State of Rhode Island

AUDIT RESULT HIGHLIGHTS
and
MANAGEMENT COMMENTS

Single Audit
Fiscal Year Ended June 30, 2004

Ernest A. Almonte, CPA, CFE
Auditor General

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

ERNEST A. ALMONTE, CPA, CFE
Auditor General
ernest.almonte@oag.ri.gov

STATE of RHODE ISLAND and PROVIDENCE PLANTATIONS

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July 29, 2005

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We have completed our Single Audit of the State for the fiscal year ended June 30, 2004 and have issued our *Single Audit Report* separately. This communication supplements the *Single Audit Report* and includes audit result highlights as well as management comments and related recommendations. In our opinion, these management comments, while less significant than findings included in the *Single Audit Report*, still warrant communication and the attention of the State's management.

Sincerely,

Ernest A. Almonte

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Auditor General

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OVERVIEW

We performed a comprehensive audit of the State of Rhode Island for the fiscal year ended June 30, 2004. The State's basic financial statements and our *Independent Auditor's Report* thereon are presented in the *State's Comprehensive Annual Financial Report*. The *Single Audit Report* includes the State's basic financial statements, our report on internal control over financial reporting and compliance, and our opinion on compliance with requirements applicable to each major federal program and our report on internal control over compliance. The *Single Audit Report*, required by federal law, also includes findings and recommendations, relating to both the financial statements and the administration of federal programs, deemed to be reportable conditions, instances of material noncompliance, or matters required to be reported by OMB Circular A-133. The results of our audit, as communicated in various opinions, reports, and findings and recommendations, are summarized below:

Financial Statements –

- We opined on the fairness of presentation of the State's basic financial statements (government-wide, major funds and aggregate remaining fund information). Our opinions were qualified because:

  Government-wide financial statements – governmental activities -

  - Capital assets reported on the governmental activities financial statements are incomplete. Due to insufficient inventories of capital assets and weaknesses in accounting controls, we were unable to satisfy ourselves as to the carrying value of the furniture and equipment, depreciable intangible, and building improvement categories of capital assets and related depreciation.

  Fund financial statements –

  - We could not satisfy ourselves as to the completeness of accounts payable and the related expenditures, federal revenue, and federal receivables reported for the Intermodal Surface Transportation Fund (a major fund).

  - Outstanding encumbrances at June 30, 2004 were not presented as a reserved component of fund balance within the State's major and non-major governmental funds.

  Our opinions on the State's business–type activities and the aggregate discretely presented component units included within the government-wide financial statements were unqualified.

- We issued a 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.* This report references twenty-eight reportable conditions of which 17 are considered material weaknesses in control over financial reporting. A table on pages 4 and 5 demonstrates the wide-ranging impact of the reportable conditions on multiple functional areas of the State's operations. These reportable conditions and related recommendations are included in the State's *Single Audit Report* for the year ended June 30, 2004.

- We presented twenty-three (23) management comments and recommendations (included herein beginning on page 6) intended to improve internal control or enhance compliance with laws, regulations or contracts. In addition, we communicated one management comment relating to the operations of the Division of Taxation separately and confidentially to avoid any unintended impact on taxpayer compliance. These management comments are less significant findings than those considered to be reportable conditions, yet, in our opinion still warrant communication and the attention of the State's management.

Federal Programs –

- We issued a report on compliance with requirements applicable to each major federal program and on internal control over compliance in accordance with OMB Circular A-133. This report references 55 reportable conditions of which 7 are considered material weaknesses in internal control over compliance with federal requirements. These reportable conditions and related recommendations are included in the State's *Single Audit Report* for the year ended June 30, 2004.

DISCUSSION OF THE SIGNIFICANCE OF THE AUDIT RESULTS

Beginning with fiscal 2002, the State's ability to generate reliable and timely financial statements has been seriously compromised. This was, and continues to be, caused by:

- an inadequate accounting system that does not meet the State's financial reporting and operational needs;
- serious control weaknesses that complicate financial reporting and impede efficient audits;
- insufficient personnel resources allocated to accounting and financial reporting matters;
- a long-standing lack of investment in and management attention to building financial controls and systems that support financial reporting; and
- increasingly complex accounting and financial reporting guidelines promulgated by the Governmental Accounting Standards Board that continually raise the financial reporting standard to which the State is held.

The State's audited fiscal 2004 financial statements were not completed until thirteen months after fiscal year-end. Although this represents some progress (the fiscal 2003 financial statements were not completed until sixteen months after fiscal year end), our *Independent Auditor's Report* continues to be qualified for multiple reasons and the weaknesses in internal control are increasing not diminishing. Collectively, these control weaknesses raise serious concerns about the integrity of the State's financial information and its ability to effectively perform its day-to-day financial operations. Many of the issues were highlighted in past audits and remain uncorrected, continuing the risk of material misstatement of the State's financial statements.

Three important themes underlie many of the fiscal 2004 findings and recommendations --

- management is responsible for preparing financial statements in accordance with generally accepted accounting principles;
- management is responsible for establishing and maintaining internal control that will, among other things, initiate, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements; and
- management's reliance on information technology necessitates the implementation of comprehensive systems security policies and procedures designed to ensure data integrity and reliability and protect data from loss or corruption.

The specific weaknesses and causes of the late financial statements are described in detail in the reportable conditions included in the *Single Audit Report*. The management comments included herein are "second tier" findings which in many instances are very significant yet less serious than those deemed reportable conditions.

The State appropriately desires to return to a more acceptable timetable for publishing audited financial statements beginning with fiscal 2005. However, consideration must be given to the impact of the multiple control weaknesses that have not been addressed and continued to exist during fiscal 2005. These control weaknesses not only complicate the accumulation of data for financial reporting purposes but prevent a controls driven audit approach where the focus is on assessing the reliability of the State's controls thereby relying on information produced under the control structure. Instead, we are forced to adopt a more substantive audit approach, which ultimately requires more audit effort thereby lengthening the audit timeframe.

CONCLUSION

The State's financial reporting situation has multiple causes, many of which precede the last three fiscal years when financial statements have been significantly delayed. We believe a complete solution is multi-faceted as well. Increased personnel resources alone without a significant investment in effective financial systems will ultimately be an incomplete and only marginally effective solution. Investment in systems without individuals capable of designing and maintaining the systems will be equally ineffective.

The State's implementation of RISAIL in fiscal 2002 clearly did not address the State's financial management and financial reporting needs. Because of multiple system design flaws and accounting issues related to the implementation, significant resources and attention were required to just maintain basic operations and correct known problems. Little or no progress has been made in addressing the fundamental inadequacies of the State's financial systems. The numerous findings enumerated in the *Single Audit Report* or included herein as management comments will likely remain without implementation of an integrated accounting system that operates with effective internal control policies and procedures.

In conclusion, the State needs to place greater emphasis and priority on financial management and reporting. While each of our findings includes specific recommendations, some of which are broad in scope, we ultimately recommend that the State make significant investments in both systems and personnel to alter its current course of financial reporting. If made, the benefits of these investments should not only improve the timeliness of financial reporting, but should significantly enhance the State's overall financial management.

			Functional Impact Area					
Finding	Description	Material Weakness[2]	Financial Reporting	Accounting Controls	Financial management	Asset Management and Protection	Information Systems Security	Compliance With Laws and Regulations
2004-1	Controls Over Accounting and Financial Reporting – Statewide Accounting System	●	■	■	■	■		
2004-2	Controls Over Accounting Transactions – RISAIL Accounting System	●	■	■	■	■	■	
2004-3	Interfund Transactions and Interfund Receivables and Payables		■	■	■			
2004-4	Timely Bank Reconciliations	●	■	■	■	■		
2004-5	Accounting Controls over Investment Transactions	●	■	■	■	■		
2004-6	Accounting and Physical Control over Capital Assets	●	■	■	■	■		
2004-7	Control over Long-term Obligations	●	■	■	■			
2004-8	Controls over Data Accumulated for Purposes of Financial Reporting from Various State Information Systems	●	■	■	■	■		
2004-9	Accounting Controls over Federal Revenue	●	■	■	■			
2004-10	Encumbrances	●	■	■	■			
2004-11	Liability for Compensated Absences		■	■				
2004-12	Escrow Liability Balances	●	■	■	■			■
2004-13	Taxation – Controls over Electronic Funds Transfer Receipts		■	■			■	
2004-14	RISAIL Access Controls		■	■			■	
2004-15	Controls Over Taxation Systems		■	■			■	
2004-16	Controls Over Employee Payroll System		■	■			■	
2004-17	Comprehensive Disaster Recovery/Business Continuity Plan		■	■	■	■	■	

			Functional Impact Area					
Finding	*Description*	*Material Weakness[2]*	*Financial Reporting*	*Accounting Controls*	*Financial management*	*Asset Management and Protection*	*Information Systems Security*	*Compliance With Laws and Regulations*
2004-18	*Comprehensive Information System Security Policies and Procedures*		■	■	■	■	■	
2004-19	*Financial Reporting – Intermodal Surface Transportation Efficiency Act (ISTEA) Fund*	●	■	■	■			
2004-20	*Controls over the Identification and Recording of Year- End Accruals*	●	■	■	■			
2004-21	*Indirect Cost Recovery*		■	■				■
2004-22	*Lottery Gaming Systems – Logical Access Security*		■	■	■		■	■
2004-23	*Prepare Timely Bank Reconciliations – Employees' Retirement System*	●	■	■	■			
2004-24	*Improve Controls Over Financial Reporting – Employees' Retirement System*	●	■	■	■			
2004-25	*Implement Reconciliation Controls over the ANCHOR and General Ledger Accounting Systems – Employees' Retirement System*	●	■	■	■			
2004-26	*Improve controls over Data Entry to Ensure Correct Posting of Data to Employer Accounts – Employees Retirement System*	●	■	■	■			
2004-27	*Fiscal Agent Oversight – Medical Assistance Program*	●	■	■	■		■	■
2004-28	*Automated Data Processing (ADP) Risk Analysis and System Security Review*		■	■	■		■	■

(1) *Reportable conditions* involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State's ability to record process summarize and report financial data consistent with the assertions of management in the financial statements.

(2) A *material weakness* is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level, the risk that misstatements caused by error or fraud in amounts, that would be material to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

	Condition Description		Recommendations
MC-1	Fraud Risk Factors As required by Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit,* we assessed the State's policies and procedures designed to mitigate fraud risk factors. Management is responsible for designing and implementing systems and procedures for the prevention and detection of fraud. The risk of fraud can be reduced through a combination of prevention, deterrence, and detection measures. It is important to place a strong emphasis on fraud prevention and deterrence to persuade individuals from committing fraudulent acts. Our assessment found that the State has inadequate policies and/or procedures designed specifically for the purpose of mitigating fraud risks. In addition, several weaknesses relating to the State's internal controls relating to fraudulent financial reporting also increase the State's overall fraud risk factors. Policies and procedures specific to the prevention, deterrence and detection of fraud within operations of the State need to be developed and implemented to safeguard assets of the State and to ensure that the State's financial reporting process is not impacted by fraud. These policies and procedures could be incorporated into the existing Fiscal Integrity Act process which requires department directors to make an annual assessment and reporting of risks facing their department or agency.		MC-1 Develop and implement policies and procedures specific to the prevention, deterrence and detection of fraud, most importantly, as it relates to the misappropriation of assets and opportunities for fraudulent financial reporting.
MC-2	Accounting for Infrastructure Assets In accordance with GASB Statement No. 34, the State is required to retroactively report, beginning in its fiscal year 2006 financial statements, all major general infrastructure assets. This will require the State to report the historical cost for major general infrastructure assets that were constructed or significantly reconstructed, or that received significant improvements, in fiscal years ending after June 30, 1980 and through the fiscal year ended June 30, 2002. Annual infrastructure outlays have been reported since fiscal 2002, however, the retroactive component has not been included in the financial statements. The Office of Accounts and Control and the Department of Transportation began developing a process to accumulate the necessary data to meet this reporting requirement in a prior fiscal year but progress has slowed.		MC-2 Continue the process to accumulate the necessary infrastructure data to comply with GASB's retroactive infrastructure reporting requirements.

	Condition Description		Recommendations
MC-3	<u>Preparation of Required Disclosures for Deposits and Investments</u> Generally accepted accounting principles (GAAP) require various disclosures in the notes to the financial statements regarding deposits with financial institutions and investments. Effective with fiscal 2005, additional disclosures will be required due to the implementation of GASB Statement No. 40. Since the Office of the General Treasurer is responsible for cash deposits and investments, much of the information required for disclosure is within their control. A work-group comprised of staff from the Offices of Accounts and Control and the General Treasurer should be established to accumulate all the information needed to meet the GAAP disclosure requirements for deposits and investments.		MC-3 Establish a workgroup to accumulate all the information needed to meet the GAAP disclosure requirements for deposits and investments.
MC-4	<u>Government–wide Statements – Accounting for Deferred Financing Costs and Bond Premiums and Discounts</u> In accordance with GAAP, bond issuance costs and any premium or discount upon issuance are deferred and amortized over the life of the related bonds in the government-wide financial statements. The Office of Accounts and Control amortizes these amounts using the "straight-line" method rather than the effective interest method preferred by GAAP. When the amount of premium or discount is small the difference in amortization methods is immaterial, however, during fiscal 2004 the State sold GARVEE bonds at a premium of approximately $21 million. With a large premium, the difference is more significant. Accumulation of this data and calculation of the annual amortization amount is not accumulated within a comprehensive debt accounting system.		MC-4a Accumulate information to demonstrate that use of the straight-line method to amortize premiums and discounts does not result in a material difference when compared with the preferred effective interest method. MC-4b Accumulate bond issuance costs, premiums and discounts and related amortization within a comprehensive debt accounting system.
MC-5	<u>State Budget</u> The annual budget enacted by the General Assembly encompasses multiple funds (General, ISTEA, University and Colleges, TDI, Unemployment Insurance) in a comprehensive format by governmental function. For budgetary control purposes, the budget must be recorded within the accounting system and be segregated by distinct fund. The Budget Office should explore the possibility of including the fund information within the budget document to facilitate recording the budget within the accounting system and preparation of budget to actual comparisons for financial reporting purposes (which are prepared on a fund basis).		MC-5 Explore the possibility of including fund information within the budget document to facilitate recording the budget in the accounting system and preparing budget to actual comparisons.

	Condition Description		Recommendations
MC-6	<u>Controls Over Payroll Expenditures</u> Our testing of internal control over State Employee payroll expenditures noted the following inconsistent application of control procedures by State departments and agencies: • Employee timesheets were not maintained in accordance with the State's records retention policy. • Timesheets were found lacking employee signatures. • Timesheets are not required of all State employees. • One agency allowed the practice of supervisors completing and signing timesheets for employees. • One payroll attendance report certificate could not be produced by the Office of Accounts and Control.		MC-6a Ensure that all departments are complying with State policies and procedures relating to the administration of State employee payroll. MC-6b Ensure that supporting documentation for all State employee payroll expenditures is maintained.
MC-7	<u>Allocation of Payroll Expenditures</u> The payroll accounting system allows for the routine allocation of an employee's personnel costs to multiple accounts. Amounts are posted in the RISAIL accounting system based on the allocation percentages recorded in the payroll accounting system for that individual. We found an instance where 100% of a Department of Human Services employee's personnel costs were charged to the Child Support program within the Department of Administration. The Child Support Agency was unaware of the personnel costs being allocated to the program. Automatic allocation of personnel costs to accounts outside of a department should not be permitted. The Child Support agency was unaware of the allocated personnel costs because the detail information (payroll register) provided to each agency does not detail allocated charges – information is provided on the payroll register based on an employee's primary assigned account, irrespective of the ultimate allocation of costs.		MC-7a Restrict automatic allocation of personnel costs through the payroll system to only accounts established within a department. MC-7b Provide a report for each account indicating allocated personnel costs and the total amount allocated.

	Condition Description		Recommendations
MC-8	<u>Medicaid Claims Liability Estimation Process</u> The State estimates a liability for amounts owed at year-end to medical providers through the Medical Assistance Program. The estimation methodology employed by the State includes utilizing expenditure data and an average lag period for the various medical service types (inpatient hospital, outpatient, pharmacy, etc.) determined by the Medical Assistance claims payment system to estimate amounts owed at year-end. In addition, the State's calculation also includes information submitted by the various State departments (Mental Health, Retardation, and Hospitals, Children, Youth, and Families, Elderly Affairs, etc) to derive a net liability (claims due providers minus any cost offsets such as drug rebates) to record in the State's accounting system. Although the net liability reported by the State in recent years has been fairly stated, specific results for individual claim types have reflected significant differences. These differences, in many instances, have been noted for several years and suggest that State's current estimation process should be refined to minimize the risk of reporting a misstated claims liability in future years. We have had specific discussions with officials of the Department of Human Services during recent audits regarding specific segments of the estimation process that require improvement. The State now has multiple years of claims processing data that it can analyze to assist the refining of the estimation process.		MC-8 Address claim-type issues noted during recent audits to improve the Medical Assistance Claims Liability estimation process. These issues related to specific claim types that have been omitted and those where estimates do not tend to support actual claims payment results in recent years.
MC-9	<u>Coding of Debt Service Expenditures</u> The State does not currently record all debt service expenditures in the State accounting system in debt service natural accounts. This causes debt service expenditures in the State's financial statements to be misstated. In addition, the State does not reconcile debt service expenditures recorded in the State accounting system with actual payments made during the year reported by the General Treasurer's Debt Management Systems.		MC-9a Reconcile debt service expenditures recorded in the State accounting system with actual payments reported by the General Treasurer's Debt Management System. MC-9b Reprogram the State accounting system's financial statement generator (FSG) to ensure that all debt service expenditures are accurately reported in the State's financial statements.

	Condition Description		Recommendations
MC-10	<u>Transactions with Component Units</u> The State does currently attempt to align transfer amounts between the primary government and discretely presented component units. This results in reporting inconsistencies within the State's financial statements where transactions are reported inconsistently between the primary government and component units. These inconsistencies are caused by transactions being incorrectly coded within the State accounting system. For example, transactions reported as transfers in the general fund may be reported as expenses within component units. Timing differences also cause inconsistencies between the financial statements of the primary government and the component units.		MC-10a Improve natural account coding of transactions with component units in the accounting system. MC-10b Provide guidance to the State's Component Units on recording transactions with the Primary Government.
MC-11	<u>Taxation – Writeoffs</u> The Division of Taxation (Division) has established a policy whereby all receivables outstanding greater than 2000 days are automatically coded for write-off without considering whether payments are being made on these accounts. The Division should conduct an analysis of receivables outstanding greater than 2000 days and change their policy to write-off only inactive accounts where there is no or only remote chance of collection.		MC-11 Refine the tax receivable write-off policy to include provision for balances determined to be uncollectible in addition to the criteria of balances more than 2000 days old.
MC-12	<u>Taxation – Estimated Receivables</u> The Division of Taxation established personal income tax receivables on the taxation receivable system for various taxpayers based on estimated data received from the Internal Revenue Service (IRS). This data usually reflects additional income information identified by the IRS but does not take into consideration any deductions, exemptions, filing status, or cost basis that the taxpayer may have as a complete or partial offset to the identified income. This often results in an inflated receivable balance being reported by the Division. The Division's receivable system does not currently differentiate between these types of receivables and those derived from a taxpayer's filing of a tax return. Although we could not determine how much of the receivable balance was derived from estimates, we did identify $1.7 million of estimated receivable balances in fiscal 2003 that were ultimately reduced to $171,000 in fiscal 2004. Similarly, $1.9 million of estimated receivables were reduced to $3,500 in fiscal 2005. The Division should consider coding these receivables separately. This would allow more detailed analysis of these balances and an appropriate allowance for financial reporting purposes.		MC-12a Distinctly code tax receivable balances established based on data received from the IRS. MC-12b Once identified, determine whether the allowance on receivable balances derived from IRS data is adequate.

	Condition Description		Recommendations
MC-13	<u>Taxation – Accrual of Pari-mutuel Betting taxes</u> The Division of Taxation accrued total pari-mutuel betting taxes for the month of July instead of only receipts relating to June 2004 activities. This resulted in pari-mutuel betting taxes being overstated by $352,804 at June 30, 2004. Consistent accrual methodology should be observed.		MC-13 Ensure that only receipts relating to pari-mutuel activities for June 30th and prior are accrued at the fiscal year-end.
MC-14	<u>Taxation – Timely update of Taxpayer Balances</u> We noted the following exceptions during our testing of tax receivables reported by the Division of Taxation's receivable system: ❑ The Division's field audit section failed to update (increase) the taxation mainframe system for an additional assessment made on a taxpayer. ❑ The Division also failed to update (decrease) a taxpayer's balance once the taxpayer complied with a hearing agreement. Both of these instances resulted in inaccurate receivable balances being reflected on the Taxation mainframe system and the State's financial statements at June 30, 2004.		MC-14 Ensure compliance with Division policies and procedures for updating receivable balances in the Taxation mainframe system.
MC-15	<u>Taxation – Accounting for the Distribution of Motor Fuel Taxes</u> The General Laws establish the distribution formula for motor fuel taxes collected by the State. The Division of Taxation is responsible for the actual distribution of motor fuel cash receipts while the Office of Accounts and Control is responsible for financial reporting aspects. Changes in the distribution formula were made at two points during fiscal 2004. Differences existed in how the Division of Taxation interpreted and applied the rate changes and distribution formula changes compared to the Office of Accounts and Controls. At issue is whether the changes are effective for the month the Division of Taxation collects the revenue or the month the underlying taxable event occurs (e.g., taxes collected by wholesalers in April are paid to the Division of Taxation in May). The accounting and distribution of motor fuel taxes should be consistent.		MC-15 Distribute motor fuel cash receipts in the same manner in which Accounts and Control accounts for motor fuel revenue for financial reporting purposes.

	Condition Description		Recommendations
MC-16	Taxation – Controls over the Recording of Accounts Receivable Correction Adjustments The Division of Taxation (Division) should strengthen controls over Accounts Receivable Correction (ARC) transactions posted to their mainframe systems. Controls are not in place to ensure that the total of ARC transactions posted 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 be detected by management.		MC- 16 Develop the reporting capability within the Taxation mainframe system to summarize ARC transactions posted to the system to improve data entry controls.
MC-17	Taxation – Reconciliation of Cash Receipts posted in Accounts Receivable Systems to RISAIL The Division of Taxation (Division) does not reconcile receipts posted to its receivable systems with receipts reported in the RISAIL accounting system. Although the Division does reconcile their cash receipts ledger to RISAIL, controls would be improved if the Division reconciled receipts reported within the Taxation receivable systems with RISAIL. RISAIL 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 receivable systems (Division's official record for tracking tax payments and refunds) would provide enhanced control over the State's reporting of tax revenue.		MC-17 Reconcile receipts reported by Taxation's mainframe system with the RISAIL accounting system.
MC-18	Taxation – W-3 Reconciliations 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. Although the employers were timely in submitting the data, the Division did not post these transactions until 7 to 11 months later. Due to staff shortages and other priorities, such as processing personal income tax refunds, the W-3 data is not entered in a timely manner on the Taxation receivable system. For electronic filers, the W-3 data is calculated from the electronic W-2 file; however, this calculation is not posted to the system until all the paper W-3 forms have been entered. When the W-3 data is loaded, reports detailing overpayments, underpayments, and discrepancies are run. Because these reports are not run timely, the Division is unaware of potential taxes, interest, and penalties that may be due. The Division should process the W-3 reconciliations more timely to identify and collect any underpayments.		MC-18 Process W-3 reconciliations more timely to identify and collect any underpayments.

	Condition Description		Recommendations
MC-19	<u>Revenue Accruals – Department of Labor and Training</u> Reported tax revenue accruals at June 30, 2004 relating to the Department of Labor and Training (DLT) did not agreed to the actual employer tax accounts on file at DLT'S Employer Tax Unit. DLT provided the Office of Accounts and Control with estimated tax revenue data and failed to update the amounts with actual tax revenue data when determined. This resulted in reported taxes receivable for the Employment Security fund for being understated by $374,815 at June 30, 2004. In addition, reported taxes receivables were overstated for the TDI and Job Development Funds in the amounts of $108,389 and $264,968, respectively.		MC-19 Implement procedures to ensure that DLT taxes receivable are fairly stated in all material respects in the financial statements at June 30, 2004.
MC-20	<u>Recording Cash Receipts – Department of Labor and Training</u> Cash receipts totaling $414,299 for employer taxes received on or before June 30, 2004 were erroneously recorded as fiscal 2005 revenue. These amounts were initially deposited in DLT's combined tax account in June 2004 and moved to the respective Employment Security and TDI tax accounts in July 2004. The General Treasurer's office used the July dates when preparing the receipt vouchers instead of the date the funds were deposited in the combined tax account causing the revenue to be posted in the wrong fiscal year.		MC-20 Ensure that DLT tax receipts are posted in the appropriate fiscal year based on the actual data received.

	Condition Description		Recommendations
MC-21	Coordinated Financial Management The State should consider appointing a Chief Financial Officer with the intent of better coordinating and controlling the financial management, including financial reporting, aspects of State operations. This position should be empowered with the resources and the authority to ensure that all agencies comply with coordinated financial management and financial reporting policies and procedures. Various units of State government perform financial management functions with the Budget Office, the Office of Accounts and Control and the Office of the General Treasurer assuming primary responsibility. Other agencies are responsible for a significant amount of the State's financial operations – for example the Department of Human Services is responsible and has its own systems to administer a significant portion of the overall State budget. Many of the control weaknesses related to financial reporting stem from a lack of coordination of the State's various operating units. Because the current statewide accounting system is not integrated, many independent accounting system and departmental systems contain essential data for financial management and financial reporting purposes. Certain of these data sources are redundant while others are not reconcilable or consistent with other data sources. Significant effort will be required to integrate these data sources into a comprehensive integrated financial management system. Improvement is also needed in enforcing uniform policies and procedures among state agencies. A Chief Financial Officer with the authority to prioritize and align resources to meet the State's overall financial management objectives could coordinate these efforts.		MC-21 Consider appointing a Chief Financial Officer to coordinate the financial management, including financial reporting, aspects of State operations.

	Condition Description	Recommendations
MC-22	<u>Subrecipient Monitoring – Review of Single Audit Reports</u> 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.	MC-22a 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-22b Build a database of all subrecipient entities that receive state and/or federal grant funding.

	Condition Description		Recommendations
MC-23	<u>Drawdowns of Federal Funds</u> 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 approximates $1.5 billion each year. Consequently, the timing of the 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.		MC-23 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.

The following corrective action plan was developed by the State's management in response to our management comments.

	Action Planned	Contact Person(s)	Planned Completion Date
MC-1	The State Controller will develop and implement policies and procedures to prevent, deter and detect fraud in conjunction with the Financial Integrity and Accountability policies and procedures.	Lawrence Franklin, Jr.	June 30, 2006
MC-2	The State Controller is working with the state Department of Transportation to accumulate the necessary infrastructure data to comply with GASB's retroactive infrastructure reporting requirements by June 30, 2006.	Lawrence Franklin, Jr.	June 30, 2006
MC-3	The State Controller will establish a workgroup to accumulate all of the information needed to meet the GAAP disclosure requirements for deposits and investments for the FY 2005 CAFR. Treasury agrees with Comment No. 3 and will comply with any request to submit short-term investment information data to the extent possible. Guidance and directions, however, need to be provided to Treasury as to the <u>specific</u> reporting requirements from GASB 40.	Lawrence Franklin, Jr. Office of General Treasurer	June 30, 2006
MC-4a	4a. The State Controller will accumulate information to demonstrate that use of the straight-line method to amortize premiums and discounts does not result in a material difference when compared with the preferred effective interest method.	Lawrence Franklin, Jr.	June 30, 2006
MC-4b	4b. A comprehensive debt accounting system will be considered as part of the multi-year strategy for the continued implementation of the Oracle Application Suite.	Jerome Williams Tracy Williams	June 30, 2006
MC-5	The Budget Office prepares two types of budget documents for release to the public and the General Assembly: the annual appropriations act, a legal document which includes proposed supplemental appropriations for the current year and recommended amount for the budget year by appropriation line item, and six technical/policy documents that provide descriptive explanations and account detail relating to appropriation line item expenditures. The annual appropriations act is structured to present supplemental appropriations and budget year appropriations programmatically by source of funds and line item for each department. The document shows the general revenues, federal funds, restricted receipts, and other funds appropriations for each program in each department. Other funds appropriations are further broken out to show the source of other funds, such as the Rhode Island Capital Fund, Gasoline Tax, Temporary Disability Insurance Fund, Employment Security Trust Fund, and University and College Funds. For most departments, all appropriation line items are within the General Fund, however, for several departments a portion of the appropriation line items in the department are either a separate fund (e.g., Temporary Disability Insurance Trust Fund and Employment Security Trust Fund) or part of a separate fund. Federal funds appropriation lines in RIHEAA, RI Public Telecommunications Authority, and RIDOT are part of separate funds. Rhode	Rosemary Booth-Gallogly	June 30, 2006

	Action Planned	Contact Person(s)	Planned Completion Date
	Island Capital Fund, which is actually in the Bond Capital Fund, is budgeted generally in the General Fund and cash is transferred in as a resource. However, for the Board of Governors/Higher Education it is budgeted in the Board of Governors/Higher Education Fund. If the appropriations act is restructured to appropriate monies by fund, the document would lose its programmatic integrity. Besides the General Fund, appropriations would be spread across numerous funds, including the University-College Fund, the Temporary Disability Insurance Fund, Intermodal Surface Transportation Fund, State Employees Retirement Fund, the Public Telecommunitications Authority Fund, the Higher Education Assistance Authority Fund, and various others. Due to space limitations associated with the printed appropriations act, additional columns cannot be reasonably added to show appropriations for each fund. For these reasons, the Budget Office believes it is not practical to show appropriations by fund in the appropriations act. Furthermore, it would not enhance programmatic presentation of appropriations. As noted above, the Budget Office publishes six budget documents that provide descriptive explanations and account detail relating to line items in the appropriation act. These include the Executive Summary, the Budget, the Technical Appendix, the Personnel Supplement, the Capital Budget, and the Budget As Enacted. The Technical Appendix provides a detailed listing of expenditures by department, program, and account that make up the appropriation line items. The data shown for each account include a nine-digit legacy account number, an eight-digit RISAIL account number, an account name, two years of expenditure history, the enacted appropriation for the current year, the revised appropriation for the current year, and the recommended appropriation for the budget year. Associated with each eight-digit RISAIL account number is an additional four-digit fund/agency number prefix, where the first two digits represent the "fund" identifier and the last two digits represent the "agency or department number" identifier. A "1073" prefix for example, indicates that the account is in the General Fund (digits 10) and the part of the Department of Labor and Training (digits 73). A "6473" prefix indicates the account is in the Employment Security Trust Fund (digits 64) and, again, part of the Department of Labor and Training. While historically the Budget Office has not included the fund/agency prefix identifier with each RISAIL account number listed in the Technical Appendix, the Budget Office will do so in the future to enhance comparisons of budget to actual expenditures by fund. Also, the Budget Office will provide in the Technical Appendix a summary page showing expenditures by fund. The Budget office is not in a position to obligate that such a schedule would be provided by the General Assembly for the enacted budget. However, the Budget Office could likely produce one from the enacted budget database.		
MC-6a MC-6b	6a. The State Controller will request the internal auditors to add audit steps to their current audit programs of state agencies to verify that all departments are complying with State policies and procedures relating to the administration of State employee payroll. 6b. The Office of Accounts and Control will review record retention procedures to ensure that supporting documentation for all State Employee payroll expenditures is maintained.	Lawrence Franklin, Jr. Lawrence Franklin, Jr.	June 30, 2006 June 30, 2006

	Action Planned	Contact Person(s)	Planned Completion Date
MC-7a MC-7b	7a. The State Controller will establish policies and procedures to prevent automatic allocation of personnel costs through the payroll system to accounts outside of the same department. 7b. The State Controller will request DoIt payroll group to develop reports to be distributed to agencies.	Lawrence Franklin, Jr. Lawrence Franklin, Jr.	June 30, 2006 June 30, 2006
MC-8	This issue has not been included in recent audit reports. DHS continues to review and refine the claims liability process to determine a reasonable amount of the Medicaid payable at the end of the state fiscal year – June 30.	Ronald Lebel	
MC-9a MC-9b	9a. The Office of Accounts and Control will establish procedures to reconcile debt service expenditures recorded in the State accounting system with actual payments reported by the General Treasurer's Debt Management System. 9b. As part of the establishment of new reconciliation procedures, the State accounting system's financial statement generator (FSG) will be reprogrammed to ensure that all debt service expenditures are accurately reported in the State's financial statements.	Lawrence Franklin, Jr. Lawrence Franklin, Jr.	June 30, 2006 June 30, 2006
MC-10a MC-10b	10a. and 10b. The Office of Accounts and Control will establish guidelines and procedures to staff and to the State's Component Units on recording transactions with the Primary Government.	Lawrence Franklin, Jr.	June 30, 2006
MC-11	We agree. We will not write-off accounts that are more than 2000 days old if the account is still active and returns/payments are being received. It should be noted that accounts that are written off are done for financial statement purposes only and they are still pursued for collections and if collected are entered as a recovery of bad debts.	R. Gary Clark	June 30, 2006
MC-12a	We batch bills based on IRS data in separate batches called 9200 batches.	R. Gary Clark	
MC-12b	We will work with the Auditor General to see how they would suggest that we do this.	R. Gary Clark	June 30, 2006
MC-13	We agree and we are currently doing this.	R. Gary Clark	September 1, 2005
MC-14	We agree and we will make every attempt to update receivables timely.	R. Gary Clark	June 30, 2006
MC-15	We agree. The Office of Accounts & Control is changing their method to the method used by the Division of Taxation.	R. Gary Clark	June 30, 2006
MC-16	This would require substantial re-writes to all systems and additional personnel to reconcile these entries. We would like to do both but it does not appear economically feasible. We have controls in place where supervisors must initial the ARC's sent to Data Entry based on previous audit recommendations.	R. Gary Clark	

	Action Planned	Contact Person(s)	Planned Completion Date
MC-17	The Division of Taxation and the Office of Accounts and Control will review the possibility of reconciling reported cash receipts between the current RISAIL system and the current tax systems.	R. Gary Clark	June 30, 2006
MC-18	We agree. The "electronic W-3 files" are actually magnetic media W-3 files such as tapes, cartridges and diskettes. We will reconcile the magnetic media W-3's when completed and the paper W-3 files when completed at a later date.	R. Gary Clark	June 30, 2006
MC-19	We agree with the recommendation. Procedures have been implemented to ensure that taxes receivable are fairly stated at year end.	Robert Christie	
MC-20	We agree with the recommendation. Fiscal year end cut-off procedures are being developed to ensure receipts are posted in the appropriate fiscal year.	Robert Christie	
MC-21	The state will consider and review the creation of a Chief Financial Officer position consistent with current priorities and budgetary constraints.	Beverly E. Najarian	
MC-22a	A team will be established within the Office of Accounts and Control to address the administration of federal grants.	Lawrence Franklin, Jr.	June 30, 2006
MC-22b	A team will be established within the Office of Accounts and Control to address the administration of federal grants.	Lawrence Franklin, Jr. Tracy Williams	June 30, 2006
MC-23	Before establishing where the responsibility for drawing federal funds vests, Treasury is of the opinion that the following two things need to happen first: 1. The re-institution of the CMIA task group that was first created in 2000. The group included representatives from A & C, Treasury, and the CFOs from the largest agencies that receive federal funds (i.e. DOT, DOE, DHS, etc...) The mandate of this group would be to establish and review the basis and guidelines for requesting and drawing federal funds. 2. The implementation of a statewide comprehensive integrated financial system that not only would incorporate a grant module, but most importantly would reflect timely, reliable, and accurate information. Until these two things happen, Treasury believes that the recommendation to assign the responsibility for CMIA in Treasury, or any other department for that matter, is hasty at this time and not warranted until conclusive analysis supports the recommendation to be the most efficient solution for the State.	Office of General Treasurer	