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, 2013 AUDIT

Dennis E. Hoyle, CPA
Auditor General
State of Rhode Island and Providence Plantations
General Assembly
Office of the Auditor General
May 13, 2014

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, 2013 and have issued our report thereon dated December 19, 2013. Our Independent Auditor’s Report on the State’s financial statements was included in the State’s Comprehensive Annual Financial Report for fiscal 2013.

As required by Government Auditing Standards, we have also prepared a report, dated December 19, 2013 and included herein, on our consideration of the State’s internal control over financial reporting, its compliance with certain provisions of laws, regulations and contracts, and other matters required to be reported by those standards. Our report includes:

- 17 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.
- 11 findings reported by the auditors of component units.
- 25 management comments – these are less significant findings, yet, in our opinion still warrant communication and the attention of the State’s management.

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

Other findings and recommendations related to the State’s administration of federal programs have been included in the State’s Single Audit Report for the fiscal year ended June 30, 2013. As required by federal regulations, the State’s Fiscal 2013 Single Audit Report also includes the 28 findings related to controls over financial reporting as outlined above.

Sincerely,

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

Schedule of Findings and Responses

JUNE 30, 2013 AUDIT

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Our audit of the State of Rhode Island’s financial statements for the year ended June 30, 2013, performed in accordance with Government Auditing Standards, requires that we communicate deficiencies in internal control over financial reporting. We identified 11 material weaknesses and six significant deficiencies in internal control over financial reporting.

The State’s management has responsibility for and maintains internal control over financial reporting. Management has been responsive in addressing control deficiencies identified in prior audits – those that remain are generally conditions that have existed for several years and will likely require additional information technology (IT) investment. Developing new or enhancing existing systems demands significant monetary and technical resources - management continues to seek funding for additional system enhancements. The benefits derived from these IT investments are many and not just limited to eliminating control weaknesses.

The common thread underlying most of these control deficiencies is outdated or incomplete systems. RIFANS, the State’s centralized accounting system is largely effective and reliable for the functionalities that are operational; however, there is substantial opportunity for further efficiencies through completion of RIFANS. These functional gaps result in control deficiencies in specific areas. For example, RIFANS does not meet the State’s needs in three important and interrelated areas – time reporting/payroll, grants management, and cost allocation – functions integral to overall State operations.

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

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

Overall, the State has not sufficiently addressed IT security risks, an increasing concern given the State’s very complex computing environment. Additionally, certain standard IT control processes, such as program change control, have not been implemented uniformly on an organization-wide basis. The State needs to address issues such as these through a plan that ensures the long-term sustainability of critical State operations that are dependent on these information systems.

We have included material weaknesses and significant deficiencies reported by the independent auditors of component units (e.g., Rhode Island Commerce Corporation, Turnpike and Bridge Authority, and I-195 Redevelopment District Commission) included within the State’s financial statements. While their financial activity is reported with the State’s, their accounting and control procedures are generally independent of the State’s control procedures.

We also reported 25 management comments, which are less significant findings that highlight financial-related policy matters as well accounting controls. New fiscal 2013 management comments address merging the two Judicial pension plans, recognizing refunds for sales tax exemptions granted by the Commerce Corporation, the “Cadillac Tax” included in the actuarial valuation of the State’s retiree health plan, indirect cost recoveries, and the assessment on consultant services payable to the Retirement System. Management comments repeated from prior years address subrecipient monitoring, drawdown of federal funds, mandating direct deposit for employee payroll, certain taxation processes, and other accounting and financial reporting issues.
INDEPENDENT AUDITOR’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Rhode Island and Providence Plantations (the State), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the State’s basic financial statements and have issued our report thereon dated December 19, 2013. Our report includes a reference to other auditors who audited the financial statements of:

- the Tobacco Settlement Financing Corporation, a blended component unit which represents 2% of the assets and 1% of the revenues of the governmental activities and 1% of the assets and 3% of the revenues of the aggregate remaining fund information;

- the Convention Center Authority, a major fund, which also represents 64% of the assets and 2% of the revenues of the business-type activities;

- the Ocean State Investment Pool, an external investment trust, which represents less than 1% of the assets and revenues of the aggregate remaining fund information; and

- all the component units comprising the aggregate discretely presented component units.

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

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

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the State’s financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: Findings 2013-001, 2013-002, 2013-003, 2013-004, 2013-005, 2013-007, 2013-009, 2013-010, 2013-011, 2013-012, and 2013-014. Other auditors of the discretely presented component units considered the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: Findings 2013-018, 2013-019, 2013-021, 2013-025, 2013-026, and 2013-027.

A significant deficiency is a deficiency, or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies: Finding 2013-006, 2013-008, 2013-013, 2013-015, 2013-016, 2013-017. Other auditors of the discretely presented component units considered the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies: Findings 2013-022, 2013-023, 2013-024, and 2013-028.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests and those of the other auditors disclosed an instance of noncompliance or other matters that is required to be reported under Government Auditing Standards and which is described in the accompanying schedule of findings and responses as Finding 2013-020.
State’s Response to Findings

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

Purpose of this Report

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

Dennis E. Hoyle, CPA
Auditor General

December 19, 2013
Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

Statewide Accounting Systems and Other Financial Reporting Matters
Material Weaknesses and Significant Deficiencies in Financial Reporting

COMPLETE IMPLEMENTATION OF A COMPREHENSIVE FULLY-INTEGRATED ENTERPRISE RESOURCE PLANNING (ERP) SYSTEM

The Rhode Island Financial and Accounting Network System (RIFANS) is used to meet the State’s accounting and financial reporting responsibilities. RIFANS, utilizing the Oracle E-Business Suite software, was intended as a comprehensive, integrated ERP system for the State. While RIFANS is largely effective and reliable for the functionalities that are operational, there is substantial opportunity for further efficiencies to be accomplished through completion of RIFANS. These functional gaps within RIFANS also result in control deficiencies in specific areas.

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

The specific areas where control deficiencies exist, mostly due to incomplete implementation of the RIFANS ERP system, are detailed in the following sections.

Federal Grants Management and Cost Allocation

As an example of the control deficiencies resulting from the functional gaps, RIFANS does not meet the State’s needs in three important and interrelated areas – time reporting/payroll, grants management, and cost allocation. These functionalities are integral to overall State operations particularly those programs supported by federal grants – representing 38% of fiscal 2013 General Fund expenditures. These functions are currently performed independent of RIFANS and generally through multiple systems - most of which are duplicative and utilize old and sometimes unsupported technology. These functions were intended to be included within the RIFANS ERP implementation.

In general, each department within State government captures time and effort information, distributes costs to programs, and manages its federal grants in its own unique way. Almost every major department within State government administers unique time and effort reporting processes in addition to cost allocation systems - none of these processes or systems operate similarly, share a common control structure or are integrated into RIFANS.

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

Segregation of Duties Between Treasury and Accounting Functions

The lack of a revenue and receivables module within RIFANS has resulted in receipts/revenue being 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 require 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.

This system limitation has also necessitated that the Office of the General Treasurer be provided with 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 bank account reconciliations, and initiating transfers from State bank 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 RIFANS. While the State has implemented various compensating controls to mitigate this risk, optimal financial control would fully segregate an organization’s treasury and accounting functions to safeguard against asset misappropriation. Allowing one agency to have responsibility for the State’s treasury function while also allowing them significant functionality in the accounting system could allow a misappropriation of assets to not be detected through circumvention of the State’s controls.

**Accounting Controls over Capital Projects**

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

**Achieving the Efficiencies and Control Benefits of a Fully-Integrated ERP System**

Management has made significant efforts to ensure that internal control over financial reporting is effective in ensuring that the State’s financial statements are fairly stated in all material respects. Often, system design deficiencies caused by the lack of a more complete ERP system have resulted in the implementation of manual or unintended processes found to be inefficient and represent risk to the State’s ability to promote timely and accurate financial reporting in certain areas.

Because both the financial and technical personnel resources necessary to complete RIFANS as originally envisioned are scarce, the State has been understandably reluctant to proceed. Further, the challenge in attracting qualified technical employees to support or assist in the implementation of new IT projects has the State considering outsourcing to meet these needs. Adequate consideration should be given to the potential loss of integration and additional control considerations that will result if various functionalities are outsourced and are not resident within RIFANS.

Despite the acknowledged challenges in advancing or completing RIFANS, the importance of these functionalities to overall State operations will require continued attention. Significant costs could be incurred replacing or improving the individual departmental systems, many of which are unsupported, utilize outdated legacy structures, and lack the benefits of widely available technology.

We recommend that a comprehensive solution, consistent with the vision of RIFANS as an integrated ERP system, be planned and executed. Many of the functionalities that remain to be implemented are interdependent. Consequently, implementing these functionalities is challenging and
requires that a coordinated time sequencing must be established. Further, due to the significant scope of some of the remaining components, adequate resources must be identified and committed to the tasks. Obtaining authorization and funding commitments for these tasks can be supported by demonstrating the intended efficiencies and enhanced effectiveness as well as addressing the control weaknesses over financial reporting identified above.

RECOMMENDATIONS

2013-001a  Develop a strategic plan to either continue the installation of Oracle modules necessary to complete and fully realize the benefits of RIFANS as a comprehensive fully-integrated ERP system or meet those ERP system objectives through other means.

2013-001b  Ensure that the plan developed addresses the control deficiencies identified within the current RIFANS system.

2013-001c  Ensure that the plan specifically identifies the amount of resources (both State and/or contracted personnel) needed to either a) support a fully-integrated State ERP system or b) transition to and monitor systems or functions outsourced by the State.

Corrective action plan / auditee views:

2013-001a - Over the last few years, the Department of Administration has implemented a new Oracle module, Isupplier, and upgraded the RIFANS Oracle Suite to version 12. This was done with current staff and limited contracting support. In order to implement other RIFANS modules, the department would need to hire additional staff and implementation support staff. The task of hiring qualified Oracle staff has been an ongoing struggle. We have gone to public hearing to create new titles and have posted for these positions. We have not been able to recruit qualified staff. In addition, we have lost staff to retirement and have critical staff that can currently retire. The addition of new Oracle modules without qualified staff to support these modules would not be prudent. In addition, previous funding requests for implementing other modules have not been approved.

The Department of Administration understands the need for updated technology to meet the needs of an integrated ERP system. We are requesting IT COPS infrastructure funds to achieve the goal of acquiring other technology to address an integrated ERP system. We are requesting funds for the following new systems: payroll, HRIS and grants. Our goal is to fund a solution that can be supported and at the same time to integrate with the current system.

2013-001b - The solutions that we would be seeking if the funds are approved are solutions that are industry standard and adhere to best practices. The vendors selected would be working with the state to ensure that such deficiencies are addressed.

2013-001c - The solutions that we are looking to implement are solutions that can be hosted and/or supported by a third party vendor with experience in integrating their solution with our current ERP system.

Anticipated Completion Date:  Dependent on Funding Approval

Contact Person:  Alan Dias, Assistant Director of IT
Phone:  401 222-6091
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 $2.6 billion for fiscal 2013. Financial reporting risks include categorizing expenditures as federally reimbursable when grant funds have either been exhausted or the expenditures do not meet the specific program limitations.

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

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

The Office of Accounts and Control has continued to enhance its required Federal Grants Information Schedule (FGIS) which is completed by the administering departments and agencies. The goal of the FGIS is to efficiently reconcile RIFANS program activity with amounts drawn and claimed on federal reports. Timely recording of adjustments is necessary to ensure that federal program expenditures recorded in RIFANS are consistent with amounts reported to the federal government and do not exceed federal grant awards. Segregating prior period adjustments in the accounting system facilitates reconciliation of current period claimed expenditures to RIFANS amounts as well as improves financial reporting by isolating amounts that may warrant consideration of restatement of prior period’s financial statements.

While recent enhancements to the schedule and increased frequency of submission for larger programs are appropriate, the FGIS process is ultimately limited in its overall effectiveness to improve controls over federal revenue recognition. One critical component missing from the FGIS process is ensuring that expenditures reported within RIFANS have not exceeded available grant awards. Additionally, the Office of Accounts and Control has limited capabilities to validate information on the FGIS since grant documentation is maintained at the department level. Presently, there is no statewide control measure to ensure that grant expenditures do not exceed available award authority.

In addition, we noted instances where federal accounts in RIFANS were not linked to the proper federal program identification number (CFDA number). This is important in preparing the State’s Schedule of Expenditures of Federal Awards, identifying major programs for OMB Circular A-133 audit purposes, and ensuring compliance with federal cash management requirements as well as other compliance provisions.

Due to the limited effectiveness of the FGIS, other comprehensive control procedures should be considered. Additionally, the various factors that cause differences between amounts reported to the
Material Weaknesses and Significant Deficiencies in Financial Reporting

State of Rhode Island – Fiscal 2013

federal government and amounts included in the RIFANS accounting system should be addressed. Many departments utilize subsidiary systems, independent of the RIFANS accounting system, to administer federal programs and provide data for federal reporting. Consequently, this presents multiple opportunities for data to be inconsistent with or require reconciliation to financial data included in RIFANS. Improved functionality with the RIFANS accounting system to facilitate federal grant administration (grants management, cash management, and cost allocation functionalities – see Finding 2013-001) could reduce or eliminate such differences and significantly improve statewide controls over federal program administration.

The State’s recently formed Office of Management and Budget (OMB) within the Department of Administration has responsibility for oversight of federal program administration. They have begun to implement statewide monitoring processes for federal grants which include accumulating all grant awards received by the various departments and agencies within a comprehensive database. These OMB efforts coupled with enhanced RIFANS federal grant administration functionalities could improve controls over recognition of federal revenue and statewide federal program administration.

RECOMMENDATIONS

2013-002a Improve functionality with the RIFANS accounting system to facilitate federal grant administration (grants management, cash management, and cost allocation).

2013-002b Build statewide processes over federal grant administration within the newly formed Office of Management and Budget to supplement accounting controls within the RIFANS accounting system.

Corrective action plan / auditee views:

2013-002a - The Governor’s 2015 Budget includes a Certificate of Participation (COPS) funding request to finance information technology projects for system and application upgrades including a budgeting, forecasting, and grants management module.

Anticipated Completion Date: COPS decision will be made by June 30, 2014. If funding is approved, implementation target date is December 2016.

2013-002b - The Governor’s 2015 Budget includes a Certificate of Participation (COPS) funding request to finance information technology projects for system and application upgrades including a budgeting, forecasting, and grants management module.

The Grants Management Office will work with the Office of Accounts and Controls and the related agencies to ensure that CFDA numbers are properly coded in RIFANS.

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

Anticipated Completion Date: CFDA validation complete April 2014. Business process alignment and training is ongoing.

Contact Person: Laurie Petrone, Director, Grants Management Phone: 401.574.8423
Finding 2013-003 (material weakness - repeat finding)

MEDICAL ASSISTANCE PROGRAM – PROGRAM OVERSIGHT AND MONITORING

The Executive Office of Health and Human Services (EOHHS) is responsible for the administration and oversight of the State’s Medicaid program and accordingly must have sufficient personnel to meet that responsibility. As departmental resources have declined over time, the State has used its fiscal agent and other contractors to perform various program operations. 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.

We noted significant control deficiencies that are, at least in part, caused by insufficient personnel resources allocated to effectively administer and monitor these aspects of the program:

- **Contracted Program Functions** – EOHHS, as the Single State Medicaid agency, uses numerous consultants and contractors within the operation and administration of the Medicaid Program. However, EOHHS’s program oversight and monitoring responsibilities remain which require a dedication of personnel resources currently lacking. EOHHS is responsible for the consideration and documentation of internal controls over significant program operations (i.e., program eligibility, contract compliance, and provider payments, as examples). Due to the size and complexity of the Medicaid program, the State should consider additional personnel resources specifically dedicated to this function in addition to EOHHS’s other program integrity operations.

- **Program operations administered by other State departments and agencies** – A significant volume of services are paid through Medicaid for (1) children in the State’s custody, (2) developmentally disabled adults, and (3) various CNOM programs (costs not otherwise matchable under Medicaid) operated by the Department of Children, Youth, and Families (DCYF), the Department of Behavioral Healthcare, Developmental Disabilities and Hospitals (BHDDH), and other State agencies. Material control weaknesses have been identified over these program areas.

- **Long-term Care Facility Audits** – EOHHS has not performed nursing home field audits and is significantly behind in conducting required desk audits to ensure timely adjustment of nursing home per diem rates.

- **Controls over Recipient and Provider Eligibility** – EOHHS’s inability to conduct timely Medicaid Eligibility Quality Control (MEQC) reviews weakens controls over recipient eligibility.

- **Surveillance Utilization Review Services (SURS)** - In 2013, we observed that inadequate staffing at the fiscal agent’s Surs unit had caused many Level III cases, those with the potential to involve fraud and/or abuse, to remain unresolved for extended periods. In addition, fiscal agent personnel dedicated to the State’s Medicaid Surs function have been utilized to assist EOHHS with other programmatic responsibilities causing resources specifically dedicated to Surs to be insufficient.

The State must allocate adequate personnel resources to ensure proper oversight and control over program expenditures that approximated $2.1 billion in fiscal 2013. Sustained reductions in personnel resources in key program areas continue to negatively impact control over program expenditures and compliance with federal program requirements.
RECOMMENDATIONS

2013-003a  Address personnel resource deficiencies in critical program areas to ensure proper administration of and control over the Medicaid program.

2013-003b  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:

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

- **Contracted Program Functions**– The Office of Policy and Innovation has hired an Administrator who has responsibility for the oversight of the fiscal agent contract as well as the systems integrator vendor hired to build and implement the new eligibility system. The Administrator is in the process of hiring two new chiefs and will ultimately have a staff of five FTEs dedicated to oversight of the systems supporting our business.

- **The Office of Health Care Programs (Medicaid)** has traditionally been responsible for the oversight and monitoring of contracts with managed care organizations. While this oversight and monitoring is supported by contracted personnel, ultimate responsibility lies with state staff. State personnel are actively engaged in these monitoring and oversight efforts. Both the Office of Policy and Innovation and Health Care Programs are supported by the efforts of the Office of Program Integrity.

- **Program operations administered by other State departments and agencies** – EOHHS has undertaken a review of the inter-agency Service Agreements with each agency and will use the exercise to strengthen these agreements with other State departments and agencies. The development and work of the EOHHS Office of Program Integrity greatly enhances EOHHS' ability to monitor other Departments' compliance with State and Federal requirements.

- **Long-term Care Facility Audits** – For the following reasons, performing field audits on a sampling of nursing homes for fiscal years 2008, 2009 and 2010 is not considered needed.

  - The desk audit process/review is detailed and field audits are unlikely to result in additional findings of a material nature;
  - The cost of training personnel, (contractors or State employees) and conducting field audits will further reduce, if any, the net financial benefit;
  - Conducting field audits on cost report four to six years old will be difficult and disruptive to the facilities selected; and
  - The results of any field audits will have no impact on current payment rates.

All desk audits reviews for 2008 have been completed and facilities have been or are being sent out for review. Desk audits for 2009 are being finalized for review by each facility. Completion is expected by the end of FY '14. Additional staff will not alter this time frame. Desk audits for 2010 are underway with the objective of completing them by the end of
calendar 2014. Training additional staff for this purpose will only take away from the time currently being spent on the desk audits.

- Controls over Recipient and Provider Eligibility – DHS accepts the recommendations of the report and we will look to add additional staff. We recently hired an MEQC Supervisor. This employee will be working with EOHHS to develop and establish protocols to meet new federal requirements regarding the implementation of the Affordable Care Act as well as federal requirements in place currently. DHS and EOHHS will take steps to determine the federal point of contact for any submission of MEQC data.

- Surveillance Utilization Review Services (SURS) - EOHHS’ fiscal agent has begun recruitment for a local (on-site) SUR nurse. During this recruitment period, EOHHS will utilize the fiscal agent’s medical management capability group to allocate an experienced SUR nurse to review and complete the Level III cases currently pending a “reviewer” assignment. Level III cases will be presented at the newly established Program Integrity bi-monthly meetings. All cases under active review will be discussed at this meeting to agree upon prioritization, ensuring timely action on all Level III cases.

Anticipated Completion Date: To be determined

Contact Person: Alda Rego, Chief Financial Officer
Phone: 401.462.1834
2013

Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

Information Systems Security
Finding 2013-004  (material weakness - repeat finding)

COMPREHENSIVE INFORMATION SYSTEMS SECURITY POLICIES AND PROCEDURES

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

The oversight and management of the State’s information security program relies upon the implementation of DoIT’s comprehensive information systems security plan that was finalized during fiscal 2006. The information systems security plan consists of detailed policies, procedures, standards, and guidelines that are designed to safeguard all of the information contained within the State’s critical systems. 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.

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

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

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

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

RECOMMENDATIONS

2013-004a Complete an initial assessment of compliance with systems security standards for the State’s mission critical systems.
2013-004b Consider contracting for the performance of IT security compliance reviews and accumulate and make use of available Service Organization Control reports, whenever available, to extend IT security monitoring of critical systems.

2013-004c 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.

2013-004d Require systems security certification procedures to be performed by DoIT prior to any significantly modified application systems becoming operational.

Corrective action plan / auditee views:

2013-004a - 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.

Anticipated Completion Date: Ongoing

2013-004b - DOIT will be adding additional MPA 230 security roles in the next MPA 230 RFP. These roles will allow for DOIT to procure additional security staff and also procure staff on fixed price deliverables to perform such audits. Funding would still have to be secured to proceed with having external organizations perform security audits.

Anticipated Completion Date: TBD

2013-004c - The preparation a corrective action plan is also resource dependent and funding depending.

Anticipated Completion Date: TBD

2013-004d - Currently, all new projects come through the PRC (Project Review Committee). Any new project that gets approved must provide the Chief Information Security Officer (CISO) a written security plan for review and approval.

DOIT now requires that all new systems and major changes require security plan signoff by the CISO. However, due to limited staff, we are not able to be retroactive in review systems already in place and provide a certification.

Anticipated Completion Date: Ongoing

Contact Person: Kurt Huhn, Chief Information Security Officer
Phone: 401.462.9292
INFORMATION TECHNOLOGY (IT) SYSTEMS - PROGRAM CHANGE CONTROLS

Procedural Issues

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

Within the State, there are a number of agencies who have mature, complex application systems that periodically need maintenance and/or code changes made to them. These customized, home-grown applications require a robust formalized change management system in order to properly control changes made to them.

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

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

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 – Enterprise-wide

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

A proper change management process should be in place to ensure that authorized, tested and accepted changes be implemented in a timely and efficient manner. The process should be a standardized, repeatable process that documents all movement of code, changes made, testing,
Program Change Control – Current Operational Issues

In response to prior audit recommendations regarding this subject dating back to fiscal 2007, DoIT has attempted to implement software designed to better maintain and control application system changes. However, for various reasons, the products selected were never properly configured and implemented to fully utilize their control features. Instead of making the program change process more efficient and productive, the process continued to be a cumbersome and time-consuming process that could circumvent DoIT’s change control policy and procedural guidance.

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

DoIT should implement a standardized formal enterprise program change control process for the application systems it supports. The program change process should provide a comprehensive, standard method and process-to-process application system changes throughout the enterprise. To assist this process, DoIT should evaluate enterprise software solutions to complement their program change process. The evaluation process should determine the appropriate combination of operational, procedural and/or technical adjustments required to use the package in a manner that results in adequate and repeatable program change control across the entire enterprise.

In addition, once a process and software package have been selected and implemented associated procedural guidance should be developed that provides detailed information pertaining to the specific activities required of DoIT support staff in order to accomplish meaningful and controlled change management. This type of guidance would provide DoIT personnel with detailed instructions pertaining to the development and correct use of change management software and mandated internal control practices and procedures, thus ensuring a documented, monitored, and repeatable process.

RECOMMENDATIONS

2013-005a Reassess the use of a standard software package to determine the appropriate combination of operational, procedural and/or technical adjustments required to use the package in a manner that results in adequate program change control for the entire enterprise.

2013-005b Design, develop, formalize and implement procedural guidance manuals detailing specific requirements for program change control and disseminate and train DoIT support staff in its proper execution.

Corrective action plan / auditee views:

2013-005a - Due to resources leaving DOIT, we have been unable to improve this environment and roll out a better change management processes. We have started the process of reviewing our options with other product lines or upgrading the current product line. We will be submitting
a request to get funding for upgrades or migration to another suite through. Funding is available for IT initiatives through a technology fund. Our request will be reviewed by a committee.

The Department of Labor and Training is also addressing issues with change management in their audit finding, 2013-16. 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 serve DOIT/DLT and other agencies.

2013-005b - This finding will be addressed when a new product line or upgrade for the current change management is selected.

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

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

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

**Phone:** 401.222.6091

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**Finding 2013-006**

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

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

**RIFANS “Super Users”**

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

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

**Agency Hierarchies**

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

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

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

During fiscal 2013, RIFANS had not activated a “versioning” functionality - the storing of data at a series of snapshots in time, rather than overwriting updates to the previous version. Accordingly, the system could not retroactively access the data tables that existed at a prior point in time, nor log the changes for ease of monitoring. After fiscal year end, the State activated the “versioning” functionality for certain hierarchies within RIFANS; however, this should be expanded along with a reporting and monitoring process.

RIFANS Delegated Authority

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

RECOMMENDATIONS

2013-006a Review activities of privileged users (system administrators) on a scheduled basis to ensure that additions, modifications, and deletions initiated by them are appropriate.

2013-006b Improve controls over RIFANS access by developing the reporting functionality necessary to allow for periodic monitoring of user access for instances of unauthorized changes to user access and/or noncompliance with policies relating to delegated user access.

Corrective action plan / auditee views:

2013-006a - We are currently investigating whether version 12 of our E-Business Suite has any new functionality that will allow us to meet this finding. We have outsourced this finding to an Oracle contractor for investigation and a report will be due by end of this year by the contractor.

2013-006b - DOIT has implemented certain changes to the responsibilities of privileged users in RI-FANS in FY2012. These changes included creating a new responsibility with additional restrictions to limit functions performed.

With the recent upgrade to Oracle E-Business Suite 12, we will explore the new auditing features Oracle has built in this release for auditing. Based on those finding will implement those features to address 2013-6b. We have also assigned this finding to an Oracle contractor for investigation and a report will be due by end of this year by the contractor.
Anticipated Completion Date:     December 31, 2014
Contact Person:                  Alan Dias, Assistant Director of IT
                                  Phone: 401.222.6091
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.

Approximately 92% of the State’s tax revenues are received electronically (through either ACH debit/credit or lock-box receipts). Funds are deposited automatically into the State’s bank accounts 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.

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.

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

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

RECOMMENDATIONS

2013-007a Perform a “data classification” review consistent with DoIT policy to ensure the proper level of data protection (e.g. encryption) is in place.
2013-007b Secure all electronic files containing taxpayer information residing on the Division of Taxation’s network to ensure data integrity.

2013-007c 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.

2013-007d Develop monitoring and reporting procedures to ensure the proper upload of data files.

Corrective action plan / auditee views:

2013-007a - 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.

**Anticipated Completion Date:** N/A

2013-007b - In the new Division of Taxation system, electronic files will be encrypted and stored on our network and then loaded into an encrypted database where it will reside. Then it will be removed from the network.

**Anticipated Completion Date:** July 2014

2013-007c - 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.

In the new Division of Taxation system, electronic files will be processed through an encrypted file on our FTP server. Then it will be loaded into STAARS and all adjustment will be made after it is loaded into STAARS.

**Anticipated Completion Date:** July 2014

2013-007d - In the new Division of Taxation system reports will be generated to ensure the files are processed correctly.

**Anticipated Completion Date:** July 2014

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

**Phone:** 401.574.8922
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 2012 were due February 28, 2013. During fiscal 2013, W-3 paper returns for tax years through 2012 were posted to the mainframe system. However, as of June 30, 2013, the system-generated W-3 reconciliation returns for tax years 2010, 2011, and 2012 had not yet been posted. The backlog in posting W-3 reconciliation returns delays identifying potential overpayments and underpayments of employer withholding taxes.

RECOMMENDATION

2013-008a Process W-3 reconciliation returns timely to identify any underpayment of employer withholding taxes.

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

2013-008b Include refund carry-forward returns within the management refund review control procedures.

Corrective action plan / auditee views:

2013-008a - The Division of Taxation will look to dedicate additional resources to this project. However, the Division of Taxation’s new system will automate this process and allow the Division to more timely process the W-3s.

Anticipated Completion Date: September 2014

2013-008b - The Division of Taxation updated the personal income processing system to include carry-forwards to the management report. This change was implemented in October 2013.

Anticipated Completion Date: N/A

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922
Finding 2013-009  (material weakness - repeat finding)

DEPARTMENT OF REVENUE – RECONCILIATION OF TAXATION RECEIPTS TO RIFANS

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

RECOMMENDATION

2013-009 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: Release I-July 2014 (fully implemented September 2016)

Contact Person: David Sullivan, Tax Administrator
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Finding 2013-010  (material weakness - repeat finding)

DEPARTMENT OF REVENUE – PERSONAL INCOME TAX - CONFIDENTIAL COMMUNICATION

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

Finding 2013-011  (material weakness - repeat finding)

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

A finding concerning the IT governance and security of the Division of Taxation’s information systems was communicated confidentially due to the potential impact on taxpayer compliance.
2013

Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

Department of Transportation
IST Fund
FINANCIAL REPORTING – INTERMODAL SURFACE TRANSPORTATION FUND – USE OF RI DEPARTMENT OF TRANSPORTATION (RIDOT) FMS AND RIFANS ACCOUNTING SYSTEMS

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

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

- RIDOT FMS and RIFANS each utilize separate and distinct account structures, which necessitates mapping to “crosswalk” the two charts of accounts.
- Since no direct interface exists between the two systems, transmission files are utilized to transfer expenditure data between the RIDOT FMS and RIFANS to disburse vendor payments. Timing differences exist and have to be identified as part of the reconciliation process.
- RIDOT establishes and maintains purchase order balances on a detailed line item basis for the entire project duration; purchase order balances in RIFANS are in summary form and only for the amount expected to be expended during that fiscal year.
- Expenditures are recorded in the RIDOT FMS after disbursement in RIFANS; expenditures are recorded in RIFANS when entered and approved for payment.
- RIDOT FMS tracks activity at the project level as this is the level at which funding sources (e.g., federal, state and other) are determined and infrastructure or maintenance categorizations are made. RIFANS accumulates activity at the major program level (e.g., interstate highways).

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

Due to the use of two separate accounting systems, RIDOT has implemented a process of reconciling RIDOT FMS to RIFANS on a monthly basis, as a control, to ensure both systems accurately reflect RIDOT activity. Specific areas of the reconciliation process have been automated but the cause for differences must be manually identified and corrected in the appropriate system. In fiscal 2013, RIDOT did not accurately identify and explain variances between RIDOT FMS and RIFANS on a monthly basis. This is caused by an upgrade to RIFANS in fiscal 2012, which affected the report used in
the RIDOT reconciliation process. RIFANS does not currently provide the detail needed to identify variances between the accounting systems.

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

RECOMMENDATIONS

2013-012a 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.

2013-012b Ensure the reconciliation process includes the reconciliation of fund balance. At a minimum, modify the reconciliation report or process so the department can accurately identify any variances that exist in the two accounting systems.

Corrective action plan / auditee views:

2013-012a - The Department intended to engage a management consultant during FY 2014 to conduct a high level review of the following key issues:

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

2. An analysis of the costs, time frames, technical expertise, and RIDOT staff resources necessary to accomplish each of the options, other than status quo, outlined in #1 above.

However, budgetary constraints have prevented the Department from engaging a consultant to perform this review.

It must also be emphasized that implementing any of the options, other than status quo, will require an investment of significant State funds, which are also currently unavailable because of the aforementioned budgetary constraints.

Additionally, at such point in the future that monetary resources may become available, the dedication of significant staff resources (i.e., RIDOT Financial Management Office, State Controller’s Office, DOIT, etc.) will be required, as well as a commitment that this initiative will be a top priority for the duration of the project.

Anticipated Completion Date: To be determined

2013-012b - Financial Management continues to work with MIS to restore the reconciliation report that was affected by the RIFANS upgrade to Oracle version 12. The department has made significant progress in creating a report capable of identifying all material variances that exist
between the two accounting systems. It is estimated that this report will be in place by the end of calendar 2014.

**Anticipated Completion Date:** December 31, 2014

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

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**Finding 2013-013**  
*(significant deficiency - repeat finding)*

**INTERMODAL SURFACE TRANSPORTATION FUND - FINANCIAL REPORTING**

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

**Controls over the Preparation of Financial Statements**

Controls can be improved over the preparation of financial statements to ensure consistent and accurate reporting of fund activity in accordance with generally accepted accounting principles. Several account balances reflected in the fiscal 2013 draft financial statements required material adjustment due to weaknesses in controls over financial reporting as described below:

- Controls over the reporting of accounts payable, other liabilities and amounts due from the federal government can be improved to ensure all material amounts are included in the financial statements. RIDOT’s process to accumulate accounts payable is manually intensive and therefore susceptible to omission, duplication or incorrect posting of payables.

- Controls over estimating and recording the pollution remediation liabilities at fiscal year end can improve by documenting the estimation process and maintaining support for the resulting liabilities recorded.

- Journal entries were recorded within the IST Fund without review or approval by RIDOT financial managers. The RIFANS approval hierarchy requires RIDOT’s supervisory approval of journals prior to posting; however, at least six material journal entries were posted without RIDOT approval. We also found that IST Fund journal entries could be posted by other departments without RIDOT’s review and approval. Additionally, we found the dollar threshold triggering review and approval was too high in certain instances.

- The IST Fund financial statements include three separate funds (IST, GARVEE, and I-195 land sale revenue). The operating transfers between the three funds are eliminated for financial statement reporting purposes; however this adjustment was not made and required audit adjustment.

- Controls over the reporting and accounting for the Mission 360 loan program can be improved by documenting the department policies, procedures and controls. In prior years, this loan program was administered by a consultant on behalf of the department but has been recently taken over by the Department. An audit adjustment was required to record the loan program in the financial statements.
Multiple activities and funding streams are included within the IST Fund. Although combined for financial reporting purposes, each activity or funding stream requires separate analysis to ensure amounts are accurately reported. Classification of fund balance by category – nonspendable, restricted, committed, assigned, and unassigned - is dependent upon the analysis of each activity and/or funding stream. Our analysis discovered misclassification of various fund balance categories. RIDOT should improve its controls over the reporting of fund balance by analyzing activity and funding stream components periodically throughout the fiscal year.

RECOMMENDATIONS

2013-013a Strengthen control procedures over financial reporting to ensure accurate identification of accounts payable, amounts due from the federal government, and classification of fund balance categories.

2013-013b Improve controls over the Accounts Payable journal entry process by documenting the policies and procedures for estimating and recording the pollution remediation liability at year-end and maintaining documentation supporting the liability.

2013-013c Improve controls over financial reporting by updating the RIFANS hierarchy to include RIDOT in all journals posted to the IST Fund and lower the dollar threshold requiring journal entries to be reviewed and approved to an amount that could not materially misstate the financial statements. Ensure RIFANS is requiring review and approval of journal entries in accordance with established hierarchies.

2013-013d Improve controls over operating transfers by modifying the Oracle financial statement generator to net the operating transfers between the RIFANS funds reported in the IST fund for financial statement purposes.

2013-013e Improve controls over financial reporting by documenting the department’s policies, procedures and controls over the Mission 360 loan program.

2013-013f Analyze each activity and/or funding source within the IST Fund to ensure activity is accurately recorded and to improve controls over the categorization and reporting of fund balance components. Perform the analysis periodically throughout the fiscal year.

Corrective action plan / auditee views:

2013-013a - Financial Management will continue to strengthen the control procedures over financial reporting to ensure accurate identification of accounts payable, amounts due from the federal government and classification of fund balance categories.

To better address this financial reporting finding, as well as the infrastructure accounting issues identified in findings 2013-14a through 2013-14f, the RIDOT Financial Management Unit filled a senior-level accounting position in January 2014 to assist in implementing these corrective actions.

Anticipated Completion Date: December 31, 2014
2013-013b - Financial Management will document the policies and procedures for estimating and recording the pollution remediation liability at year-end and maintaining documentation supporting the liability.

Anticipated Completion Date: December 31, 2014

2013-013c - RIDOT will work with the Controller’s Office to determine whether the RIFANS hierarchy can be revised to include RIDOT in all journals posted to the IST Fund and lower the dollar threshold requiring journal entries to be reviewed and approved to an amount that could not materially misstate the financial statements.

Anticipated Completion Date: December 31, 2014

2013-013d - Financial Management will better coordinate efforts with the Controller’s Office to ensure the appropriate accounting treatment for operating transfers between the RIFANS funds reported in the IST Fund for financial statement purposes.

Anticipated Completion Date: December 31, 2014

2013-013e - Financial Management will document the policies, procedures, and controls governing financial reporting related to the Mission 360 program.

Anticipated Completion Date: June 30, 2014

2013-013f - Financial Management will analyze the components of fund balance more frequently during the fiscal year.

To better address this financial reporting finding, as well as the infrastructure accounting issues identified in findings 2013-014a through 2013-014f, the RIDOT Financial Management Unit filled a senior-level accounting position in January 2014 to assist in implementing these corrective actions.

Anticipated Completion Date: December 31, 2014

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

**Finding 2013-014 (material weakness - repeat finding)**

**TRANSPORTATION INFRASTRUCTURE REPORTING**

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

**Process to Accumulate Infrastructure Outlays**

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

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

We noted misstatements relating to the infrastructure balances initially reported for fiscal 2013. Certain completed projects totaling $16.8 million were still included in construction in progress and $2 million was excluded from construction in progress at June 30, 2013. Although corrected through audit adjustment, these misstatements indicate that controls should be improved to capitalize all infrastructure expenditures and more accurately identify when infrastructure assets are placed in service.

We also determined that RIDOT had not included internal payroll costs related to construction projects as infrastructure costs since fiscal year 2006. This required material adjustment to the infrastructure balance report for fiscal 2013; payroll cost for fiscal year 2013 totaling $17 million and a prior period adjust for associated payroll costs from fiscal 2006 through 2012 totaled $83 million.

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 2013-12 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 leads to the inefficient and error-prone spreadsheet approach.

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

Asset Impairments

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

RECOMMENDATIONS

2013-014a Develop controls over the identification of project expenditures (to include construction costs, design costs, internal payroll, subtotaling of project expenditures, categorization of projects and reconciling between RIDOT FMS and RIFANS) to be recorded as infrastructure investment in the State’s financial statements.
<table>
<thead>
<tr>
<th>Action Plan</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013-014a</td>
<td>Improve controls and the methodology for determining when infrastructure assets are placed in service.</td>
</tr>
<tr>
<td>2013-014b</td>
<td>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.</td>
</tr>
<tr>
<td>2013-014c</td>
<td>Develop and document controls, policies and procedures to ensure inclusion of internal construction payroll costs in infrastructure investment in the State’s financial statements.</td>
</tr>
<tr>
<td>2013-014d</td>
<td>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.</td>
</tr>
</tbody>
</table>

**Corrective action plan / auditee views:**

2013-014a - Financial Management will continue to improve controls over the identification of project expenditures to be recorded as infrastructure investment in the State’s financial statements.

**Anticipated Completion Date:** December 31, 2014

2013-014b - For FY 2013, Financial Management utilized the date of substantial completion identified on RIDOT’s “Substantial Completion and Request for Partial Acceptance / Final Inspection” form as the basis 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 recognizes that, from time to time, traffic can already be utilizing infrastructure assets prior to the date of substantial completion identified on RIDOT’s “Substantial Completion and Request for Partial Acceptance / Final Inspection” form. However, the department believes that utilizing this form provides both consistency and documentation of the date that infrastructure assets are substantially complete, as opposed to a more manually-intensive, and potentially more subjective, approach that would require tracking the date that the motoring public was first able to utilize the asset.

2013-014c - The Department does not dispute the auditors’ contention that a properly-aligned, automated systems approach would be a more efficient way to account for infrastructure assets. An internal RIDOT Asset Management Council meets regularly to continue implementing the department’s comprehensive Asset Management initiative, including assessing information technology needs.

One of the Council’s standing subcommittees is charged with evaluating infrastructure accounting issues, and will evaluate an automated systems approach.

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

2013-014d - Financial Management will develop and document controls, policies and procedures to ensure inclusion of internal construction payroll costs in infrastructure investment in the State’s financial statements.
Anticipated Completion Date:  August 31, 2014

2013-014e - The RIDOT Financial Management Unit intended to establish, on or before June 30, 2013, an impairment policy that conforms with the criteria outlined in generally accepted accounting principles applicable to governmental entities; however, the RIDOT Financial Management Unit was only recently (i.e., January 2014) able to fill a senior-level accounting position to assist in implementing corrective actions.

Anticipated Completion Date:  June 30, 2014

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

Finding 2013-015 (significant deficiency - repeat finding)

INTERMODAL SURFACE TRANSPORTATION (IST) – CONTROLS OVER KEY DATA FILES

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

Progress Payment Data Files

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

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

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

Intermodal Surface Transportation Fund – Federal Billing

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

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

- The file is in an open text format with no encryption. This open text format allows anyone who has access to the server directory to modify the file.
There is no change management system in place tracking changes to the file, documenting who made the change, or requiring management approval of changes.

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

RECOMMENDATIONS

2013-015a  Review the progress payment file transfer process to identify critical points where automated controls could be implemented to eliminate the need for manual intervention.

2013-015b  Create and implement appropriate approval hierarchies. Automatically identify RIFANS/FMS payment discrepancies for review.

2013-015c  Improve controls over the RIDOT federal billing process to include transferring files without modification.

2013-015d  Modify the Financial Management System to allow for multiple funding source award numbers (FSAN) to be linked to one Federal Aid Project.

Corrective action plan / auditee views:

2013-015a - Discussions and analysis will continue regarding the potential implementation of automated controls in lieu of the manual intervention currently required in certain situations. Manual intervention can occur for a variety of reasons, and budgetary constraints are a limiting factor for the Department’s ability to automate the process.

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

Anticipated Completion Date: To be determined

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

2013-015b - Approval Hierarchies will need to be reviewed during the FMS system upgrade to Oracle Release 12. Accounts Payable workflows will be implemented during the Release 12 upgrade. Also, existing reports have been modified to determine discrepancies in invoice payment amounts between FMS and RIFANS. Budgetary constraints have delayed the upgrade to Oracle Release 12, but RIDOT is hopeful that funding will be identified in the near future. It is currently estimated that the Oracle Release 12 upgrade will cost approximately $1.3 million.

Should the funding be found, the upgrade will consume considerable staff resources and time, and will need to be a top priority. As a result, there will be an impact on operations during the time period that the Oracle Release 12 upgrade is implemented.

Anticipated Completion Date: December 31, 2015

Contact Person: Thomas Lewandowski, Agency IT Manager
Phone: 401.222.6935
2013-015c - It is currently not possible to modify FMS to accommodate ‘no changes’ to the text file. Federal Highway is aware that manual file modification is necessary to change the program codes on occasion in order to bill the proper code. To be able to effect such a change to FMS would require a major modification to the program. This issue has been discussed at length with Tom Lewandowski of RIDOT’s IT section and he has cautioned that this type of customization would likely void the support received from ORACLE.

Anticipated Completion Date: To be determined

Contact Person: John Megrdichian
Administrator for Financial Management
Phone: 401.222.2496

2013-015d - To be able to effect such a change to FMS would require a major modification to the program. We have discussed this at length with Tom Lewandowski of our IT section and he informs us that any such customization would void the support received from ORACLE.

Anticipated Completion Date: To be determined

Contact Person: John Megrdichian
Administrator for Financial Management
Phone: 401.222.2496
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
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 DLT’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, memoranda, and paper-based forms to document and control the program change process. There is no automated control system that can be queried to report pertinent information regarding changes made to the various applications. 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 on all application program changes made by the DLT programming staff is a control weakness in financial reporting for the Employment Security Fund.

RECOMMENDATION

2013-016 Implement an automated program change management process over DLT computer applications. Coordinate with DoIT to implement the approved and supported State Enterprise Change Management solution.

Corrective action plan / auditee views:

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 identify new tools and implement these tools to meet the requirements. This finding will be addressed with finding 2013-5a

Anticipated Completion Date: June 30, 2015

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

Employees’ Retirement System Pension Trust Funds
EMPLOYEES’ RETIREMENT SYSTEM - INVESTMENT ACCOUNTING

The Employees’ Retirement System’s (System’s) investments are held by an independent custodian who also maintains all the accounting records related to those investments including the reporting of investment income and expenses. For financial reporting purposes, summarized information is recorded at the close of the fiscal year based on information provided by the custodian. Due to this arrangement, the System is reliant on the controls and accounting records maintained by the custodian.

Understanding and monitoring the activities of the investment custodian is a critical control area, particularly when the custodian’s records are the only accounting records maintained. We found that the System can improve its understanding and oversight of the custodian’s accounting policies, controls, and procedures to ensure investment transactions are reported on the System’s financial statements consistent with its accounting policies.

The System transferred its investments to a new custodian effective November 1, 2012. We found that the new custodian (1) recorded certain transactions differently than the prior custodian and (2) certain other transactions required reclassification. The System accepted our proposed audit adjustments, which reclassified $3.1 million to the financial statement line item “investment expense” from “net appreciation in fair value of investments”. While these situations are partly attributable to transitioning to a new investment custodian, we believe the System should enhance its monitoring controls over the custodian’s accounting and reporting of transactions to allow timely identification and correction of variances or errors.

There is a substantial volume of information provided on the System’s investments by each of the various investment managers engaged by the State Investment Commission as well as the System’s investment custodian. We observed that the review and reconciliation of such information to the custodian’s records could be improved with the goal, among others, of providing enhanced documentation for financial reporting purposes.

Additionally, investment staff overseeing the System’s investment portfolio is organizationally separate from the Retirement Division and consequently independent from the accounting and financial reporting processes of the Division. This contributes to a split responsibility for (1) information included within the System’s financial statements and (2) the design and operation of key controls over financial reporting.

These organizational areas should be better integrated to enhance controls over financial reporting with regard to investments and related disclosures. This includes ensuring that those individuals responsible for preparing the System’s financial statements in accordance with generally accepted accounting principles include important investment activities within that scope of work.

RECOMMENDATIONS

2013-017a Enhance the understanding and monitoring of the accounting and reporting activities performed by the System’s investment custodian.

2013-017b Enhance controls over financial reporting by better integrating responsibility for the investment cycle with all other System activities.
Corrective action plan / auditee views:

During Fiscal 2013 Treasury converted to a new custodian on November 1, 2012, saving the system more than $300,000 annually. We had maintained a relationship with our prior custodian for 25 years, and mechanical and accounting processes had been worked out and refined over time.

Our custodian provides the accounting function for our investments. To supplement the custodian, staff has a thorough process to review activity on a monthly basis. Further, in the case of private equity and real estate transactions, we reconcile transactions with the custodian bank (Bank of New York Mellon) and the consultants (Cliffwater for private equity and Pension Consulting Alliance for real estate) in a three-way reconciliation.

During the set-up process with Bank of New York Mellon (BNY), we reviewed the methods of recording and valuation of our investment partnerships. There are three widely accepted methods for accounting: cost method, equity method, and hybrid method. With the previous custodian, we had used a hybrid method. At inception with BNY, we elected to use the cost method. This method is used by 65% of BNY’s clients because it allows BNY to reconcile with the consultant and partnerships in the most efficient way. The cost method is the accounting method used by both the partnerships and consultant; it is fully GAAP compliant.

At no time was the bottom-line valuation of the partnerships different from that of the hybrid method, meaning that the pension fund’s balance and performance were always properly recorded. There was no change to the bottom line. As is the case with the cost method, those expenses are realized as a component of the realized and unrealized losses of the partnership (It is considered a loss because at the time of payment these transactions are recorded as purchases and later reclassified).

Based on the concerns of the Auditor General, we have switched to the hybrid method, an accounting treatment used by only 4% of BNY clients. Under the hybrid method, the custodian will post management fees and partnership expenses in the “fees and expenses” category on a quarterly basis when they reconcile valuations. Remaining valuation adjustments, including indirect fees, will be posted to unrealized gains and losses. For the January 2014 statements, the first quarter of fy14 will be reconciled and expensed accordingly. Due to timing of quarterly reconciliations, the fees for fiscal fourth quarter will be accrued and subsequently reversed.

Staff continues to enhance its understanding and monitoring of the accounting and reporting activities of the System’s investment custodian. We also continue to work closely with the Retirement accounting department and its additional staff to ensure the most accurate representation and categorization on the financial statements.

Anticipated Completion Date: Ongoing

Contact Persons: Anne-Marie Fink, CIO
Zachary Saul, Director of Finance
Phone: 401.462.7650
Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

Component Units

(findings reported by the auditor of each component unit)
Finding 2013-018  
(material weakness – new finding)

CENTRAL FALLS SCHOOL DISTRICT – SEGREGATION OF DUTIES

The School District’s current internal control procedures over financial reporting has resulted in the lack of segregation of duties in certain areas, which is a weakness in internal controls.

The Staff Accountant has the responsibility for maintaining the general ledger for all funds, including reconciling all cash accounts, the authorization and posting of bi-weekly payroll, recording all cash receipts, preparing and posting journal entries and preparing all the trial balances for the year-end audit. The Staff Accountant also assumed additional authorization and approval responsibilities at times during the fiscal year when the Finance Director’s position was vacant. The internal control system does not include formal procedures that require the Finance Director’s review and approval of journal entries, reconciliations and financial reports.

The Staff Accountant’s responsibilities should not include the initiating, authorization and recording of transactions. The current responsibilities of the Staff Accountant and the lack of a formal policy requiring approval of all reconciliations, journal entries and the review of all financial reports results in a lack of segregation of duties and as a result a weakness in internal control.

RECOMMENDATION

2013-018 We recommend that the School District review the current job responsibilities of the Staff Accountant and reassign those responsibilities that result in a lack of segregation of duties. We also recommend that the School District implement formal procedures that require the Finance Director to approve all journal entries and review on a periodic basis all reconciliations and financial reports.

Corrective action plan / auditee views:

The District has begun the process of reviewing the duties of all finance staff inclusive of the Finance Director. Once completed, duties will be reassigned amongst staff members as necessary to better segregate duties. Additionally, staffing changes may occur based on internal control requirements and District needs. An internal control policy will be drafted to include the following duties of the Finance Director: The Finance Director will have final approval on all journal entries, approve all reconciliations performed by staff members, and review and approve financial reports on a monthly basis.

Contact Person: Brad Peryea, Central Falls School District
Phone: 401.727.7700 x25112

Finding 2013-019  
(material weakness - repeat finding)

CENTRAL FALLS SCHOOL DISTRICT – CAPITAL ASSETS

The School District does not have formal policies and procedures and an accounting system in place to properly maintain and account for their capital assets on a perpetual basis. Although a list of capital assets and depreciation expense were prepared as of June 30, 2013, the list was prepared after year-end. The School District does not have procedures in place to maintain the list of capital assets on a perpetual basis or to provide for the periodic physical inventory of the capital assets.

RECOMMENDATION
2013-019 We strongly recommend that the School District implement policies and procedures and utilize the Unifund capital asset accounting system to account for the addition and deletion of capital assets and related depreciation expense, throughout the year. We also recommend that the School District perform an inventory of the capital assets and compare it to the list of capital assets at least annually. This will ensure proper recording and safeguarding of capital assets.

Corrective action plan / auditee views:

The District has engaged a third party to inventory all capital assets. This inventory was completed after the close of fiscal year 2013. As soon as the final report is received, information will be entered into Unifund. All District assets will then be reviewed regularly to account for asset additions and deletions, along with the recording of all necessary depreciation expenses.

Contact Person: Brad Peryea, Central Falls School District
Phone: 401.727.7700 x25112

Finding 2013-020 (material noncompliance - repeat finding)

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

During the fiscal year ended June 30, 2013, the Convention Center Authority was unable to fund the Operating Reserve and Renewal and Replacement components of its restrictive covenants pursuant to the bond indentures.

Corrective action plan / auditee views:

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

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

Finding 2013-021 (material weakness - new finding)

RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – IMPLEMENTATION OF OPEN ROAD TOLLING AND NEW BACK OFFICE SYSTEM

During June 2012, the Authority placed into service open road tolling (ORT) lanes. Transactions related to ORT activities (for example, tolls and violations) were captured and reported by an in-house system developed by a third-party service provider. The Authority contracted with an additional third party to bill and collect violation tolls and fees. In July 2012, the contract with the billing contractor was terminated. In connection with that action, in August 2012, the Authority contracted with a new third-party billing service provider to process invoices for violations using information obtained from the newly developed in-house system. However, invoices for violations were not processed by the billing service provider until October 2012 due to the in-house system’s inability to communicate to, or receive
from, the billing service provider information related to the violation billings. Consequently, financial transactions related to ORT violation transactions were not recorded in the Authority’s accounting records as they occurred, violators were not billed timely, and controls could not be implemented to determine whether transactions were accurately and completely recorded.

The Authority used a third party to capture and report all E-ZPass transactions, including ORT E-ZPass transactions, through mid-June 2013, at which time the Authority terminated its contract with the third party. The reports generated by the service provider were used to report financial transactions in the Authority’s books and records and to facilitate the settlement of receivables from and payables to other states related to E-ZPass transactions. As part of its contract with the in-house developer, the Authority contracted with the in-house developer to develop an in-house back office system (the Back Office System) to capture and report all E-ZPass transactions, including ORT violations, and to facilitate the (i) recording of transactions in the Authority’s accounting records; (ii) settlement of receivables from other states for E-ZPass transactions; and (iii) billing of violations related to ORT transactions. The Back Office System was not adequately tested in an IT test environment by users prior to its implementation, and the system did not appropriately report transactions captured during the period from implementation through year-end until mid-July 2013. Consequently, financial transactions were not reported in the Authority’s accounting records timely and controls could not be implemented to determine whether transactions were accurately and completely recorded.

RECOMMENDATION

2013-021 Although we were able to use information generated subsequent to year-end during the audit process, we recommend that the Authority design and implement policies and procedures that would (i) require new systems to be adequately tested in an IT test environment by users prior to their implementation to ensure that the system is operating effectively; (ii) determine whether transactions are captured and reported accurately and completely to enable the Authority to record transactions timely and accurately as part of its normal month-end financial closing process prior to system implementation; and (iii) to identify and correct on a timely basis system features that are subsequently noted as not operating effectively or as intended.

Corrective action plan / auditee views:

Based on discussions, the Authority agrees with the recommendation and has implemented the process.

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

Finding 2013-022 (significant deficiency - new finding)

RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – RECORDING OF CAPITAL ASSETS AND CONSTRUCTION IN PROGRESS

The Authority records capital additions as construction in progress. However, the Authority does not reclassify amounts previously recorded as construction in progress to the appropriate capital asset category (for example, bridges), or commence the recording of depreciation expense, in the month during which the capital asset was placed in service for assets which are not part of a lengthy completion
process. Consequently, significant journal entries are required to be recorded at year-end to reclassify amounts that were incorrectly categorized as construction in progress and to record depreciation expense.

**RECOMMENDATION**

2013-022 We recommend that the Authority reclassify amounts initially recorded as construction in progress to the appropriate capital asset category in the month in which the capital asset is placed in service, and record depreciation expense commencing in the month the capital asset is placed in service.

**Corrective action plan / auditee views:**

Based on discussions, the Authority agrees with the recommendation and has implemented the process.

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

**Finding 2013-023**  
(significant deficiency - repeat finding)

**RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – ACCOUNTS PAYABLE AND YEAR-END CUTOFF PROCEDURES**

During our audit, we noted that certain capital assets and associated liabilities at year-end related to the construction of certain equipment were not recorded.

**RECOMMENDATION**

2013-023 We recommend that the Authority review work performed and liabilities incurred related to construction activities to identify liabilities related to goods and/or services received on or prior to year-end in order to record such transactions in the period to which they relate.

**Corrective action plan / auditee views:**

Based on discussions, the Authority agrees with the recommendation and has implemented the process.

Contact Person: Buddy Croft, Executive Director  
Rhode Island Turnpike and Bridge Authority  
Phone: 401.423.0800
### Finding 2013-024  
**RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – RECORDING OF NONRECURRING TRANSACTIONS**

During our audit, we noted that the Authority recorded as revenue the reduction in the estimated legal settlement liability previously recorded, rather than recording the amount as reduction of settlement expense.

**RECOMMENDATION**

**2013-024**  
As previously communicated in the prior year, we again recommend that upon the occurrence of a nonrecurring transaction the Authority identify, research, and evaluate applicable accounting guidance based on the nature of the nonrecurring transaction in order to select and apply the appropriate accounting principle to ensure that the transaction is recorded in the general ledger in accordance with U.S. GAAP.

**Corrective action plan / auditee views:**

*Based on discussions, the Authority agrees with the recommendation and has implemented the process.*

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

### Finding 2013-025  
**RHODE ISLAND ECONOMIC DEVELOPMENT CORPORATION – RECORDING OF FINANCIAL TRANSACTIONS**

Certain transactions were not recorded in the Corporation’s books and records in the period in which the underlying transaction occurred or consistent with the financial elements of the underlying transactions. As a result, significant audit adjustments were required to record such transactions, adjust previously recorded amounts, or reclassify the manner in which previously recorded amounts were presented.

**RECOMMENDATION**

**2013-025**  
We recommend that management design and implement a process which (i) incorporates the review of the various existing contracts, grants and agreements, including amendments thereto, for which the Corporation currently is a party, and that incorporates the timely review of such agreements entered into in the future in order to identify and record transactions in the period during which they occur based on the economic substance of the transaction; (ii) includes a review of transactions occurring shortly after each reporting period to determine whether all transactions were recorded in the proper period and to adjust previously recorded transactions based on the most recent information available; and (iii) if information required to record certain transactions is required from the State Controller’s office, to initiate communication with the State Controller’s office.
when known transactions are expected to occur to obtain information required to record such transactions in the period during which they occur.

We also recommend that a person independent of the person responsible for identifying and recording such transactions review available financial information and approve recorded transactions to determine whether all transactions were properly recorded during the period to which they relate based on the substance of the underlying transaction.

Corrective action plan / auditee views:

During the audit period of July 1, 2012 through June 30, 2013, the Corporation experienced changes in personnel, including organizational restructuring and changes in management, contributing toward the audit adjustments noted in the audit’s schedule of findings. Referenced findings generally included non-recurring transactions. As recommended, management has already begun implementing procedures to (1) incorporate the timely review of existing and future contracts, grants and agreements to ensure that transactions are identified and recorded accurately and within the proper reporting period; (2) review transactions occurring shortly after each reporting period to determine whether all transactions were recorded in the proper period and make the necessary adjustments to previously recorded transactions shortly after each reporting period based on the most recent information available; and (3) initiate communication with the State Controller’s office when known transactions are expected to occur to obtain information required to record such transactions in the period during which they occur. In addition, management has designated an independent individual to review available financial information and approve recorded transactions to ensure that all transactions are properly recorded during the appropriate period based on the substance of the underlying transaction.

Contact Person: Adam N. Quinlan, Chief Financial Officer RI Commerce Corporation (formerly RIEDC) Phone: 401.278.9100

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<tr>
<th>Finding 2013-026</th>
<th>(material weakness – new finding)</th>
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RHODE ISLAND ECONOMIC DEVELOPMENT CORPORATION – RENEWAL ENERGY FUND – LOAN FILES AND COMPLIANCE

Certain Renewable Energy Fund (REF) loans require borrowers to comply with certain terms and provisions, including, among others, financial reporting requirements and the requirement to commence loan repayment upon the achievement of certain financial targets. During our audit, we noted that the Corporation had not fully implemented periodic loan monitoring processes as of year-end to monitor the terms and conditions with which a borrower must comply, including provisions which would require the borrower to make loan repayments upon the achievement of certain financial targets. It is our understanding that the Corporation began implementing loan monitoring processes near year-end in response to a similar finding contained within the Bureau of Audits’ final report, dated July 8, 2013, of its audit of the REF (the Bureau’s Report).

Also, although no REF loans were originated during the year ended June 30, 2013, we reviewed the loan file for selected loans recorded as loans receivable at year-end. During our review of the selected loan files, consistent with management’s prior knowledge based on similar findings contained within the Bureau’s Report, we noted that the selected loan files did not contain sufficient supporting documentation evidencing decisions related to loan origination and were not maintained using a consistent file structure.
**RECOMMENDATION**

2013-026 We recommend that management complete the implementation of its monitoring processes which would incorporate the review of all loans to determine the terms and provisions with which each borrower must comply and to monitor the borrowers’ compliance with such terms and provisions. Also, we recommend that management implement a formal loan origination and maintenance file structure, similar to that currently used within the Small Business Loan Fund, to facilitate the documentation of all loan decisions.

*Corrective action plan / auditee views:*

As recommended, management is completing the implementation of its monitoring processes which will incorporate the review of all loans to determine the terms and provisions with which each borrower must comply and will monitor the borrowers’ compliance with such terms and provisions. In addition, management will finish implementing a formal loan origination and maintenance file structure to facilitate the documentation of all loan decisions.

**Contact Person:** Adam N. Quinlan, Chief Financial Officer
RI Commerce Corporation (formerly RIEDC)
Phone: 401.278.9100

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**Finding 2013-027** *(material weakness – new finding)*

**I-195 REDEVELOPMENT DISTRICT COMMISSION – RECORDING OF FINANCIAL TRANSACTIONS**

Certain transactions were not recorded in the Commission’s books and records in the period in which the underlying transaction occurred, consistent with the financial elements of the underlying transactions, or on the accrual basis of accounting. As a result, significant audit adjustments were required to record such transactions and adjust previously recorded amounts.

**RECOMMENDATION**

2013-027 We recommend that management design and implement a process which (i) incorporates the review of the various existing contracts and agreements to which the Commission is a party, and incorporates the timely review of such agreements entered into in the future in order to identify and record transactions in the period during which they occur based on the economic substance of the transaction; (ii) includes a review of the transactions occurring shortly after each reporting period to determine whether all transactions were recorded in the proper period and to adjust previously recorded transactions based on the most recent information available; and (iii) if information required to record certain transactions is required from the State Controller’s office, to initiate communication with the State Controller’s office when known transactions are expected to occur to obtain information required to record such transactions in the period during which they occur.

We also recommend that a person independent of the person responsible for identifying and recording such transactions review available financial information and approve recorded transactions to determine whether all
transactions were properly recorded during the period to which they relate based on the substance of the underlying transaction.

Corrective action plan / auditee views:

The referenced findings generally include non-recurring transactions (e.g., reconciling inter-agency balances with State Controller’s office related to closing of bond transactions associated with the land transfer) and were subsequently recorded based on information provided by the State Controller’s office.

Management has already begun implementing procedures to (1) incorporate the timely review of existing and future contracts, grants and agreements to ensure that transactions are identified and recorded accurately and within the proper reporting period; (2) review transactions occurring shortly after each reporting period to determine whether all transactions were recorded in the proper period and make the necessary adjustments to previously recorded transactions shortly after each reporting period based on the most recent information available; and (3) initiate communication with the State Controller’s office when known transactions are expected to occur to obtain information required to record such transactions in the period during which they occur. Additionally, management has designated an independent individual to review available financial information and approve recorded transactions to ensure that all transactions are properly recorded during the appropriate period based on the substance of the underlying transaction.

Contact Person: Jan Brodie, Executive Director
I-195 Redevelopment District Commission
Phone: 401.278.9100 Ext. 148

Finding 2013-028 (significant deficiency - repeat finding)

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY – CONTROLS OVER FINANCIAL REPORTING

During the fiscal year ended June 30, 2013, we tested a sample of 40 cash disbursements to determine if the Authority’s internal controls were being implemented. The results of our testing identified 4 invoices that didn’t have the proper approval according to the internal controls documented by management. Due to the significant amount of exceptions noted during this test, we recommend that the Authority evaluate the current internal controls over this function and modify them to match the controls that are in place or implement a review process that ensures that the controls have been implemented and documented appropriately.

During the audit process, we requested a reconciliation to support the cash account held with the State Treasurer. When we obtained the bank reconciliation from the State and there was a significant variance between the balance they reconciled and what was reported on the Authority’s books. We inquired with management as to their records of how the balance was reconciled as of June 30, 2013 and no reconciliation was provided. Due to the significant variance between the Authority and the State, we recommend that the Authority evaluate the current internal controls over this function and implement a more effective control to ensure all transactions recorded on the State level have been properly recorded on the Authority’s books.
RECOMMENDATIONS

2013-028a  Evaluate the current internal controls over cash disbursements and modify them to match controls that are in place or implement a review process that ensures that the controls have been implemented and documented appropriately.

2013-028b  Evaluate the current internal controls over the Authority’s cash reconciliation process and implement a more effective control to ensure all cash transactions recorded on the State level have been properly recorded on the Authority’s books.

Corrective action plan / auditee views:

Management noted that there were compensating controls in place to ensure that these disbursements were not erroneous expenses and that the disbursements were related to general and proper operating expenses of the Authority. Management will ensure that the controls identified by the Authority are being followed going forward.

Anticipated Completion Date:  November 2013

Management agreed that the balance of this account held with the State Treasurer was not reconciled on a monthly basis to the balance on the Authority’s books to ensure that all the Authority’s activity had been properly recorded during the year. Going forward, management has decided to obtain information from the State Controller and State Treasurer on a monthly basis to help facilitate the reconciliation process on the Authority’s books.

Anticipated Completion Date:  January 2014

Contact Person:  Marc M. Lacroix, Chief Financial Officer
Rhode Island Higher Education Assistance Authority
Phone: 401.736.1139
**Management Comment 2013-1**

**DEPARTMENT OF REVENUE – CONTROLS OVER COLLECTION OF CIGARETTE TAX STAMP RECEIVABLES**

Rhode Island General Law section 44-20-19 permits licensed cigarette distributors to pay for cigarette tax stamps within thirty (30) days, provided the distributor has posted a surety bond at least equal to the outstanding balance due the State.

During fiscal 2013, we noted numerous instances in which cigarette distributors had balances that were not paid within thirty days of purchase and the balance exceeded the surety bond amounts. Monitoring procedures should be enhanced to ensure compliance with the General Laws and to ensure the collectability of cigarette taxes owed to the State.

**RECOMMENDATION**

MC-2013-1 Enhance monitoring procedures to ensure that cigarette distributors are complying with the General Law section 44-20-19.

**Corrective action plan / auditee views:**

The Division of Taxation dedicates specific resources to monitor and tracking cigarette stamp sales. There may be isolated situations when distributors do not pay within the thirty days; in those situations the Division contacts the distributors and works out payment terms. The Division has never had a receivable for cigarette stamp unpaid.

**Anticipated Completion Date:** N/A

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

Phone: 401.574.8922

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**Management Comment 2013-2**

**DEPARTMENT OF REVENUE – QUALITY CONTROL REVIEW OF DATA USED TO CALCULATE SIGNIFICANT ESTIMATES**

The Office of Accounts and Control utilizes various Division of Taxation (Taxation) generated information to estimate financial statement revenue accruals including revenue refunds. A file detailing personal income tax refunds paid during the fiscal year included an erroneous refund amount of nearly $10 million due to a data entry error. The data entry error was detected and did not result in payment of an erroneous refund. Although never paid, the amount was included on the refund data file.

Due to the dollar amount of the erroneous data included in the file, this affected the estimates used to prepare the State’s financial statements at June 30, 2013. Enhanced quality control procedures over the data supporting estimates used in preparing the financial statements should be employed. These should include reconciling the data file extracted from the Taxation’s system to the amount of actual refunds disbursed as recorded in the State’s RIFANS accounting system.
RECOMMENDATION

MC-2013-2 Enhance quality control procedures over data used to develop tax refund accrual estimates by reconciling Taxation refund data to actual refunds processed and paid.

Corrective action plan / auditee views:

To account for manual refund checks that are issued by the General Treasurer’s Office, the Division of Taxation must manually data enter the voucher number and refund amount in the taxpayer’s account on the Mainframe System. On all manual checks the voucher number is enter as “9999999”. In one case during fiscal year 2013 the voucher number was entered in the refund amount field. Safe guards have been programmed into mainframe system not to allow refunds amount to be enter in over $1,000. The Division’s new system will automatically track these manual refunds eliminating the need for manually data entry of these transactions.

Anticipated Completion Date: N/A

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

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

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

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

RECOMMENDATION

MC-2013-3 Develop and adopt a policy regarding the timing and recognition of refund liabilities for entities granted sales tax exemptions by the Rhode Island Commerce Corporation.
Corrective action plan / auditee views:

The Division of Taxation will work with Office of Accounts and Control to determine the best method to account for potential refunds related to sales tax agreements with the Rhode Island Commerce Corporation.

**Anticipated Completion Date:** June 2014

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

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**Management Comment 2013-4**  
(new comment)

**MINUTES OF THE STATE PROPERTIES COMMITTEE**

The State Properties Committee has responsibility for approving all acquisitions and disposals of State property including lease arrangements involving the State as lessor or lessee. As part of our audit, we use the meeting minutes of the State Properties Committee to demonstrate that the appropriate official approvals of property transactions has occurred and also as a means to ensure the completeness of the State’s accounting records with regard to significant property transactions.

Section 42-46-7 of the General Laws requires that minutes of a meeting be available within 35 days of the meeting date. For the last two fiscal years, minutes of the State Properties Committee have not been consistently prepared on a timely basis - minutes had not been prepared for many of the meetings held during fiscal 2013.

**RECOMMENDATION**

MC-2013-4 Ensure minutes of the State Properties Committee are prepared timely consistent with the requirements of General Law section 42-46-7.

Corrective action plan / auditee views:

The Committee shall utilize substitute staff to review and format 2012 meeting minute transcripts and produce at least two (2) sets of minutes for Committee approval per week. The Committee meets every two (2) weeks. The Committee anticipates that all 2012 meeting minutes shall be approved and filed with the Secretary of State by May 1, 2014.

The Committee has adopted a new format for its minutes that conforms to the requirements of the “Open Meetings Act”, R.I. Gen. Laws § 42-46-7, yet reduces the amount of time required to transcribe, review, edit, and produce meeting minutes. The Committee has also adopted a policy that requires minutes of each meeting to be voted upon at the next regularly scheduled meeting, i.e. within two (2) weeks. In addition, the executive secretary shall be required to advise the Committee whenever meeting minutes have not been timely filed with the Secretary of State.

**Anticipated Completion Date:** May 1, 2014

**Contact Person:** Ronald N. Renaud, Executive Director  
Phone: 401.222.3390
ACCOUNTING FOR INDIRECT COST RECOVERY – ENSURE CONSISTENT ACCOUNTING TREATMENT AMONG ALL STATE AGENCIES

The State needs to ensure that its accounting policies and procedures used to account for indirect costs charged to federal grants are well communicated and consistently applied across the departments and agencies of the State. Many federal grants allow reimbursement of both direct and indirect costs related to the administration of a grant program. Typically, these include the pro rata share of agency administrative costs, which are allocated by (1) an approved indirect cost rate applied as a percentage of direct costs or (2) a departmental cost allocation plan. For accounting purposes, these costs need to be included in the total expenditures charged to and reimbursed by a federal grant. An accounting procedure is followed to compensate for the “duplication” of expenditures through the creation of indirect cost recovery restricted receipt accounts.

During our fiscal 2013 audit, we proposed an audit adjustment to correct federal revenues and record federal expenditures in the Child Support Enforcement (CSE) program by $1.3 million. Specifically, the Judiciary utilized a restricted receipts account to record indirect costs related to the administration of the CSE program, in accordance with the provision of its federally approved indirect cost rate. Rather than recording these indirect costs as federal expenditures within the designated CSE program accounts, the Judiciary reclassified federal drawdowns to the indirect cost restricted receipt accounts causing an understatement of reported federal revenues and expenditures for the CSE program.

The Judiciary’s CSE program indirect costs were properly reported as federal expenditures in quarterly federal financial reports; however, the federal reports were not consistent with amounts recorded in the State’s RIFANS accounting system as the departmental account did not properly categorize the indirect costs as federal expenditures.

We also observed that there was a need to assess how these accounts are used across State government with the objective of ensuring consistent and appropriate use. Additional communication and training regarding accounting for indirect costs reimbursed through grants may be necessary. Enhanced monitoring within the Office of Accounts and Control to ensure consistent and appropriate use is needed.

RECOMMENDATIONS

MC-2013-5a Assess how departments are accounting for indirect cost within the RIFANS accounting system. Provide enhanced statewide guidance regarding consistent accounting and reporting of indirect costs charged to federal programs.

MC-2013-5b Require departments and agencies to record indirect cost recoveries consistent with the State’s accounting policies and the manner in which such amounts are reported on federal grant reports.

Corrective action plan / auditee views:

An assessment of how state agencies account for indirect costs is currently underway. Once this process is completed, uniform guidelines will be developed for agencies to follow for such costs in the future. In addition, an ongoing mechanism to monitor compliance with the new guidelines will also be created.

Anticipated Completion Date: September 30, 2014
SEEK TO MERGE THE TWO JUDICIAL PENSION PLANS

A new pension plan – the Rhode Island Judicial Retirement Fund Trust (RIJRFT) - covering just seven (7) active judges was created during fiscal 2013. The new plan resulted from enactment of the Retirement Security Act of 2011 and required the seven active judges who were appointed before January 1, 1990 to begin making an employee pension contribution. Judges appointed after December 31, 1989 are members of a separate judicial pension plan – the Judicial Retirement Benefits Trust (JRBT). Other retired judges who were appointed prior to January 1, 1990 are provided pension benefits through an appropriated pay-as-you-go plan.

While the plan was established and began receiving employee contributions from the judges, the State has not yet begun to make employer contributions to the plan. The first actuarial valuation of the plan (performed as of June 30, 2012) utilized actuarial assumptions consistent with the fact that the State has not begun to fund the plan on an advance funding basis.

The ERSRI Board and Retirement Division should consider whether the two judicial plans could be merged into one plan for ease of administration and to avoid the widely divergent funded status of the plans – the JRBT at 83.4% (as of June 30, 2012) and the new RIJRFT at 0.0%. The State, as the employer, is equally obligated for all judicial pensions whether provided through a pay-as-you-go mechanism or through the two established judicial pension trusts. The only distinction, as provided in the General Laws, is the date of judicial appointment. Consequently, funding one plan such that it is nearly fully funded while making no employer contribution to the other is inconsistent with the actual equal obligation of the State as the employer. Further, due to other provisions in the General Laws, the State actually contributed more than the actuarially required amounts for the ERS plan covering most state employees and teachers while making no employer contribution to the new judicial plan.

Similarly, the idea of including all active and retired judges under one plan, including those that are presently provided a pension through an appropriated pay-as-you-go funding mechanism, should be explored. The incremental cost of making an actuarially determined contribution for all active and retired judges should be compared to the current total cost for some on a pay-as-you-go basis and others on an actuarially-determined basis.

(A similar management comment was also communicated to the Employees’ Retirement System)

RECOMMENDATIONS

MC-2013-6a Seek to merge the two judicial retirement trusts.

MC-2013-6b Determine the incremental cost of funding all judicial pensions on an actuarially-determined basis.

Corrective action plan / auditee views:

The State, in conjunction with the ERSRI Board and the Retirement Division, will explore the recommendations regarding the two judicial plans.
IMPROVE THE FORMAT OF THE INTERMODAL SURFACE TRANSPORTATION FUND
BUDGET AND THE BUDGET TO ACTUAL COMPARISON SCHEDULE

The format of the enacted budget for the Intermodal Surface Transportation (IST) Fund could be
enhanced to provide a more effective annual financial plan and monitoring tool. A budgetary comparison
schedule is included in the State’s financial statements which compares budget to actual results. This
schedule is prepared based on the detail included in the legislatively enacted budget. We observed that in
some instances the detail appropriation lines are so highly summarized (e.g., infrastructure engineering)
that it precludes effective analysis of the budget compared to actual results. Additionally, the activities of
the Department of Transportation (RIDOT) are now accounted for within three separate special revenue
funds, which for financial reporting purposes, are aggregated into the IST Fund. A budget is enacted by
the General Assembly for activity which somewhat corresponds with activity recorded in only one of the
three funds.

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

The budgetary comparison schedule is included in the State’s financial statements as required by
generally accepted accounting principles; however, its effectiveness as a monitoring tool is limited.

RECOMMENDATION

MC-2013-7  Reevaluate the presentation of the budget plan for the Department of
Transportation and the related funds used to account for its activities. Consider
changes in the level of detail and the inclusion of other items to facilitate
comparison to actual results.

Corrective action plan / auditee views:

The Office of Accounts and Control will work with the Budget Office to reevaluate the
presentation of the budget plan for the Department of Transportation. If an enhanced format is
developed and acceptable to each office, this plan will be submitted to the General Assembly.

Anticipated Completion Date:  June 30, 2015

Contact Person:  Marc Leonetti, State Controller
                 Phone: 401.222.2271
Management Comment 2013-8
(new comment)

TIMING OF ACTUARIAL VALUATIONS

The State (as the employer) and the Employees’ Retirement System of Rhode Island (ERSRI) are required to disclose the most recent actuarial valuation data available in their respective financial statements. On December 17, 2013, the ERSRI Board adopted valuations performed as of June 30, 2013 for the ERS and MERS plans. For the State’s fiscal 2013 Comprehensive Annual Financial Report and the separately issued ERSRI 2013 financial statements, the most current 2013 actuarial valuation information was disclosed as a subsequent event due to the release of the new information at the time of completion of the audited financial statements.

Due largely to changes resulting from the State’s enactment of the Retirement Security Act of 2011, the State’s actuary and the Board of the Employee’s Retirement System (Board) have accelerated the timeframe for completing the annual actuarial valuations of the defined benefit plans within the System. Consequently, valuations will likely be presented to the ERSRI Board in December each year for valuation periods ending the previous June 30. This new schedule suggests that the most recent actuarial valuations will be available at the same time the audits of the State and ERSRI’s financial statements are drawing to a close.

Readers of the State’s and ERSRI’s fiscal 2013 financial statements had the most current information available; however, on a go-forward basis, both the State and ERSRI should coordinate the planned availability of such information to allow for full inclusion in the financial statements (notes to the financial statements and required supplementary information).

RECOMMENDATION

MC-2013-8 Plan and coordinate the availability of updated actuarial valuations of the State’s defined benefit plans in connection with the anticipated completion dates of annual audits of the State and ERSRI financial statements.

Corrective action plan / auditee views:

The State will work with ERSRI to ensure that the most recent plan valuations are included in the State’s financial statements.

Anticipated Completion Date: November 30, 2014

Contact Person: Marc Leonetti, State Controller
Phone: 401.222.2271

Management Comment 2013-9
(new comment)

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

The federal Affordable Care Act imposes an excise tax on high-cost health plans beginning in 2018. The excise tax, commonly referred to as the “Cadillac tax” is 40% on the cost of coverage for health plans that exceed an annual limit. The tax is paid by insurers or by employers when they are self-insured such as the State of Rhode Island.
While the excise tax is not effective until 2018, the State’s actuary, in performing the actuarial valuation of the State’s retiree health plans at June 30, 2011, calculated that the State would be subject to the 40% excise tax beginning in 2018 and included that cost in the development of the actuarial accrued liability for the retiree health plans. Consequently, this factor, among others, led to an increase in the actuarially determined employer cost (expressed as a percentage of active employee payroll costs) beginning in the July 1, 2013. This projected applicability of the excise or “Cadillac tax” results in approximately $3 million more in employer contributions to the OPEB trust for fiscal 2014 alone.

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

RECOMMENDATION

MC-2013-9 Explore options to determine if the excise or so called “Cadillac tax” on high-cost health plans could be avoided through changes in plan design for the State’s retiree health care plans.

Corrective action plan / auditee views:

The number of early retiree plan participants (under age 65) who will be impacted by the Cadillac tax in 2018 is diminishing each year due to recent pension law changes that require state employees to work up to or beyond their Medicare eligible age to receive their state pensions.

Management will continue to explore options that will minimize the impact of this new excise tax.

Anticipated Completion Date: June 30, 2015

Contact Person: Deborah Blair, Chief of Employee Benefits
Phone: 401.222.3745

Management Comment 2013-10 (new comment)

ASSESSMENT ON CONSULTANT PAYMENTS FOR TRANSFER TO THE RETIREMENT SYSTEM

During fiscal 2013, the State implemented procedures to administer RI General Law 42-149-3.1, which levies an assessment on State departments and agencies equal to 5.5% of the cost of services provided by nongovernmental persons or entities which are “substantially similar to and in lieu of services heretofore provided, in whole or in part, by regular employees” of the department or agency. The assessment is then paid to the retirement system on a quarterly basis. For fiscal 2013, $434,677 was transferred to the Employee’s Retirement System pursuant to this General Law provision.

As written, the services subject to the assessment is open to interpretation since determining which services are substantially similar or in lieu of those provided by State employees is challenging. The State applied a narrow interpretation of the law – focusing only on certain master price agreements (MPAs) that clearly provide temporary services to departments and agencies with job vacancies. In many instances, these master price agreements provide temporary services as long-term arrangements, when the State is unable to fill the position with qualified candidates.
In addition, the State opted to exclude consultant charges to federal expenditure accounts, to avoid noncompliance with federal cost principles since the assessment would not be considered eligible for federal reimbursement. However, there is no specific provision in the enacted legislation that allows the exclusion of contract services on other master price agreements and purchase orders, nor is there a provision allowing the exclusion of charges to federal accounts.

Further legislative clarification of the services subject to the assessment would ensure that the intent of the law is being met. The State engages many contractors and delineating which of those services could be performed by state employees is subjective. Additionally, this is an administratively complex process to effect a relatively modest supplemental contribution to the Employee’s Retirement System. Actuarially required contributions by the State (employer share) to the plans within the Employees’ Retirement System totaled more than $211 million for fiscal 2013. If the goal is simply to provide supplemental funding to the pension system there are more administratively direct means to accomplish the same result.

RECOMMENDATION

MC-2013-10 Seek amendment of the RI General Law 42-149-3.1 to clarify the services subject to the assessment thereby facilitating compliance with the law.

Corrective action plan / auditee views:

Management agrees that this law is subject to interpretation and requires a labor intensive, administratively complex process to comply.

A budget article has been submitted to eliminate this section of RI General Law.

Anticipated Completion Date: June 30, 2014

Contact Person: Wayne Hannon, Deputy Budget Officer
Phone: 401.222.8279

ACCOUNTS RECEIVABLE FOR TDI BENEFIT OVERPAYMENTS

Total account receivable due from claimants for TDI benefit overpayments is the sum of two reports from the TDI computer system, i.e., TDR 130 TDI Overpayment Recapitulation Report (Active Claims worked by the TDI Unit) and OP-550A Statement of Overpayment Report (Inactive Claims worked by the Overpayment Unit). The sum of these reports is reconciled to the DLT business office books, monthly. The reports support the accounts receivable balance in the DLT business office books, the State accounting system and annual financial statements of the TDI Fund.

During fiscal 2013, the active claims report began reflecting a negative month end balance. As of June 30, 2013, the active claims report reflected a cumulative negative balance of ($850,996) and the sum of the active and inactive report balances was ($43,932). These balances are recorded in the DLT business office books. However, management considers these balances to be unreasonable. DLT has not determined the cause of this condition and as a result does not know the actual balance of accounts receivable at June 30, 2013.
The effect on the June 30, 2013 annual financial statements is immaterial because the state used an estimated accounts receivable balance less a significant allowance for uncollectible and unavailable amounts.

DLT should investigate this condition, determine the actual account receivable balance and adjust the active claims report balance to reflect actual accounts receivable.

**RECOMMENDATION**

MC-2013-11 Investigate the negative balance of TDI accounts receivable in the TDI Overpayment Recapitulation Report and identify the actual accounts receivable balance. Adjust the report to reflect the actual accounts receivable balance.

**Corrective action plan / auditee views:**

The TDI Overpayment Recapitulation Report has been corrected and reflects the proper accounts receivable balance.

**Anticipated Completion Date:** February 28, 2014

**Contact Person:** Joan DiSanto, Programming Supervisor  
Phone: 401.462.8058

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**Management Comment 2013-12**

**UNRECEIPTED FEDERAL FUNDS**

At June 30, 2013, approximately $2.5 million of federal grant receipts deposited in the State’s bank accounts remained unidentified for accounting purposes. In general, this results from departments or agencies drawing federal funds, which are wired to the State’s bank accounts, but failing to prepare required receipt accounting documentation. While the balance decreased by more than $1 million in FY2013, the remaining unreceipted federal funds represent a significant number of receipts that were not recognized by departments responsible for administering federal programs.

The Office of the General Treasurer maintains a log of all unrecorded deposits and periodically requests State departments and agencies to review the listing in an effort to identify the appropriate federal program and properly record federal revenues. While the aggregate effect of the unidentified receipts was appropriately reflected on the State’s financial statements, specific federal program balances are potentially misstated which impacts federal reporting and federal cash management requirements.

Efforts to identify the origin and destination of the funds received should be enhanced to ensure timely recognition of federal revenues. As more fully explained in Management Comment 2013-15, unidentified federal program receipts could be eliminated if the draw of federal funds was automated and centralized.

**RECOMMENDATIONS**

MC-2013-12a Enhance current procedures to resolve unrecorded deposits in a timely manner with the responsible State agencies.

MC-2013-12b Improve coordination of the drawdown of federal funds by departments with the
corresponding bank deposit and required receipt accounting transactions.

Corrective action plan / auditee views:

The General Treasurer in conjunction with the Office of Accounts and Control has initiated an intra-state agency communications campaign to drive better conformance with RIFANS accounting and entry standards. The results are that the unallocated balance is down almost 30% since the prior year. We will continue to attempt a procedural improvement regarding the initial request, bank deposit, and receipt accounting procedures at the agency and department level.

**Anticipated Completion Date:** June 30, 2014

**Contact Person:** Chris Feisthamel, COO, Office of the Treasurer
Phone: 401.462.7650

**Management Comment 2013-13**

**CHILD SUPPORT COLLECTIONS – RESOLUTION OF UNIDENTIFIED COLLECTIONS**

Child support collections and distributions are processed through a separate computer system maintained by the Department of Human Services. Summary level data is also included in an escrow liability account within the State’s General Fund. A long-standing unreconciled variance between the two systems has existed for what has traditionally been regarded as undistributed collections not identifiable to specific child support cases. As of June 30, 2013, this accumulated balance totaled $622,000.

While the variance has been, to a certain degree, consistent, fluctuations occurring during the last two fiscal years indicate that certain elements of current activity are not recorded consistently between the two systems.

In response to prior year recommendations, in fiscal 2013, the State initiated a review of certain receipt activity in the Child Support Collections escrow liability account. Continuing to review the activity in the account should aid in determining the cause of the inconsistencies. The State should pursue measures to ensure that activity in the escrow liability account is reserved for child support collections and distributions, and that activity relative to the administration of the Child Support Enforcement program is recorded properly on the State accounting system. A permanent resolution to this long-standing variance should be obtained.

**RECOMMENDATION**

MC-2013-13 Resolve the balance of unidentified child support collections reported at year-end.

Corrective action plan / auditee views:

The implementation of the State Disbursement Unit in partnership with the State of Connecticut in 2010 resolved many of the underlying issues regarding the reconciliation. Also, during the past year we identified and resolved several more transactions that were being recognized incorrectly on the State’s financial system. Although, the nature of the child support payment processing and distribution rules and regulations will probably always contribute to, and result in a variance due to unidentified payments, OCSS will continue addressing these issues and performing daily reconciliations to maintain a minimum variance.
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-2013-14a 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-2013-14b Build a database of all subrecipient entities that receive State and/or federal grant funding.

**Corrective action plan / auditee views:**

State agencies, as conditioned in their federal award agreements, are responsible for subrecipient monitoring, including collecting and reviewing the single audits for sub-recipient entities with more than $500,000 in federal funding from federal agencies or pass through entities.

The OMB’s Grants Management Office provides training, technical assistance, and resources to agencies on managing federal award including meeting federal award requirements. The Grants Management Office has posted the current circulars on its website so agency personnel can readily access information on the Administrative Requirements, Cost Principles, or Audit Requirements. The Office routinely responds to questions from state agencies regarding the award requirements.

Recently, the Office hosted the Council of Financial Assistance Reform (COFAR) webinar on the new federal OMB “Super-Circular” and posted the COFAR webinars on its website (http://www.omb.ri.gov/grants/resources/circulars.php so that agencies unable to attend the session could view the material. The COFAR has committed to providing additional training opportunities; the Office will ensure that these opportunities are made available to state agencies. The new Super Circular is effective December 2014.

The OMB believes it is appropriate for state agencies to continue to be responsible for sub-recipient monitoring because this ensures these agencies are held accountable for their programs and services. The Grants Management Office will continue to provide technical support and training to enhance the resources at the agency level. For example, the Grants Management Office will organize training for agencies on the single audit collection and review requirements. The training will be completed by October 1, 2014. Supporting materials will be developed and posted on OMB’s website.

**Anticipated Completion Date:** N/A

**Contact Person:** Laurie Petrone, Director, Grants Management

Phone: 401.574.8423

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**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 $2.6 billion this year. Consequently, the timing of receipt of these funds has a significant impact on the State’s overall cash management. We have reported for many years that the State should enhance controls to ensure compliance with federal cash management requirements. In many instances, agencies do not draw federal cash as frequently as permitted by federal regulations thereby adversely impacting the State’s overall cash management.

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

**RECOMMENDATION**

MC-2013-15  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 has reviewed the benefits of centralizing and automating the withdrawal of the remaining federal funds with the implementation of the appropriate accounting system module. The cost of such a system was untenable. If such a system is installed, we will seek to automate the drawdowns.

**Anticipated Completion Date:** June 30, 2014

**Contact Person:** Anne-Marie Fink, CIO, Office of the Treasurer

Phone: 401.462.7650

**Management Comment 2013-16**

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 88% 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 special security check paper, printing costs, and 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-2013-16a  Require all State employees to be paid through direct deposit.
MC-2013-16b 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 Fiscal 2015 Budget submission includes legislation that requires all State employees to be paid through direct deposit. Furthermore, a cross functional team is currently working on the implementation of an online payroll viewer in lieu of printing and distributing direct deposit statements.

Anticipated Completion Date: June 30, 2014

Contact Person: Marc Leonetti, State Controller
Phone: 401.222.2271

PAYROLL ACCOUNTING SYSTEM

The State’s payroll information system, for fiscal 2013, calculated payroll expenditures for over 14,000 employees totaling more than $990 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.

Systems Documentation And Monitoring

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. The State often makes policy decisions or interpretations when implementing changes to the personnel system for changes in statute or employee contracts which do not appear to be formalized within State policy or system documentation. Documentation of such decisions is critical to ensure their uniform application in future periods. 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.

Controls Over Data Within The 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 found that 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. 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 captured and logged. Logging these data element changes should be implemented to enhance controls over changes to the payroll master file.
System access controls need to be improved by tracking transactions within key data fields by individual user.

**RECOMMENDATIONS**

MC-2013-17a  Improve formalized documentation of the State’s payroll system.

MC-2013-17b  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:**

MC2013-17a - The State’s payroll system is a legacy application written in COBOL in an IBM mainframe environment. In the State’s response to 2013-1a, the state will be requesting funds for a new payroll system. Given this request, we will continue the ongoing effort to document the current system to aid in the transition to a new system should the funding be approved. We have also added a staff member to the payroll group which will aid the payroll group.

*Anticipated Completion Date:    March 31, 2015*

MC-2013-17b - In the State’s response to 2013-1a, the state will be requesting funds for a new payroll system. Given this request, we will be putting this on hold until a funding determination is made. This management comment would be addressed if a new payroll system is approved. If funding is not approved, this effort is resource dependent.

*Anticipated Completion Date:    TBD*

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

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**Management Comment 2013-18**

**IMPROVE CASH RECONCILIATION EFFICIENCY**

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

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

**RECOMMENDATION**

MC-2013-18  Increase automation of the bank reconciliation process by exploring enhanced electronic transaction matching. Investigate the technology and functionalities provided by modules available within the RIFANS (Oracle) accounting system.
Corrective action plan / auditee views:

The 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, 2014

**Contact Person:** Chris Feisthamel, COO, Office of the Treasurer
Phone: 401.462.7650

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**Management Comment 2013-19**

**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 active 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.

The legacy account conversion project has been an “active” project for many years but without sufficient priority or allocation of resources to complete it. Continued use of the legacy account structure for certain subsidiary accounting systems prevents moving forward with the implementation of various modules of the overall RIFANS accounting system. Consequently, the legacy conversion project should be reevaluated in that context. If the intent is to complete RIFANS as originally envisioned and implement remaining modules, then the legacy account conversion may or may not be necessary depending on the path chosen and the anticipated timing for full implementation.

**RECOMMENDATIONS**

MC-2013-19a Complete conversion of subsidiary accounting systems using the legacy account structure to the new RIFANS account structure.

MC-2013-19b Reevaluate the legacy account conversion project within the context of the overall plans to complete RIFANS as originally envisioned with implementation of the remaining module.

**Corrective action plan / auditee views:**

MC-2013-19a - In the State’s response to 2013-1a, the state will be requesting funds for a new payroll system. Given this request, we will be putting this on hold until a funding determination is made. This management comment would be addressed if a new payroll system is approved. If funding is not approved, will we continue the effort.

MC-2013-19b - In the State’s response to 2013-1a, the state will be requesting funds for a new payroll system. Given this request, we will be putting this on hold until a funding determination
is made. This management comment would be addressed if a new payroll system is approved.

**Anticipated Completion Date:** TBD

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

**Phone:** 401.222.6091

**Management Comment 2013-20**

**RIDOT – UNDOCUMENTED POLICIES AND PROCEDURES**

RIDOT has not formally documented many policies and procedures that DoIT security policies require. Although unwritten, many RIDOT policies and procedures are understood by both management and personnel. However, unwritten policies and procedures increase the risk of misunderstandings and tend to lead to inconsistencies in management’s enforcement of systems and security policy and procedures.

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

The following is a partial listing of RIDOT undocumented policies:

- **System configuration policy and procedures** - departmental agency management is responsible to formally document an appropriate system configuration policy for systems under their control *(Policy 10-06: IT Security Handbook Operational Controls, §4.2.3).*

- **Periodic review of baseline system configurations** - a baseline configuration should include controls for changes to IT system resources, including hardware, software, administrative requirements, documentation, and network connections *(Policy 10-06: IT Security Handbook Operational Controls, §4.2.4.3)* and that it is the responsibility of the departmental IT manager to maintain a current configuration diagram for all systems, networks, and telecommunication components under their control *(Policy 10-05: IT Security Handbook Management Controls, §5.5.5).*

- **Periodic review of its system security plan** - all department offices must develop and implement procedures to provide guidance and support for the IT security program *(Policy 10-05: IT Security Handbook Management Controls, §2.2.1)* and that agency IT management, in conjunction with DoIT, is responsible for maintaining such a plan *(Policy 10-05: IT Security Handbook Management Controls, §3).*

- **Incident response or incident response training policy and procedure** - such a policy is often included within an overall system security plan (RIDOT does not have a formally documented system security plan). Agencies are responsible for developing, implementing, and managing a comprehensive IT security program, which includes violations of DoIT security policy *(Policy 10-05: IT Security Handbook Management Controls, §3).* Additionally, Agencies are responsible for developing an incident reporting program in accordance with DoIT policy *(Policy 10-05: IT Security Handbook Operational Controls, §2).* Further, RIDOT indicated that incident handling is a subset of contingency planning. All department personnel must be trained in, and continually practice and up-
date, their contingency-related duties (Policy 10-05: IT Security Handbook Management Controls, §3.4.1.9).

- **System and information audit and accountability policy and procedure** - such a policy is often included within an overall system security plan to define auditing and accountability controls to be implemented (RIDOT does not have a formally documented system security plan). All departments must complete a system security plan to provide adequate levels of protection for each IT resource (Policy 10-05: IT Security Handbook Management Controls, §3).

- **Periodic review of security assessment and authorization** - All department offices must develop and implement procedures to provide guidance and support for the IT security program (Policy 10-05: IT Security Handbook Management Controls, §2.2.1) and that agency CISOs are responsible for developing, implementing, and managing the office-specific IT security policies (Policy 10-05: IT Security Handbook Management Controls, §2.3.5).

- **Security alerts, advisories, and directives, and threats such as viruses, trojans, worms, spam** - all department offices must develop and implement procedures to provide guidance and support for the IT security program and ensure compliance with IT security policy, guidelines, and directives (Policy 10-05: IT Security Handbook Management Controls, §2).

- **Risk assessment process** - agency management and information security officer are responsible for implementing a risk management program that assesses the balance of risks, vulnerabilities, threats and countermeasures in order to achieve an acceptable level of risk based on the sensitivity or criticality of the system (Policy 10-05: IT Security Handbook Management Controls, §4.4.2, §4.4.4).

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

**RECOMMENDATION**

**MC-2013-20** Document agency policies and procedures to provide all RIDOT personnel with approved managerial, operational, and technical guidance and ensure compliance with DoIT published security policies.

**Corrective action plan / auditee views:**

RIDOT’s DoIT IT manager and DoIT Technical Support Manager will work with the DoIT office of the Chief Information Security Officer (CISO) to review DoIT Security policies 10-05 and 10-06. RIDOT will request resources from the CISO to assist the department in the implementation of these policies and procedures.

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

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

Phone: 401.222.6935
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-2013-21    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, 2015

Contact Person:    Bernard Lane, Associate Director – Financial Management
                    Phone: 401.222.6603
Management Comment 2013-22

SURPLUS FURNITURE AND EQUIPMENT

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

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

RECOMMENDATION

MC-2013-22 Implement a statewide network or database of “surplused” furniture and equipment assets to facilitate notification and use by other state or local entities.

Corrective action plan / auditee views:

The Department of Facilities Management will review the current process to see if the recommendation is feasible to implement.

Anticipated Completion Date: June 30, 2015

Contact Person: Marco Schiappa, Facilities Management
Phone: 401.222.6200

Management Comment 2013-23

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

The Division of Taxation (Taxation) utilizes a data warehouse to (1) collect data from Taxation systems and external sources for data analysis purposes, and (2) attempt to identify taxes potentially owed to the State of Rhode Island. During fiscal 2013, Taxation continued to use the enhanced analytical capabilities of the data warehouse to identify taxpayers that should have filed tax returns or potentially underreported and underpaid taxes to the State. Further, use of the data warehouse will increase with the Division’s migration to its new STAARS system.

“Notices” are generated from the data warehouse, which operates independently of the various mainframe tax systems. A 60-day threshold has been established before the notice results in recognition of a tax receivable balance within the mainframe tax systems. During this time, the data can be modified or adjusted if the taxpayer provides information indicating that the notice is in error or the balance potentially owed is less. However, these changes are not subject to the same control procedures that would apply to other adjustments or entries recorded in the mainframe systems.
New transaction codes detailing the original data warehouse notice total, tax amount, interest, and penalties were added to the mainframe to identify tax balances that resulted from analysis within the data warehouse. However, there are no codes that identify corrections or adjustments made to data warehouse notices. Consequently, correction or adjustment to tax amounts originating from the data warehouse cannot be readily identified within Taxation’s systems. Being able to segregate these amounts is necessary due to the inherently different collection characteristics of these notices versus known tax balances due. An allowance for uncollectible amounts, reflective of the unique characteristics of the data warehouse tax billings, should be developed and used for financial reporting purposes.

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

RECOMMENDATIONS

MC-2013-23a Identify corrected and adjusted tax amounts for transactions emanating from the data warehouse within the mainframe systems with unique codes to allow separate identification for analysis and collection purposes.

MC-2013-23b Establish an allowance for uncollectible taxes receivable, which reflects the unique collection characteristics of the data warehouse notices/billings.

MC-2013-23c Recognize all data warehouse generated receivables within Taxation’s systems at the time of the notice creation, i.e. eliminate the 60-day waiting period.

Corrective action plan / auditee views:

MC-2013-23a - 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.

MC-2013-23b - 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.

MC-2013-23c - 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: N/A

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922
Management Comment 2013-24

DEPARTMENT OF REVENUE - 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, 2013, there were 27,231 returns dating from 1989 through 2013. Approximately 17,000 returns include requests for refunds totaling more than $10.2 million. The Division has made progress in reducing the number of returns on the error register by 50% compared with the prior year.

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

MC-2013-24 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:

The Division of Taxation has made tremendous progress in reducing the total number of returns on the error register. As of January 1, 2014 the total number of returns on the error register was 3,490 compared to 40,549 in January 2012. This is the lowest number of returns on the error register in over a decade.

Anticipated Completion Date: N/A

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

Management Comment 2013-25

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

The Division of Taxation (Taxation) should strengthen controls over Accounts Receivable Correction (ARC) transactions posted to its mainframe systems. Controls are not in place to ensure that the total of ARC transactions posted to each mainframe tax system matches the amount approved for data entry. The lack of data entry “batch” controls could result in an ARC transaction being incorrectly posted to the mainframe system and not being detected.

RECOMMENDATION

MC-2013-25 Improve data entry controls over ARC transactions.

Corrective action plan / auditee views:

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

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

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

Other Management Comments

Our audits of the Rhode Island Lottery and the Employees’ Retirement System for fiscal 2013 (which are included within the State’s financial statements) also included management comments, which are not repeated in this document. Those reports are available on our website oag.ri.gov.

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