non-agency individuals granted access to agency system resources *(Policy 10-06: Operational Controls, §1).*

<u>RECOMMENDATIONS</u>

2010-27a Evaluate all groups, roles, and granted permissions defined within its application system access control structure in accordance with DoIT IT security policies and industry accepted best practice standards to ensure that granted access is commensurate with official duties, job functions, and industry accepted security standards. Further, RIDOT management should employ IT-based controls to ensure that all PMP source code changes are reviewed and approved prior to promotion into the production environment.

2010-27b Establish a formal plan to periodically review Microsoft SourceSafe audit trail logs in accordance with DoIT policies to ensure that only authorized system changes/modifications are implemented and that system and data integrity are maintained.

<u>Corrective action plan / auditee views</u>:

2010-27a

Evaluation will begin on limiting roles and permissions of non-lead programmers. There will be additional Active Directory groups created for the developer's team to further limit their permissions on both the test and production environments. A team leader will manage this effort in working with Tech Support on redefining the current Active Directory groups. A new working structure will be in place by September 30, 2011.

<u>Anticipated Completion Date</u>: September 30, 2011

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

2010-27b

An additional Active Directory Group will be created restricting non-lead programmers to move/publish code to production. This will be managed and controlled by one group assigned to the lead programmer. The lead developer will create a log outside of Microsoft SourceSafe of all code published to the Production environment. This person will also do a *quarterly comparison of the Microsoft SourceSafe history log with the lead developer log to look for any disparity. A new working structure will be in place by September 30, 2011.*

Anticipated Completion Date: September 30, 2011

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

Finding 2010-28

EMPLOYMENT SECURITY FUND - PROGRAM CHANGE CONTROL PROCESS WITHIN THE DEPARTMENT OF LABOR AND TRAINING

Program change management controls are intended to mitigate known risks associated with making changes to large, complex IT applications. The Department of Labor and Training (DLT), has a number of large automated applications operating on the department's internal computer systems. In Fiscal 2010, the Unemployment Benefit system required an extraordinary number of program changes prompted by the federal program requirements and the significant increase in UI claimants.

Program change management controls generally utilize a mix of automated and manual procedural controls. The application change management process established within DLT is a manual process that primarily utilizes e-mails, memorandum and paper based forms in documenting and controlling the program change process. There is no automated control system that could be queried to offer pertinent information regarding changes made to the application. An automated system could improve controls over the change management process by providing:

- change request initiation, documentation, authorization, and acceptance status;
- tracking of change request status and authorizations;
- approvals required for change package;
- program check-in / check-out information;
- release management information;
- program documentation;
- program change history;
- audit trails / standard audit reports;
- emergency change process; and
- review and acceptance of test results

DLT's lack of an automated system to control, track and report upon all application program changes made by the DLT programming staff is a control weakness in financial reporting for the Employment Security Fund. DLT should request assistance from DoIT in performing a search for an automated solution that meets both industry standard "best practices" and, satisfies the program change control requirements specific to DLT's current operation.

RECOMMENDATION

2010-28 Implement an automated program change management process over DLT computer applications. Coordinate and request needed assistance in implementing an automated solution that meets DoIT policies and procedures and industry standards.

Corrective action plan / auditee views:

DoIT has indicated to the DLT that there was discussion with audit staff about using ClearCase for this process. DoIT has outlined its planned corrective actions regarding the use of ClearCase in its response to Finding 2010-11.

Anticipated Completion Date: June 30, 2012

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

Diane Gagne, Assistant Director,
Financial and Contract Management
Phone: 401.462.8147

Finding 2010-29

DEPARTMENT OF LABOR AND TRAINING COMPUTER APPLICATIONS - DISASTER RECOVERY PLAN

The DLT Data Center houses the computers hosting a variety of applications mostly related to the Unemployment Insurance and the Temporary Disability Insurance programs. In fiscal 2010, benefit payments processed through these computer systems totaled $930 million.

All of the data that is being captured and maintained by these systems is backed up on a scheduled basis with copies being securely maintained on and off site. If a problem arose within one of these automated applications or a minor equipment failure, existing DLT recovery procedures would be used to resolve the problem. However, there is no formal, comprehensive disaster recovery plan designed specifically for DLT IT operations in the event the DLT data center was rendered inoperable.

The State has contracted with SunGard Availability Services for backup and recovery services which covers selected applications hosted at the State's data center; however, the DLT applications have not been included in this recovery plan or periodic testing.

RECOMMENDATION

2010-29 Implement a formal comprehensive disaster recovery plan for the DLT applications hosted at the DLT Data Center. Explore, in conjunction with DoIT, the possibility of including DLT systems within the State's existing DOA/DoIT Master Disaster Recovery Plan.

Corrective action plan / auditee views:

DoIT is in the process of developing a Contingency Plan for the DLT Data Center and expects to complete the project during calendar year 2011. The State plans to consolidate the DLT data center into the DoIT Enterprise Data Center within the next couple of years. Upon completion of the consolidation, DLT's disaster recovery will be incorporated into the DoIT plan.

Anticipated Completion Date: June 30, 2011

Contact Person: Diane Gagne, Assistant Director, Financial and Contract Management
Phone: 401.462.8147

Finding 2010-30

RHODE ISLAND LOTTERY - INFORMATION SYSTEMS SECURITY POLICIES AND PROCEDURES – MONITORING AND ASSESSMENT

The Lottery has comprehensive information system security policies designed to safeguard the information systems utilized within its operations. Due to the highly computerized nature of the Lottery's operations, these policies are key to ensuring the integrity of the Lottery's information systems. The Lottery ensures compliance with these policies through monitoring procedures performed by information technology (IT) security personnel as well as contracted IT security professionals who assist with evaluating compliance by the Lottery's gaming systems contractor and licensees involved in the operation of video lottery games (licensees).

The Lottery contracted with an IT security consultant during fiscal 2010 to conduct a comprehensive assessment of the significant information systems utilized within the Lottery's operations. The scope of this review involved evaluating compliance of all significant information systems (whether operated by the Lottery, its contractors, or other licensees involved in the operation of Lottery games) with the Lottery's comprehensive information system security policies and industry accepted security standards.

The majority of the Lottery's information systems policies and procedures were found to be in place and operating effectively by the consultant; however, instances of noncompliance with these policies were observed and reported by the contracted IT security professionals. Due to the significance of certain instances of reported noncompliance, the Lottery must ensure that these deficiencies are corrected to enhance controls over the gaming system environment and over financial reporting. Additionally, the Lottery should assess its overall monitoring efforts to ensure comprehensive coverage of all critical IT security components. As necessary, the scope and frequency of scheduled monitoring procedures should be modified to ensure timely identification of noncompliance with mandated IT security policies.

To ensure continuous compliance with its mandated policies and procedures over all information systems utilized within Lottery operations, the Lottery should:

- Conduct a more formalized risk assessment process on an annual basis (with updates performed as prompted by significant system modifications) to better identify critical IT risk areas. A formalized risk assessment process will identify risks more timely and assist the Lottery in utilizing its internal and external monitoring resources.

- Mandate that all contractors and licensees involved in the operation of lottery games have an Information Security Administrator function with responsibility for ensuring their entity's compliance with the Lottery's information system security policies.

- Contract annually, based upon risk assessment outcomes, for a comprehensive review of all significant system components involved in the operation of the Lottery's games.

These recommendations will enhance the Lottery's existing monitoring efforts to ensure compliance with its information systems security policies.

RECOMMENDATIONS

2010-30a Address IT security deficiencies reported by the Lottery's information systems security contractor.

2010-30b Conduct more formalized risk assessment processes on an annual basis with updates as needed for significant system modifications to better identify critical IT risk areas and utilize resources (both internal and external) to mitigate these risks.

2010-30c Mandate that all contractors and licensees involved in the operation of lottery games have an Information Security Administrator function with responsibility for ensuring their entity's compliance with the Lottery's information system security policies.

2010-30d Contract on an annual basis for a comprehensive security review of all significant information systems involved in the operation of the Lottery's games.

Corrective action plan / auditee views:

2010-30a

With the implementation of GTECH's anti-virus and patching program, as well as the newly-implemented controls and additional oversight over the Facilities' Player Tracking systems, the overall program is much stronger.

The findings within the contractor's report were easily correctable, and this review was different from any previous review, due to the scope of the audit. Previously, the Lottery had auditing firms review the Online and Video Systems separately. This review had a much broader scope that included all the Online and Video Systems and associated infrastructure. Also, the review was done by an auditing firm that provided a different perspective than reviews done in the past.

The Lottery ISA and Video Systems Manager heavily monitor and regulate the security over the GTECH and VLT Facility Systems. The Lottery also relies on the annual external audits to strengthen the overall program. The Lottery has been working with all parties involved to *address the deficiencies reported in the most recent audit. As stated, most of the deficiencies (80%) have been closed; and the remaining deficiencies will be completed within 60 days.*

2010-30b

The Lottery MIS Director and ISA perform internal reviews of all IT Security areas throughout the year to ensure that the current monitoring process and implemented security controls in place are effective. These reviews include:

- *Network management*
- *System management*
- *User and group policy management*
- *Intrusion detection system review*
- *Firewall review*
- *Review of all device syslogs*
- *Change management controls*
- *Software and hardware inventory review*
- *Software release management*
- *Anti-virus and security update review*

2010-30c

The Lottery understands the value of having an Information Security Administrator function and continues in its well-established efforts to ensure that GTECH and the VLT Facilities assign designated resources to this job function to ensure compliance with the Lottery's policies.

2010-30d

Over the past ten years, the Lottery has engaged the services of consultants to perform annual external security reviews. Each time the Lottery has had an external auditing firm perform an IT Security review, the auditing scope has been reviewed by the Auditor General's Office to ensure that they are involved with the process and that the scope is satisfactory. The Lottery will continue this important practice to ensure its Information Security Program is what it should be and to protect the revenue source the Lottery systems generate.

<u>Anticipated Completion Date</u>: June 30, 2011

Contact Person: *Gerald S. Aubin, Director*
Rhode Island Lottery
Phone: 401.463.6500

Finding 2010-31

CONVENTION CENTER AUTHORITY – FUNDING OF THE OPERATING RESERVE AND DEBT SERVICE COMPONENTS OF ITS RESTRICTIVE COVENANTS

During the fiscal year ended June 30, 2010, the Convention Center Authority was unable to fund the Operating Reserve and Debt Service Reserve components of its restrictive covenants pursuant to the bond indentures.

Corrective action plan / auditee views:

The Authority will fund the Operating Reserve and Debt Service Reserve components noted above provided there is sufficient cash flow.

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

Finding 2010-32

EMPLOYEES' RETIREMENT SYSTEM - IMPROVE CONTROLS OVER THE RELIABILITY OF CONTRIBUTIONS RECEIVABLE FOR FINANCIAL STATEMENT PURPOSES

Contributions from both employees and employers are recognized as revenue (additions) based on employer payroll activity – contributions are considered receivable when wages are paid to the employee. For financial reporting purposes, contributions receivable at June 30 are derived from (1) the ANCHOR wage and contribution system based on actual contributions data submitted, without cash remittance to the system prior to the end of the fiscal year, and (2) an analysis performed to calculate contributions receivable based upon actual contribution data received after the end of the fiscal year relating to payroll periods prior to the end of the fiscal year.

The year-end analysis of contributions receivable can be improved to provide a higher level of assurance that the contributions receivable balances are accurately recorded. Our audit procedures in prior years found several instances where one or more of the contributions receivable balances were misstated.

Our 2010 audit found another instance where one of the receivable balances (and related revenue balance) was misstated – both were understated by $6.5 million. Specifically, the System typically performs an analysis at year-end to calculate employee and employer contributions accruals for the teacher units within the ERS fund. The 2010 analysis resulted in an appropriate accrual related to the employer portion of this receivable. ERSRI did not, however, accrue the receivable due from the employee share (because of an oversight).

The System should adopt certain control procedures that would help to prevent or detect misstatements in the contributions receivable balances. This should include a written policy describing standard close-out procedures. This policy should require specific analytical procedures that would aid in determining whether or not the receivables balances are complete in all material respects (in fact, this is how we discovered that the balance was understated by $6.5 million in 2010).

RECOMMENDATION

2010-32 Implement control procedures over the manual processes used to calculate contributions receivable at fiscal year end for financial reporting purposes.

Corrective action plan / auditee views:

The System has over 190 participating member units that submit wage and contribution data into the ANCHOR system on various payroll frequencies. The process for analyzing contributions receivable is reviewed by the accounting department. However, given the various pension reforms enacted during the 2010 session, additional off-line efforts were required to be immediately implemented to comply with the enacted budget articles. The limited resources of the accounting department dedicated a significant amount of time to these additional year-end efforts and inadvertently omitted the referenced transaction.

Currently, ERSRI is seeking to procure a new accounting system in addition to an updated line-of-business system in which it will develop enhanced capability for computing, recording, and tracking accounts receivable.

In the interim, ERSRI will develop additional procedures to improve financial reporting of contributions receivable.

Anticipated Completion Date: June 30, 2011

Contact Person: Zachary Saul, Assistant Director-Finance
Employees' Retirement System of Rhode Island
Phone: 401.457.3999

Finding 2010-33

RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – WIRE TRANSFER AUTHORIZATIONS AND BANK RECONCILIATIONS

Currently, the CFO/Controller has the authority to initiate, process, and record in the general ledger a wire transfer from the Authority's operating cash accounts. A person independent of the CFO/Controller does not review and authorize the wire transfer transaction before it is executed by the bank. Also, the CFO/Controller prepares the Authority's bank reconciliations; however, a person independent of the CFO/Controller does not review and approve the bank reconciliations.

RECOMMENDATION

2010-33 We understand that the Authority's Board of Directors and Executive Director review monthly financial reports prepared by the CFO/Controller. However, to strengthen existing internal control over financial reporting we recommend that the Authority:

- Implement a process with its banks to require that the bank call one of several authorized representatives, other than the CFO/Controller, (for example, the Executive Director, Chairperson of the Board of Directors) to verify and authorize the wire transfer request initiated by the CFO/Controller before the wire transfer is executed.

- Assign the function of preparing the month-end reconciliation of each bank and investment account, and comparing the reconciled bank and investment account balances to the respective balances reported in the general ledger to a person independent of the CFO/Controller.

Corrective action plan / auditee views:

Management will implement appropriate procedures to strengthen internal controls.

Contact Person: Christine Callahan, CFO
Rhode Island Turnpike and Bridge Authority
Phone: 401.423.0800

Finding 2010-34

RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – AUDIT ADJUSTMENTS

During our audit, we proposed and management reviewed, approved, and accepted audit adjustments including, among others, an adjustment to record capitalized interest related to interest expense incurred on a bond obligation issued to fund construction costs.

RECOMMENDATION

2010-34 When events occur or transactions are executed that are different in nature from the Authority's normal transaction processing, we recommend that the Authority determine whether there are any accounting principles generally accepted in the United States that are required to be implemented to record the substance of such events or transactions.

Corrective action plan / auditee views:

Management will comply with the suggestion.

Contact Person: Christine Callahan, CFO
Rhode Island Turnpike and Bridge Authority
Phone: 401.423.0800

Finding 2010-35

CENTRAL FALLS SCHOOL DISTRICT – FINANCIAL REPORTING

An entity's system of internal controls should be designed and operate to allow the entity to prepare accurate financial statements in conformance with generally accepted accounting principles and be designed and operate to prevent, detect and correct misstatements in the financial statements on a timely basis.

The financial reports prepared by the Central Falls School District for the year ended June 30, 2010 had misstatements that resulted in the proposal of several audit adjustments. The misstatements resulted from the inadequate reconciliation and review of the financial statement accounts throughout the year and at year-end. Central Falls School District's internal controls over financial reporting are not operating as intended and did not prevent and detect misstatements in the financial statements.

The School District's internal control procedures only include a monthly reconciliation of cash accounts and do not include a monthly reconciliation of all other significant general ledger accounts for all funds. The School District's policies and procedures also do not include the formal preparation and review of monthly and year-end financial reports and the distribution of monthly financial reports to the Board of Trustees and Superintendent.

RECOMMENDATION

2010-35 We recommend that the School District implement internal control procedures that include monthly reconciliation of all significant account balances. The procedures should also include the preparation and review of monthly and year-end financial reports for all funds. The monthly reconciliations and financial reports should also be reviewed and approved by the Director of Finance and the financial reports should be submitted to the Superintendent and the Board of Trustees.

Corrective action plan / auditee views:

The District will begin adhering to the Auditor's findings regarding reconciliation and review of the financial statements throughout the year to avoid misstatements in the financial statements and numerous audit adjustments at year end. On a monthly basis the Director of Finance will review all monthly financial reports and financial statement accounts and backup documentation to ensure the correct accounts and entries are made to substantiate the financial documents. In addition, on a monthly basis, the Director of Finance will review the monthly financial reports with the Superintendent and distribute the District's financial reports to the Board of Trustees.

The District continues the process of refining the financial management system and continues in the professional development training of its staff in order to increase their proficiency with the proper use of the various modules and adhere to the audit findings for the fiscal year ended June 30, 2010.

Contact Person: *Giovanna Venditti, Finance Director*
Central Falls School District
Phone: 401.874.7530

Finding 2010-36

CENTRAL FALLS SCHOOL DISTRICT – CAPITAL ASSETS

The School District does not have formal policies and procedures and an accounting system in place to properly maintain and account for their capital assets on a perpetual basis. Although a list of capital assets and depreciation expense were prepared as of June 30, 2010, the list was prepared after year-end and was incomplete and several audit adjustments were proposed to correct the list of capital assets and depreciation expense. The School District does not have procedures in place to maintain the list of capital assets on a perpetual basis or to provide for the periodic inventory of capital assets.

RECOMMENDATION

2010-36 We strongly recommend that the School District implement policies and procedures and utilize the Unifund capital asset accounting system to account for the addition and deletion of capital assets and related depreciation expense, throughout the year. We also recommend that the School District inventory capital assets and compare the inventory to its list of capital assets at least annually. This will ensure proper recording and safeguarding of capital assets.

Corrective action plan / auditee views:

The District will make every effort to comply with the Auditor's findings with respect to capital assets and ensure the implementation of the recommended policies and procedures to ensure proper recording of capital asset additions and deletions in the next fiscal year.

The District will begin reviewing on a monthly basis asset purchases and deletions and update the capital assets inventory schedules accordingly to ensure compliance.

The District continues the process of refining the financial management system and continues in the professional development training of its staff in order to increase their proficiency with the proper use of the various modules especially the capital asset module which is available in the financial system and adhere to the compliance with the audit findings for the fiscal year ended June 30, 2010.

Contact Person: Giovanna Venditti, Finance Director
Central Falls School District
Phone: 401.874.7530

Finding 2010-37

CERTAIN FEDERAL PROGRAMS ADMINISTERED BY THE DEPARTMENT OF HUMAN SERVICES - AUTOMATED DATA PROCESSING (ADP) RISK ANALYSIS AND SYSTEM SECURITY REVIEW

Federal regulation (45 CFR section 95.621) mandates that States are responsible for the security of all ADP operational systems involved in the administration of U.S. Department of Health and Human Services (DHHS) programs. State agencies are required to determine and implement appropriate ADP security requirements based on recognized industry standards governing security of federal ADP systems and information processing. Such requirements include the establishment of a security plan that addresses the following areas of ADP security:

- physical security of ADP resources;
- equipment security to protect equipment from theft and unauthorized use;
- software and data security;
- telecommunications security;
- personnel security;
- contingency plans to meet critical processing needs in the event of short or long-term interruption of service;
- emergency preparedness; and,
- designation of an agency ADP Security Manager.

45 CFR section 95.621 also requires State agencies to review the ADP system security of installations involved in the administration of DHHS programs on a biennial basis. At a minimum, these reviews shall include an evaluation of physical and data security operating procedures and personnel practices to ensure that they comply with the ADP security plan established by the agency. State agencies must also establish and maintain a program for conducting periodic risk analyses to ensure that appropriate, cost-effective safeguards are incorporated into new and existing systems. Such risk analysis procedures should be performed whenever significant system changes occur.

DHS utilizes two primary systems, INRHODES and the Medicaid Management Information System (MMIS), to administer DHHS federal programs. Benefits processed through these two systems during fiscal year 2010 totaled over $2 billion. These systems are interrelated --Medicaid eligibility is determined within INRHODES and then transmitted to the MMIS where Medicaid claims are paid. In addition to its eligibility determination functions, INRHODES also determines benefit amounts for federal programs such as TANF and Food Stamps.

During fiscal year 2010, DHS did not materially comply with the ADP Risk Analysis and System Security review requirements for the MMIS and INRHODES. Although our audit work found that the contractors that operate the MMIS and INRHODES systems do have formalized system security policies and procedures, federal requirements mandate that DHS should have an understanding of these policies and procedures and an evaluation of their operating effectiveness. During fiscal year 2010, DHS and its fiscal agent had planned a Type II "SAS 70" examination of the fiscal agent's IT security policies and procedures over the MMIS, however, a flood of the fiscal agent's data center in the spring of 2010 caused that review to be postponed.

DHS can best comply with the above federal requirements by implementing a comprehensive system security review process to assess and manage the risks of both systems as well as other ADP issues impacting the administration of HHS programs. DHS should coordinate its efforts with the State's Division of Information Technology (DoIT), the division responsible for the coordinated security of all mission critical systems of the State. DoIT has promulgated information system security policies and procedures that reflect accepted industry standards and additionally could provide experienced information systems security staff to be part of the periodic ADP risk analysis team. By coordinating its efforts with DoIT, DHS could better ensure that the MMIS and INRHODES systems meet the federally mandated ADP risk analysis requirements as well as the system security policies promulgated by the State.

A Type II "SAS 70" examination designed to evaluate the required ADP security requirements outlined above for the MMIS was performed during December 2010 with the goal of fully complying with the ADP risk analysis and system security review requirements for fiscal 2011. DHS still needs to formalize a plan to address these requirements for the INRHODES system in fiscal 2011.

RECOMMENDATIONS

2010-37a Develop an enterprise-wide comprehensive ADP risk analysis and system security review process to ensure a coordinated approach to identifying and addressing security risks related to information systems used to administer federal programs.

2010-37b Implement procedures and dedicate information systems security resources to ensure that ADP risk assessments are conducted at required intervals and when significant system changes occur in accordance with federal regulation 45 CFR 95.621.

2010-37c Coordinate information system security activities for the MMIS and INRHODES systems with the State's Division of Information Technology to ensure compliance with the State's mandated information systems security policies and procedures.

Corrective action plan / auditee views:

The Department of Human Services (DHS) is developing an enterprise-wide ADP risk analysis and security review process that will ensure the security of its eligibility (InRhodes) and claims processing (MMIS) systems. Written policy and procedures for these systems are in place. To test these controls, SAS 70 Type II audits are being scheduled to ensure the procedures for risk assessment and security reviews are working properly. DHS will continue to work collaboratively with the Division of Information Technology (DoIT) to ensure that InRhodes and MMIS security policies comply with DoIT's security policies and procedures.

Anticipated Completion Date: June 30, 2011

Contact Person: Ralph Racca, Administrator
Department of Human Services
Phone: 401.462.1879

Finding 2010-38

DEPARTMENT OF HUMAN SERVICES - FISCAL AGENT OVERSIGHT - MEDICAID

DHS is highly dependent on the Medicaid Management Information System (MMIS) operated by its fiscal agent to process claims on behalf of eligible Medicaid beneficiaries and provide controls over disbursing state and federal funds and other aspects of Medicaid program administration. DHS has delegated many critical program operations to its fiscal agent such as billing for third party recoveries and drug rebates, administering provider enrollment and eligibility, and conducting surveillance and utilization reviews over paid claims activity. Oversight of these operations by DHS is essential to ensure that the fiscal agent complies with program regulations, and that related controls are in place and operating as designed. This is critically important considering the authority delegated to and dollar value of disbursements processed by the fiscal agent.

We have recommended in prior audit reports that DHS improve its oversight by monitoring the internal control procedures and financial activities employed by the fiscal agent. Monitoring is necessary to ensure that effective controls are in place over program disbursements, and that financial data is being accurately reported for presentation in the State's financial statements and federal reports. Financial monitoring procedures have not been fully developed, and responsibility for financial monitoring has not been centralized or well coordinated. DHS may need additional resources to fully accomplish these objectives. We noted the following matters:

- *DHS should ensure that the fiscal agent has adequate internal control policies and procedures in place to pay claims in accordance with program regulations and to control cash disbursements made on behalf of the State.* The internal control structure through which the fiscal agent processes Medicaid claims is totally separate and distinct from the State's accounting system and related control procedures used to disburse other state expenditures. During fiscal 2010, the fiscal agent's control structure was not evaluated independently in the form of a "SAS 70" review or by utilization of other means by DHS. A Type II "SAS 70" review, which includes testing the operating effectiveness of the fiscal agent's documented controls over Medicaid claims processing should be performed annually as part of DHS's monitoring of fiscal agent activities.

- *DHS has not developed procedures to effectively monitor the financial activities of the fiscal agent*. For example, DHS has not implemented sufficient procedures to verify MMIS financial data used to record program activity and prepare federal reports. Additionally, procedures are not in place to ensure all prescription drug rebates are billed and collected, provider accounts receivable balances are accurately reported, and third party liabilities have been identified and collected. Most importantly, the fiscal agent performs incompatible functions of billing, recording, and receiving drug rebates, third party liability collections, and provider refunds. While the fiscal agent does have documented control procedures relating to these activities, DHS does not have formalized policies requiring the evaluation of these controls as mandated risk assessment activities that would serve as an important part of DHS's overall controls over Medicaid activities performed by its fiscal agent.

The above issues in conjunction with the control deficiency noted in Finding 2010-37 relating to DHS's overall IT security over the MMIS must be addressed to better safeguard Medicaid operations delegated to the State's fiscal agent. Performance of an annual Type II "SAS 70" examination of the fiscal agent's internal control would provide the State with additional assurance regarding the effectiveness of control procedures over Medicaid program expenditures totaling $2 billion in fiscal 2010. Such assurance is particularly important considering that the operations of the State's fiscal agent are separate and distinct from any of the State's other centralized control processes.

A Type II "SAS 70" examination of the MMIS was subsequently performed during December 2010.

RECOMMENDATIONS

2010-38a Obtain an annual Type II "SAS 70" examination performed by independent certified public accountants of the fiscal agent's internal control policies and procedures.

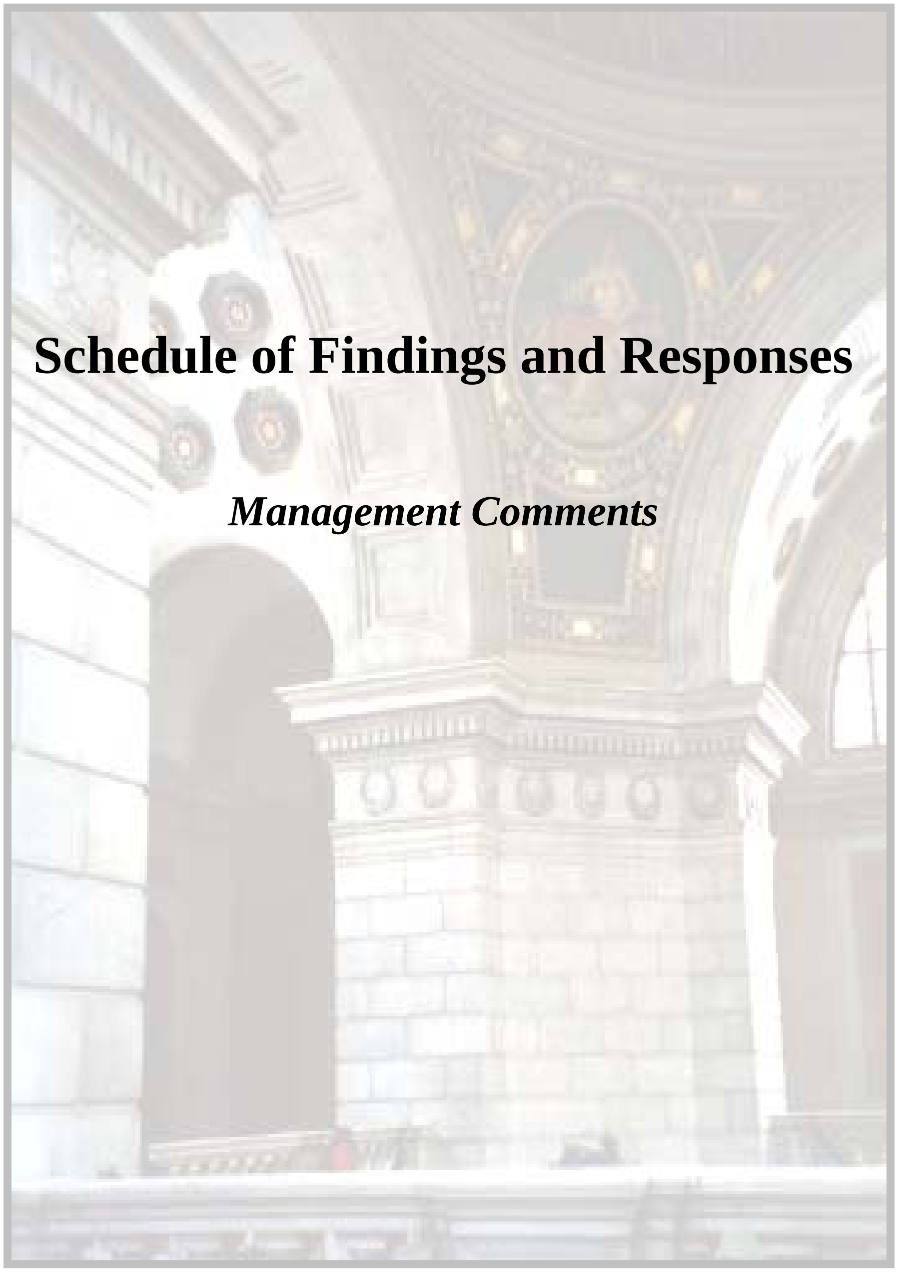
2010-38b Take a more active financial oversight role with respect to the fiscal agent by enhancing procedures to (1) verify information from the MMIS used to record program activity and prepare federal reports, (2) monitor the billing and collection of drug rebates and (3) ensure third party liabilities are identified and collected.

Corrective action plan / auditee views:

A SAS 70 Type II audit of the internal control policies and procedures was scheduled and conducted during the two week period beginning December 6, 2010. As noted above, the audit was originally scheduled for April 2010, but was canceled due to the flooding of the fiscal agent's office.

Anticipated Completion Date: June 30, 2011

Contact Person: *Ralph Racca, Administrator*
Department of Human Services
Phone: 401.462.1879



Schedule of Findings and Responses

Management Comments

Management Comment 2010-1

DEPARTMENT OF REVENUE – YEAR-END TAX ACCRUAL CALCULATIONS

The Department of Revenue and Office of Accounts and Control should revisit and revise, as appropriate, the methodology used to calculate the fiscal year-end tax accruals. The assumptions and date underlying significant estimates should be periodically reassessed to ensure the estimates are appropriate and reflective of current methods and data. For example, since most personal income tax returns are filed on a calendar year basis, estimates of refunds and additional taxes due must be used to calculate refunds payable or taxes receivable at fiscal year end. Such estimates are based on historical data but must also be updated to reflect current filing trends, economic conditions, changes in tax structure, and withholding rates. Personal income tax rates and withholding rates changed effective January 1, 2011. Additionally, the estimates and accrual methodology, need to more fully consider the impact of taxpayers who elect to carryforward any overpayments rather than receive a refund.

Absent changes warranting revision of estimates, accrual methodologies should be employed consistently. We noted that the estate tax accrual methodology was changed in fiscal 2009 and then, in fiscal 2010, reverted back to the fiscal 2008 methodology.

RECOMMENDATION

MC-2010-1 Revisit and revise, as appropriate, the methods for calculating tax revenue accruals. Apply such methodologies consistently.

Corrective action plan / auditee views:

The current process used to calculate the receivable and payable for personal income taxes is being reviewed and will be modified to address any identified issues.

Anticipated Completion Date: June 30, 2011

Contact Person: Marc Leonetti, Controller
Phone: 401.222.6731

Management Comment 2010-2

SUBRECIPIENT MONITORING – 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 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-2010-2a 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-2010-2b Build a database of all subrecipient entities that receive state and/or federal grant funding.

Corrective action plan / auditee views:

The centralization of sub-recipient monitoring related to Single Audit Reports will require the transfer of FTE's to the centralized department or the creation of additional FTE's. Therefore, this will require the collective efforts of the Budget Division as well as the affected agencies to accomplish. The centralization of this function will continue to be researched.

Anticipated Completion Date: June 30, 2012

Contact Person: Marc Leonetti, Controller
Phone: 401.222.6731

Management Comment 2010-3

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 $2.5 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 does not have adequate controls in place 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-2010-3 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:

The major and routine federal drawdowns are currently performed on a same day basis, thus materially reducing the float exposure. The Office of the General Treasurer in conjunction with the Office of Accounts and Control will review the benefits of centralizing and automating the withdrawal of the remaining federal funds with the implementation of the appropriate accounting system module.

Anticipated Completion Date: June 30, 2011

Contact Persons: *Ken Goodreau, Chief Investment Officer*
Office of the General Treasurer
401.222.8578

Marc Leonetti, Controller
401.222.6731

Management Comment 2010-4

REQUIRE PAYROLL DIRECT DEPOSIT FOR ALL EMPLOYEES

State employees currently have the option of being paid by check or direct deposit to their financial institution. Approximately 80% of state employees have opted for direct deposit. The costs to disburse employee payroll through direct deposit are significantly less than for traditional paper checks. Savings accrue from eliminating specialized security check paper, printing costs as well as costs associated with the physical distribution of checks to the various departments and agencies throughout the State.

The State should require direct deposit for all employees to accomplish savings and achieve administrative efficiencies.

RECOMMENDATION

MC-2010-4 Require all state employees to be paid through direct deposit.

Corrective action plan / auditee views:

The Department of Administration agrees that this is an area that could be enhanced and has researched a similar initiative. The department's initiative includes a self-service portal for employees to view or print their advices. The portal will allow the State to stop printing and distributing advices that are required for employees who are on direct deposit, and thereby accomplish greater savings. It is important to note that this initiative may require legislative change and / or a change in the collective bargaining agreements to move forward. The department will continue to research this project.

Anticipated Completion Date: June 30, 2012

Contact Person: Marc Leonetti, Controller
Phone: 401.222.6731

Management Comment 2010-5

IMPROVING CASH RECONCILIATION EFFICIENCY

The General Treasurer's Office should continue to explore options to further automate the cash reconciliation process with the State's financial institutions. Electronic matching could be facilitated by aligning transaction detail between the bank and the State's accounting system to minimize any differences. Opportunities for automating the reconciliation process should be explored within the State's accounting system.

RECOMMENDATION

MC-2010-5 Explore options to increase automation of the reconciliation process with the State's financial institutions by aligning the manner in which transactions are processed by both the bank and accounting system to allow electronic matching for reconciliation purposes.

Corrective action plan / auditee views:

The cash reconciliation process was improved near the end of 2010, with the installation of a download, sort and match process. The benefits of further matching automation will be considered and evaluated against the costs of such development.

Anticipated Completion Date: June 30, 2011

Contact Person: Chris Feisthamel, Chief Operating Officer
Office of the General Treasurer
401.222.8550

Management Comment 2010-6

CHILD SUPPORT COLLECTIONS-RECONCILIATION OF ESCROW LIABILITY

The State's Office of Child Support Services (Child Support) does not reconcile child support collections and disbursements recorded in its computer system (INRHODES) with amounts recorded in the State's accounting system. Child Support collections approximated $84 million in fiscal 2010. All Child Support collections are recorded in an escrow liability account in the State's General Fund. The lack of reconciliation of this escrow liability account over the years has resulted in an accumulated balance that Child Support has been unable to reconcile to its departmental records. The reconciliation of this escrow liability account on an on-going basis and the resolution of the balance reported in the State's accounting system would improve control over Child Support program receipts and disbursements, as well as the State's controls over financial reporting.

At June 30, 2010, the balance of undistributed collections reported in the State's RIFANS accounting system totaled $4.2 million. The State should consider establishing a new account which would allow Child Support to reconcile current activity as it is recorded and allow the original escrow account to disburse over a period of time to resolve the current unreconciled balance. Child Support should consider whether new or additional reporting of its program activity will be required to accomplish these objectives.

RECOMMENDATIONS

MC-2010-6a Reconcile Child Support program activity reported by departmental records with the reported escrow liability balance in the State's accounting system on a monthly basis.

MC-2010-6b Implement procedures to resolve the unreconciled escrow liability account balance reported at June 30, 2010.

Corrective action plan / auditee views:

The Office of Accounts and Control will work jointly with the DHS and the Office of Child Support Services to develop a process to reconcile this account and resolve the outstanding variance.

Anticipated Completion Date: August 15, 2011

Contact Person: Peter Keenan, Associate Controller-Finance
Phone: 401.222.6408

Management Comment 2010-7

TIMELY RESOLUTION OF TAX REMITTANCES BY THE DEPARTMENT OF LABOR AND TRAINING (DLT)

Most remittances of Unemployment Insurance, Temporary Disability Income, and Job Development Fund taxes are made electronically – an electronic deposit is made to the State's bank account and a data file containing taxpayer identification, amount, tax and tax period is transmitted to DLT's revenue unit. In certain instances, the electronic tax remittances are not accepted by DLT's tax mainframe system (the system) upon initial submission, usually due to use of an incorrect account number. These rejected or "kicked" transactions require manual resolution by DLT before they can post to the system. Delays of a month or longer in resolving these transactions are common. Additionally, these errors recur until eventually corrected by the taxpayer (or typically the employer's payroll service company).

The unresolved rejected transactions result in incorrect taxpayer account balances and cause funds to remain in the State's "combined tax" bank account. The combined tax account is the initial deposit account that all employer taxes (UI, TDI, JDF) are deposited until the total deposit is distributed based on posting of the electronic remittance data. Electronic transaction data that is rejected due to incorrect account numbers or other data should be immediately researched and corrected to allow timely distribution of tax collections to the appropriate benefit program (UI, TDI, JDF) and to accurately reflect taxpayer account balances.

RECOMMENDATION

MC-2010-7 Investigate and resolve, on a timely basis, employer tax remittances that are rejected by the DLT tax mainframe system.

Corrective action plan / auditee views:

Payroll companies file thousands of quarterly returns on behalf of their clients. Many records from new clients or clients that maybe successor/predecessor employers have incorrect or old employer account numbers. The employer account numbers are assigned by Employer Tax section in the Division of Taxation.

Each filing quarter, the Employer Tax section receives a list of employers who filed using incorrect employer account numbers. This list is assigned to a Principal Revenue Agent to research and resolve. During fiscal year 2010, staff reductions caused this process to be *delayed. During the last quarter of calendar year 2011, the report was reviewed and resolved by February 7th, only one week after the due date. The correct employer account number is forwarded to the appropriate payroll company to update their records to resolve this issue going forward.*

Taxation will continue to examine and review this process to ensure that remittances are reconciled timely and accurately posted to the mainframe system.

Anticipated Completion Date: June 30, 2011

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

Management Comment 2010-8

IMPLEMENTATION OF GOVERNMENTAL ACCOUNTING STANDARDS BOARD STATEMENT 54 (GASB 54)- FUND BALANCE REPORTING AND GOVERNMENTAL FUND TYPE DEFINITIONS

The State should begin to prepare for GASB 54 - the new governmental accounting standard for reporting governmental fund balance. This new standard is effective for fiscal 2011 and redefines the classifications of fund balance for governmental funds. Beginning in fiscal 2011, the State will need to categorize fund balance into one of the following five categories:

- **Nonspendable Fund Balance** is used to account for amounts which cannot currently be spent, including prepaid expenses, amounts held in inventory, balances of long-term notes and loans receivable, and value of land and other property acquired and held for resale.

- **Restricted Fund Balance** represents fund balance which has constraints placed on the use of the funds by creditors, grantors, contributors, or laws and regulations of outside governments (i.e., federal or state laws); or through constitutional provisions or enabling legislation.

- **Committed Fund Balance** will be utilized to identify fund balance which has been restricted through actions of the government's highest level of decision-making authority. Management will be required to provide documentation to support balances that are presented as committed fund balance. This documentation may take the form of resolutions, budget articles, etc. Once an amount has been reported as committed fund balance it must be used for the committed purpose, or action must be taken by the government's highest level, in the same manner that was taken to establish the committed fund.

- **Assigned Fund Balance** is used to represent the amount which is set-aside to be used for a specific purpose, but does not meet the definition of restricted or committed fund balance. Committed and assigned fund balance both represent restrictions placed on fund balance internally by the government. The distinction between the two is that committed fund balance is through the government's highest decision making authority, while assigned fund balance can be made by the governing body, finance or budget committee, or an official who has the governing body's authority to assign amounts for specific purposes.

- **Unassigned Fund Balance** will be used primarily in the General Fund of the governmental entity. This balance represents the fund balance portion which does not meet the requirements of the other classifications. The only way a fund other than the General Fund can have an unassigned fund balance is if the fund overspent the restricted, or committed resources, resulting in a deficit to that fund. In such an event, the unassigned fund balance will in fact be a deficit fund balance. If a special revenue fund, capital projects fund or other governmental type fund has fund balance which does not meet the criteria of restricted or committed, then it must be presented as assigned fund balance. Moreover, by including the fund balance in that specific fund the governmental entity has assigned the fund balance to meet the specific purposes of that fund.

GASB 54 also clarifies the definitions for governmental fund type classifications. The State will need to re-evaluate how it utilizes and classifies certain governmental fund types to ensure that the uses are consistent with the clarified guidance. The definition of the **special revenue fund type** is probably most impacted by GASB 54. According to the clarified guidance, a fund classified as a special revenue fund must have revenue or proceeds from specific revenue sources which are either restricted or committed for a specific purposes other than debt service or capital projects. The definition of **capital project funds** has been also expanded to include restricted, committed, or assigned funds which are to be used for the acquisition or construction of capital facilities **and** other capital assets.

The State should consider the following in preparation of implementing GASB 54 for fiscal 2011:

- Ensure that actions to commit fund balance take place prior to the end of the fiscal year and that appropriate documentation is accumulated.

- Management should develop policies and procedures which provide guidance on the order for which fund balance is liquidated as expenditures are incurred. This policy would be applied when a specific fund has various classifications of fund balance and the expenditure meets the requirement of any one of the classifications.

- The accounting policies and procedures for determining the order in which funds are utilized must be disclosed in the notes to the financial statements.

- Note disclosures must define the government’s highest level of decision making authority and the formal action required to establish and remove the commitment.

- Determine the policies and level of management authorization required for the assignment of amounts for specific purposes. This information will be required within the State’s note disclosures.

- Perform a review of the most recent audited financial statements and prepare a spreadsheet of all special revenue funds. Identify the revenue source for each of the special revenue funds and the composition of the current fund balance. If the special revenue was the result of transfers from the General Fund or another fund of the governmental entity, and there is no identifiable revenue base, then the fund should be reclassified and included in the General Fund. Once in the General Fund the fund balance should be identified as committed, assigned, or unassigned, dependent on the constraints applied by the government.

RECOMMENDATION

MC-2010-8 Consider the above guidance when implementing GASB 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

Corrective action plan / auditee views:

The financial reporting section within Accounts and Control has already started the process to implement GASB 54.

Anticipated Completion Date: June 30, 2011

Contact Person: Peter Keenan, Associate Controller-Finance
Phone: 401.222.6408

Management Comment 2010-9

DEPARTMENT OF REVENUE – HISTORIC TAX CREDIT MAINFRAME POSTING

The Division of Taxation has identified a specific code for tracking the Historic Preservation Investment Tax Credits within the Taxation systems. However, not all of the credits are being posted to the assigned code. In some instances, the credit is posted to the Investment Tax Credit and/or the Historic Residence Tax Credit. As a result, the Division of Taxation must research and track the Historic Preservation Investment Tax Credit offline. When incorrect postings are identified by the Division of Taxation, corrections are not made to the mainframe which can cause the Historic Preservation Investment Tax Credit transfers, as reported by the mainframe systems, to be misstated.

RECOMMENDATION

MC-2010-9 Establish controls over coding Historic Tax Credits in the Taxation mainframe.

Corrective action plan / auditee views:

As part of the Fiscal Year 2012 budget request, the Division of Taxation requested funding for an integrated tax system. This system will, among other things, overhaul the front end entry systems, accounting and processing systems. The new system will allow for greater data capture and more accurate reporting of credits, exemptions and modifications that are currently tracked off-line. The current mainframe system records credits reported by a taxpayer in calculating the regular tax liability, but some credits may not ultimately be utilized due to the laws governing the alternative flat tax system. Procedures will be established to ensure that all credits utilized for Historic Tax Credits are adjusted in the mainframe and properly recorded in the taxpayer's account.

Anticipated Completion Date: June 30, 2011

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

Management Comment 2010-10

DEPARTMENT OF REVENUE – RECONCILIATION OF CASH RECEIPTS POSTED TO THE TAXATION MAINFRAME SYSTEMS TO RIFANS

The Division of Taxation (Division) does not reconcile receipts posted to its mainframe system with receipts reported in the RIFANS accounting system. Although the Division does reconcile their cash receipts ledger to RIFANS, controls could be improved if the Division reconciled receipts reported within the Taxation mainframe system 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 the Taxation mainframe system (Division's official record for tracking tax payments and refunds) would provide enhanced control over the State's reporting of tax revenue.

RECOMMENDATION

MC-2010-10 Develop the reporting capability within the Taxation mainframe system to facilitate reconciling receipts reported by Taxation's mainframe system with the RIFANS accounting system.

Corrective action plan / auditee views:

One of the major priorities of the Division 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 15 of these databases. As part of the fiscal year 2012 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 Division of Taxation is currently working with DoIT programming staff to develop procedures to balance deposits recorded in RIFANS to the mainframe.

Anticipated Completion Date: June 30, 2011

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

Management Comment 2010-11

ACCOUNTING FOR AGENCY FUND DEPOSITS

The State reported $98.7 million in agency fund deposits at June 30, 2010 that constituted pledged securities for certain entities doing business in the State and court deposits held by the Judiciary. The underlying transaction activity for these deposits is not being accounted for within the State's accounting system. Instead, the State adjusts year-end accounting system balances based on deposit amounts reported at year-end for financial reporting purposes. Controls could be improved over agency fund deposits by recording all deposit transactions within the State accounting system and requiring periodic reconciliation of these balances to the underlying bank or trustee statements. This would implement the same control procedures over agency fund deposits that are in place over all other deposits reported by the State.

RECOMMENDATION

MC-2010-11 Record all agency fund deposit transactions in the State accounting system with periodic reconciliation of reported balances to underlying bank or trustee statements.

Corrective action plan / auditee views:

The Office of Accounts and Control will work with the impacted agencies, the Judiciary and Department of Business Regulation, to develop a process to record this activity in the general ledger and reconcile balances to subsidiary ledgers on a regular basis.

Anticipated Completion Date: December 31, 2011

Contact Person: Peter Keenan, Associate Controller-Finance
Phone: 401.222.6408

Management Comment 2010-12

STATEWIDE CENTRALIZED COST ALLOCATIONS

The State discontinued the 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 has increased the risk that federal revenue and expenditures could be overstated and be realized by officials responsible for the administration of the State's federal programs.

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 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-2010-12 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 Technology, and Facilities Management, the accounting of these costs does not 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, 2012

Contact Person: Bernard Lane, Associate Director – Financial Management
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