# STATE OF RHODE ISLAND
# AND PROVIDENCE PLANTATIONS

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

Schedule of Findings and Responses

JUNE 30, 2011 AUDIT


Dennis E. Hoyle, CPA
Acting Auditor General

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

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STATE of RHODE ISLAND and PROVIDENCE PLANTATIONS

GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

♦ *INTEGRITY*
♦ *RELIABILITY*
♦ *INDEPENDENCE*
♦ *ACCOUNTABILITY*

April 3, 2012

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

We have audited the financial statements of the State of Rhode Island and Providence Plantations (the State) for the year ended June 30, 2011 and have issued our report thereon dated December 22, 2011. Our Independent Auditor's Report on the State's financial statements was included in the State's Comprehensive Annual Financial Report for fiscal 2011.

In conjunction with our audit of the State's financial statements, we have also prepared a report, dated December 22, 2011 and included herein, on our consideration of the State's internal control over financial reporting, its compliance with certain provisions of laws, regulations and contracts, and other matters required to be reported by *Government Auditing Standards*. Our report includes 38 findings that we considered significant deficiencies or material weaknesses in internal control over financial reporting or other matters required to be reported by *Government Auditing Standards.*

This report also includes 13 management comments, which are less significant findings, yet, in our opinion still warrant communication and the attention of the State's management.

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

Other findings and recommendations related to the State's administration of federal programs will be issued separately in the State's *Single Audit Report* for the fiscal year ended June 30, 2011.

Sincerely,

Dennis E. Hoyle, CPA
Acting Auditor General



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# State of Rhode Island and Providence Plantations

## Schedule of Findings and Responses

## JUNE 30, 2011 AUDIT

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Our audit of the State's financial statements, performed in accordance with *Government Auditing Standards*, requires that we communicate deficiencies in internal control over financial reporting. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. Control deficiencies classified as ***material weaknesses*** represent a higher likelihood that a material misstatement could occur and not be prevented or detected than those findings classified as ***significant deficiencies.***

The control deficiencies identified in our audit can be broadly categorized as follows:

- ***Statewide Accounting Systems and Other Financial Reporting Matters***
  - full implementation of the planned statewide accounting system (RIFANS) has stalled
  - deficiencies in control over financial reporting relating to federal programs

- ***Information Systems Security***
  - monitoring of comprehensive information system security policies and procedures
  - secure transmission of financial data to external parties

- ***Department of Revenue - Division of Taxation***
  - controls over tax payments received electronically
  - consistent revenue recognition and data warehouse billings
  - personal income tax administration

- ***Department of Transportation (DOT) - Intermodal Surface Transportation Fund***
  - design of DOT's accounting system is incompatible with the State's RIFANS system resulting in control weaknesses and various inefficiencies
  - transportation infrastructure reporting

- ***Department of Labor and Training (DLT) - Employment Security and Temporary Disability Insurance Funds***
  - security of DLT's systems and data transmissions

- ***Component Units***
  - weaknesses in controls for separate component units of State government

Most of the control deficiencies reported herein are conditions that have existed for several years. Many continue due to a lack of investment by the State in the operation and security of its information systems. The State has struggled in recent years to maintain its complex information systems environment without sufficient resources. The State needs to address these issues through a carefully designed plan that ensures it can maintain its current information systems and meet the challenges posed by expanding RIFANS. The plan should focus on 1) addressing control deficiencies inherent in the State's current processes, 2) advancing departmental efficiencies by leveraging more effective statewide processes, and 3) ensuring the long-term sustainability of critical State operations that are dependent on these information systems.

We have also included 13 management comments, which are less significant findings yet still warrant the attention of the State's management and represent opportunities for efficiency or enhancing controls. These include recommendations concerning subrecipient monitoring, drawdown of federal funds, certain taxation processes, and other accounting and financial reporting issues.

STATE of RHODE ISLAND and PROVIDENCE PLANTATIONS

GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

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- *ACCOUNTABILITY*

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

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

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Rhode Island and Providence Plantations (the State), as of and for the year ended June 30, 2011, which collectively comprise the State's basic financial statements and have issued our report thereon dated December 22, 2011. Our report includes a reference to other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. As described in our report on the State's financial statements, other auditors audited the financial statements of:

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

- the Convention Center Authority, a major fund, which also represents 68% of the assets and 2% of the revenues of the business-type activities; and

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

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



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Internal Control Over Financial Reporting

Management of the State is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the State's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed in the accompanying schedule of findings and responses, we and the other auditors identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: Findings 2011-1, 2011-2, 2011-4, 2011-6, 2011-7, 2011-10, 2011-16, 2011-18, 2011-19, 2011-20, 2011-22, 2011-23, 2011-24, and 2011-35.

*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 2011-3, 2011-5, 2011-8, 2011-9, 2011-11, 2011-12, 2011-13, 2011-14, 2011-15, 2011-17, 2011-21, 2011-25, 2011-26, 2011-27, 2011-28, 2011-31, 2011-32, 2011-33, 2011-34, 2011-36, 2011-37, and 2011-38.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests and the reports of the other auditors disclosed an instance of noncompliance required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as Finding 2011-30.

We noted a matter required to be reported under *Government Auditing Standards* that is included in the schedule of findings and responses as Finding 2011-29.

We also noted certain matters described as Management Comments 2011-1 through 2011-13 in the schedule of findings and responses that we consider to be less significant findings than those considered to be significant deficiencies, yet, in our opinion still warrant communication and the attention of the State's management.

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

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

Dennis E. Hoyle, CPA
Acting Auditor General

December 22, 2011

# Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

## Statewide Accounting Systems and Other Financial Reporting Matters

## Finding 2011-1

COMPLETE IMPLEMENTATION OF A COMPREHENSIVE FULLY-INTEGRATED STATE ACCOUNTING SYSTEM

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

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

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

- *human resources (personnel/payroll)* – this module should be implemented to automate, standardize and streamline employee time and effort reporting and perform various payroll related processing functions. A centralized human resources module would eliminate the need to support 13 distinct departmental personnel systems. These supported systems all utilize an antiquated legacy account structure not recognized by the State's RIFANS system.

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

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

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

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

In addition to the costs of supporting these legacy systems, deferred implementation of the complete RIFANS accounting system weakens rather than strengthens overall controls over financial reporting. Lastly, realization of the operational efficiencies and overall effectiveness anticipated with the implementation of RIFANS has been delayed.

RECOMMENDATIONS

2011-1a Complete installation of remaining modules necessary to achieve a comprehensive fully-integrated accounting system.

2011-1b Substantiate the cost/benefit relationship of completing the RIFANS implementation.

*Corrective action plan / auditee views:*

*2011-1a*

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

*The department will continue to request further funding to implement the remaining modules. Installation of these modules will remain resource and funding dependent. The department is upgrading the current modules from the Oracle E-Business Suite Version 11 to the Oracle E-Business Suite Version 12 during fiscal 2012.*

*2011-1b*

*In regards to substantiating the cost/benefit relationship of completing the RIFANS implementation, this would require quite an effort to complete and is thus resource dependent and not planned in FY2013.*

*Anticipated Completion Date: Not applicable.*

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

## Finding 2011-2

ACCOUNTING CONTROLS – SEGREGATION OF DUTIES WITHIN FUNCTIONS PERFORMED BY THE OFFICE OF THE GENERAL TREASURER

Appropriate controls over cash receipts and disbursements require segregation of duties. Specifically, the authorization and recording of transactions should be performed by individuals totally separate from those with responsibility for the actual movement of cash and subsequent reconciliation of bank and book balances. Over time, responsibility for what should be separate functions has become less distinct, largely due to the incomplete implementation of the RIFANS accounting system (which is more fully described in Finding 2011-1). This results in weakened controls over the State's cash receipts and disbursements.

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

*Recording of Payments made from Subsidiary Accounting Systems*

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

Treasury currently initiates, departmentally approves, and final approves most of these payment transactions. Additionally, Treasury is responsible for the movement of cash and the bank reconciliation process. In the past, the time sensitivity of the required cash movement prompted Treasury's involvement in the entire process rather than segregating certain duties consistent with effective control procedures. As noted above, Treasury should execute the funds transfer but should not authorize the accounting entries as well.

In July 2011, in an effort to begin addressing this control deficiency, the State assigned responsibility for the posting of the electronic funds transfer (EFT) portion of Medicaid provider payments to the Department of Human Services. This improved controls by removing the General Treasurer as the initiator and approver of these transactions allowing for improved segregation of duties over this transaction class.

The State should continue to evaluate the types of transactions that are currently recorded through this process and restore appropriate segregation without disrupting the required timely movement of funds. Moving the initiation and approval function for these transactions from the General Treasurer's office, as was done for the Medicaid provider payments made via EFT, is one possible solution.

RECOMMENDATION

2011-2 Improve controls over cash receipts and disbursements by completing the process of analyzing transactions and better segregating certain duties currently performed by the Office of the General Treasurer.

*Corrective action plan / auditee views:*

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

*It was noted that the initiation of the cash movement is typically performed by the agencies and as a compensating control; they reconcile the authorized cash movement to the subsequent accounting entry. Also, the initiation of cash movement, the initiation of an accounting entry, the* *approval of the accounting entry and the reconciliation of the cash movement to the general ledger, while all potentially performed within Treasury, is effectively segregated and not all functions are performed by the same individual.*

*Anticipated Completion Date: June 30, 2012*

*Contact Person: Chris Feisthamel, COO, Office of the Treasurer*
*Phone: 401.462.7660*

## Finding 2011-3

PAYROLL ACCOUNTING SYSTEM – SYSTEMS DOCUMENTATION AND MONITORING

The State's payroll information system, for fiscal 2011, calculated payroll expenditures for 14,000 employees totaling more than $920 million. This system has been programmed for a multitude of distinct contract provisions outlined in agreements with approximately 100 separate bargaining units of the State as well as administration of payroll related benefit plans and required withholdings.

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

During fiscal 2011, in response to prior recommendations, the Office of Accounts and Control implemented monitoring procedures designed to detect coding errors of certain payroll fields. While this provided additional monitoring over payroll processing, the State still needs to:

- Formalize the documentation of the State's payroll system;
- Ensure that the Office of Accounts and Control receives documentation regarding changes made to the State's payroll system; and
- Further expand monitoring procedures relating to data inputs (i.e., employee additions and terminations) and payroll processing changes.

Implementation of the above would improve control over payroll processing, allow for more comprehensive monitoring of payroll processing by the Office of Accounts and Control, and better prepare the State in the event of employee turnover and/or future systems upgrades. Monitoring procedures should ensure that only authorized changes to payroll coding are made within the system.

RECOMMENDATIONS

2011-3a Improve formalized documentation of the State's payroll system.

2011-3b Ensure that all payroll programming modifications are communicated to the Office of Accounts and Control and ensure that monitoring procedures include testing of these modifications.

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

*2011-3a*

*The State's payroll system is a legacy application written in COBOL in an IBM mainframe environment. In FY2011 and FY2012 payroll codes and other incremental steps were taken in documenting the payroll system. In FY2012 and FY2013 we will continue to take incremental steps in documenting the payroll system. A formal document outlining certain portions of the system will be prepared with the legacy account conversion and with the changes occurring with the pension reform act. We will focus on those areas for documentation.*

*<u>Anticipated Completion Date</u>: Ongoing through June 2013*

*2011-3b*

*DOIT will ensure that payroll programming modifications are communicated to the Office of Accounts and Control and require a formal acknowledgement before moving changes into production.*

*<u>Anticipated Completion Date</u>: December 30, 2012*

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

## Finding 2011-4

<u>CONTROLS OVER THE PREPARATION OF GOVERNMENT-WIDE FINANCIAL STATEMENTS</u>

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

We noted misstatements that required adjustment within the government-wide financial statements. Most misstatements were caused by formula errors, failure to update prior year data, or incorrect computations in the spreadsheets supporting the government-wide accounting entries. Controls over the preparation of the government-wide financial statements would be improved by enhanced supervisory review of the government-wide accounting entries including underlying support and computations. The State should also consider whether more automated processes can be utilized in the preparation of the government-wide financial statements.

RECOMMENDATIONS

2011-4a Improve controls over the preparation of the government-wide financial statements by implementing enhanced supervisory review of government-wide accounting entries and supporting documentation.

2011-4b Consider whether more automated processes can be utilized within the preparation of the government-wide financial statements.

*Corrective action plan / auditee views:*

*The process used to prepare entity wide financial statements will be reviewed to identify areas where controls can be further improved, especially through increased automation of processes. In addition, all critical calculations that impact the preparation of the statements will be reviewed by another staff member. Notwithstanding control enhancements, this rather involved accounting process requires manual involvement and, as such, will continue to be subject to manual error.*

*Anticipated Completion Date: November 30, 2012*

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

## Finding 2011-5

CONTROLS OVER VENDOR REGISTRATION

The Division of Purchasing in conjunction with the Office of Accounts and Control is responsible for maintaining the State’s list of approved vendors. Prior to the enrollment of new vendors, the State requires submission of a W-9 form, signed by authorized vendor personnel and containing the vendor's federal identification or social security number. Vendor information should also be periodically updated to ensure that data is current and valid.

We tested 57 vendor files to assess compliance with vendor registration procedures. We were unable to obtain vendor registration documentation for 21 vendors (37% of our sample). Additionally, we were unable to obtain vendor banking documentation for four of the 19 vendors in our sample which had opted to be paid through ACH (electronic payment - automated clearing house).

In fiscal 2011, the State’s compliance with required vendor registration documentation procedures deteriorated due to the related staff position being vacant during part of the year. Validating vendor registration information is an important control over procurement and vendor disbursements and the State should ensure that current documentation is maintained for all registered vendors.

RECOMMENDATION

2011-5 Ensure that current vendor documentation is maintained for all active vendors paid through RIFANS.

*Corrective action plan / auditee views:*

*The Supplier Coordinator position has been vacant due to budgetary constraints. The lack of a dedicated staff member for this process was the origin of the control weakness. In March of 2012, the administration approved the position to be filled.*

*Anticipated Completion Date: June 30, 2012*

*Contact Person: Lorraine Hynes, Purchasing Agent*
*Phone: 401.574.8123*

## Finding 2011-6

ACCOUNTING CONTROLS OVER FEDERAL REVENUE AND EXPENDITURES

The State needs to improve controls over recording federal revenue to ensure (1) amounts are consistent with the limitations of grant awards from the federal government and (2) claimed expenditures on federal reports are consistent with amounts recorded in the State's accounting system. Federal revenue within the governmental activities totaled $2.5 billion for fiscal 2011.

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

Expenditures could be recorded in a specific federal program account yet not be reimbursable from the federal government either because grant funds have been exhausted or the expenditures do not meet the specific program limitations. Further, official claims for reimbursement from the federal government as documented on federal reports should be reconciled to amounts considered reimbursable per the RIFANS accounting system.

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

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

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

- For fiscal 2011, the Office of Accounts and Control required departments and agencies to complete an automated Federal Grants Information Schedule (FGIS) that was developed as a standardized RIFANS report. The goal of this revised FGIS process was to provide agencies with the required revenue and expenditure information from the State accounting system to efficiently reconcile expenditures reported on federal reports. We found that although most agencies completed the form, many were unable to fully reconcile their federal reports to amounts reported in the State's accounting system. In addition, the Office of Accounts and Control did not validate the accuracy of the information reported through the FGIS process. The State should improve its FGIS process to ensure the reconciliation of:

    - federal expenditures reported in RIFANS with federal expenditures reported on federal reports (cash-basis);

    - federal revenue reported in RIFANS is reconciled with amounts reimbursed or reimbursable; and

    - deferred revenue or federal receivable balances recorded at year-end by the Office of Accounts and Control utilizing revenue and expenditure amounts recorded for the fiscal year.

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

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

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

RECOMMENDATIONS

2011-6a Improve the effectiveness of the Federal Grants Information Schedule (FGIS) reconciliation process by validating revenue and expenditure amounts reported on federal reports and ensuring that these amounts are consistent with amounts recorded within the State accounting system and available federal award limitations.

2011-6b Ensure that variances identified on the FGIS are fully resolved prior to the preparation of draft financial statements.

2011-6c Enforce accounting procedures that distinctly identify adjustments to prior period federal activity in the State's accounting system.

2011-6d Allocate additional personnel resources needed to enhance statewide control over the financial reporting aspects of federal programs.

*Corrective action plan / auditee views:*

*2011-6a and 6b*

*The Federal Grants Information Schedule (FGIS) review process will be enhanced to provide additional assurance that information submitted by agencies is accurate.*

*A new policy has been implemented that requires the FGIS and related reconciliations to be submitted quarterly to the Controller's Office for major Federal programs. We believe the significant increase in the frequency of submission of the FGIS will allow for more timely submission at fiscal year-end also.*

*This recommendation focuses solely on the FGIS as the tool to reconcile federal revenue and expenditures to the State's accounting system. However, it is important to note that the FGIS is not the only mechanism to reconcile with the accounting system as there are agencies that have alternative and effective reconciliation processes in place. As a result, we are working with those agencies to formally document their process for control purposes.*

*Anticipated Completion Date: June 30, 2012*

*2011-6c*

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

*Anticipated Completion Date: April 30, 2012*

*2011-6d*

*Allocation of additional resources is subject to budgetary constraints. However, if there is an opportunity to obtain additional funding, a position will be established to enhance statewide controls over the financial reporting aspects of federal programs.*

*Anticipated Completion Date: June 30, 2012*

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

## Finding 2011-7

ACCOUNTING AND PHYSICAL CONTROL OVER CAPITAL ASSETS

During fiscal 2011, we continued to note control weaknesses which collectively impact the State's financial reporting of capital assets. While the State has improved its recording of capital assets in recent years, RIFANS' current system limitations have made it difficult to effectively eliminate these control deficiencies.

## Accounting for Capital Projects

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

Capital assets, excluding transportation infrastructure reporting which is detailed in Finding 2011-24, approximating $8 million, most of which were building and infrastructure improvement projects in the construction phase at June 30, 2011, were not recorded in the capital asset accounting records. In some of these instances, significant project expenditures were not capitalized because the magnitude and scope of the project was not sufficiently understood based on analysis of the current period's expenditures or because the project was divided into smaller subcomponents that did not individually meet the State's capitalization threshold.

The State's ability to accumulate expenditures for project-based capital assets needs to be improved within the State accounting system. The Office of Accounts and Control should work closely with the State's Budget Office to identify authorized projects meeting the State's capitalization criteria. This process would allow the State to identify projects that are expected to meet the State's capitalization threshold prior to their start-up rather than attempting to make that identification through later analysis. Once identified, the Office of Accounts and Control should continue to utilize unique project numbers that will allow the State to track all related project expenditures regardless of how many fiscal periods the project spans. The State may need to develop a standard report in RIFANS that details cumulative project expenditures by fiscal year as a means of periodically reconciling reported construction in progress for all active but incomplete capital projects. This report would also provide the State with a resource for evaluating agency compliance with appropriated funding for capital projects.

## Periodic Physical Inventories

The State has increased efforts devoted to performing physical inventories of capital assets. This important control measure can be further enhanced by ensuring all departments and agencies have a physical inventory at least every three years and prioritizing larger departments which have significant investments in capital assets.

During fiscal 2011, the State completed physical inventories of eleven State agencies. Inventories of these agencies resulted in the removal of a significant number of capital assets (mostly office equipment) from the State's accounting records. Most of the inventory exceptions related to older equipment which was disposed but not reported to the Office of Accounts and Control as required by State policy.

We noted that the Departments of Environmental Management, Transportation, and Behavioral Health, Developmental Disabilities, and Hospitals, all of which have significant amounts of capital assets, have not been inventoried since the initial recording of capital assets in fiscal 2002. Physical inventories should be performed on a cyclical basis such that each agency is visited at least every three years.

The State should also address missing data elements (e.g., asset location) in the capital asset records to improve the accuracy of the database and enhance the efficiency of physical inventories when conducted. The timeliness of recording the results of the physical inventories could also be enhanced.

Departments and agencies do not have direct access to the capital asset module of the State's accounting system. Enhanced access to system information should be provided to the departments and agencies to engage their assistance in maintaining the accuracy of the capital asset data and to allow them to perform interim departmental inventories in between the Accounts and Control cyclical inventories.

Capital Assets Acquired with Federal Funds

Office of Management and Budget (OMB) Circular A-102 requires States to use, manage, and dispose of equipment acquired with federal funds in accordance with state laws and procedures. During fiscal year 2011, the State developed a RIFANS report to identify capital assets by funding source. Additionally, the State's weaknesses in accounting and physical controls over capital assets acquired prior to fiscal year 2007, coupled with delays in performing physical inventories of all State agencies, impacted its ability to identify equipment purchased with federal funds and to ensure compliance with its own procedures regarding the use, management and disposition of all equipment.

RECOMMENDATIONS

2011-7a Enhance procedures to improve the tracking and monitoring of capital projects within RIFANS. Implement procedures to identify capital projects that qualify for capitalization upon project approval rather than a subsequent analysis of project expenditures incurred.

2011-7b Continue improvement of controls over furniture and equipment disposals by performing physical inventories of capital assets utilized by the State's departments and agencies on a cyclical basis.

2011-7c Improve accounting controls to ensure the identification of federal funds utilized to purchase or construct capital assets.

*Corrective action plan / auditee views:*

*2011-7a*

*New procedures to address these and other issues relating to accounting for capital projects are currently being finalized.*

*Anticipated Completion Date: April 30, 2012*

*2011-7b*

*The physical inventory process has been significantly enhanced over the past several years. In fiscal year 2012 we are conducting fixed asset inventories at two major departments-DEM and DOT. The fixed asset inventory for one other major department, BHDDH, will be conducted no later than in fiscal year 2013. At that point, inventories will have been conducted at all major departments. Subsequently we will conduct inventories at all major departments at least every 3 years.*

*Anticipated Completion Date: December 31, 2012*

*2011-7c*

*For all assets purchased since the implementation of the Oracle Fixed Asset Module in 2007, the funding source is available in the data tables. A standard Oracle report has been developed to access this information. All agencies will be notified of the availability of this report.*

*Anticipated Completion Date: April 30, 2012*

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

## Finding 2011-8

DOCUMENTATION AND MONITORING OF CHANGES TO RIFANS ACCESS AND APPROVAL HIERARCHIES

RIFANS employs complex agency initiation and approval hierarchies along with transaction workflow processes to control system transaction processing. Agency approval hierarchies are a key control within RIFANS to ensure adequate segregation of duties is maintained between the initiation and approval of transactions. The hierarchies outline the authorization limits at which specific agency personnel can initiate and approve transactions.

When departments and agencies require modifications to a user's RIFANS access, these changes are initiated through the completion of a form routed for approval by the Office of Accounts and Control. These forms are not retained to support the authorization for changes in the design of the agency approval hierarchies. The Office of Accounts and Control is responsible for updating its documented agency hierarchies to reflect the authorized design of the structure at each agency for general ledger, accounts payable and purchase requisition functions. This current process is manually intensive, difficult to keep updated, and deficient in documenting changes in user access over a period of time.

Additions, deletions and changes in authorization are subsequently entered into the RIFANS system by programmers within the Division of Information Technology (DoIT). There is no current system capability that preserves a clear audit trail of modifications made to system access. RIFANS does not have an adequate reporting function capable of identifying and summarizing additions, deletions, and changes to system access for a period of time upon request. Further, the RIFANS system exists without a "versioning" functionality, the storing of data at a series of snapshots in time, rather than overwriting updates to the previous version. As such, the system cannot retroactively access the data tables that existed at a prior point in time, nor does it log the changes made in a form that allows for monitoring of system changes.

The State should explore a more automated manner within RIFANS to document changes in system access. This will not only allow for an improved audit trail of transactions processed through the system but also provide a monitoring tool to ensure that only authorized changes are being made to employee access within RIFANS. The State should develop reports that show when individuals have delegated their authority to other employees, a functionality that RIFANS allows in certain situations. Currently, no policy or restrictions exist to limit employees from delegating their authority to others and this functionality could be utilized to circumvent the agency hierarchy controls established within RIFANS. Such monitoring is required to ensure that unauthorized changes in system access are not being made in RIFANS and to ensure that individuals are only delegating their authority in limited and acceptable situations.

RECOMMENDATIONS

2011-8a Institute a state-wide policy regarding the assignment, delegation or granting of approval authority. This policy should include specific requirements and limitations, and prohibit long-term arrangements without express authorization from the Office of Accounts and Control. Develop procedures to monitor delegated access within RIFANS.

2011-8b Design procedures and reports to enhance the documentation and monitoring of all changes to agency hierarchies in RIFANS.

*Corrective action plan / auditee views:*

*2011-8a*

*The Office of Accounts & Control will prepare and communicate a policy for delegation of approval authority within RIFANS. Also, we will work with DoIT to create a report which shows all delegated approvals in RIFANS. The report will be run monthly and reviewed to ensure that all delegations abide by the policy set forth.*

*2011-8b*

*The Office of Accounts and Control will work with DoIT to prepare a report that will show all hierarchy changes. The report will be run monthly and reviewed to ensure that all changes were approved by the appropriate Associate Controller.*

*Anticipated Completion Date: September 30, 2012*

*Contact Person: Louise Anderson, Associate Controller-Operations*
*Phone: 401.222.2704*

## Finding 2011-9

MEDICAL ASSISTANCE PROGRAM – MANUAL PAYMENTS BY FISCAL AGENT

The State's Medical Assistance Program, administered by the Executive Office of Health and Human Services (EOHHS), utilizes a fiscal agent to process medical claims and issue payments to providers. The majority of program expenditures, which total nearly $2 billion annually, are processed through the State's Medicaid Management Information System (MMIS). In addition to normal MMIS program disbursements, EOHHS also instructs the fiscal agent to disburse other payments ("manual payments"), including but not limited to the following:

- payments to the Rhode Island Public Transit Authority (RIPTA) for bus passes provided to Medicaid eligible individuals;
- payments advancing nursing home providers for the current month's services;
- certain claims approved for payment by DHS after appeal by the provider;
- disproportionate share payments to hospitals for uncompensated care;
- certain outpatient hospital payments required by RI General Laws; and

- year-end advances to State-operated providers for services provided but unbilled.

These manual payments, which approximated $200 million in fiscal 2011 (of which $122 million relates to disproportionate share payments as listed above), are issued when the State's fiscal agent receives formal authorization from EOHHS with detailed payment instructions. Although these authorizations are tracked with unique control numbers, manual payments essentially allow EOHHS personnel the ability to authorize payments outside expected control measures. In contrast, program payments made through regular MMIS cycles are system-determined amounts subject to all the processing controls of the system. Similarly, payments made through the State's accounting system are subject to procurement and disbursement controls as well as multiple levels of authorization and review. While we acknowledge that there are limited instances where manual payments by the fiscal agent may be necessary, most of the payments currently made as manual payments should be disbursed subject to enhanced control mechanisms.

Overall program controls could be improved as follows:

- Payments to RIPTA for non-emergency transportation should be either fully adjudicated through the MMIS or paid through the State's accounting system;

- Payments to inpatient hospitals for uncompensated care relating to inpatient and outpatient services could be made through the State's accounting system;

- Practices such as year-end advances to state-operated providers should be eliminated as there is no justification or benefit to such payments. State-operated provider agencies such as the Department of Behavioral Health, Developmental Disabilities, and Hospitals (BHDDH) and the Department of Children, Youth, and Families (DCYF) should record year-end receivables in the State's accounting system for services provided but unbilled and receive payment for the services when the actual claims are processed through the MMIS.

Manual payments by the State's fiscal agent should be utilized infrequently in circumstances when other existing payment mechanisms are impractical. In addition, EOHHS should also require authorization by two financial managers on all requests for manual payments to ensure that no one employee can authorize a payment by the fiscal agent. These enhancements will improve overall control over program expenditures currently being made through fiscal agent manual payments.

RECOMMENDATIONS

2011-9a Minimize the use of manual payments by the Medicaid fiscal agent. Process payments through RIFANS when appropriate and improve authorization controls over manual payments that must be processed through the MMIS.

2011-9b Eliminate the practice of processing advances to state-operated providers at fiscal year-end.

*Corrective action plan / auditee views*:

*The OHHS is currently working with the Controller's Office to identify manual payments that can be made through RIFANS. We will also review the authorization procedures for manual payments to determine if changes are needed to enhance the controls over such payments.*

*Generally, payments to providers are more appropriately made through MMIS, e.g. advance payments to nursing homes are recouped with the next claims payment cycle, and the timing of* *disproportionate share payments to hospitals are better controlled. Payment through MMIS also provides improved tracking/monitoring for Caseload Estimating purposes.*

*Anticipated Completion Date:* 4th *Qtr. SFY 2012*

*Contact Person:* *Ralph Racca, Administrator*
*Executive Office of Health and Human Services*
*Phone: 401.462.1879*

## Finding 2011-10

MEDICAL ASSISTANCE PROGRAM – PROGRAM OVERSIGHT AND MONITORING

The Executive Office of Health and Human Services (EOHHS) is mainly responsible for the administration and oversight of the State's Medicaid program. The administration and oversight of the program is dependent on EOHHS having sufficient personnel resources to discharge this responsibility. Various program operations have been delegated to the State's fiscal agent or other contractors over time as departmental resources have declined. The State does not have sufficient personnel dedicated to the consideration and documentation of internal controls, including related monitoring procedures performed to ensure the proper administration of significant program areas. Considering the size and complexity of Medicaid, documenting and considering internal controls over program operations should be given more attention by the State. Federal regulations require non-federal entities to establish and maintain internal control designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements.

As part of our audit, we noted control deficiencies, and in certain instances, noncompliance with program requirements, in the following areas that are, at least in part, caused by inadequate personnel resources allocated to effectively administer and monitor these aspects of the program:

- *Program operations delegated to the fiscal agent* – Although the fiscal agent has adequate control procedures designed over its operations, EOHHS should document and identify specific areas of fiscal agent operations where it performs specific monitoring and validation of fiscal agent performance. For example, EOHHS should adopt procedures to ensure that all receipts (TPL recoveries, drug rebates, program overpayments, etc.) received by the fiscal agent are properly credited and deposited by the fiscal agent.

- *Program operations administered by other State departments and agencies* – Material weaknesses in internal control relating to significant services billed through Medicaid for (1) children in the State's custody, (2) developmentally disabled adults, and (3) various CNOM programs operated by the Department of Children, Youth, and Families (DCYF), the Department of Behavioral Health, Developmental Disabilities and Hospitals (BHDDH), and other State agencies, have been identified in relation to these aspects of program administration.

- *Inpatient Hospital and Long-term Care Facility Audits* – EOHHS has substantially reduced its performance of field audits and is significantly behind in conducting the required desk audits to ensure timely adjustment of nursing home per diem rates. EOHHS has also been unable to review and finalize hospital settlements in recent years even though hospital providers have submitted required cost reports in a timely manner. We considered EOHHS's inability to perform these vital Medicaid functions to be material noncompliance in fiscal 2011.

- *Controls over Recipient and Provider Eligibility* – EOHHS's ability to conduct timely Medicaid Eligibility Quality Control (MEQC) reviews continued to be significantly diminished during fiscal 2011, weakening controls over recipient eligibility in the program. In addition, controls over Medicaid provider eligibility were also noted as being deficient due to delays in re-enrolling providers after the fiscal agent's headquarters were destroyed by flooding in March 2010. Once the fiscal agent is able to re-enroll all Medicaid providers, additional monitoring that ensures compliance with provider eligibility requirements will need to be performed by EOHHS.

- *Contracted Program Functions* – Over the years, reductions in personnel have resulted in EOHHS delegating additional areas of program administration to its contracted consultants. This delegation, however, does not relieve EOHHS's program oversight and monitoring responsibilities in these areas. Such oversight and monitoring responsibilities require a dedication of personnel resources currently deficient in the Medicaid program.

The State must weigh the importance of maintaining adequate personnel resources to ensure proper oversight and control over program expenditures that exceeded $2 billion in fiscal 2011. Sustained reductions in personnel resources in program areas referenced above will continue to negatively impact control over program expenditures and compliance with federal program requirements. In addition, the State should consider additional personnel resources dedicated to the documentation, consideration, and monitoring of internal control over program operations.

RECOMMENDATIONS

2011-10a Address personnel resource deficiencies in critical program areas to ensure proper administration and control over the Medicaid program.

2011-10b Consider dedicating additional personnel resources responsible for the consideration, documentation, and monitoring of significant program operations and related controls to ensure compliance with federal and program regulations.

*Corrective action plan / auditee views:*

*OHHS is seeking to establish an Administrative Services Unit for the purpose of centralizing certain functions currently the responsibility of and performed separately by each agency. An internal audit function would be one of the key responsibilities of the Administrative Services Unit. It would address the issue of appropriate control and monitoring of operations to ensure compliance with federal regulations.*

*Anticipated Completion Date:* *2nd Qtr. SFY 2013*

*Contact Person:* *Lawrence Ross, Assistant Director*
*Executive Office of Health and Human Services*
*Phone: 401.462.6025*

# Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

## Information Systems Security

# Finding 2011-11

COMPREHENSIVE INFORMATION SYSTEMS SECURITY POLICIES AND PROCEDURES

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

The oversight and management of the State's information security program relies upon the implementation of DoIT's comprehensive information systems security plan that was finalized during fiscal 2006. The information systems security plan consists of detailed policies, procedures, standards, and guidelines that are designed to safeguard all of the information contained within the State's critical systems. The plan is comprehensive in its coverage of all security issues and reflects the security needs of the State's diverse information systems. The information security plan also includes appropriate consideration of disaster recovery/business continuity planning aspects as well.

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

During fiscal 2009, the State started a process of evaluating each mission critical information system's compliance with formalized system security standards. DoIT has been unable to complete this evaluation due to a lack of personnel resources. The State must complete this process to identify those mission critical systems that represent significant information system security risks within its operations. Once completed, the State should prepare a corrective action plan that prioritizes significant security risks identified and ensures that all security deficiencies are addressed in a timely manner. In addition, new information systems or significant system modifications should be subjected to a formalized systems security certification by DoIT prior to becoming operational.

RECOMMENDATIONS

2011-11a Complete an initial assessment of compliance with recently promulgated systems security standards for the State's mission critical systems.

2011-11b Prepare a corrective action plan that prioritizes significant system security risks with the goal of achieving compliance of all significant State systems with DoIT's formalized system security standards.

2011-11c Require systems security certification procedures to be performed by DoIT prior to any significantly modified application systems becoming operational.

2011-11d Consider additional information system security personnel resources to assist in the daily information systems security operational and monitoring procedures.

*Corrective action plan / auditee views:*

*2011-11a*

*The Department of Administration under the direction of the Chief Information Security Officer (CISO) will continue to work on the initial assessment of compliance with system security standards for the State's mission critical systems. The security group has worked with Departments in addressing auditing needs. For example, the security group recently worked with the IRS and the Department of Revenue and DHS to address auditing needs. However, these activities are not proactive at this point in time. Audit finding 2011-11 is resource dependent and DOIT is working on obtaining additional resources for the security group.*

*2011-11b*

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

*2011-11c*

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

*DOIT now requires that all new systems and major changes require signoff by the CISO. However, due to limited staff, we are not able to retroactively review and certify systems already in place.*

*Anticipated Completion Date: To be determined.*

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

*2011-11d*

*Currently, DOIT has one Chief Information Security Officer (CISO) and one FTE assisting the CISO. DOIT is requesting an additional FTE for the security group in FY2011. DOIT recently posted for this position but was unable to find a qualified candidate. We will continue to pursue filling this FTE but now are limited by budget constraints.*

*Anticipated Completion Date: September 30, 2011*

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

## Finding 2011-12

RIFANS LOGICAL ACCESS CONTROLS

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

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

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

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

RECOMMENDATION

2011-12 Review activities of privileged users (system administrators) on a scheduled basis to ensure that additions, modifications, and deletions initiated by them are appropriate.

*Corrective action plan / auditee views:*

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

*RI-FANS provides for auditing features of system users. To address this finding, we had configured the auditing features to produce system reports of system changes by privileged users. After configuring these features in version 11 of Oracle E-Business Suite, the results were not as expected. Rather than continuing configuring version 11, we will work on making these changes in version 12 of Oracle E-Business Suite. Version 12 has additional auditing features and we will work to configure those in version 12.*

*Anticipated Completion Date: December 30, 2012*

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

## Finding 2011-13

LEGACY SYSTEMS – ACCOUNT STRUCTURE CONVERSION

Various subsidiary accounting systems (e.g., employee payroll and departmental cost allocation) which process material classes of expenditures have not been converted to the current account structure used within the RIFANS accounting system. These subsidiary accounting systems continue to use an old account structure that has not been utilized since July 2001. Consequently, account conversion tables must be continually maintained which increases the risk that data may be misposted in the accounting system. This adds unnecessary complexity to the overall internal control structure and requires that certain employees remain knowledgeable about and even create new accounts (to match new activities or programs within RIFANS) in an account structure that was discontinued more than a decade ago.

RECOMMENDATION

2011-13 Complete conversion of subsidiary accounting systems using the legacy account structure to the new RIFANS account structure.

*Corrective action plan / auditee views:*

*There are two major systems, Payroll and Human Resources (HR,) that require the legacy account conversion. Some system changes have been made on the Payroll system with HR currently undergoing system changes.*

*This project has been ongoing since 2006 and is resource and project dependent. We will be modifying the master file again this year due to pension changes which must be in by June 30, 2012. During these changes, we will be putting in new security to access both legacy and new accounts. The file will also be able to handle the new legacy numbers when the file is expanded.*

*Anticipated Completion Date: September 30, 2012*

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

## Finding 2011-14

CONTROLS OVER EMPLOYEE PAYROLL SYSTEM

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

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

RECOMMENDATION

2011-14 Identify critical data elements to be tracked as changes occur. Capture and maintain the unique user identification for each transaction resulting in changes to critical payroll master file data elements.

*Corrective action plan / auditee views:*

*Division of Information Technology will assign a team to implement this capability using current available technology. This audit finding will be implemented after audit finding 2011-13 and is thus resource dependent.*

*Anticipated Completion Date: To be determined.*

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

## Finding 2011-15

INFORMATION TECHNOLOGY (IT) SYSTEMS - PROGRAM CHANGE CONTROLS

Procedural Issues

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

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

Program Change Management Control - Policy Directives

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

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

Program Change Management Control - Procedural Guidance

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

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

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

Program Change Control – Current Operational Issues

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

During fiscal 2011, ClearQuest continued to function effectively; however, operational issues relating to ClearCase had not been addressed. Instead of making the program change process more efficient and productive, the process continued to be cumbersome and time-consuming. Software/hardware problems, improper installation/configuration and slow download speeds contributed to product dissatisfaction and resulting non-use. Further, application programmers were able to circumvent DoIT’s change control process thereby rendering the controls ineffective.

DoIT should review its use of the ClearCase software package to determine 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. Further, DoIT should implement a formal program change control process for its mainframe applications.

RECOMMENDATIONS

2011-15a DoIT needs to design, develop, formalize and implement procedural guidance manuals detailing specific requirements for program change control.

2011-15b Re-assess the use of the ClearCase software package to determine the appropriate combination of operational, procedural and/or technical adjustments required to use the package in a manner that results in adequate program change control.

*Corrective action plan / auditee views:*

*2011-15a*

*The current procedures and policies do need to be upgraded and improved upon. The original procedures and policies to be used with the version control and application tracking system, Clearcase/ClearQuest, were put into place in June 2006 and was meant to serve as an enterprise solution. Due to resources leaving DOIT, we have been unable to improve this environment and roll out better change management processes.*

*The Department of Labor and Training is also addressing issues with change management in their audit finding, 2011-27. We will address this finding jointly and pool resources and available funds that DLT may have to address this finding. By pooling resources and enhancing this environment, we can position these tools to server DOIT/DLT and other agencies.*

*2011-15b*

*DOIT acknowledges that improvements need to be made to the original software implementation to better improve the program change controls originally put into place. We currently have maintenance and support on those products and believe these products will meet our needs. The issue is developing expertise and having staff available to support these products. As mentioned in 2011-15a, we will be combining our efforts with DLT to address this finding.*

*The completion of this finding is funding dependent for the outside resources.*

*Anticipated Completion Date:* *June 30, 2013*

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

# Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

## Department of Revenue

## Division of Taxation

## Finding 2011-16

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

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

The majority of the State's tax revenues (approximately $2.5 billion) is received electronically. Funds are deposited automatically into the State's bank accounts and electronic files, which contain abbreviated tax payment data (taxpayer identification number, payment amount, tax type, tax period), are transmitted by the State's financial institutions. Through a lockbox arrangement with a financial institution, other returns and payments that are mailed to Taxation are processed and converted to electronic data files. Other initiatives have increased the receipt of data in electronic form. For example, Taxation began accepting electronic returns and payments for insurance taxes through a system called OPTins, which is operated and maintained by the National Association of Insurance Companies (NAIC).

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

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

To ensure that the proper level of data protection is in place, Taxation, working with the Division of Information Technology (DoIT), should perform a "data classification" review of these files. DoIT has polices requiring that all State data being captured, maintained and reported by any agency or department be "data categorized" based upon three levels of availability and four levels of confidentiality (DoIT policy *# 05-02 – Data Categorization).* If the data is considered confidential or sensitive, the data must be protected by an acceptable method of data encryption.

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

RECOMMENDATIONS

2011-16a Perform a "data classification" review consistent with DoIT policy to ensure the proper level of data protection (e.g. encryption) is in place.

2011-16b Secure all electronic files containing taxpayer information residing on the Division of Taxation's network to ensure data integrity.

2011-16c 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.

2011-16d Develop monitoring and reporting procedures to ensure the proper upload of data files.

2011-16e Improve controls over the processing of electronic insurance tax returns by better segregating certain duties performed by Taxation.

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

*As part of the Fiscal Year 2013 budget request, the Division of Taxation requested funding for an integrated tax system. This system will, among other things, overhaul the front end entry systems, accounting systems and processing systems. These improvements will address many of the Auditor Generals Findings and meet their recommendations.*

*2011-16a*

*The Division of Taxation has performed a preliminary review of the data received based on DoIT's Data Classification Policy (Policy #05-02). It is the Division of Taxation's opinion that this data should be classified as "sensitive" and therefore requires 256 bit or higher encryption.*

*The Division of Taxation will work with DoIT to ensure that all data received meets the minimum encryption level.*

*2011-16b*

*The Division of Taxation will work with DoIT's Chief Information Security Officer to identify the best encryption and most cost effective method for electronic files contained on our internal servers.*

*2011-16c*

*The Division of Taxation is working with DoIT to modify the daily transmission of OCR files. The initial plan will have all OCR files combined daily into one file; this combined file will be made accessible to Taxation. Taxation will then make any adjustments to the file and then BIM the file to the mainframe. Each night that the OCR process is run, a mainframe program will write all the OCR transactions to a new combined / accumulated OCR file. This new file will archive all the transactions for comparison with the original OCR files that were transmitted each day. This process will be repeated for the files with the EFT format and the EFT transactions will also be archived for comparison.*

*2011-16d*

*Along with the proposed changes outlined in 2011-16c, the Division of Taxation will develop monitoring and reporting procedures to ensure that OCR and EFT data was uploaded correctly.*

*2011-16e*

*As part of the Division of Taxation's strategic plan, the Division is continually looking for ways to increase and improve electronic filing. In 2011, the Division of Taxation partnered with the National Association of Insurance Companies (NAIC) to implement electronic filing of insurance* *premiums tax returns. Currently, the Corporate Tax Section is responsible for downloading any return received through NAIC. The return is then reviewed and verified by the Corporate Tax Section. The Division of Taxation will explore modifying the process and procedures to have E-Government Section download the files from NAIC to ensure better segregation of duties.*

*Anticipated Completion Date: To be determined.*

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

## Finding 2011-17

DEPARTMENT OF REVENUE – PERSONAL INCOME TAX ADMINISTRATION

W-3 Reconciliations

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

There has been a significant backlog in posting/processing W-3 reconciliation returns. W-3 reconciliation returns for tax year 2010 were due February 28, 2011. During fiscal 2011, W-3 paper returns for tax years 2000 through 2010 were posted to the mainframe system. However, as of June 30, 2011, the system-generated W-3 reconciliation returns for tax years 2009 and 2010 had not yet been posted. The backlog in posting W-3 reconciliation returns delays identifying potential overpayments and underpayments of employer withholding taxes.

RECOMMENDATION

2011-17a Process W-3 reconciliation returns timely to identify any underpayment of employer withholding taxes.

*Corrective action plan / auditee views:*

*As part of the Fiscal Year 2013 budget request, the Division of Taxation requested funding for an integrated tax system. This system will, among other things, centralize all data received by the Division of Taxation. These improvements will allow Taxation to process returns faster and more efficiently. In addition, the system will allow Taxation the ability to change/modify return processing procedures without major programming changes.*

*Over the past year, the Division of Taxation has dedicated staff from Processing and Office Audit Sections to focus on reconciling and processing W-3s. During the past few months, the Division of Taxation has generated assessments for approximately $650,000.*

*With the experiences gained in Office Audit, Taxation will focus on developing an automated compliance program for employers, utilizing the data warehouse to match various data sources. This program will expedite the processing of W-3s and ensure that employers are complying with all Rhode Island tax laws.*

Management Review of Overpayment Carry-forwards

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

RECOMMENDATION

2011-17b Include refund carry-forward returns within the management refund review control procedures.

*Corrective action plan / auditee views:*

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

Tax Returns Remaining on the Error Register

Personal income tax returns that cannot be processed completely (due to data entry or taxpayer errors) are placed on an "error register" pending investigation. We noted a significant backlog of returns on the error register that are pending resolution. As of June 30, 2011, there were 49,429 returns dating from 1994 through 2011. Approximately 26,000 returns include requests for refunds totaling more than $13.5 million.

This backlog results in an inability to offset current taxes owed against prior refunds that remain unpaid and the failure to bill taxpayers for amounts that may be owed.

RECOMMENDATION

2011-17c Investigate and resolve returns on the error register in a timely and efficient manner. Apply refund offsets and bill taxpayers amounts owed.

*Corrective action plan / auditee views:*

*While electronic returns have increased the speed of processing returns and shortened the time to issue refunds, it has created an easier method for individuals to file fraudulent returns. Over the past few tax seasons, the Division of Taxation has seen an increase in the amount of fraudulent returns filed. During the past two tax seasons, the Division of Taxation has amended the parameters used to stop returns with potential fraudulent activity. These additional measures have increase the number of errors and stops placed on returns filed. These increased fraud detection measures along with reduced staffing due to employee turnover in the personal income tax section has increased the total number of returns on error throughout the year. The Division of Taxation will review all the errors codes in personal income tax to determine the effective and potential elimination or restructure in an effort to reduce to total number of returns on error.*

Withholding Tax Filing Frequency

Taxpayers are required to remit personal income tax withholding payments on a frequency as determined by past dollar amounts paid. Larger taxpayers are required to remit more frequently. The

Division of Taxation has not updated taxpayer information by running specific reports (WT9074 and WT9075) since March 2009 to ensure that each taxpayer is filing at the required interval. Some taxpayers may not be filing as frequently as required thereby impacting the timing and availability of tax receipts to the State.

RECOMMENDATION

2011-17d Review and update taxpayer information to ensure taxpayers are remitting tax withholdings on the required frequency.

*Corrective action plan / auditee views:*

*Under Regulations issued by the Division of Taxation employers are required to file and pay withholding tax either daily, quarter/monthly, monthly or quarterly depending on the amount of withholding during the previous twelve months. The Division of Taxation will run a special automated program before issuing the withholding booklets for calendar year 2013 to update all withholding agents filing methods.*

*Anticipated Completion Date: To be determined.*

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

## Finding 2011-18

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

The Division of Taxation (Taxation) should strengthen controls over Accounts Receivable Correction (ARC) transactions posted to their mainframe systems. Taxation currently requires supervisory approval of all ARC transactions for sales, withholding, and corporate taxes before they are posted to those respective systems. However, ARC transactions relating to personal income taxes did not require supervisory review prior to posting until May 2011 when a new policy was established. From July 1, 2010 to May 1, 2011 over $68 million in ARC transactions were posted to the personal income tax system. There were six individual ARC transactions over $1 million each, totaling $18.9 million. Even though Taxation established a new approval procedure, ARC transactions prepared by certain section heads (corporate and e-government sections) are not required to be reviewed and no additional Taxation approval is required.

In addition, controls are not in place to ensure that the total of ARC transactions posted to each mainframe tax system matches the amount approved for data entry. The lack of data entry controls could result in an ARC transaction being incorrectly posted to the mainframe system and not being detected.

RECOMMENDATIONS

2011-18a Subject all accounts receivable corrections to supervisory review including those created by the corporate tax and e-government section heads.

2011-18b Improve data entry controls over ARC transactions.

*Corrective action plan / auditee views:*

*2011-18a*

*The Division of Taxation will reissue the policy for approvals of ARC transactions. Each Section Chief will be reminded of the policy and approval process will be established for each Chief.*

*2011-18b*

*The Division of Taxation uses ARC Transactions for many reasons other than adjusting accounts receivable transactions. For example, a filer may omit information from the return (i.e. other state name in credit for taxes paid to other states) causing the credit to be disallowed. When a revenue agent obtains the omitted information they would prepare a return correction to allow the credit. These transactions are better classified as return perfection adjustment, not Accounts Receivable Correction Transaction. The Division of Taxation will work with DoIT to properly classify these adjustments and create a balancing procedure for the data entry ARC batches.*

*Anticipated Completion Date:* *To be determined.*

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

## Finding 2011-19

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

The Department of Revenue – Division of Taxation (Taxation) utilizes a data warehouse to (1) collect data from Taxation systems and external sources for data analysis purposes, and (2) attempt to identify taxes potentially owed to the State of Rhode Island. During fiscal 2011, the Division used the enhanced analytical capabilities of the data warehouse to identify taxpayers that should have filed tax returns or potentially underreported and underpaid taxes to the State. While the effort to identify unreported tax liabilities to the State is noteworthy, use of the data warehouse affected the State's recognition of tax revenue during fiscal 2011.

"Notices" are generated from the data warehouse, which operates independently of the various mainframe tax systems. These tax systems are the official record of tax revenues and receivables for financial reporting purposes. Upon generation of the tax notice from the data warehouse, data is uploaded to the respective tax system(s). A 60-day threshold has been established before the notice results in recognition of a tax receivable balance within the tax systems. The 60-day waiting period reflects the nature of a notice as being a high likelihood but yet uncertain claim of taxes owed. The notice is in essence a request for additional information from the taxpayer to either file and pay or explain the filing discrepancy. During this time, the data can be modified or adjusted if the taxpayer provides information indicating that the notice is in error or the balance potentially owed is less. However, these changes are not subject to the same control procedures that would apply to other adjustments or entries recorded in the system.

New transaction codes detailing the original data warehouse notice total, tax amount, interest, and penalties were added to the mainframe to identify tax balances that resulted from analysis within the data warehouse (these codes are only effective for mainframe transactions processed after August 14, 2009).

However, there are no codes that identify corrections or adjustments made to data warehouse notices. Consequently, correction or adjustment to tax amounts originating from the data warehouse cannot be readily identified within Taxation's systems. Being able to segregate these amounts is necessary due to the inherently different collection characteristics of these notices versus known tax balances due. An allowance for uncollectible amounts, reflective of the unique characteristics of the data warehouse tax billings, should be developed and used for financial reporting purposes. In fiscal 2011, determination of the allowance for uncollectible taxes receivable did not reflect the unique characteristics of these balances.

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

RECOMMENDATIONS

2011-19a Identify corrected and adjusted tax amounts for transactions emanating from the data warehouse within the mainframe systems with unique codes to allow separate identification for analysis and collection purposes.

2011-19b Establish an allowance for uncollectible taxes receivable, which reflects the unique collection characteristics of the data warehouse notices/billings.

2011-19c Recognize all data warehouse generated receivables within Taxation's systems at the time of the notice creation, i.e. eliminate the 60-day waiting period.

*Corrective action plan / auditee views:*

*2011-19a*

*Assessments created in the Data Warehouse which are transferred to the mainframe are coded with a special indicator. Any correction or adjustment made to these assessments can be separately identified and reported. Division of Taxation will request that DoIT separately report any correction or adjustment made to an assessment originating from the Data Warehouse.*

*2011-19b*

*Allowance for uncollectible taxes receivable for most tax types are determined using a weighted average over a three year period. The Division of Taxation does not have enough historical data for assessments and collections from the Data Warehouse to perform the same analysis. The Division of Taxation will continue to work with the Office of Accounts and Control to establish and modify the allowance for uncollectible tax receivables relating to assessments originating from the Data Warehouse.*

*2011-19c*

*Any assessment created in the Data Warehouse is transferred to the Mainframe System within 48 hours. The assessments are held for 60-days to avoid duplicate billings and to* *afford the taxpayer their statutory 30-day right appeal the assessment. The Division of Taxation will examine the feasibility of eliminating or reducing the 60-day waiting period.*

*Anticipated Completion Date: To be determined.*

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

## Finding 2011-20

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 2011-21

DEPARTMENT OF REVENUE – INFORMATION TECHNOLOGY (IT) GOVERNANCE AND SECURITY– CONFIDENTIAL COMMUNICATION

A finding concerning the IT Governance and Security of Taxation's Information Systems was communicated confidentially due to the potential impact on taxpayer compliance.

# Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

## Department of Transportation

## IST Fund

## Finding 2011-22

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

Financial statements for the Intermodal Surface Transportation (IST) fund are prepared primarily from the State's RIFANS accounting system; however, a significant amount of data required for financial reporting is also derived from RIDOT's Financial Management System (FMS). Because these two accounting systems were not designed to easily share data or be compatible, preparation of the annual financial statements for these funds 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 necessitate a mapping scheme to "crosswalk" the two charts of accounts.

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

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

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

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

In essence, the RIDOT FMS contains detailed project-level data which loses its project character when transmitted to RIFANS. However, the project-level data is needed 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. "Work-arounds" and reconciliation processes have been implemented to provide the information needed for financial reporting.

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

RECOMMENDATION

2011-22 Reevaluate the continued operation of two separate accounting systems to support financial reporting for the IST fund. Establish short and long-term goals to ensure reliable information is available to support timely financial reporting.

*Corrective action plan / auditee views:*

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

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

*Anticipated Completion Date: To be determined.*

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

## Finding 2011-23

INTERMODAL SURFACE TRANSPORTATION FUND - FINANCIAL REPORTING

The Intermodal Surface Transportation (IST) Fund, a special revenue fund, includes financial reporting for transportation related activities of the State, including highway construction programs, and 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.

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. Several account balances reflected in the fiscal 2011 draft financial statements required material adjustment due to weaknesses in controls over financial reporting.

***Accounts payable and amounts due from the federal government*** – Controls over the reporting of accounts payable and amounts due from the federal government can be improved to ensure all material amounts are included in the financial statements. RIDOT's current processes to identify accounts payable are manually intensive and therefore susceptible to omitting or duplicating payables. RIDOT's process to record legal claims and settlements should also be improved to better identify those amounts that are current fund liabilities based on amounts to be liquidated within the next year.

***Classification of fund balance components*** – Weaknesses in control over financial reporting resulted in the following misstatements in the reported IST Fund balance amounts:

- RIDOT was unable to explain changes in fund balance components tied to specific funding sources when those changes were different than expectations. For example, our analysis of fund balance highlighted unrecorded federal receivables in the draft financial statements. RIDOT should improve its controls over the reporting of fund balance by analyzing its components more frequently during the fiscal year.

- RIDOT did not include the unspent portion of gas tax proceeds dedicated for repayment of the Motor Fuel Bonds as restricted fund balance. In accordance with GARVEE and Motor Fuel bond covenants, any amounts available from the dedicated portion of the State's gas tax are restricted for future debt service.

- Additionally, fund balance did not properly reflect all accruals recorded at year-end.

The above misstatements were corrected through audit adjustments in the fiscal 2011 IST Fund financial statements.

Reconciliation between the GARVEE Trustee, RIDOT FMS and RIFANS

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

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

RECOMMENDATIONS

2011-23a Strengthen control procedures over financial reporting to ensure accurate identification of accounts payable, amounts due from the federal government, and categories of fund balance within the general ledger.

2011-23b Analyze the change in fund balance by funding source to ensure that results are consistent with the programs and activities being accounted for within the IST Fund.

2011-23c Expand the reconciliation between the trustee and the State accounting system to encompass transactions at the account level to ensure the financial statements accurately reflect all trustee activity.

*Corrective action plan / auditee views:*

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

- *Analyze the components of fund balance more frequently during the fiscal year;*

- *Compare (a) revenues received per the federal FMIS report to (b) receipts booked in RIFANS and resolve any differences; and*

- *Include transactions at the account level as part of the GARVEE reconciliation process.*

*To better address these financial reporting findings, as well as the infrastructure accounting issues identified in findings 2011-24a through 2011-24e, the RIDOT Financial Management Unit intends to post a senior-level accountant position in early FY 2013.*

*<u>Anticipated Completion Date</u>: December 31, 2012*

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

## Finding 2011-24

<u>TRANSPORTATION INFRASTRUCTURE REPORTING</u>

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

<u>Process to Accumulate Infrastructure Outlays</u>

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.

Significant misstatements relating to the State's reporting of infrastructure were noted during fiscal 2011. The most significant related to the State's failure to recognize the completion of certain projects totaling $108 million from previously reported construction in progress. The State did not recognize an additional $22.2 million in expenditures that required capitalization as construction in progress during fiscal 2011. Although the above misstatements were corrected through audit adjustment in the State's financial statements, the significant number of issues noted during fiscal 2011 indicates that the State needs to improve controls over its recording of infrastructure outlays. Controls can also be improved to more accurately identify when infrastructure assets are placed in service.

<u>Infrastructure Disposals and Asset Impairments</u>

Identifying and recording infrastructure disposals continues to be a significant weakness in RIDOT's financial reporting. RIDOT has not disposed of any infrastructure assets since their initial recording which includes approximately 30 years of infrastructure investments by the State. Although disposed infrastructure was mostly fully depreciated and therefore not material in impact to the State's financial statements at June 30, 2011, RIDOT must develop policies and procedures to identify and record infrastructure asset disposals. For example, as a result of the recently completed I-WAY project, various sections of interstate highway, previously in use, were demolished. Although this occurred largely during fiscal 2011 no infrastructure disposals were recorded. Failure to fully quantify infrastructure disposals could impact the accuracy of the State's financial statements in future years.

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.

Explore an Automated Approach to the Accumulation of Capitalized Infrastructure Outlays

The control deficiencies noted here are significantly interrelated to the issues detailed in Finding 2011-21 which describes the use of two incompatible accounting systems to prepare financial statements for the IST Fund. Due to the use of the two systems, accumulation of infrastructure outlays meeting the State's capitalization criteria is performed independent of either system. 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 necessitates the inefficient and error-prone spreadsheet approach.

The Department of Transportation and 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.

RECOMMENDATIONS

2011-24a Improve controls over the recording of infrastructure investment and disposal in the State's financial statements.

2011-24b Improve controls for determining when infrastructure assets are placed in service.

2011-24c Accumulate and link actual design as well as construction costs related to a project. Include all project costs from design through project completion in the amounts capitalized as infrastructure.

2011-24d 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.

2011-24e 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:*

*Financial Management will continue to improve controls over the recording of infrastructure investment and disposal, as well as when infrastructure assets are placed into service.*

*Regarding the identification and recording of infrastructure asset disposals, a control procedure will be implemented for FY 2012 to make the determination based upon useful life codes. This* *will require increased levels of coordination between RIDOT Financial Management, Accounts and Control, and other RIDOT divisions.*

*Additionally, Financial Management will improve its methodology of determining when infrastructure assets are placed into service. For FY 2011, Financial Management utilized the date of substantial completion identified on RIDOT form "Substantial Completion and Request for Partial Acceptance / Final Inspection" as the basis of determining when infrastructure assets are placed into service. This methodology has been agreed upon by both RIDOT and the Auditor General's Office. RIDOT's Financial Management Office is aware that better coordination between RIDOT Units is required to ensure that it possesses a complete list of infrastructure assets that have been placed into service during each fiscal year.*

*Regarding the issue of linking actual design and construction costs to projects, the RIDOT Financial Management Office has dedicated significant time and personnel resources to revamp the past practice of calculating design costs by using 19 percent of the total construction costs incurred during the fiscal year for each project. For FY 2011, Financial Management determined the total design costs incurred and linked specific design costs for large-dollar projects, while the remaining design costs were allocated based upon construction costs incurred by each respective smaller-dollar project. The Department concurs that this methodology results in timing issues, and will examine further refinement for linking design and construction costs on a go-forward basis.*

*The Department does not dispute the auditors' observation that an automated systems approach could potentially be a less cumbersome and more efficient way to account for infrastructure assets. However, severe budgetary constraints presently limit the Department's ability to upgrade to an automated system. Notwithstanding this significant hurdle, the Department will explore whether automated infrastructure accounting systems exist. If they do, a cost/benefit analysis will be performed to determine if this is an effective approach in the future when funding for such enhancements may become available.*

*Regarding the issue of impairment, the Department will establish a policy that conforms with the criteria outlined in generally accepted accounting principles applicable to governmental entities.*

*To better address these infrastructure findings, as well as the financial reporting issues identified in findings 2011-23a through 2011-23c, the RIDOT Financial Management Unit intends to post a senior-level accountant position in early FY 2013.*

*Anticipated Completion Date: December 31, 2012*

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

## Finding 2011-25

RIDOT - DISASTER RECOVERY AND CONTINGENCY PLAN

The RI Department of Transportation (RIDOT) relies on two mission critical application systems to manage its business operations: the Project Management Portal (PMP) and Financial Management System (FMS). Both systems are periodically backed up and able to be restored in the event of a localized system failure. However, maintaining backups of system data only addresses part of the disaster recovery equation. To address this, RIDOT formally documented and tested a disaster recovery and contingency plan for its IT infrastructure during fiscal 2011; however, this plan did not include the PMP.

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

RECOMMENDATION

2011-25 Develop and implement a comprehensive disaster recovery and contingency plan for all RIDOT systems. Upon approval, periodically test and review the plan in accordance with DoIT published policies.

*Corrective action plan / auditee views:*

*A portion of RIDOT's systems were tested offsite April 2011. The next Disaster Recovery test will take place June 2012. During this time, the remaining systems are planned to be tested. If the test results are positive, documentation of the process will be documented. If the test results are not positive and/or there is not enough time permitted to complete testing of remaining systems, a third test will take place. Currently TBD. After all test are verified and complete, documentation of the process will follow. A contingency plan has not yet been developed. This will be addressed with further discussion among DoIT personnel.*

*Anticipated Completion Date:* *Disaster Recovery - August 2012.*
*Contingency Plan – TBD pending results from June 2012.*

*Contact Person:* *Keith Graham, Technical Support Specialist III*
*Phone: 401.222.6935 x-4329*

## Finding 2011-26

RIDOT – CONTROLS OVER PROGRESS PAYMENT DATA FILES

There are instances where payment data is manually verified prior to progress payment data files being transmitted from the Project Management Portal (PMP) to the Financial Management System (FMS). In addition, some data elements are 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. 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 (the State's accounting system), should be performed to identify critical points where automated controls should be implemented to eliminate all instances of manual involvement.

Upon posting to FMS, a hold is automatically placed on progress payments pending supervisory approval. RIDOT Finance Office policy forbids approving and releasing holds of self-initiated progress payments. However, the FMS allows such actions - no automated control is in place to prevent an individual from doing so. An actively enforced FMS approval hierarchy would reduce separation of duties concerns.

Approved progress payment invoices are transmitted to RIFANS for final processing and to make vendor payments. Daily, FMS receives a RIFANS file containing all progress payments paid the previous day in order to record the payment in its database. Although some reviews are conducted (i.e. identify unpaid progress payments), there are no automated controls in place to identify RIFANS payments that do not agree with the original FMS invoice. Automatically identifying such payment discrepancies for review by appropriate personnel would reduce the risk of an improper payment being made.

RECOMMENDATIONS

2011-26a Review the progress payment file transfer process to identify critical points where automated controls could be implemented to eliminate the need for manual intervention.

2011-26b Create and implement appropriate approval hierarchies. Automatically identify RIFANS/FMS payment discrepancies for review.

*Corrective action plan / auditee views:*

*2011-26a*

*Discussions and analysis of the manual processes for PO/AP invoice/payment processes with Purchasing and Accounts Payables will continue. Multiple purchases orders can exist for a single approved awarded CMS contract. However, the original FMS Purchase Order may close and subsequent Purchase Orders open. To address this, additional FMS validations will be put in place to identify the appropriate FMS PO to match and process against. If validations can not occur, Accounts Payables will track and log all manual changes.*

*Anticipated Completion Date: September 2012*

*2011-26b*

*(1) Approval Hierarchies will be addressed during the system upgrade to Release 12. Accounts Payable workflows will be implemented during the R12 upgrade. The first step needed to upgrade to R12 requires replacing the current time and attendance module from OIT (Oracle Internet Time) to OTL (Oracle Time and Labor). Vendor selection is in process to assist DoIT in the OIT upgrade. Once complete, work will begin on the R12 upgrade of the overall system. (2) Discussions with Accounts Payable will take place in identifying additional validations on payments. In addition, existing reports will be reviewed to determine if any can be used or modified to identify discrepancies in invoice payment amounts between FMS and RIFANS. New reports can be created if none exist.*

*Anticipated Completion Date: (1) July 2014; (2) July 2013*

*Contact Person: Jimena Resto, Systems Administrator*
*Phone: 401.222.6935 x-4562*

# Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

## Department of Labor and Training

## Employment Security and Temporary Disability Insurance Funds

## Finding 2011-27

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

Program change management controls are intended to mitigate known risks associated with making changes to large, complex IT applications. The Department of Labor and Training (DLT) has a number of large automated applications operating on the department's internal computer systems.

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

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

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

RECOMMENDATION

2011-27 Implement an automated program change management process over DLT computer applications. Coordinate and request needed assistance in implementing an automated solution that meets DoIT policies and procedures and industry standards.

*Corrective action plan / auditee views:*

*The Department of Labor and Training's DoIT Staff will work with DoIT's Enterprise Staff to jointly address this finding by working to meet the requirements set forth in finding 2011-27. DLT's DoIT Staff will address the issues of change management by working together using a combined group of resources and funding to implement Clearcase/ClearQuest, if this is the toolset used to meet the requirements set forth. In addition, DLT's DoIT staff will investigate a* *change management solution for use on the IBM AS400/I5 computer systems that also meets the requirements set forth in Finding 2011-27.*

*DLT's DoIT staff along with the DoIT Enterprise Staff realizes that improvements need to be made to the current software to improve functionality and usability. DLT's DoIT staff will have to develop knowledge and expertise of these products and have the necessary staff to implement and manage these programs. DoIT will work with DLT to identify the required funding to implement these tools to meet the requirements.*

*Anticipated Completion Date: June 30, 2013*

*Contact Person: Robert M. Genest, Administrator, MIS*
*Phone: 401.462.8012*

## Finding 2011-28

TRANSMISSION OF TEMPORARY DISABILITY INSURANCE (TDI) PROGRAM DISBURSEMENT DATA FILE

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

This finding was initially reported in our fiscal 2010 audit results. DLT's IT personnel indicated they were planning to resolve this weakness in fiscal 2011 by implementing the needed software and operational changes; however, this did not occur.

RECOMMENDATION

2011-28 Secure the TDI data files that are currently being transmitted in an unsecure format by implementing encryption and originating the transmission from a dedicated secure PC or directly from the mainframe computer system.

*Corrective action plan / auditee views:*

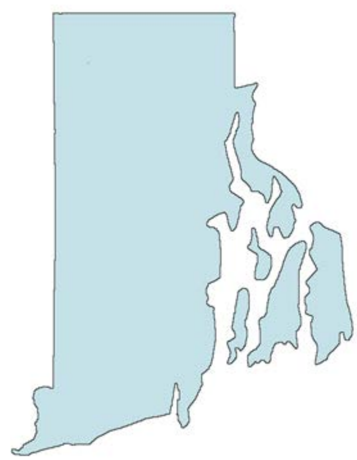
*The current transmissions are prepared from a dedicated, secure PC then sent to the financial institution. DLT DoIT's staff will work with the financial institution so they can accept an encrypted file format from the IBM I5 System. DoIT will coordinate this secure transmission with the financial institution.*

*Anticipated Completion Date: December 31, 2012*

*Contact Person: Robert M. Genest, Administrator, MIS*
*Phone: 401.462.8012*

# Schedule of Findings and Responses

Material Weaknesses and
Significant Deficiencies in
Internal Control over
Financial Reporting



## Component Units

## Finding 2011-29

RHODE ISLAND LOTTERY - OTHER MATTER REQUIRED TO BE REPORTED UNDER *GOVERNMENT AUDITING STANDARDS*

In May 2011, the Rhode Island Lottery (the Lottery) became aware of a potential fraud involving the bonus play rewards program ("bonus play program") at Twin River, a licensed video lottery facility. An employee with access to the bonus play system allegedly awarded bonus play credits to themselves and family members for unauthorized gain. This potential fraud, which was discovered by compensating controls employed at the facility, was investigated by the Lottery and the State Police and led to the arrest and arraignment of the employee. The Lottery plans to seek reimbursement from Twin River for the amount of any loss attributable to this unauthorized bonus play activity.

Twin River is currently planning to install a new version of their bonus play rewards software. This updated version of the software is expected to address the current system access design limitations that facilitated the potential fraud described above.

## Finding 2011-30

CONVENTION CENTER AUTHORITY – MATERIAL NONCOMPLIANCE - FUNDING OF THE OPERATING RESERVE, DEBT SERVICE RESERVE, AND RENEWAL AND REPLACEMENT COMPONENTS OF ITS RESTRICTIVE COVENANTS

During the fiscal year ended June 30, 2011, the Convention Center Authority was unable to fund the Operating Reserve, Debt Service Reserve, and Renewal and Replacement components of its restrictive covenants pursuant to the bond indentures.

*Corrective action plan / auditee views*:

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

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

## Finding 2011-31

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

As noted in the prior year audit, the CFO has the authority to initiate, process, and record in the general ledger a wire transfer from the Turnpike and Bridge Authority's (the Authority) operating cash accounts. A person independent of the CFO does not review and authorize the wire transfer transaction before it is executed by the bank. Also, the CFO prepares the Authority's bank reconciliations; however, a person independent of the CFO does not review and approve the bank reconciliations.

RECOMMENDATION

2011-31 We understand that the Authority's Board of Directors and Executive Director review monthly financial reports prepared by the CFO. However, to strengthen existing internal control over financial reporting we recommend that the Authority:

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

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

*Corrective action plan / auditee views:*

*Management will implement appropriate procedures to strengthen internal controls.*

*Contact Person: Buddy Croft, Executive Director*
*Rhode Island Turnpike and Bridge Authority*
*Phone: 401.423.0800*

## Finding 2011-32

RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – RECONCILIATION OF INVESTMENTS

As part of our audit procedures, we requested confirmation of the dollar amount of investments at year-end from entities holding the Turnpike and Bridge Authority's (the Authority) investments. As a result of the confirmation process, we noted that the confirmed dollar amount of certain investments at year-end did not agree to amounts recorded in the general ledger. We proposed and management reviewed, approved, and accepted an audit adjustment to record certain investment activities not previously recorded.
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RECOMMENDATION

2011-32 We recommend that a person independent of the person posting investment activity in the Authority's general ledger prepare a detailed investment reconciliation for each investment account at the end of each month, and compare the reconciled balance to the amount recorded in the general ledger to determine whether all transactions occurring within all investment accounts have been recorded completely and accurately.

*Corrective action plan / auditee views:*

*Since year-end, the reconciliation process has been changed to reflect the reporting of investments in the general ledger to properly reflect what is reported by the bank.*

*Contact Person: Buddy Croft, Executive Director*
*Rhode Island Turnpike and Bridge Authority*
*Phone: 401.423.0800*

## Finding 2011-33

RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – RECONCILIATION OF TOLL REVENUE AND RELATED ACTIVITIES

The Turnpike and Bridge Authority (the Authority) receives monthly reports from ACS summarizing, among other information, the dollar amount of toll activities resulting from the use of the E-ZPass system. Information reported in the monthly reports produced by and received from ACS is used to record certain toll activities in the Authority's general ledger, including, but not limited to, recording toll revenue earned during the month, the electronic toll liability (prepaid toll payments received from customers) at the end of each month, and amounts due to other states at the end of each month as a result of passengers using a Rhode Island transponder to pay tolls when traveling in other states. During our audit, we noted that certain amounts summarized and reported by ACS did not agree to amounts reported in the general ledger. We proposed and management reviewed, approved and accepted audit adjustments to reconcile toll revenue, the electronic toll liability and amounts payable to other states.

RECOMMENDATION

2011-33 We recommend that a person independent of the person recording toll-related financial activity in the Authority's general ledger reconcile recorded amounts to the amounts summarized and reported by ACS at the end of each month and investigate and correct any differences on a timely basis.

*Corrective action plan / auditee views:*

*Since year-end, the monthly reports received from ACS are incorporated into the monthly closing and reconciliation process.*

*Contact Person: Buddy Croft, Executive Director*
*Rhode Island Turnpike and Bridge Authority*
*Phone: 401.423.0800*

## Finding 2011-34

RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – CUT-OFF AND CLASSIFICATION OF CONSTRUCTION COSTS

During our audit, we noted that the Turnpike and Bridge Authority (the Authority) did not record estimated liabilities for construction work completed from the date through which work was complete as reported on the last certified AIA document (or similar document) through the year-end date.

RECOMMENDATION

2011-34 We recommend that the CFO and the Chief Engineer work cooperatively to estimate liabilities for construction work completed from the date through which work was complete as reported on the latest certified AIA document through each month-end date so that construction-related costs are appropriately capitalized, and construction-related liabilities are recognized in the period incurred.

*Corrective action plan / auditee views:*

*Since the year-end, the CFO has made an effort to ensure that the Chief Engineer is processing invoices timely.*

*Contact Person: Buddy Croft, Executive Director*
*Rhode Island Turnpike and Bridge Authority*
*Phone: 401.423.0800*

## Finding 2011-35

RHODE ISLAND PUBLIC TELECOMMUNICATIONS AUTHORITY – RESTATEMENT OF NET ASSETS

The Public Telecommunications Authority's (the Authority) 2010 consolidated statement of net assets, as previously reported, included assets capitalized under the terms of a bargain purchase option contained within a sublease with the State of Rhode Island for the land and building located at 50 Park Lane, Providence, Rhode Island. This sublease expired in 2009; the bargain purchase option was not exercised. Accordingly, the asset and related accumulated depreciation as reported in the June 30, 2010 consolidated financial statements, which net to $3,213,187, have been removed from the 2010 consolidated statement of net assets as a prior period adjustment.

Additionally, due to a calculation error, the amount reported as due to the State of Rhode Island at June 30, 2010 was understated by $68,282. This amount has been adjusted to the actual amount of $107,781 as a prior period adjustment.

Additionally, due to a change in Broadcasting format, the Authority no longer uses an analog antenna located on a tower in Johnston, Rhode Island. The antenna was located on the tower under the terms of a lease which expired in 2009. The owners of the tower have demanded the antenna be removed. Costs associated with the removal of the antenna are estimated at $45,000. The liability for $45,000 has been recognized as a prior period adjustment.

RECOMMENDATION

2011-35 We recommend that the Authority revise its policies and procedures to include a review, performed by the Board of Directors, of the calculations and the amounts used in the consolidated financial statements.

*Corrective action plan / auditee views:*

*Management agrees with the auditors' recommendation and will work to implement a revision to its policies and procedures to include a review performed by the Board of Directors of the calculations and amounts used in the consolidated financial statements.*

*Contact Person:* *David Piccerelli, Executive Director*
*Rhode Island Public Telecommunications Authority*
*Phone: 401.222.3636*

## Finding 2011-36

RHODE ISLAND PUBLIC TELECOMMUNICATIONS AUTHORITY – BANK RECONCILIATION

During our audit procedures, we noted that checks written during the last week of June 2011 were dated July 2011. The checks were sent to vendors prior to July 2011 and, of those checks, $44,472 cleared the banks before June 30, 2011. The Public Telecommunications Authority (the Authority) included the amount as negative outstanding checks on the June 2011 reconciliation, resulting in a reported overstatement of cash and understatement of prepaid expenses.

RECOMMENDATION

2011-36 We recommend that the Authority date checks on the date they are written to accurately report the cash balance at month's end.

*Corrective action plan / auditee views:*

*Management agrees with the auditors' recommendation and will employ the practice of dating checks the day they are written.*

*Contact Person:* *David Piccerelli, Executive Director*
*Rhode Island Public Telecommunications Authority*
*Phone: 401.222.3636*

## Finding 2011-37

RHODE ISLAND PUBLIC TELECOMMUNICATIONS AUTHORITY – RECORDING OF DEPOSIT

During our audit procedures, we noted that an amount given to the Public Telecommunications Authority (the Authority) by a not-for-profit foundation was recorded as a deposit; the amount was subsequently forwarded to a for-profit entity. Source documentation stated that the amount was a contribution to the Authority by the Foundation. The Authority stated that the amount was given to the Authority by the Foundation with instructions to forward to the for-profit entity.

RECOMMENDATION

2011-37 We recommend that the Authority put in place procedures that would require sufficient documentation of transactions of this nature to support its treatment as a deposit payable to a third party.

*Corrective action plan / auditee views:*

*Management agrees with the auditors' recommendation and will improve upon its procedures for recording deposits with accurate and appropriate documentation to reflect all donations.*

*Contact Person: David Piccerelli, Executive Director*
*Rhode Island Public Telecommunications Authority*
*Phone: 401.222.3636*

## Finding 2011-38

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY – SEGREGATION OF DUTIES - FINANCE

During the fiscal year ended June 30, 2011, the Higher Education Assistance Authority (the Authority) experienced turnover in its finance department. Thus, certain duties that were previously segregated are performed by the chief financial officer (CFO). As a result, the CFO prepares, reviews, and approves bank and investment account reconciliations; has access to blank check stock; and can transfer cash between financial institutions. Properly segregated duties minimize the risk of potential material financial statement misstatement, whether due to error or fraud.

RECOMMENDATION

2011-38 We recommend that the Authority evaluate its current human resources and segregate the above functions such that the CFO can independently exercise his review responsibilities.

*Corrective action plan / auditee views:*

*On August 15, 2011, RIHEAA hired a person in the role of Senior Accountant. This individual will be taking responsibility for bank statement reconciliations in the near future. In addition, RIHEAA's management has been reviewing the roles of all members of the finance department so as to determine how best to accomplish appropriate segregation of duties.*

*Contact Person: Charles Kelly, Executive Director*
*Rhode Island Higher Education Assistance Authority*
*Phone: 401.736.1100*

# Schedule of Findings and Responses

# Management Comments

## Management Comment 2011-1

SUBRECIPIENT MONITORING – REVIEW OF SINGLE AUDIT REPORTS

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

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

- Many subrecipients receive funding from multiple departments of the State – each is required to receive and review the same audit report.

- Specific agencies reviewing the audit reports do not consider noted deficiencies from the perspective of the risks that they pose to all state and federal funds passed through to the subrecipient. One large subrecipient of the State, which receives significant funding from multiple departments and agencies, has been very late in presenting its audit reports and those audit reports have highlighted serious deficiencies.

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

- Effective subrecipient monitoring requires that individuals reviewing the audit reports be trained in governmental accounting and auditing requirements (specifically the Single Audit Act and OMB Circular A-133). This level of proficiency is difficult to achieve and maintain at all the departments and agencies now required to review subrecipient audits.

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

RECOMMENDATIONS

MC-2011-1a Centralize subrecipient monitoring procedures related to receipt and review of Single Audit Reports within one agency. This function should be staffed with individuals trained in governmental accounting and auditing matters to allow effective review of the Single Audit Reports.

MC-2011-1b Build a database of all subrecipient entities that receive state and/or federal grant funding.

*Corrective action plan / auditee views:*

*The centralization of sub-recipient audit report monitoring will require the transfer of personnel to a centralized department or the approval of additional FTE's. Therefore, this recommendation is subject to budgetary constraints.*

*Anticipated Completion Date: June 30, 2013*

*Contact Person: Marc Leonetti, Controller*
*Phone: 401.222.6731*

## Management Comment 2011-2

DRAWDOWN OF FEDERAL FUNDS

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

Federal grant revenue for the State approximated $2.5 billion this year. Consequently, the timing of receipt of these funds has a significant impact on the State's overall cash management. We have reported for many years that the State does not have adequate controls in place to ensure compliance with federal cash management requirements. In many instances, agencies do not draw federal cash as frequently as permitted by federal regulations thereby adversely impacting the State's overall cash management.

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

RECOMMENDATION

MC-2011-2 Vest responsibility for drawing federal funds with the Office of the General Treasurer. Automate the drawing of federal funds as part of the implementation of a comprehensive integrated accounting system.

*Corrective action plan / auditee views:*

*The General Treasurer in conjunction with the Office of Accounts and Control will review the benefits of centralizing and automating the withdrawal of the remaining federal funds with the implementation of the appropriate accounting system module.*

*Anticipated Completion Date: June 30, 2012*

*Contact Person: Ken Goodreau, CIO, Office of the Treasurer*
*Phone: 401.462.7640*

## Management Comment 2011-3

REQUIRE PAYROLL DIRECT DEPOSIT FOR ALL EMPLOYEES

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

Further savings and efficiencies could be obtained if employees had on-line access to their direct deposit payroll “stub”. Although direct deposit avoids check printing and distribution, the direct deposit payroll “stubs” are still printed and distributed biweekly to employees. The State could create an on-line employee portal to allow this access and/or ultimately include such functionality within contemplated human resource/employee payroll system enhancements.

RECOMMENDATIONS

MC-2011-3a Require all state employees to be paid through direct deposit.

MC-2011-3b Implement an employee portal to allow access to direct deposit payroll “stub” information in lieu of printing and distributing such information on a biweekly basis.

*Corrective action plan / auditee views:*

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

*Anticipated Completion Date:* *June 30, 2013*

*Contact Person:* *Marc Leonetti, Controller*
*Phone: 401.222.2271*

## Management Comment 2011-4

IMPROVE CASH RECONCILIATION EFFICIENCY

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

RECOMMENDATION

MC-2011-4 Explore options to increase automation of the reconciliation process with the State's financial institutions by aligning the manner in which transactions are processed by both the bank and accounting system to allow electronic matching for reconciliation purposes.

*Corrective action plan / auditee views:*

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

*Anticipated Completion Date:* *June 30, 2012*

*Contact Person:* *Chris Feisthamel, COO, Office of the Treasurer*
*Phone: 401.462.7660*

## Management Comment 2011-5

CHILD SUPPORT COLLECTIONS – RESOLUTION OF UNIDENTIFIED COLLECTIONS

All Child Support collections are recorded in an escrow liability account in the State's General Fund. The lack of reconciliation of this escrow liability account over the years has resulted in an accumulated balance of collections not identifiable to specific active Child Support cases. While the State has begun reconciling monthly current child support collection activity recorded as an escrow liability in the State accounting system, older collections not specifically assigned to active child support cases totaling $1.3 million remained unidentified at June 30, 2011. The State should establish a process to properly resolve the balance of unidentified collections recorded in this escrow liability account. The resolution of the balance reported in the State's accounting system would improve control over Child Support Enforcement program receipts and disbursements, as well as the State's controls over financial reporting.

RECOMMENDATION

MC-2011-5 Resolve the balance of unidentified child support collections reported at year-end.

*Corrective action plan / auditee views:*

*The Office of Accounts and Control will work with the Department of Human Services, the agency responsible for oversight of this account, to resolve the residual variance.*

*Anticipated Completion Date:* *December 31, 2012*

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

## Management Comment 2011-6

FINAL APPROVAL OF "CSH" TRANSACTIONS IN RIFANS

Certain RIFANS general ledger transactions commonly referred to as "CSH" transactions, (CSH is the prefix of the transaction identification number) are utilized to record cash transfers between State bank accounts. "CSH" transactions are a type of journal entry designated for the movement of cash between bank accounts of the State. "CSH" transactions, however, do not systematically limit the accounts to which the transaction initiator can record financial activity. The State's controls rely on the approval process to reject "CSH" transactions that are not initiated properly.

"CSH" transactions, upon final approval, create a notification to personnel at the Office of the General Treasurer to initiate the transfer of cash between State bank accounts. During fiscal 2011, certain "CSH" transactions initiated by the RI Lottery were not routed for final approval by the Office of Accounts and Control. Lottery transfers are identified uniquely on the RIFANS system through the use of a specific category code for which the system workflow has been programmed without approval by the Office of Accounts and Control. The fact that the Lottery could initiate and approve "CSH" transactions impacting other departments makes final approval by the Office of Accounts and Control a necessary control over the State's financial reporting.

RECOMMENDATION

MC-2011-6 Ensure that all "CSH" transactions receive final approval by the Office of Accounts and Control prior to posting their RIFANS.

*Corrective action plan / auditee views:*

*The Office of Accounts and Control will modify the Oracle general ledger workflow to route CSH transactions that originate at the RI Lottery to the Office of Accounts & Control for approval.*

*Anticipated Completion Date: December 31, 2012*

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

## Management Comment 2011-7

DEPARTMENT OF LABOR AND TRAINING COMPUTER APPLICATIONS - DISASTER RECOVERY AND CONTINGENCY PLAN

The Department of Labor and Training's (DLT) Data Center hosts a variety of applications mostly related to the Unemployment Insurance and Temporary Disability Insurance programs. In fiscal 2011, benefit payments processed through these computer systems totaled in excess of $700 million. DLT implemented and tested its disaster recovery and contingency plan during fiscal 2011 for the systems that are housed within its data center. DLT's plan proved to be only partially successful as not all operations were able to be restored during the test.

Data captured and maintained by these systems is backed up on a scheduled basis with copies securely maintained on and off site. If operational issues are experienced within these applications, existing DLT recovery procedures would be utilized to resolve the problem. In these instances, a fully operational disaster recovery and contingency plan would be vital to ensuring that the data center is restored and operational in a timely manner.

RECOMMENDATION

MC-2011-7 Ensure that the disaster recovery and contingency plan operates effectively to ensure the complete recovery of DLT systems.

*Corrective action plan / auditee views:*

*DLT is under contract with SunGard Services to develop an IT Contingency Plan for Disaster Recovery. Based on the current schedule SunGard will deliver a comprehensive disaster recovery plan by June 30, 2012. In addition, in 2011 DLT participated in a disaster recovery exercise with the DoIT Enterprise disaster recovery team. DLT is now part of these ongoing exercises with DoIT until all systems at DLT are sufficiently tested for disaster recovery backup and restore. This will continue until the DLT data center is consolidated with the DoIT Enterprise Data Center. At such time DLT's disaster plan will be integrated with the DoIT Enterprise Data Center plan.*

*Anticipated Completion Date:* *December 31, 2012*

*Contact Person:* *Robert M. Genest, Administrator, MIS*
*401.462.8012*

## Management Comment 2011-8

DEPARTMENT OF REVENUE – CONTROLS OVER TAX REVENUE RECOGNITION

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

Taxation was aware of these situations before fiscal year-end, but the receivable balances were not adjusted prior to providing the balances to the Office of Accounts and Control for financial reporting purposes.

RECOMMENDATION

MC-2011-8 Improve controls over processing taxpayer data (i.e., returns, payments, etc.) to ensure timely and accurate posting to taxpayer accounts particularly at fiscal year-end.

*Corrective action plan / auditee views:*

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

*Anticipated Completion Date: To be determined.*

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

## Management Comment 2011-9

DEPARTMENT OF REVENUE – RECONCILIATION OF TAXATION RECEIPTS TO RIFANS

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

RECOMMENDATION

MC-2011-9 Develop the reporting capability to facilitate reconciliation of receipts reported by Taxation's systems with RIFANS.

*Corrective action plan / auditee views:*

*One of the major priorities of the Division of Taxation is the timely depositing of payments received. All payments received by Taxation are posted to various systems subsequent to their deposit. Currently the Division of Taxation has over 70 databases used to record payments and other taxpayer transactions (the mainframe system contains only 15 of these databases). As part of the Fiscal Year 2013 budget request, the Division of Taxation requested funding for an integrated tax system. This system will, among other things, overhaul the front end accounting systems and deposit systems. The system will also allow for real time posting of payments and transactions to taxpayer accounts, therefore any deposit made will be recorded in a more efficient manner.*

*Anticipated Completion Date: To be determined.*

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

## Management Comment 2011-10

ACCOUNTING FOR AGENCY FUND DEPOSITS

The State reported $98.1 million in agency fund deposits at June 30, 2011 that constituted pledged securities for certain entities doing business in the State and court deposits held by the Judiciary. The underlying transaction activity for these deposits is not being accounted for within the State's accounting system. Instead, the State adjusts year-end accounting system balances based on deposit amounts reported at year-end for financial reporting purposes. Controls could be improved over agency fund deposits by recording all deposit transactions within the State accounting system and requiring periodic reconciliation of these balances to the underlying bank or trustee statements. This would implement the same control procedures over agency fund deposits that are in place over all other deposits reported by the State.

RECOMMENDATION

MC-2011-10 Record all agency fund deposit transactions in the State accounting system with periodic reconciliation of reported balances to underlying bank or trustee statements.

*Corrective action plan / auditee views:*

*The Judiciary is currently in the process of transitioning the accounting for all its agency accounts to RIFANS. Once this transition is complete procedures will be implemented at the agency level to reconcile the subsidiary records for such accounts to RIFANS information.*

*Anticipated Completion Date:* *July 31, 2012*

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

## Management Comment 2011-11

STATEWIDE CENTRALIZED COST ALLOCATIONS

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

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

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

RECOMMENDATION

MC-2011-11 Reevaluate the current centralized cost allocation process for personnel, facilities and maintenance, and information technology services to ensure that these cost allocations comply with financial reporting and federal program requirements.

*Corrective action plan / auditee views:*

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

*Anticipated Completion Date: June 30, 2013*

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

## Management Comment 2011-12

RIDOT – DATA CLASSIFICATION

RIDOT has not formally classified data residing in the Project Management Portal information system. Classifying system data is a best business practice essential to assigning proper security over the data as well as granting appropriate user access rights. Benefits include permitting data to be accessed, updated, protected, recovered and managed more securely and efficiently. DoIT policy states that data owners categorize all data under their control according to three levels of availability (critical, necessary, non-critical) and four levels of confidentiality (confidential, sensitive, private, public). It provides guidance for all State agencies in establishing appropriate security over and on the proper management of their data *(Policy 05-02: Data Categorization)*.

RECOMMENDATION

MC-2011-12 Classify all data in accordance with DoIT Policy 05-02 (Data Categorization).

*Corrective action plan / auditee views:*

*RIDOT will review the DoIT policy and then meet with stakeholders to develop an implementation plan.*

*Anticipated Completion Date: June 30, 2013*

*Contact Person: Kazem Farhoumand, Chief Engineer*
*Phone: 401.222.2492*

## Management Comment 2011-13

WIRE TRANSFERS – OFFICE OF THE GENERAL TREASURER

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

RECOMMENDATION

MC-2011-13 Dedicate secure personal computers for the initiation and transfer of wire transfer information via web-based applications of the State's various financial institutions.

*Corrective action plan / auditee views:*

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

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

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

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

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

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

*Anticipated Completion Date: Not applicable.*

*Contact Person: Ken Goodreau, CIO, Office of the Treasurer*
*Phone: 401.462.7640*