STATE OF RHODE ISLAND
AND PROVIDENCE PLANTATIONS

Findings and Management Comments
Audit of the Fiscal 2016
Financial Statements

Dennis E. Hoyle, CPA
Auditor General

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

Office of the Auditor General
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March 20, 2017

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

We have audited the financial statements of the State of Rhode Island for the year ended June 30, 2016 and have issued our report thereon dated December 23, 2016 (as included in the State's Comprehensive Annual Financial Report for fiscal 2016).

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

- 28 findings considered significant deficiencies or material weaknesses in internal control over financial reporting;
- 2 findings concerning compliance or other matters required to be reported by *Government Auditing Standards;*
- 11 management comments – less significant issues that still warrant the attention of management.

As required by *Government Auditing Standards*, we have also prepared a report, dated December 23, 2016 and included herein, on our consideration of the State's internal control over financial reporting, its compliance with certain provisions of laws, regulations and contracts, and other matters required to be reported by those standards.

Our report includes six findings reported by the auditors of component units (legally separate entities included within the State's financial statements).

The State's management has provided their 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, 2016.

Sincerely,

Dennis E. Hoyle, CPA
Auditor General

State of Rhode Island and Providence Plantations

Findings and Management Comments

Audit of the Fiscal 2016 Financial Statements

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The State lacks a strategic plan to (1) coordinate needed replacements/enhancements to its key statewide financial systems and (2) ensure that critical legacy financial systems, such as the payroll system, which pose a business continuity risk, will be available to support State operations. Because the State has opted to utilize various independent software solutions, the plan is critically important. Without a comprehensive plan, there is substantial risk that the intended integration of various components may not be achieved.

Weaknesses identified in the State's internal control over financial reporting, result from our annual audit of the State's financial statements for the year ended June 30, 2016. The State's management has responsibility for, and maintains internal control over, financial reporting. *Government Auditing Standards* require that we communicate deficiencies in internal control over financial reporting based on our audit.

The State can enhance its communication and implementation of a statewide approach to design, document, and monitor its internal control policies and procedures following the principles contained in the revised internal control framework. The State's system of internal controls is intended to safeguard public resources and support accurate financial reporting.

Net recoverable gain share amounts totaling $101 million from Medicaid managed care organizations (MCOs) were outstanding at June 30, 2016. Of this amount, gain share totaled $120 million for individuals covered under the Medicaid expansion provision. Only $36 million of $133 million (Medicaid expansion) that was outstanding at the close of the prior fiscal year was collected during fiscal 2016. An additional $22 million is owed to the State for the contract period ended June 30, 2016.

The complexity of Medicaid program operations adds to the challenge of accurately accounting for all Medicaid program related financial activity within the State's financial statements. The complexity of the Medicaid program continues to increase each year through federal Affordable Care Act (ACA) provisions and various State initiatives that have changed how services are delivered and providers are reimbursed. Medicaid is the State's single largest program activity - representing nearly 25% of the annual budgeted outlays. Consequently, the financial aspects of this program are material to the State's financial reporting objectives.

Overall, the State has not sufficiently addressed information technology (IT) security risks, an increasing concern given the State's very complex computing environment. The State needs to ensure its IT security policies and procedures are current and well communicated. Assessments of compliance for all critical IT applications have not been performed - systems deemed to pose the most significant operational risk must be prioritized.

The State did not perform tests of its disaster recovery plan during fiscal 2015 and 2016. This reduces the assurance that all mission critical systems can be restored should a disaster disable or suspend operations.

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

Implementation of a new Taxation IT system (STAARS) presented issues impacting financial reporting due to processing timeframes for personal income tax returns and other returns held in suspense. This affected accruals based on historical processing timelines and complicated 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.***

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

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

estimates due to the uncertain effect of returns that had not fully processed at June 30, 2016.

Electronic data received by Taxation should remain encrypted and then be uploaded to Taxation's systems through automated processes without manual intervention. Current procedures create rather than restrict opportunities for data manipulation.

Historical data used to support significant financial reporting estimates for tax revenues should be reassessed periodically to ensure continued validity – this is particularly important with more current data emanating from the new STAARS system.

Critical Division of Taxation back-up data files are not stored off-site – a recommended disaster recovery best practice. Additionally, the Division of Taxation had inconsistent measures of recognizing taxes receivable across different tax types.

STAARS system user access rights need to be assessed and tailored to ensure access is consistent and appropriate with each employee's responsibilities.

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

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

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

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

Our report also includes 11 management comments, which are less significant findings that highlight financial-related operational, policy or accounting control matters. These address the formats of annual budgets, monitoring of internal service funds, subrecipient monitoring, the "Cadillac tax" on health plans, accounting for capital assets, accumulation of significant commitments, and other accounting and financial reporting issues.

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

2016

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

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Rhode Island and Providence Plantations (the State), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the State's basic financial statements and have issued our report thereon dated December 23, 2016 (*except for Note 19 and our opinion on the aggregate discretely presented component units as to which the date is February 2, 2017*). Our report includes a reference to other auditors who audited the financial statements of:

- the Tobacco Settlement Financing Corporation, a blended component unit which represents 1% of the assets and deferred outflows and 1% of the revenues of the governmental activities and 1% of the assets and 2% of the revenues of the aggregate remaining fund information;
- the Convention Center Authority, a major fund, which also represents 34% of the assets and deferred outflows and 2% of the revenues of the business-type activities;
- the HealthSource RI Trust, an agency fund, the Ocean State Investment Pool, an investment trust fund, and the Rhode Island Higher Education Savings Trust, a private-purpose trust fund, which collectively represent 43% of the assets and 35% of the revenues of the aggregate remaining fund information; and
- all the component units comprising the aggregate discretely presented component units.

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

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

Internal Control Over Financial Reporting

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

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the State's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: Findings: 2016-007, 2016-010, 2016-011, 2016-012, 2016-013, 2016-014, 2016-015, 2016-020, and 2016-023. Other auditors of the discretely presented component units considered the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: Findings 2016-025 and 2016-027.

A significant deficiency is a deficiency, or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies: Findings: 2016-001, 2016-002, 2016-003, 2016-004, 2016-005, 2016-006, 2016-008, 2016-016, 2016-017, 2016-018, 2016-019, 2016-021, 2016-022, and 2016-024. Other auditors of the discretely presented component units considered the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies: Findings: 2016-026, 2016-028, and 2016-029.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests and those of the other auditors disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as Findings: 2016-009 and 2016-030.

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

State's Response to Findings

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

Purpose of this Report

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

Dennis E. Hoyle, CPA
Auditor General

December 23, 2016

2016

Schedule of Findings and Responses

Finding 2016-001 (*significant deficiency - repeat finding)*

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

The State lacks a strategic plan to (1) coordinate needed replacements/enhancements to its key statewide financial and administrative systems and (2) ensure that critical legacy financial systems, such as the payroll system, which pose a business continuity risk, will be available to support State operations. Without a comprehensive plan, there is substantial risk that the intended integration of various components may not be achieved.

The State has signaled, through a series of recent actions, that it intends to address needed functionalities within its centralized financial and administrative systems by implementing various independent software solutions rather than modules within the Oracle E-Business Suite – the original platform for the State's Enterprise Resource Planning (ERP) system. The intent of an ERP system is to optimize integration thereby enhancing efficiency.

Currently, the State is (1) implementing a time and effort reporting system, (2) selecting a grants management software solution, and (3) contemplating a budget preparation system, procurement system, and options to replace its outdated payroll system. The need for these replacements/enhancements is undisputed and the allocation of resources to these projects is encouraging. However, failure to develop a comprehensive plan to guide these projects and ensure the intended integration is a significant concern. Without a comprehensive plan, there is substantial risk that the intended integration of various components may not be achieved.

A comprehensive plan is critical to ensure that the various software solutions align at some future point to meet the State's overall financial management needs. When separate software solutions are used to accomplish multiple objectives, the responsibility of ensuring data connectivity and integration falls more to the user. Examples of the desired integration among these functionalities include:

- time and effort information flows to the payroll system which supports allocation of personnel costs to federal grants through grants management software;

- budget preparation is aided by information flows from the payroll system and the centralized accounting system which contains actual expenditure data; grants management software provides information on grant awards available; and

- the procurement system easily interfaces with the accounts payable module to optimize controls and streamline payment processing.

Many of the functionalities either pending implementation or contemplated are interdependent. The risk of failed integration is increased due to the long-term implementation timeline that could likely transcend multiple administrations. A significant amount of resources, both financial and personnel, will be deployed in implementing these systems.

A comprehensive plan should include the following critical elements:

- identification of stakeholders and system users and how design and implementation will reflect their needs;

- identification of planned common data elements to be exchanged between the various component systems including data definitions and data imports and exports of the various component systems;
- a coordinated timeline which sequences critical completion targets that impact other project components;
- internal staff or vendors who will ensure the integration of components;
- resources needed (personnel and dollars) during implementation and ongoing support;
- identification and coordination of how the various software solutions will address the State's overall internal control objectives; and
- address the business continuity risks associated with critical systems that utilize outdated technology and are challenging to replace.

Important functionalities are currently met either through legacy systems or through multiple departmental processes without the intended integration and efficiencies. This results in business continuity risk, decreased efficiency and effectiveness, and control weaknesses. Some of the State's critical systems utilize outdated technology which makes these operations vulnerable from a business continuity and systems security perspective. Certain legacy systems utilize software that is no longer supported and the availability of skilled personnel to work on the systems is limited.

The State's payroll system is a key example of a critical computer system that results in business continuity risk. The payroll system processes payroll for over 14,000 employees totaling more than $1 billion in fiscal 2016 and accommodates the provisions of 100 separate collective bargaining agreements, health and pension benefit plan contributions and other withholdings. The payroll system utilizes outdated technology and is maintained by a very small group of employees. It still utilizes an outdated legacy account structure and external support for the system would largely be unavailable. Documentation of the system has not been maintained consistent with current information technology (IT) standards further heightening business continuity risks and complicating development of a replacement system.

Implementing a new payroll system that meets current information technology standards would be a significant challenge and undertaking; however, planning for that eventuality is necessary. Further, conversion to a modern platform is needed to allow other integrated functionalities to progress, such as grants and project management and cost allocation – again highlighting the need for a comprehensive plan.

The importance of these functionalities to overall State operations and the State's control structure as well as the significance of the amount of resources that will be deployed in improving the State's centralized systems requires that a comprehensive strategic plan be developed to guide this effort. External resources to assist in developing the plan and providing an objective view of the planned approach should be considered.

<u>RECOMMENDATION</u>

2016-001 Develop and implement a comprehensive strategic plan to address the integration approach and business continuity risks for planned and contemplated replacements/enhancements to critical statewide financial system functionalities.

Corrective action plan / auditee views:

We will engage a contract consultant to assist in developing a strategic plan. A mini bid will be developed to determine scope of the plan and to assist in the development of the plan.

Anticipated Completion Date: *120 days from contractor's start.*

Contact Person(s): *Chris Antonellis / Jonathan Womer*
DoIT/OMB
Phone: 401.462.2185 / 401.222.2280

Finding 2016-002 (*significant deficiency - repeat finding)*

COMPREHENSIVE DOCUMENTATION OF THE STATE'S INTERNAL CONTROL STRUCTURE CONSISTENT WITH THE REVISED INTERNAL CONTROL FRAMEWORK

The State can enhance its communication and implementation of a statewide approach to design, document, and monitor its internal control policies and procedures following the principles contained in the revised internal control framework. The State's system of internal controls is intended to safeguard public resources and support accurate financial reporting.

The State's management has responsibility for the design and operation of internal control. The Committee of Sponsoring Organizations (COSO) has designed a framework for internal control that consists of three categories of objectives – *operations, reporting and compliance* – and five components – *control environment, control activities, risk assessment, information and communication, and monitoring.* An internal control framework, such as COSO, provides an overall structure for management to design, document, and monitor its internal control policies and procedures. Both within and outside government, there is an expectation for management to take increasing responsibility for the adequacy of design and operation of an entity's control structure.

In 2013, COSO revised its framework, and in an effort to tailor this framework to the public environment, the federal Government Accountability Office (GAO) issued an update to its "Green Book", *Standards for Internal Control in the Federal Government*. The "Green Book" is required for federal agencies as a basis for establishing effective internal control systems; however, it can be useful to other governments when applying the principles contained within the COSO internal control framework.

While certain control policies and processes have been documented, opportunity exists for a coordinated effort to implement the revised internal control framework and to reassess the design of its current control structure with particular emphasis on assessing risk and monitoring control results - both essential components of internal control.

Recently, the Office of Accounts and Control allocated a full-time employee to facilitate adoption of the revised COSO/Green Book framework and communicate internal control requirements to State departments and agencies. Additionally, the Office of Internal Audit has adopted the revised internal control framework in its planning and has begun to evaluate internal processes at State departments and agencies. Further efforts are needed to communicate the State's overall objectives and related guidance regarding the internal control framework to departments and agencies. Additional training is necessary to ensure that departments and agencies are adequately documenting their internal control structures to reflect an understanding of its required elements as prescribed by the revised framework.

We acknowledge that this effort is likely to require significant resources and full implementation would span multiple years. We believe reasonable next steps may involve development of an implementation strategy which may require external assistance. The most significant statewide control processes should be assigned the highest priority for documentation and monitoring. A concurrent education program for key finance individuals within the departments and agencies should also be a near term priority.

A statewide plan should be implemented to communicate and educate departments and agencies on the State's overall objectives for its comprehensive internal control structure.

RECOMMENDATION

2016-002 Enhance communication and implementation of a statewide approach to design, document, and monitor its internal control policies and procedures following the principles contained in the COSO/Green Book. Reassess, document, and monitor control procedures following the guidelines of the internal control framework.

Corrective action plan / auditee views:

We will develop a program to better inform financial management about internal controls. In addition, subject to funding availability, we will engage a partner and implement SOX-like internal control reviews for 4 key statewide processes-financial reporting, procure to pay, human resources/payroll and revenue recognition.

Anticipated Completion Date: *June 2019*

Contact Person: *Jennifer Pate, Administrator, Financial Management*
Phone: 401.222.5098

Finding 2016-003 *(significant deficiency - repeat finding)*

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

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

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

During fiscal 2016 and prior years, we observed numerous journal entries initiated and approved by Treasury personnel that were not consistent with the appropriate level of segregation of duties over cash receipts and disbursements thereby weakening controls.

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

Treasury has engaged a consultant to recommend changes that would strengthen controls within systemic and personnel resource limitations. Optimally, changes to current procedures should include reassignment of certain duties now performed by certain Treasury personnel that would segregate journal entry initiation and approval from the cash receipt and reconciliation functions.

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

<u>RECOMMENDATIONS</u>

2016-003a Reorganize accounting responsibilities currently performed by the Office of the General Treasurer to ensure proper segregation of duties over cash receipt and disbursement functions.

2016-003b Redirect workflows for certain accounting transaction types so that adequate segregation of duties over cash receipt and disbursement functions is maintained.

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

As noted by the Auditor, this is a repeat finding from prior fiscal year audits and Treasury management largely agrees with the Auditor's recommendations.

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

Since being initially advised of this finding in the FY 2014 audit, Treasury Management has taken a number of actions to improve controls and executed on a strategy to improve segregation in light of systemic constraints. These improvements include requesting modifications to permissions in the RIFANS system and making substantial changes to the process by which the state handles RDI (Returned Deposit Items).

In July of 2016 Treasury contracted with a public accounting firm to assist in developing a plan to further improve the design of certain workflows, processes, and control activities over cash receipts, NSF checks and re-deposits, recording of deposits to the general ledger, initiation and approval of related journal entries, and bank account reconciliations and to communicate recommendations to assist the Treasurer in (i) designing controls in areas in which there is an absence of appropriate controls, and (ii) enhancing the existing design of controls.

In February of 2017, Treasury staff finalized a plan of action and Treasury is committed to implementing the plan in collaboration with the Office of Accounts and Control by the end of fiscal year 2017. Specific action items in the plan include: development of additional workflow restrictions in RIFANS to further improve segregation, change of certain personnel responsibilities, development of new transaction types with custom routing and approval limits, and routing of certain RIFANS transaction types to Accounts and Controls for approval.

Anticipated Completion Date: *June 2017*

Contact Person: *Lisa Churchville, Chief Operating Officer - Treasury*
Phone: 401.378.4886

Finding 2016-004 **(significant deficiency - repeat finding)**

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

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

The sections of the Rhode Island General Laws, creating the Office of Management and Budget (OMB) within the Department of Administration, delineate various responsibilities to the OMB including those related to oversight of the State's federal grant programs. We have highlighted in past audits, through conduct of the annual Single Audit of the State, that the administration of federal programs is almost exclusively the purview of the departments and agencies - there are few uniform statewide grant administrative procedures and little statewide oversight of federal grant activities. Federal grants support approximately 40% of state operations accounted for within the General Fund.

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

> **§ 35-1.1-5 Federal grants management. –** (a) The office of management and budget shall be responsible for managing federal grant applications, providing administrative assistance to agencies regarding reporting requirements, providing technical assistance and approving agreements with federal agencies pursuant to § 35-1-1. The director shall:
>
> (2) Ensure that the state establishes and maintains statewide federally-mandated grants management processes and procedures as mandated by the federal Office of Management and Budget;
>
> (6) Assist the state controller in managing and overseeing the disbursements of federal funds in accordance with § 35-6-42;
>
> (7) Assist the state controller in the preparation of the statewide cost allocation plan and serve as the monitoring agency to ensure that state departments and agencies are working within the guidelines contained in the plan; and,
>
> (8) Provide technical assistance to agencies to ensure resolution and closure of all single state audit findings and recommendations made by the Auditor General related to Federal funding.

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

We acknowledge OMB's efforts to provide training on the new federal regulations affecting all federal awards (Uniform Guidance) and vendor vs. subrecipient determinations. Additionally, OMB is leading the effort to select grants management software for statewide application.

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

RECOMMENDATION

2016-004 Enhance the operational activities of the OMB to comply with the enabling statute and to meet the need to provide centralized monitoring of federal programs, which constitute a material portion of the State's overall activities.

Corrective action plan / auditee views:

The Division of Purchases on behalf of the Office of Management and Budget's Grants Management Office issued an RFP to identify a vendor to provide and implement a COTS SaaS Grants Management System. The end-to-end grants management system will automate and administer the grants management business process across state agencies turning disparate systems, data sources, files, and processes into a single, centralized repository for use by all state agencies. The system will integrate with state's financial, budget, and time and attendance systems and will automate workflow to improve efficiency and promote transparency. The planned grants management solution includes functionalities that will result in the fulfillment of the statutory responsibilities outlined in Chapter 35-1.1-5.

The vendor is expected to start in March 2017. The first release (release 0) will establish and configure the statewide functional aspects of the Grant Management System, including improved functionality within RIFANS, and will be completed by March 2018. The system will be rolled out to the 30 agencies in a series of releases over the subsequent three years with full implementation completed February 28, 2021.

Anticipated Completion Date: *February 2021*

Contact Person: *Laurie Petrone, Director of Grants Management*
Office of Management and Budget
Phone: 401.574.8423

Finding 2016-005 *(significant deficiency - repeat finding)*

MONITORING RIFANS ACCESS PRIVILEGES AND AGENCY APPROVAL HIERARCHIES

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

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

RIFANS "Super Users"

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

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

Agency Hierarchies

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

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

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

In FY2016, the State created a reporting functionality designed to capture changes made to certain systemic data- for instance, RIFANS authorization. The reporting functionality is intended in order to facilitate timely review of changes in RIFANS user access and notify the Office of Accounts and Control when modifications have been made on an exception basis. However, as the resulting reports were not found to be sufficient to meet their intended purposes, the reports have as yet not been utilized. Additional modifications are required in order to provide adequate documentation of the designed and approved access structure which underlies the State accounting system control structure and objectives.

RIFANS Delegated Authority

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

RECOMMENDATIONS

2016-005a Review activities of privileged users (system administrators) on a scheduled basis to ensure that additions, modifications, and deletions initiated by them are appropriate.

2016-005b Improve controls over RIFANS access by continuing to explore reporting functionalities that would allow for periodic monitoring of user access for instances of unauthorized changes to user access and/or noncompliance with policies relating to delegated user access.

Corrective action plan / auditee views:

Newly created reports are being modified to identify changes made to sensitive data elements by privileged users. In addition, procedures are being developed for these reports to be reviewed to identify any questionable or incorrect changes that have been recorded.

Anticipated Completion Date: *June 30, 2017*

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

Finding 2016-006 *(significant deficiency – repeat finding)*

COMPREHENSIVE GENERAL LEDGER CONTROLS OVER RECEIVABLES

Statewide accounting controls over receivables should be enhanced.

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

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

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

The lack of an integrated revenue and receivables functionality within the RIFANS accounting system requires that receipts/revenue be recorded via journal entry transactions (directly to the general ledger). Typically, receipts/revenue would be recorded in a separate module with expanded functionality that would interface with and post information to the general ledger.

The Office of Accounts and Control has added certain receivable categories to an existing revenue/receivables module that is part of RIFANS. However, since that module is more designed to track receivables on a unique customer basis; it does not easily match the need to control receivables within the State's various subsidiary systems (e.g., tax receivables). Other options need to be considered to meet the State's comprehensive control objectives for receivables, given the complicated and decentralized nature of revenue collection points throughout the State.

RECOMMENDATION

2016-006 Explore options to enhance statewide general ledger controls over receivables.

Corrective action plan / auditee views:

Will review feasibility of recording Taxation and Court receivables through a monthly recording in RIFANS and implement, if deemed practical.

Anticipated Completion Date: *Taxation - December 2017, Courts - June 2018*

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

Finding 2016-007 **(material weakness - repeat finding)**

CONTROLS OVER FEDERAL PROGRAM FINANCIAL ACTIVITY

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

Federal programs represented 40% of fiscal 2016 General Fund expenditures. Financial reporting risks include categorizing expenditures as federally reimbursable when grant funds have either been exhausted or the expenditures do not meet the specific program limitations. Further, the State can improve its overall centralized monitoring of federal program operations to ensure compliance with federal requirements.

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

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

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

During our fiscal 2016 audit, we proposed audit adjustments relating to federal grant activity. One adjustment corrected the recording of expenditures allocated to a federal grant that exceeded allowable federal funding. Other adjustments involved a mismatch of timing when expenditures were incurred and when federal revenues in reimbursement of those expenditures were recognized.

Federal Grants Management and Cost Allocation

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

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

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

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

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

RECOMMENDATIONS

2016-007a Improve functionality within the statewide financial systems to facilitate federal grant administration (grants management, cash management, and cost allocation).

2016-007b Build statewide processes over federal grant administration within the Office of Management and Budget to supplement accounting controls within the RIFANS accounting system.

Corrective action plan / auditee views:

Refer to Corrective Action Plan Finding 2016-004

Anticipated Completion Date: *February 2021*

Contact Person: *Laurie Petrone, Director of Grants Management*
Office of Management and Budget
Phone: 401.574.8423

Finding 2016-008 *(significant deficiency – repeat finding)*

STATEWIDE CENTRALIZED COST ALLOCATIONS

Controls are weakened due to the use of "mirror" accounts rather than internal service funds to account for and distribute centralized costs to functions and activities.

The State discontinued use of certain internal service funds during fiscal 2007 and began budgeting and distributing costs for human resources, facilities and maintenance, and information technology services through centralized procedures within the Department of Administration (DOA). In order to obtain federal reimbursement for costs allocable to federal programs, the State created "mirror" accounts (within DOA and other departments) for purposes of distributing the federal share of centralized costs to the other departments. Expenditures reported in federal accounts and linked to federal programs are claimed and drawn down by departments with the federal revenue being moved to reimburse DOA for costs allocable and recoverable from federal programs.

This allocation method results in a process that is inherently complex and not fully understood by many of the State's departmental financial managers. The process increases the risk that federal revenue and expenditures could be overstated.

Using internal service funds to distribute centralized shared costs to programs and activities is simpler, far less prone to error and subject to enhanced control and monitoring procedures. Internal service funds more clearly demonstrate when other functions and activities (in aggregate) have been over or undercharged for services.

RECOMMENDATION

2016-008 Restore internal service funds as the means to account and distribute centralized costs to functions and activities.

Corrective action plan / auditee views:

Implementation of this recommendation to convert services currently billed via the mirror account process to an internal service funds requires approval by the General Assembly. We will begin an initiative to obtain this approval and convert these services to internal service funds.

Anticipated Completion Date: *June 2019*

Contact Person: *Bernard Lane Jr., Administrator, Management Services*
Phone: 401.574.8594

Finding 2016-009 ***(other compliance matter – repeat finding)***

COLLECTION OF OVERPAYMENTS TO MEDICAID MANAGED CARE ORGANIZATIONS

Net recoverable gain share amounts totaling $101 million from Medicaid managed care organizations (MCOs) were outstanding at June 30, 2016. Of this amount, Medicaid Expansion gain share totaled $120 million.

Unusually large balances due to the State from managed care organizations in settlement of various contract periods beginning in January 2014 largely remained outstanding at June 30, 2016. We reported in our prior audit that $133 million was due to the State at June 30, 2015. During fiscal 2016, the Executive Office of Health and Human Services (EOHHS) recouped approximately $36 million of the Medicaid Expansion dollars that were due. The MCOs were overpaid an additional estimated amount of $22 million for Medicaid Expansion for the contract period ending June 30, 2016 resulting in an aggregate amount owed to the State of $120 million at June 30, 2016.

The overpayments due to the State resulted primarily from coverage extended to the "Medicaid expansion population" – a group provided coverage under the provisions of the federal Affordable Care Act (ACA). EOHHS faced early challenges in establishing a capitation rate for this population due to the high utilization of services expected at the inception of coverage. Actuarially certified capitation rates were based on conservative cost assumptions, which did not materialize as expected in the actual experience. This resulted in large recoverable gain share amounts under these risk/gain share arrangements with the MCOs - amounts much larger than typical risk share/gain share contract settlement amounts that routinely occur. The contracts provide for settlement of actual claims experience and the determination of risk share/gain share amounts due to or from the State measured at the close of contract periods, with final settlement at the end of the claims run-out period - one year later.

These amounts have been recognized within the overall Medicaid program receivables and payables calculated for inclusion in the State's financial statements at June 30, 2016. The amounts paid for the Medicaid expansion population were 100% funded by the federal government – once collected, the overpayments are due to the federal government.

Due to contract provisions in effect during fiscal 2015 and 2016, the MCOs unintentionally benefitted from a large interest free cash infusion and were allowed to retain a portion (approximately

$7.7 million) of the excess capitation payments due to gain share provisions. Gain share provisions in the contract were intended to reward the MCOs for overall cost efficiencies attained through enhanced case management, preventative care, and enhanced coordination of services. In this instance, the gain share amounts retained by the MCOs resulted from overstated capitation assumptions and not from efficiencies achieved.

EOHHS did not fully recoup the overpayments initially cited in our fiscal 2015 audit by June 30, 2016 as reported in the State's corrective action plan for the 2015 findings. A 90-day required notice of recoupment stipulated in the MCO contracts and the MCOs refusal to waive such provision stalled collection efforts. While we recognize these contract provisions, we believe the extraordinary amount and nature of the overpayments was such that earlier repayment should have been negotiated and achieved. These overpayments, as acknowledged by all parties, were clearly beyond the normal scope and expectation of the managed care rate settlement process. Had the capitation payments to the MCO's been insufficient to cover actual claims experience, it is unlikely that the State would have been able to defer any further payment until the end of the contract settlement period.

EOHHS has reduced capitation rates to more accurately reflect the medical claims experience of the population. In addition, EOHHS added contract language modifying the risk share / gain share determination under managed care contracts going forward to prevent gains or losses when determined capitation rates are significantly different from the actual medical experience of the population. Lastly, EOHHS has also included an audit requirement in its future managed care contracts that mandates that the MCOs require their independent auditor to opine on the MCO's schedules that determine risk share / gain share outcomes for their annual contracts.

EOHHS finally recouped fiscal 2015 overpayments to the MCOs for the Medicaid Expansion population in early fiscal 2017. The fiscal 2016 overpayment to the MCOs (approximately $22 million) is expected to be recouped after the one-year claim runout period ends on June 30, 2017.

<u>RECOMMENDATION</u>

2016-009 Recoup overpayments from the MCOs using the newly effective and enhanced contract provisions.

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

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

Capitation rates were set for the first six months of CY 2014 and the second set of rates applied to the 12-month period from July 1, 2014 through June 30, 2015. The division of the contract period into two rate periods allowed the State to recognize the anticipated selection bias during the initial rollout of the Medicaid Expansion program in the rates and to align with other managed care contract periods. The Medicaid Expansion capitation rates were later revised for FY 2015, resulting from reconsideration of the original assumptions used in the previous rate calculations. In addition, capitation rates for FY 2016 for the Medicaid Expansion group were further refined based on the MCOs' financial statements related to the risk-sharing reporting. Certain *enrollment-driven assumptions were also updated to reflect 2016 enrollment projections as were other assumptions, including pent-up demand, adverse selection, and adverse risk margin based on the MCOs' financial statements. For each capitation rate revision period, the capitation rates were compiled in accordance with Title 42 CFR 438.6 and 438.60, and reviewed and approved by CMS.*

In December 2014, when it was observed, based on monthly risk/gain share financial reports, that the MCOs were incurring and reporting medical expenses that were significantly less than the medical portion of the capitation dollars paid to the MCOs, the State began recouping a portion of the MCOs gain share. The State then received notice from United Healthcare disputing the State's actions to recoup these monies, stating that, per the contract, "Final settlement is based on review of the complete experience for the contract period following the full twelve-month run out … ". The State then acted to address this situation by amending the MCOs' contracts to allow for interim payments and recoupments when the over- or under-risk/gain share payment amounts are significant.

The State then recouped all of the remaining FY 2015 gain-share dollars from the MCOs for the Medicaid Expansion population by October 2016. Based on the current contract with MCOs, the FY 2016 gain-share dollars will be recouped by September 30, 2017, after the one-year claims runout period ends on June 30, 2017.

Per the Recommendations of the State Auditors, 2016-009, by using the newly effective and enhanced contract provisions, the State has recouped all of the gain-share dollars from the MCOs for the Medicaid Expansion FY 2015 contracts.

Anticipated Completion Date: *October 31, 2016*

Contact Person: *Deborah Florio, Deputy Medicaid Director - EOHHS*
Phone: 401.462.0140

Finding 2016-010 ***(material weakness – new finding)***

MEDICAL ASSISTANCE PROGRAM COMPLEXITY AFFECTS FINANCIAL REPORTING AND OVERALL PROGRAM CONTROLS

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

The complexity of the Medicaid program has continued to increase each year through federal Affordable Care Act (ACA) provisions and various State initiatives that have changed how services are delivered and providers are reimbursed. Medicaid is the State's single largest program activity - representing nearly 25% of the annual budgeted outlays. Consequently, the financial aspects of this program are material to the State's financial reporting objectives.

The added complexity and related challenges are mainly attributable to the following initiatives and trends:

- New program initiatives have changed the way services are reimbursed through the program;
- Program changes are often implemented through managed care coverage increasing an already

significant segment of Medicaid that is being administered outside of EOHHS's direct financial systems and controls;

- Contracts with managed care organizations (MCOs) are subject to complex settlement provisions. These settlements are increasingly dependent on data received from other providers and MCOs and require substantial data analysis to evaluate prior to recognizing the accounting impact on the State's books and additional payments to and from the providers. EOHHS is largely dependent on contractors to provide the data analysis and tracking of these settlement provisions.

- Financial activity relating to Medicaid that is manually accounted for, in total or in part, has increased the risk that certain receivables or liabilities may be omitted from the State's financial reporting processes and not be detected;

- New eligibility systems have resulted in claim processing problems that have resulted in estimated payments to providers in advance of the actual claims or capitation payments being processed;

- Several components of Medicaid financial activity, due to the timing and duration of contract and provider settlements, require material receivables and liabilities to be classified on a short and long-term basis that impacts how these amounts are reported in the State's financial statements; and

- The State lacks effective auditing and monitoring of MCO financial activity.

Ensuring this financial activity is properly and completely recorded in the State's financial statements is an increasingly complex task. MCO risk and gain share settlements, primary care service increases, certain "reinventing Medicaid" initiatives, and other settlements relating to delayed enrollment of newborns within the new UHIP system were all accounted for external to Medicaid's claims processing system. The financial effect of these settlements and program provisions totaled in the hundreds of millions of dollars. Much of this activity is higher risk from a financial reporting and federal program compliance perspective as it is less subject to systemic controls and instead is accounted for through manual independent processes.

EOHHS appropriately included a host of specific programmatic provisions that had a financial statement impact within its closing package provided to the Office of Accounts and Control at fiscal year-end. Identification of these provisions is solely dependent on individuals knowledgeable about the program. Due to the complexity, it would be challenging for any one person to have a complete financial understanding of all program operations as well as an understanding of the State's financial reporting objectives. Significant audit adjustments were required for fiscal 2016 relating to Medicaid financial activity reported in the State's financial statements.

For example, in accordance with ACA, Medicaid reimbursements to primary care physicians (PCP) were increased for the purpose of improving access to primary care with the federal government generally reimbursing States for 100% of the increase. The increases applied to Medicaid primary care services paid on a fee-for-service basis or through managed care organizations. Since these additional reimbursements were not reflected in the original capitation rates for these managed care organizations (MCOs), additional amounts owed to the MCOs were paid through settlements separate from the normal capitation settlement process. We found the State overpaid one of the MCO's $2.3 million for the PCP reimbursement during our audit - the State was invoiced for an incorrect amount that was subsequently paid.

PCP reimbursements under the ACA are similar to many other Medicaid program initiatives which require significant data analysis and periodic settlements typically for significant dollar amounts.

The significance of Medicaid expenditures and the continued trend of providing more services through capitation necessitate an examination of how the State ensures completeness and accuracy from a financial reporting perspective. Due to the heavy reliance on contractors to manage and analyze this financial activity, control processes should be evaluated and documented delineating contractor and EOHHS responsibilities and how overall financial reporting objectives are met. Additionally, increased financial oversight of the MCOs is needed to further support data used to prepare the State's financial statements.

RECOMMENDATIONS

2016-010a Evaluate and document control processes to meet the financial reporting objectives for the Medicaid program. Delineate those responsibilities delegated to contractors and how those responsibilities are integrated in the overall control structure.

2016-010b Improve financial oversight of the MCOs as a basis for enhancing program compliance objectives and enhancing data available for financial reporting purposes.

Corrective action plan / auditee views:

EOHHS acknowledges the complexity and challenges of the Medicaid Program given the various State initiatives that have changed how services are delivered and providers are compensated.

Per the Recommendations of the State Auditors, EOHHS recognizes the need for and engages in continuous improvements in the oversight of the State's managed care expenditures and contract settlements, particularly with their increased share of Medicaid expenditures overall. EOHHS continues to ensure that claims data is received from the MCOs and that this claims data is reconciled to the MCOs' contract settlements before the final settlements of the risk/gain share contracts. In addition, EOHHS' contracts with the MCOs mandate that the MCOs require their independent auditors, in their annual audited statements, to comment on the accuracy of the contractual financial arrangements that the MCOs have with the State.

EOHHS will continue to probe areas where focused scrutiny could provide additional support as to the appropriateness and accuracy of these expenditures. Under new leadership as of February 2017, EOHHS is currently working, in coordination with the Office of Management and Budget, to assess overall financial and program capacity, and develop a comprehensive action plan to strengthen state-led reporting and oversight.

In addition, EOHHS will explore the feasibility and expense of procuring the services of an independent auditor for those areas of MCO contracting with the State that are not currently subject to systematic review under the MCOs' mandatory external audit program.

Anticipated Completion Date: *June 30, 2018*

Contact Person: *Robert Farley, Associate Director Management Services EOHHS*
Phone: 401.462.6259

Finding 2016-011 ***(material weakness - repeat finding)***

COMPREHENSIVE INFORMATION SYSTEMS SECURITY POLICIES AND PROCEDURES

The State needs to ensure its IT security policies and procedures are current and well communicated. Assessments of compliance for all critical IT applications have not been performed. Systems deemed to pose the most significant operational risk must be prioritized.

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

The oversight and management of the State's information security program relies upon the implementation of DoIT's comprehensive information systems security plan, which includes detailed policies and procedures that are designed to safeguard all of the information contained within the State's critical systems.

The State has updated and created new policies and procedures for its critical information systems; however, it has lagged approving, communicating and implementing these policies. Further, the State has not performed an assessment to determine whether its IT systems are in compliance with these IT security policies and procedures. Due to the number and complexity of systems within State government, a risk-based approach should be employed where those systems deemed most critical or most at risk are prioritized for assessment.

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

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

RECOMMENDATIONS

2016-011a Continue to update IT security policies and procedures to ensure such policies and procedures conform to current standards and address all critical systems security vulnerabilities.

2016-011b Complete an initial assessment of compliance with systems security standards for the State's mission critical systems. Contract for the performance of IT security compliance reviews and accumulate and make use of available Service Organization Control reports to extend IT security monitoring of critical systems.

2016-011c Prepare a corrective action plan that prioritizes significant system security risks with the goal of achieving compliance with DoIT's formalized system security standards for all significant State systems.

Corrective action plan / auditee views:

DoIT will engage a partner via the bid process to get a full security assessment proposal from an outside firm. This assessment should include a standard type health checks with penetration testing, internal server checking and all the "normal" items a firm might offer. DoIT's next step is to develop the bid and engage a partner for the testing.

Anticipated Completion Date: *60 days from contractor start.*

Contact Person(s): *Kurt Huhn, Assistant Director for Special Projects - DoIT*
Phone: 401.462.4706

Finding 2016-012 *(material weakness – repeat finding)*

DIVISION OF INFORMATION TECHNOLOGY - DISASTER RECOVERY PLAN

The State did not perform tests of its disaster recovery plan during fiscal 2015 and 2016. This reduces the assurance that all mission critical systems can be restored should a disaster disable or suspend operations.

The State has not performed testing of its disaster recovery plan since fiscal 2014. Tests of the disaster recovery plan are an important component of overall business continuity planning to increase the likelihood that systems can be restored should a disaster disable or suspend operations at the State's data center. The State needs to test the viability of its recovery center and its employees' knowledge and ability to perform restoration of the systems. Industry best practices stipulate that disaster recovery testing be performed twice a year in order to accommodate the ever-changing systems environment. The State should perform a full disaster recovery test at least annually.

DoIT has a designated data center recovery facility in New Jersey (operated by a vendor). Since the last test performed in fiscal 2014, the State has undergone a number of changes to its system environment. New systems such as UHIP, STAARS, and numerous patches to RIFANS along with network and communications configuration changes have not been part of a disaster recovery test.

If a test of the disaster recovery plan is conducted in June 2017, as now planned, the State will have gone more than 3 years without a comprehensive test performed at its off-site recovery data center.

RECOMMENDATION

2016-012 Perform an off-site disaster recovery test at the State's designated disaster recovery site at least annually.

Corrective action plan / auditee views:

DoIT will increase its efforts on the upgrade of the existing backup and DR process for mission critical systems and will engage the current vendor to complete the DR testing by July 2017.

Anticipated Completion Date: *July 2017*

Contact Person(s): *Tony Lupinacci / Frank Pate*
Assistant Directors for Special Projects DoIT
Phone: 401.462.4710 / 401.462.8540

Finding 2016-013 ***(material weakness - repeat finding)***

INFORMATION TECHNOLOGY (IT) SYSTEMS - PROGRAM CHANGE CONTROLS

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

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

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

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

In response to prior audit recommendations made since fiscal 2007, DoIT has attempted to implement change control software. These packages were never implemented enterprise-wide and with minimal success, thus leaving agencies to develop their own methods and procedures to control application changes. Various methods are used to control program change management which rely mostly upon manual and automated procedures that incorporate emails, memorandums and other paper-based forms to document application changes.

This has led to inconsistent methods and noncompliance and circumvention of DoIT’s change control policy and procedural guidance. In a number of instances, we found no automated control system demonstrating that only authorized and proper changes had been implemented.

DoIT has indicated that it will implement an automated standardized formal enterprise program change control process for the application systems it supports. DoIT should develop procedural guidance that details the correct use of change management software and mandated internal control practices and procedures, thus ensuring a documented, monitored, and repeatable process.

RECOMMENDATIONS

2016-013a When implementing the new change management software, DoIT should determine the appropriate combination of operational, procedural and/or technical adjustments required to use the package in a manner that results in adequate program change control for the entire enterprise.

2016-013b Develop and implement procedures detailing specific requirements for program change control and disseminate and train DoIT support staff in its proper execution.

Corrective action plan / auditee views:

DoIT has decided to implement an ITIL change control process. DoIT will obtain feedback on costs to implement and resources required.

Anticipated Completion Date: *Dependent on software and FTE.*

Contact Person(s): *Tom O'Donnell, Assistant Director Central Information Management Services - DoIT*
Frank Pate, Assistant Director for Special Projects DoIT
Phone: 401.462.4701 / 401.462.8540

Finding 2016-014 ***(material weakness - repeat finding)***

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

Electronic data received by Taxation should remain encrypted and then be uploaded to Taxation's systems through automated processes without manual intervention. Current procedures create, rather than restrict, opportunities for data manipulation.

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

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

The electronic files are encrypted during transmission; however, they are not all directly uploaded to Taxation's systems without manual intervention. When these electronic files are in an open unencrytped text format, this allows, rather than restricts, manipulation of data prior to recording in Taxation's systems. Additionally, the files reside in an unprotected network folder prior to and after upload. These electronic files should be in a file format that is secure and configured to facilitate an efficient upload to Taxation's systems without need for manual intervention.

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

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

Enhanced coordination with the primary financial institution regarding file layouts and unique processing requirements could alleviate any need to modify the tax payment files prior to upload to Taxation's systems.

RECOMMENDATIONS

2016-014a Secure all electronic files containing taxpayer information residing on the Division of Taxation's network to ensure data integrity.

2016-014b Control all electronic files that contain taxpayer information by requiring the file format to be secure and configured to the computer system in order to allow automatic transmission without any manual intervention.

2016-014c Develop monitoring and reporting procedures to ensure the proper upload of data files.

Corrective action plan / auditee views:

2016-014a: The Division of Taxation will continue to work with the Division of Information Technology to complete the tasks relating to this finding.

Anticipated Completion Date: March 31, 2017 (per DoIT)

2016-014b: DoIT has addressed this finding and encryption has been purchased. We are currently verifying that encryption has been enabled on the encryption of the ACH/Bank Files.

The Division of Taxation will continue to work with the Division of Information Technology to complete the tasks relating to findings 2016-014b by creating ftp processes that are automated and manual intervention will only be required for files containing incorrectly formatted records.

Anticipated Completion Date: May 31, 2017

2016-014c: The Division of Taxation will continue to work with the Division of Information Technology to complete the tasks relating to this finding by creating automated notification.

Anticipated Completion Date: May 31, 2017

Contact Person(s): *Kurt Huhn, Assistant Director for Special Projects - DoIT*
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Finding 2016-015 **_(material weakness - new finding)_**

DEPARTMENT OF REVENUE – STAARS IMPLEMENTATION AND FINANCIAL REPORTING IMPACTS

Implementation of a new Taxation IT system presented issues impacting financial reporting due to processing timeframes for personal income tax returns and other returns held in suspense. This affected accruals based on historical processing timelines and complicated financial reporting estimates due to the uncertain effect of returns that had not fully processed at June 30, 2016.

Beginning in November 2015, personal income tax returns were processed by the Division's new State Tax Administration and Revenue System (STAARS). Processing of calendar 2015 tax returns through the new system was slowed due to a variety of issues associated with the implementation of STAARS. These included:

- more refined edits to detect potentially fraudulent returns – this resulted in more returns being held for review prior to payment of claimed refunds;
- scanning errors related to scanning equipment that did not meet designed system specifications for reliability - reading tax return bar codes and converting paper returns to electronic records; and
- manual intervention required to clear system processing edits and exceptions without sufficient personnel resources to meet the peak demand.

Financial reporting estimates at fiscal year-end were affected because normal processing timeframes and volumes differed from previous patterns. A significant volume of returns were held in suspense (posted exceptions report) or on the suspected fraud register at June 30, 2016. STAARS "classified" the returns held in suspense; however the system classification was unreliable with respect to accurately estimating the revenue impact when the return was fully processed (i.e., result in no revenue impact, a refund liability or a receivable).

STAARS Return Scanning Accuracy

The scanning functionality implemented as part of STAARS did not meet planned reliability targets. Scanning "errors" resulted from the inability to accurately read bar coding included on the returns, which impacted the accuracy of "reading" the return information. Errors also resulted from tax forms produced from commercial tax preparation software that did not align with the Division's scanner or STAARS system. This caused the returns to appear inaccurate and triggered edits which held the return in suspense pending further resolution.

The impact of the scanning errors was difficult to address in the midst of active processing. Controls and processes should be in place to ensure that returns are successfully scanned within designed tolerances. The Division has worked with its scanning vendor and tax preparation software companies to resolve the issues for the 2016 tax return processing season.

Refining system edits for optimal fraud detection and processing efficiency

STAARS was designed with heightened fraud detection edits. Based on a variety of criteria, a return could be flagged by the system as potentially fraudulent, which suspends further processing (refund payment) until the fraud suspicion is resolved or substantiated. This also slowed refund processing and contributed to the volume of returns held in suspense.

The Division prioritized the processing of likely refund returns prior to June 30, 2016. A significant volume of returns remained which required resolution; thereby complicating the various estimates used for financial reporting purposes. The Division must employ various measures to eliminate the volume of tax year 2015 returns pending full processing before the 2016 tax processing season commences. Most returns require human intervention to resolve errors, and staff were significantly challenged to handle the volume given the continued implementation of STAARS for additional tax types.

The Division has communicated its targeted strategy to eliminate the unreliability in its scanning functionality and coordinate with tax preparation software companies for the next tax return processing season. Additionally, fraud edit checks may need to be reviewed and refined to achieve the desired balance between heightened fraud detection and processing efficiency.

The Division should also increase its use of advanced analytical tools, in concert with the STAARS development vendor, to (1) prioritize resolution efforts for items included on the posted exceptions report, and (2) potentially apply a "system" resolution to groups of returns to reduce the number of returns requiring staff intervention. Lastly, staffing levels must be sufficient to meet peak demands and avoid processing backlogs.

RECOMMENDATIONS

2016-015a Ensure scanning reliability is restored to designed levels. Monitor scanning reliability on a timely basis to avoid processing backlogs and to allow for timely correction and recalibration as needed.

2016-015b Assess and refine system edits to achieve the optimal balance of fraud detection and processing efficiency.

2016-015c Utilize advanced analytical tools to (1) prioritize resolution efforts for items included on the posted exception report, and (2) potentially apply a system resolution to groups of returns to reduce the number of returns requiring staff intervention.

2016-015d Assess and add additional staff as needed to meet peak demands, resolve existing backlogs and prevent processing backlogs from occurring going forward.

Corrective action plan / auditee views:

The impact of the IT system implementation was consistent with ordinary expectations related to transition from a 40 year old legacy mainframe to a web-based software system necessary to keep up with:

- *demands for audit efficiencies/controls*
- *security needs*
- *increasing and evolving methods of fraud*
- *dynamic external IT technologies and advancements*
- *consumer needs/demands*

The extended filing processes were a result of a combination of factors including but not limited to:

- *automated scanning technology that prevented manual corrections by data entry staff (an audit/control enhancement)*
- *taxpayer/vendor noncompliance (prior errors corrected by manual intervention)*

- *resource limitations in staffing*
- *reasonable experience delays related to first year implementation*
- *Scanning deficiencies that came to light during processing*

Further, the tying of processing of returns/refunds to an impact on financial reporting may be overstated given that the Division of Taxation has well over 20 years of data on refunds/returns by weekly count and amount. Additionally, the Division had processed 90% of all refunds by June 30, 2016 (compared to 94% by June 30, 2015, 91% by June 30, 2014, 92 % by June 30, 2013). The 94% processing rate in 2015 was in anticipation of resource limitations due to system testing/training in the summer of 2015 and implementation of Personal Income Tax into STAARS in November 2015. The processing rate/volume of refunds in FY 2016 was consistent with prior years.

Throughout the tax season, in anticipation of transitional impacts on processing, the Division staff worked to monitor, address, and correct issues consistent with sound processing and review standards to ensure first year system integrity. The Division monitored the queues and had on-site vendors monitoring and correcting issues as the issues came to light. The Division shifted staff as necessary to processing and personal income tax and as indicated above maintained consistent processing levels by the end of the fiscal year. Additionally, the Division independently with its vendors, engaged in constant evaluation of suspended returns and implemented corrections and adjustments where appropriate. The Division also engaged the Office of Revenue Analysis to sample the error queues that provided further guidance on allocation of resources.

2016-015a - *A substantial amount of the scanning errors were caused by lack of compliance with form requirements by third party tax software vendors and taxpayer noncompliance.*

The Division of Taxation has worked with its vendor, third party tax software vendors and performed outreach to tax professionals and taxpayers to enhance scanning reliability both internally and externally. The Division of Taxation has been and continues its monitoring of all scanning issues on a daily basis. The Division will continue to monitor, assess, and respond to all scanning issues.

<u>Anticipated Completion Date</u>: February 28, 2017

2016-015b - The Division of Taxation has been actively assessing and refining system edits throughout the 2016 tax season and will continue to review and assess all queues to determine and achieve processing efficiency.

<u>Anticipated Completion Date:</u> February 28, 2017

2016-015c - *The Division of Taxation is using advanced analytical tools to prioritize resolution efforts to reduce the items on the posted exception report and is also using that analysis to apply system resolutions to groups of returns.*

<u>Anticipated Completion Date:</u> February 28, 2017

2016-015d - The Division of Taxation has taken the following steps to prepare for the 2017 personal income tax season:

- *Adding staff to both the Processing and Personal Income Tax Sections. Processing staff are cross-trained across multiple tasks including mail, scanning preparation, scanning, and data entry.*

- *Communication with Stakeholders (Tax professionals, vendors, taxpayers) to enhance compliance with forms and returns and expedite processing.*
- *Improved processing protocols in the preparation of documents into the scanner, tracking of returns/refunds into the scanner, tracking of employee responsible for task (to troubleshoot training issues)*
- *Daily evaluation of all suspended returns both in the IBML, Qmodules (Fairfax/Scanner) and STAARS to identify and correct issues.*
- *Daily evaluation of all queues IBML, Qmodules (Fairfax/Scanner) and STAARS to ensure efficiency and control over volume/rate of processing and to address any staffing gaps as necessary.*
- *Daily evaluation of output of Scanner, Fairfax, STAARS to ensure consistent production.*
- *Performance of additional analytics/confirmation to ensure fraud and error queues do not have valid returns.*

Anticipated Completion Date: *January 31, 2017*

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

Finding 2016-016 *(significant deficiency - repeat finding)*

DEPARTMENT OF REVENUE - OFF-SITE STORAGE OF TAXATION CRITICAL DIGITAL BACKUP FILES AND INCLUSION IN ANNUAL DISASTER RECOVERY TEST

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

Critical data files, such as the personal income tax processing file information, should be backed-up and stored off-site consistent with recommended best practice guidance. This allows, along with periodic testing of a disaster recovery "hot-site", for system recovery in the event of disaster at the data center or loss of data.

The Division of Taxation continued implementing a new integrated tax system (STAARS - State Tax Administration and Revenue System) during Fiscal 2016 and used the system to process calendar 2015 personal income tax returns. Although STAARS data was routinely backed-up on digital media, the back-up media was not sent to an off-site storage location. Critical back-up files should be moved off-site to a geographically different location. This process is generally followed for other State systems with critical data files; however, it has not been put into effect for STAARS.

RECOMMENDATION

2016-016 Ensure that digital backups are stored off-site in a geographically different location for disaster recovery and business continuity purposes.

Corrective action plan / auditee views:

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

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

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

Finding 2016-017 ***(significant deficiency – new finding)***

DEPARTMENT OF REVENUE – REVENUE RECOGNITION

The Division of Taxation had inconsistent measures of recognizing taxes receivable across different tax types.

During fiscal 2016, the Division of Taxation expanded use of its new STAARS system to more tax types but also continued to use its legacy main-frame systems to administer and collect other tax revenues. We found this resulted in inconsistent measures of when taxpayer receivables were recognized and reported. For example, in some instances, taxpayer liabilities were recognized immediately and in other instances, a period of 30 days was provided before recognition to allow time for taxpayer appeal.

Revenue and receivable recognition should be consistent among all tax types. The taxpayer's legal right to appeal should not limit the recognition of revenue and receivables for financial reporting purposes when tax liabilities are known (e.g., taxpayer files a return indicating a tax liability but has not fully paid the amount).

Further, some receivables were recognized as revenue for financial reporting purposes but bills were suppressed by STAARS and not mailed to the taxpayer. These were appropriately suppressed from billing due to a payment known to the system that had not yet been matched or associated to the taxpayer liability. Suppression of the billing notice should have also prevented recognition of the revenue and receivable for financial reporting purposes.

As The Division continues implementation of its STAARS system, it should ensure consistent and appropriate recognition of revenue and receivables among all tax types.

RECOMMENDATION

2016-017 Establish uniform criteria and consistent recognition of revenue and receivables across all tax types.

Corrective action plan / auditee views:

The Division of Taxation has established consistent criteria for recognition of revenue and receivables across all tax types in its integrated tax system (STAARS). The criteria have been provided to the Auditor General and Office of Accounts and Controls.

Anticipated Completion Date: *November 14, 2016*

<u>*Contact Person:*</u> *Neena S. Savage, Tax Administrator*
Phone: 401.574.8922

Finding 2016-018 ***(significant deficiency - new finding)***

<u>DEPARTMENT OF REVENUE – DATA USED TO CALCULATE SIGNIFICANT ESTIMATES</u>

Historical data used to support significant financial reporting estimates for tax revenues should be reassessed periodically to ensure continued validity – this is particularly important with more current data emanating from the new STAARS system.

The Office of Accounts and Control utilizes various Division of Taxation generated information to estimate financial statement revenue accruals, revenue refunds, and allowances for uncollectible and unavailable amounts. The Division's new STAARS system is capable of providing different and likely more detailed reporting on which to build estimates. Many of the estimates are derived from multi-year historical statistics – care must be exercised in using a combination of legacy data and STAARS to ensure the resulting estimates are still valid. Regardless, the data and assumptions underlying all significant estimates should be reassessed periodically to ensure they are valid and appropriate for the circumstances.

Additionally, STAARS data should be used to refine certain estimates. For example, the allowance for uncollectible and unavailable amounts for certain smaller dollar collection taxes should be developed based on collection history data specific to that tax rather than using the average of other taxes.

<u>RECOMMENDATION</u>

2016-018 Assess the validity of data used to develop significant tax revenue and refund accrual estimates particularly in light of current data emanating from the new STAARS system. Refine estimates where necessary to reflect enhanced data provided by STAARS.

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

The Division of Taxation agrees with this finding and is meeting with the Office of Accounts and Control to review data relied upon for estimates and assess the data for validity and appropriateness.

<u>*Anticipated Completion Date*</u>*:* *July 31, 2017*

<u>*Contact Person:*</u> *Neena S. Savage, Tax Administrator*
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Finding 2016-019 *(significant deficiency – new finding)*

DEPARTMENT OF REVENUE – STAARS SYSTEM ACCESS

STAARS system user access rights need to be assessed and tailored to ensure access is consistent and appropriate with each employee's responsibilities.

The Division of Taxation continues implementation of its integrated tax system - STAARS (State Tax Administration and Revenue System) with full system implementation by June 2017. We found that during the STAARS implementation, system user access for some users was broader than necessary. System access controls should be designed and monitored such that users have access tailored to their specific job functions and duties yet maintaining appropriate segregation of duties. This is particularly important in a tax processing system with sensitive data and large payment inflows and outflows.

We acknowledge that during system implementation user access is often broader than ultimately necessary. As the Division moves towards full implementation of its STAARS system, it should perform a thorough system access review to ensure user access is appropriately limited and consistent with each user's specific job function and responsibilities.

RECOMMENDATION

2016-019 Complete a thorough review of system access for all STAARS users to ensure user access is appropriately limited and consistent with each user's specific job function and responsibilities.

Corrective action plan / auditee views:

The Division of Taxation completed its review of system access for all STAARS users during the Summer of 2016. The Division has designated DoIT staff to monitor access. The Division created a new Chief role and shifted certain Superuser access to view only. Roles and access will continue to be modified and refined as business processes change.

Anticipated Completion Date: *July 31, 2017*

Contact Person: *Neena S. Savage, Tax Administrator*
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Finding 2016-020 *(material weakness – repeat finding)*

DEPARTMENT OF REVENUE – PERSONAL INCOME TAX – CONFIDENTIAL COMMUNICATION

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

Finding 2016-021 *(significant deficiency-repeat finding)*

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

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

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

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

- RIDOT FMS and RIFANS each utilize separate and distinct account structures, which necessitates mapping to "crosswalk" the two charts of accounts.

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

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

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

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

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

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

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

<u>RECOMMENDATIONS</u>

2016-021a Reevaluate the continued operation of two separate accounting systems to support financial reporting for the IST Fund. Consider using the RIDOT FMS for financial reporting.

2016-021b Ensure the control over the reconciliation of FMS to RIFANS is operating as intended by modifying the reconciliation report to properly map the natural accounts between the systems.

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

2016-021a - The overall goal is to work at better aligning the two accounting systems used by RIDOT. In order to better align the two accounting systems, both short term and long term goals have been identified.

Short-term goals: FMS was upgraded in the fall of 2016 which better aligned FMS more closely with RIFANS to allow for more accurate reconciliation reports to be developed. Reports are currently being developed to eliminate most of the manual intervention when reconciling the two systems and allow for a more automated approach. DOT has procured the services of the technical consultant that assisted in the upgrade and he will remain with DOT until the end of 2017. His main role is to assist in developing various reports.

<u>Anticipated Completion Date</u>: December 31, 2017

Long-term goals: Due to resources and funding, the Department does not see the ability or the benefit to merge to one system. As resources and funding becomes available, the Department would be willing to revisit this evaluation.

Anticipated Completion of Reviews: Review Complete

2016-021b - DOT has procured the services of the technical consultant that assisted in the upgrade and he will remain with DOT until the end of 2017. The consultant along with IT staff are working on modifying the report to ensure mapping of natural accounts between the systems is accurate.

<u>Anticipated Completion Date</u>: December 31, 2017

<u>Contact Person:</u> Loren Doyle, DOT Chief Financial Officer
Phone: 401.222.6590 X4524

Finding 2016-022 *(significant deficiency - repeat finding)*

INTERMODAL SURFACE TRANSPORTATION FUND - FINANCIAL REPORTING

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

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

Controls over the Preparation of Financial Statements

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

- Multiple activities and funding streams are included within the IST Fund. Although combined for financial reporting purposes, each activity or funding stream requires separate analysis to ensure amounts are accurately reported. Classification of fund balance by category – nonspendable, restricted, committed, assigned, and unassigned - is dependent upon the analysis of each activity and/or funding stream. Our analysis identified misclassifications of various fund balance categories. During fiscal 2016 RIDOT did reconcile the federal funding streams related to fund balance and plans to expand the reconciliation to all other funding streams in fiscal year 2017.

- Controls over the reporting and accounting of fees collected by the Division of Motor Vehicles (DMV) and transferred to RIDOT in accordance with RI General Law 39-18.1 can be improved. The improvements at a minimum should include documenting how the fee structure identified by RI General Law 39-18.1 has been incorporated into the DMV computer system (document the surcharge amount being applied to each DMV transactions code.) In addition to obtaining weekly, monthly and yearly summary reports, the DMV should be identifying the number of transactions by type and the amount collected by transaction type to ensure the proper amounts are being transferred to the IST Fund.

- Transactions were identified in the reconciliation of funds on deposit with fiscal agent to the general ledger that were not timing differences. These transactions should be posted to the general ledger.

- There were several adjustments to payables, receivables, deferred inflows and due to/ due from the federal government that were booked to the financial statements in order for the statements to be materially correct.

RECOMMENDATIONS

2016-022a Ensure the transactions identified through the analysis of each activity and/or funding source within the IST Fund are booked to the general ledger. Also improve controls over the categorization and reporting of fund balance components.

2016-022b Strengthen control procedures over the fees collected by the Division of Motor Vehicles (DMV) and transferred to RIDOT to ensure compliance with General Law Chapter 39-18.1 by obtaining weekly, monthly and yearly summary reports which identify the number of transactions by type and the amount collect by transaction type.

2016-022c Improve controls over financial reporting to ensure payables, receivables, deferred inflows and due to/due from the federal government are properly recorded in the State's accounting system and financial statements.

Corrective action plan / auditee views:

2016-022a - During FY 2016, RIDOT has implemented a process for reconciling fund balance. During this process fund activity is reconciled by RIFANS line items for all Federal accounts to ensure accuracy and consistency. Any inconsistencies found are adjusted at that time. The reconciliations are done on a monthly basis. During FY 2017 and 2018, RIDOT will expand the reconciliation process to include not only RIFANS line items for all Federal accounts but also all other RIFANS line items. The loss of staff resources has delayed the expansion of the process into FY 2018.

Anticipated Completion Date: *June 30, 2018*

2016-022b - During FY 2016, RIDOT communicated with DMV to begin to coordinate a process where RIDOT will go to DMV throughout the fiscal year and complete sample audits of amounts being transferred to RIDOT. RIDOT will also follow up with DMV on the status of their new computer system and work on developing electronic documentation that will be provided to RIDOT on a monthly basis once the system is in place. Since the new DMV system is not in place, DOT will continue to go out and conduct sample reviews.

Anticipated Completion Date: *August 31, 2017*

2016-022c - Improvements to Controls Currently Implemented: RIDOT has amended the policy to be any payable or receivable over $200,000 received after the July cut off but prior to the August deadline and related to the fiscal year being closed will be booked. RIDOT also coordinates with other agencies such as DEM, RIPTA and the RI Historical Society to ensure transfers being reported as accruals are accurate.

Anticipated Completion Date: *Complete*

Contact Person: *Loren Doyle, DOT Chief Financial Officer*
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Finding 2016-023 *(material weakness - repeat finding)*

TRANSPORTATION INFRASTRUCTURE REPORTING

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

Process to Accumulate Infrastructure Outlays

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

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

We noted misstatements relating to the infrastructure balances initially reported for fiscal 2016. Certain projects were erroneously reclassified from construction in progress to infrastructure during fiscal year 2016 and from infrastructure to construction in progress. Although corrected through audit adjustment, these misstatements indicate that controls should be improved over the process for identifying projects to be included in construction in progress and infrastructure.

Explore an Automated Approach to the Accumulation of Capitalized Infrastructure Outlays

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

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

Asset Impairments

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

RECOMMENDATIONS

2016-023a Develop controls over the identification of project expenditures (to include construction costs, design costs, internal payroll, subtotaling of project expenditures, categorization of projects and reconciling between RIDOT FMS and RIFANS) to be recorded as infrastructure investment in the State's financial statements.

2016-023b Explore ways that capitalized infrastructure outlays could be accumulated through an automated systems approach rather than the inefficient and error-prone spreadsheet approach currently used.

2016-023c Evaluate and document the consideration of whether any of the State's transportation infrastructure has been impaired consistent with the criteria outlined in generally accepted accounting principles applicable to governmental entities.

Corrective action plan / auditee views:

2016-023a - Phase 1: RIDOT now uses PTS ID numbers as unique tracking numbers for each project. These numbers have been integrated into RIDOT's financial system. The use of the numbers will allow all costs associated with a project to be linked which is something that was a manual process in the past. This will improve the reporting of infrastructure assets however older projects that consisted of comingled costs may still require some manual processing until they are closed.

Anticipated Completion of Phase 1: Complete

Phase 2: RIDOT will begin to identify each project in the FMS Oracle system with the proper infrastructure categorization code which is currently a manual process.

Anticipated Completion of Phase 2: December 31, 2017

Phase 3: Once all projects have PTS ID numbers and infrastructure categorization codes assigned in the FMS Oracle system, RIDOT will begin working with IT to develop reports that will assist with the reconciliation of infrastructure expenditures between RIDOT FMS and RIFANS. The reports will replace the manual reconciliation that is currently being done.

Anticipated Completion of Phase 3: December 31, 2017

2016-023b - By implementing the corrective action for finding 2016-024a, finding 2016-024b will also be accomplished therefore the corrective action for both findings will be the same.

Phase 1: RIDOT now uses PTS ID numbers as unique tracking numbers for each project. These numbers have been integrated into RIDOT's financial system. The use of the numbers will allow all costs associated with a project to be linked which is something that was a manual process in the past. This will improve the reporting of infrastructure assets however older projects that consisted of comingled costs may still require some manual processing until they are closed.

Anticipated Completion of Phase 1: Complete

Phase 2: RIDOT will begin to identify each project in the FMS Oracle system with the proper infrastructure categorization code which is currently a manual process.

Anticipated Completion of Phase 2: December 31, 2017

Phase 3: Once all projects have PTS ID numbers and infrastructure categorization codes assigned in the FMS Oracle system, RIDOT will begin working with IT to develop reports that will assist with the reconciliation of infrastructure expenditures between RIDOT FMS and RIFANS. The reports will replace the manual reconciliation that is currently being done.

Anticipated Completion of Phase 3: December 31, 2017

2016-023c - RIDOT will review the criteria for impairment of assets and from there develop a policy and a procedure for determining if any of the State's transportation infrastructure assets have been impaired.

Anticipated Completion Date: December 31, 2017

Contact Person: Loren Doyle, DOT Chief Financial Officer
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Finding 2016-024 *(significant deficiency - repeat finding)*

INTERMODAL SURFACE TRANSPORTATION FUND – CONTROLS OVER KEY DATA FILES

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

Progress Payment Data Files

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

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

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

Federal Billing

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

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

- The file is in an open text format with no encryption. This open text format allows anyone who has access to the server directory to modify the file.

- There is no change management system in place tracking changes to the file, documenting who made the change, or requiring management approval of changes.

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

RECOMMENDATIONS

2016-024a Review the progress payment file transfer process to identify critical points where automated controls could be implemented to eliminate the need for manual intervention.

2016-024b Create and implement appropriate approval hierarchies.

2016-024c Improve controls over the RIDOT federal billing process to include transferring files without modification.

2016-024d Modify the Financial Management System to allow for multiple funding source award numbers (FSAN) to be linked to one Federal Aid Project.

Corrective action plan / auditee views:

2016-024a - Currently Implemented. RIDOT worked with IT about two years ago to review the progress payment file transfer process. Critical points were identified where ideally automated controls could be implemented however due to limitations of both the FMS Oracle system and the Project Management Portal (PMP) the automated controls could not be done. Nonetheless, while automated controls were unable to be implemented, RIDOT did implement other compensating controls. A process was put in place where a screen shot of the payment prior to manual intervention was taken and a screen shot after manual intervention was taken so that the Supervisor could sign off to ensure accuracy. A tracking sheet is also maintained of all payments brought into FMS from PMP and changes are indicated where necessary. Throughout all this manual intervention, the dollar amount of a progress payment is never being changed. While the corrective action is not the ideal solution, it ensures controls are in place and due to system limitations automation is not feasible at this time.

Anticipated Completion Date: Implemented

2016-024b - Approval hierarchies in FMS were implemented in accounts payable through the R12 Oracle upgrade process in the fall of 2016.

Anticipated Completion Date: Complete

2016-024c - Currently Implemented. RIDOT has discussed at lengths with IT automating the federal billing process to include transferring files without modification and it has been determined that FMS Oracle does not have the capability. However, compensating controls have been put in place to ensure the accuracy of the federal billing process. Any payment file that is modified is signed off by a supervisor prior to being transferred to the federal government for processing. While it is not the ideal automated control that was implemented, the compensating *controls accomplishes the same result which is that the federal billing file is properly being transmitted.*

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

2016-024d - Currently Implemented. This is a system limitation; FMS is unable to have multiple funding source award numbers linked to one Federal Aid Project. RIDOT has discussed with IT who has also consulted with Oracle to determine if this was something that could be done and it was determined it could not be so compensating controls were put in place.

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

<u>*Contact Person:*</u> *Loren Doyle, DOT Chief Financial Officer*
Phone: 401. 222.6590 x4524

Finding 2016-025 *(material weakness - repeat finding)*

<u>CENTRAL FALLS SCHOOL DISTRICT - SIGNIFICANT ADJUSTMENTS</u>

<u>Criteria</u> – Management is responsible for the maintenance of adequate accounting records, internal controls and the fair presentation of the financial statements in accordance with generally accepted accounting principles.

<u>Condition</u> – Material adjustments to year-end balances, restatements of opening balances and current year activity were necessary for the financial statement to be fairly presented in accordance with generally accepted accounting principles.

<u>Cause</u> – There are a number of causes for this condition, many being the result of attempts to correct circumstances. However, the principle causes are a lack of a coordinated, comprehensive plan to implement and train employees with new financial software, concurrent with the retirement of several key long term employees.

<u>Effect</u> – Information recorded in and reports produced from the accounting system contained numerous material errors related to the inclusion or exclusion of information resulting from data entry and software execution errors, resulting in material adjustments accepted by management to the District's financial statements.

<u>RECOMMENDATION</u>

2016-025 A comprehensive plan to coordinate all District financial accounting recording and reporting activities is in the process of being developed and implemented. This plan should include the development of a comprehensive policies and procedures manual; adequate staffing including training of all staff as to both the processes and the software involved; appropriate controls related to authorization and review of recorded transactions; timely recording of transactions, reconciliations and reviews of reconciliations so as to detect and correct errors in a timely manner, and a comprehensive review of the District's organizational structure to ensure adequate levels of supervision and clear reporting paths for all staff involved.

Corrective action plan / auditee views:

Management will correct the material weakness by ensuring adequate staffing including training the processes and software involved, appropriate controls related to authorization and review of recorded transactions, and timely recording of transactions and reconciliations.

Finding 2016-026 *(significant deficiency - repeat finding)*

CENTRAL FALLS SCHOOL DISTRICT - CAPITAL ASSETS

Criteria – Capital assets are maintained by the District and reported in the government-wide statement of net position. Although these capital assets and the related depreciation do not impact the fund statements of the District, they do have an impact on the overall governmental net position. Additionally, the District is required to maintain capital asset records for all assets that are purchased with federal grant funds.

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

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

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

RECOMMENDATION

2016-026 We recommend that the District implement an integrated software package that will enable capital assets to be recorded when the asset is acquired rather than being captured at year end. We further recommend that the capital asset inventory be updated to include the location of the asset and a code to identify all assets that are acquired with federal funds. Management should utilize this capital asset inventory listing, as well as the controllable asset listing, to conduct periodic inventories of the assets.

Corrective action plan / auditee views:

Management will correct the noted significant deficiencies by hiring a third party to complete an inventory of all capital assets. Management will then incorporate this information into the financial software system.

Finding 2016-027 ***(material weakness - repeat finding)***

METROPOLITAN REGIONAL CAREER AND TECHNICAL CENTER (THE "MET") - GENERAL LEDGER RECONCILIATIONS

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

Condition - During the performance of our audit of the Met's financial statements, we noted the monthly reconciliations of the operating cash account for fiscal year 2016 included a variance of $92,417 resulting from improper reconciling items in the prior fiscal year.

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

Effect - Failure to properly reconcile cash accounts to bank statements on a timely basis in previous years resulted in reconciling errors not discovered until fiscal year 2016. In addition, this resulted in an overstatement of cash and equivalents on the fiscal year 2015 audited financial statements requiring a prior period adjustment to reflect the proper account balances held at that time.

RECOMMENDATION

2016-027 Policies and procedures should be developed and implemented by the Met's management to ensure that appropriate internal controls are enforced.

Corrective action plan / auditee views:

Early in the 2016 fiscal year, The Met reviewed all monthly bank reconciliations as far back as June 2013 and found that said variance was there in all prior periods. The Met made every effort to resolve however, given internal programmatic flaws in the SunGard financial system, The Met could not discover the reason for the variance. In fact, we believe it was an issue with the way SunGard was posting and clearing accounts payable. The Met requested assistance from its auditors on how to account for the matter so that moving forward the prior year variance would not remain an issue.

In addition, The Met has implemented a process where monthly reconciliations are performed by the Chief Accountant once bank statements for the prior month have been received. The Met also requires that monthly reconciliations be signed off by the Business Manager in order to insure timeliness and accuracy.

Finding 2016-028 ***(significant deficiency - repeat finding)***

RHODE ISLAND CONVENTION CENTER AUTHORITY - UNTIMELY BANK RECONCILIATIONS

Criteria - Bank reconciliations should be performed timely after month-end.

Condition - Operating Bank Account and the Box Office Bank Account reconciliations at the Dunkin' Donuts Center were not completed on a timely basis.

Cause - Bank reconciliations were not completed on a timely basis.

Effect - Because the bank reconciliations were not timely performed, it is possible that errors at the Dunkin' Donuts Center, whether accounting errors or bank errors, would not be timely detected and corrected. In addition, as a result of bank reconciliations not being timely, it is also reasonably possible that not all expenses were captured during the event settlement process at the Dunkin' Donuts Center, meaning the Authority likely absorbed more expenses that it was contractually obligated to do. The impact of these issues, combined with the expenses being absorbed rather than being reimbursed as allowed in the event agreement, have the potential to be material to the financial statements as a whole.

Perspective - In July 2016 during preliminary audit fieldwork, we noted Dunkin' Donuts Center Operating Bank Account and Box Office Bank Account had not been reconciled since November 2015 and that the Payroll Bank Account has not been reconciled since March 2016.

RECOMMENDATION

2016-028 We recommend that all bank reconciliations be performed on a timely basis.

Corrective action plan / auditee views:

Due to the unexpected turnover and resignation of key associates, there were not enough associates and/or associates that were too new to complete certain tasks in a timely manner during this fiscal year. Both venues are currently hiring and training associates in order to reconcile all bank accounts in a timely manner.

Finding 2016-029 ***(significant deficiency - repeat finding)***

RHODE ISLAND CONVENTION CENTER AUTHORITY - REVIEW OF BANK RECONCILIATIONS, JOURNAL ENTRIES AND EVENT SETTLEMENTS

Criteria - Bank reconciliations, journal entries and event settlements should be reviewed.

Condition - We noted that bank accounts, journal entries and an event settlement were not being reviewed.

Cause - Accounting staff were not reviewing or documenting their reviews of bank accounts, journal entries or an event settlement.

Effect - As a result of reviews not being performed, errors, which have the potential of being material, may occur which could go undetected.

Perspective - We noted based on a sample of 25 journal entries tested at the Rhode Island Convention Center, three journal entries that were not reviewed.

- We noted, based on a sample of 25 journal entries tested at the Dunkin' Donuts Center, one journal entry that was not reviewed at the Dunkin' Donuts Center.
- We noted one event settlement that was not reviewed at the Dunkin' Donuts Center.
- We also noted that operating and box office account bank reconciliations were not reviewed.

RECOMMENDATION

2016-029 We recommend that all bank reconciliations, journal entries and event settlements be reviewed by an appropriate accounting staff or management, and that the review be performed on a timely basis.

Corrective action plan / auditee views:

A more structured month end close process is currently being implemented.

Finding 2016-030 *(material noncompliance - repeat finding)*

RHODE ISLAND CONVENTION CENTER AUTHORITY - RESTRICTIVE COVENANTS

Criteria - Bond indentures require that the Authority fund the Operating Reserve and Renewal and Replacement components.

Condition - During the years ended June 30, 2016 and 2015, the Authority was unable to fund the Operating Reserve requirement of the restrictive covenants for the RICC and the DDC pursuant to the indentures. During the years ended June 30, 2016 and 2015, the Authority was unable to fund the Renewal and Replacement requirement of the restrictive covenant for the DDC pursuant to the indenture.

Cause - The Authority does not have sufficient cash flow to fund the Operating Reserve and Renewal and Replacement components.

Effect - As a result of these funds not being funded, the Authority is in noncompliance with bond indentures.

Perspective - Debt covenants.

RECOMMENDATION

2016-030 We recommend that the Authority fund the Operating Reserve and Renewal and Replacement Funds.

Corrective action plan / auditee views:

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

2016

Management Comments

Management Comment 2016-01 **_(repeat comment)_**

FORMAT OF BUDGET AND ACTUAL COMPARISON SCHEDULES AND LEGISLATIVELY ENACTED BUDGETS

The form and content of the enacted operating budgets for certain components of State operations should be enhanced to provide more effective planning and monitoring tools. The format of financial reporting schedules prepared at fiscal year-end to compare budget to actual results can also be enhanced.

Format of the Detailed General Fund Budget and Actual Schedule

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

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

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

Intermodal Surface Transportation Fund

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

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

Lottery Division

The State includes estimated operational expenses for the RI Lottery in its annual appropriated budget. However, the amounts included in the budget are not inclusive of all expenses reported in the Lottery's financial statements. Specifically, the budget does not include estimated prize awards or required transfers to the General Fund. The Lottery is required by General Laws to transfer net proceeds of the Lottery games to the General Fund for funding of State operations. While the State projects estimated revenues to the General Fund as part of the Revenue Estimating Conference, net transfers are not included in the Lottery Division's budget. As such, the budgeted appropriations do not reflect the actual expenditures of the RI Lottery. In fiscal 2016, expenditures paid for prize awards, net of prize recoveries, totaled over $159 million and transfers to the General Fund totaled almost $370 million.

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

Comprehensive, Multi-Fund Budgeting

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

RECOMMENDATIONS

MC-2016-01a Modify the current format of the detailed General Fund budget and actual comparison schedule to facilitate identification of relevant data at a departmental and unit level.

MC-2016-01b Reevaluate the presentation of the budget plan for the Department of Transportation and the related funds used to account for its activities. Consider changes in the level of detail and the inclusion of other items to facilitate comparison to actual results.

MC-2016-01c Consider modifying the level of detail included in the budget plan for the RI Lottery Division to include estimates for all expected expenses.

MC-2016-01d Explore the possibility of including fund information within the budget document to facilitate recording the budget in the accounting system and preparing budget to actual comparisons.

Corrective action plan / auditee views:

MC-2016-01a - The current format of the detail General Fund budget and actual comparison schedule will be reviewed and modified, where possible, to better identify totals by source and at the program and department levels.

Anticipated Completion Date: *December 2017*

Contact Person: *Jennifer Pate, Administrator, Financial Management*

Phone: 401.222.5098

MC-2016-01b-d - The Office of Management and Budget/State Budget Office is open to working with the State Controller's Office and the Auditor General's Office on improving the format of the annual appropriations act to address the concerns raised in these findings. The State Budget Office will develop some options to share with the State Controller and Auditor General with the goal of the FY 2019 Appropriations Act being submitted in an updated format. Review of any format changes will also require input from the House and Senate Fiscal Advisors.

Anticipated Completion Date: *January 2018*

Contact Person: *Thomas A. Mullaney, State Budget Officer*
Office of Management and Budget/State Budget Office
Phone: 401.222.6300

Management Comment 2016-02 ***(repeat comment)***

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

Four internal service funds have incurred repeated operating deficits - charges to departments and agencies are insufficient to cover operating costs.

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

Federal regulations (*Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*) state that working capital reserve balances within internal service funds should not exceed 60 days of cash expenses for normal operating purposes. We noted one instance in which there was a working capital reserve significantly exceeding the 60-day expense reserve - the Central Warehouse fund had working capital reserves exceeding 350 days of expenses at June 30, 2016.

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

RECOMMENDATION

MC-2016-02 Enhance internal service fund monitoring procedures to ensure that billing rates are appropriate to prevent significant losses or profits and to ensure compliance with federal regulations.

Corrective action plan / auditee views:

The Central Business Office and other offices responsible for managing internal service funds recognize the importance of the management comment, and are working towards enhancing the monitoring procedures to ensure billing rates are at a level that recovers the appropriate amount of funding for each service. The rates will be further analyzed and refined by internal staff to confirm that the charged amount is sufficient to avoid the deficits cited in the management comment, as well as to avoid an excessive fund balance.

The Business Office also plans to engage an outside vendor to assist in rate development to further the objective of operating Internal Service Funds as close as possible to break-even.

Anticipated Completion Date: *Summer of 2017*

Contact Person: *Bernard Lane Jr., Administrator, Management Services*
Department of Administration, Central Business Office
Phone: 401.574.8594

Management Comment 2016-03 *(new comment)*

RIDOT FEDERAL RECEIVABLES - EARNED BUT UNBILLED COSTS

Certain allowable costs are not reimbursed timely from the federal government which negatively impacts the State's cash position.

Certain amounts due from the federal government are classified as "Earned but Unbilled" (EBUB) within the Intermodal Transportation (IST) Fund since they represent allowable and federally reimbursable project costs; however, collection of federal funds is deferred due to the following:

- RIDOT is not actively monitoring federal project category authorizations allocated to projects to maximize drawdowns;
- a project modification is pending federal approval;
- RIDOT has chosen to use its authorization of federal funds for new projects; or
- the federal authorization has project set aside requirements that have not been met.

At June 30, 2016, EBUB federal receivables amounted to $2.3 million. RIDOT believes these federal receivable amounts are a necessary consequence of making the most effective use of federal highway authorizations for the State's highway construction program. Failure to collect these amounts timely from the federal government for extended periods of time results in the State financing these expenditures, which negatively impacts the IST fund cash position.

Federal funds should be drawn for all amounts due from the federal government as soon as all federal requirements have been met.

RECOMMENDATION

MC-2016-03 Collect all amounts due from the federal government in reimbursement of highway project expenditures as soon as all federal requirements have been met.

Corrective action plan / auditee views:

RIDOT is currently working on creating a policy and procedure where earned but unbilled will be tracked on a more frequent basis. Assuming all requirements are met, this new policy and procedure would allow for more frequent billing of earned but unbilled.

Anticipated Completion: *December 31, 2017*

Contact Person: *Loren Doyle, DOT Chief Financial Officer*
Phone: 401.222.6590 x4524

Management Comment 2016-04 ***(repeat comment)***

FINAL APPROVAL OF RIFANS JOURNAL ENTRIES

Workflow controls can be enhanced to ensure all journal entries which require approval by the Office of Accounts and Control are appropriately routed.

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

In RIFANS, the category code for Electronic Benefit Transfer (TANF) funding transactions allows those transactions to be initiated by the departmental users without being routed for final approval to the Office of Accounts and Control. In addition, other vulnerabilities exist for additional category codes generally reserved for use by personnel within the Office of Accounts and Control, as these categories may erroneously be used by departmental users. Because these category codes are, by policy, limited to certain centralized accounting staff, there is no systemic workflow routing the transactions to final approval at the Office of Accounts and Control.

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

RECOMMENDATION

MC-2016-04 Ensure that all journal entry transactions receive final approval by the Office of Accounts and Control prior to posting to RIFANS.

Corrective action plan / auditee views:

DOIT will install a systemic check that will only allow certain journal categories to be used when a cash account is used. These journals will then follow the current workflows. There will be no changes made to the TANF Funding journals due to the time sensitivity of the transactions. If the

TANF Funding journals are not final approved in a timely manner there are provisions for financial penalties.

Anticipated Completion Date: *December 2017*

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

Management Comment 2016-05 **(repeat comment)**

FINANCIAL STATEMENT DISCLOSURE OF SIGNIFICANT COMMITMENTS

Further improvements can be made in accumulating information about significant commitments for disclosure in the State's annual financial statements

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

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

In fiscal 2016, the Office of Accounts and Control manually accumulated significant commitments mostly by obtaining information from project managers at various State departments and agencies. While those procedures yielded a significant reporting of State commitments at year-end, the process is inefficient and does not provide the type of control needed to ensure completeness of the State's commitments disclosed at year-end.

The State should ideally explore implementing procedures that accumulate the data at the time contracts and related amendments are approved through the Division of Purchasing. Such procedures would provide better control over completeness through the accumulation of commitment data at the time the underlying purchasing authorization occurs.

RECOMMENDATION

MC-2016-05 Improve systems and procedures to enhance the disclosure of significant commitments within the State's annual financial statements.

Corrective action plan / auditee views:

When the new procurement system is implemented in 2018, we will review the feasibility of obtaining more information directly from that source. In the intervening period we will continue to enhance existing methods of gathering data regarding commitments.

Anticipated Completion Date: *June 2019*

Contact Person: *Jennifer Findlay, Acting Associate Controller*
Phone: 401.222.5771

Management Comment 2016-06 *(repeat comment)*

ACCOUNTING CONTROLS OVER CAPITAL PROJECTS

Controls over accumulating capital asset additions for project-based, multi-year projects can be improved.

The largest capital asset additions (in $) are project-based rather than single item acquisitions. The RIFANS capital asset module is programmed to flag expenditures in designated natural account codes as potential capital asset additions. This works well for single capital items but not as effectively for projects that involve multiple categories of expenditures and span more than one fiscal year. Independent processes have been developed which include accumulation of project costs on spreadsheets external to RIFANS. This process is manually intensive and can lead to error or omission of capital projects if system coding or system query is not performed accurately.

Governmental Activities capital assets (construction in progress) were restated by a net decrease of $7.7 million as a result of removing seven prior years of projects that were no longer deemed capital in nature as well as the identification and addition of one computer system project that had not been identified in the prior year. Implementation of the capital projects module or another application with similar functionality would facilitate accumulation and management of project costs for both financial reporting and project management purposes.

RECOMMENDATION

MC-2016-06 Implement an automated application to facilitate the accumulation and management of project based costs for both financial reporting and project management purposes.

Corrective action plan / auditee views:

We believe the current methods used to identify, track and accumulate costs for capital projects are more than adequate to provide accurate information for financial statement purposes. We would like to emphasize that these methods have been carefully evaluated and improved over the past several years.

Anticipated Completion Date: *Not applicable*

Contact Person: *Not applicable*

Auditor response:

We believe the process to accumulate project related capital additions can be further enhanced as evidenced by the adjustments resulting from the audit. Additionally, capitalization policy enhancements should be considered regarding the accumulation of costs in construction in progress and then subsequent expensing of those costs when the capitalization dollar threshold is not met.

Management Comment 2016-07 **_(repeat comment)_**

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

Actuarially determined contribution rates for retiree health benefits include provision for the "Cadillac Tax" which significantly increases annual required contribution amounts.

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

While the excise tax is not effective until 2020, the State's actuary, in performing the actuarial valuation of the State's retiree health plans at June 30, 2013, calculated that the State would be subject to the 40% excise tax beginning in 2020 and included that cost in the development of the actuarial accrued liability for the retiree health plans. This has a significant impact on the annual required employer contribution amount to the State's OPEB plan for state employees.

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

Changes at the federal level regarding the Affordable Care Act or specific provisions contained are anticipated. In addition to monitoring those potential changes, options should be considered to modify plan design to potentially avoid the "Cadillac" excise tax and the resultant impact on the actuarially determined OPEB employer contribution rate.

RECOMMENDATION

MC-2016-07 Explore options to determine if the excise or so called "Cadillac tax" on high-cost health plans could be avoided through changes in plan design for the State's retiree health care plans.

Corrective action plan / auditee views:

The State has retained Segal Consulting as its employee benefits consultant. The State is currently working with Segal in developing plan changes for the State's pre-65 retiree health plan(s) that will enable the State to avoid the excise tax.

Anticipated Completion Date: *December 31, 2017*

Contact Person: *Paula M. Cofone, Deputy Personnel Administrator*
Phone: 401.574.8505

Management Comment 2016-08 *(repeat comment)*

SUBRECIPIENT AND GRANTEE MONITORING - CENTRALIZED REVIEW OF AUDIT REPORTS

Required monitoring of subrecipients and other state grantees could be made more effective and efficient by centralizing certain monitoring aspects at a statewide rather than department-wide level.

Subrecipients and grantees assist the State in carrying out various programs funded with State and/or federal monies and include entities such as municipalities, community action programs, local educational agencies and non-profit organizations. 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 require any entity that expends $750,000 or more in federal assistance [direct or pass-through (e.g., State)] to have a Single Audit performed. Copies of the Single Audit Reports must be provided to the pass-through entity and the federal government.

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

- Many subrecipients and grantees 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 or grantee. 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. Another entity, also receiving significant funding from multiple state agencies, reported fraud and misappropriation of assets by a key employee.

- There is no centralized database detailing which entities receive funding from the State, which are required to have a Single Audit performed, and the status of the audits.

- Effective subrecipient monitoring requires that individuals reviewing the audit reports be trained in governmental accounting and auditing requirements. This level of proficiency is difficult to achieve and maintain at all the departments and agencies now required to review subrecipient audits.

We have reported various deficiencies in the process used to review subrecipient audit reports. Considerable advantages can be gained by centralizing the subrecipient and grantee monitoring function within one unit of State government. This will raise the level of assurance that subrecipients and grantees 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-2016-08a Centralize subrecipient and grantee monitoring procedures related to receipt and review of Single Audit Reports and other 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 audit reports.

MC-2016-08b Build a database of all subrecipient and grantee entities that receive state and/or federal grant funding.

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

MC-2016-08a - Recent changes to the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (aka Uniform Grant Guidance) coupled with changes to the Single Audit reporting process have reduced the administrative burden for both sub-recipients and state agencies. Sub-recipients required to file a single audit must upload the new SF-SAC form and the full reporting package to the Federal Audit Clearinghouse. The Uniform Grant Guidance (2 CFR 200.512(2)(b)) stipulates that pass-through entities <u>must</u> access the reporting package and data collection form through the Clearinghouse.

Based upon the above, OMB's Grants Management Office disagrees with the recommendation to centralize the review of Single Audit Reports. The Uniform Grant Guidance defines the responsibilities of pass through entities, i.e., state agencies, as it relates to sub-recipient monitoring. State agencies, as the direct recipients of awards, are responsible for single audit review. The Agencies must consider whether the results of the single audit review necessitate adjustments to their own program records and issue a management decision, where appropriate.

We expect implementation of the Grant Management System to facilitate coordination and communication among state agencies, including in the area of sub-recipient monitoring. Sub-recipients will be users of the Grants Management System. Some sub-recipient data, e.g., risk assessments and sub-recipient monitoring findings, will be viewable to all state agency grant managers. OMB is committed to leveraging the definition of the standard grants business during the system implementation to identify opportunities for improved efficiency and effectiveness of sub-recipient monitoring process including the review of single audits.

<u>*Anticipated Completion Date:*</u> *not applicable*

MC-2016-08b - The Grants Management Office developed and implemented a tool to assist agencies in determining the nature of the relationship between the state and the entity (sub-recipient or contractor). The Division of Accounts and Controls refined RIFANS so that agencies designate state and federally-funded sub-recipient relationships in the system using dedicated natural account numbers. Agencies received training on the new tool and the new codes. A memo summarizing the changes was sent to CFOs. Given these changes, reports can now be generated from RIFANS by entity and the sub-recipient natural account.

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

<u>*Contact Person:*</u> *Laurie Petrone, Director of Grants Management*
Office of Management and Budget
Phone: 401.574.8423

<u>Auditor response:</u>

We continue to believe there are multiple benefits and efficiencies to be achieved through centralization of certain aspects of subrecipient and grantee monitoring and do not agree that the implementation of the federal Uniform Guidance provisions modify or negate the intended benefits of our recommendations.

Management Comment 2016-09 ***(repeat comment)***

IMPROVE CASH RECONCILIATION EFFICIENCY

Automation and technology enhancements could improve the efficiency of bank reconciliations.

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

RECOMMENDATION

MC-2016-09 Increase automation of the bank reconciliation process by exploring enhanced electronic transaction matching.

Corrective action plan / auditee views:

During FY2017 Treasury conducted preliminary research on SaaS-based automated reconciliation systems. Treasury staff participated in vendor demonstrations and conducted due diligence on available solutions.

Treasury plans to post an RFP for electronic reconciliation in April of 2017. Due to the retirement of the current Chief Fiscal Officer, the decision was made to implement electronic reconciliation starting in FY 2018 to accommodate the onboarding of a new department manager.

Anticipated Completion Date: *August 2017*

Contact Person: *Lisa Churchville, Chief Operating Officer - Treasury*
Phone: 401. 378.4886

Management Comment 2016-10 ***(repeat comment)***

SURPLUS FURNITURE AND EQUIPMENT

Awareness and communication of available surplus furniture and equipment could be improved by creating a searchable, web-based functionality.

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

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

RECOMMENDATION

MC-2016-10 Implement a statewide network or database of "surplused" furniture and equipment assets to facilitate notification and use by other state or local entities.

Corrective action plan / auditee views:

The Division of Capital Asset Management and Maintenance (DCAMM) is in agreement with the recommendation to implement a statewide database of surplus assets to promote identification and use by other state or local entities. We propose to facilitate this initiative through a DCAMM web page. DCAMM has already reached out to the Division of Information Technology (DoIT) with the surplus database requirements. We are waiting for an estimated cost to implement. DCAMM web page set up required.

Anticipated Completion Date: *December 2017*

Contact Person: *Artie Jochmann, Chief Property Manager*
Phone: 401.462.3043

Management Comment 2016-11 ***(new comment)***

SOFTWARE LICENSING FEES FOR RIFANS ACCOUNTING SYSTEM MODULES

Recurring annual licensing fees must be paid for software purchased but never intended to be used.

The State purchased multiple modules within the Oracle E-Business Suite – the original intended platform for the State's Enterprise Resource Planning (ERP) system but has not implemented certain modules (e.g., human resources, grants and projects, and human resources benefits) and has no plan to use these module going forward. Annual licensing fees must be paid for each of the modules regardless of use. Now that there is a clear intent not to implement these modules, options should be explored to avoid paying the licensing fees in perpetuity.

RECOMMENDATION

MC-2016-11 Explore options to avoid licensing fees for software that will not be used.

Corrective action plan / auditee views:

The licensing model for our Oracle E-Business Suite limits the state's ability to renegotiate the licensing costs. Oracle's licensing model reprices our contract if any changes are made to reflect a much lower original purchase discount than the original purchase price discount. By eliminating line items in the contract, repricing would occur and would reflect no savings and we would own less licenses. This has been explored in the past and the final determination was not to eliminate the licenses as this would yield no savings and actually may increase the cost.

Anticipated Completion Date: *not applicable*

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