April 9, 2013

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, 2012 and have issued our report thereon dated December 20, 2012. Our Independent Auditor’s Report on the State’s financial statements was included in the State’s Comprehensive Annual Financial Report for fiscal 2012.

As required by Government Auditing Standards, we have also prepared a report, dated December 20, 2012 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 25 findings that we considered significant deficiencies or material weaknesses in internal control over financial reporting or other matters required to be reported by Government Auditing Standards. This report also includes 12 findings reported by the auditors of component units.

This report also includes 25 management comments, which are less significant findings, yet, in our opinion still warrant communication and the attention of the State’s management.

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

Other findings and recommendations related to the State’s administration of federal programs were issued separately in the State’s Single Audit Report for the fiscal year ended June 30, 2012, which is available on our website at oag.ri.gov.

Sincerely,

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

Schedule of Findings and Responses

JUNE 30, 2012 AUDIT

TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>EXECUTIVE SUMMARY</td>
<td>1</td>
</tr>
<tr>
<td>INDEPENDENT AUDITOR’S REPORT</td>
<td>2</td>
</tr>
<tr>
<td>Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <em>Government Auditing Standards</em></td>
<td>2</td>
</tr>
<tr>
<td>SCHEDULE OF FINDINGS AND RESPONSES</td>
<td>5</td>
</tr>
<tr>
<td>Material Weaknesses and Significant Deficiencies in Internal Control Over Financial Reporting</td>
<td>5</td>
</tr>
<tr>
<td>Statewide Accounting Systems and Other Financial Reporting Matters</td>
<td>5</td>
</tr>
<tr>
<td>Information Systems Security</td>
<td>17</td>
</tr>
<tr>
<td>Department of Revenue – Division of Taxation</td>
<td>23</td>
</tr>
<tr>
<td>Department of Transportation – Intermodal Surface Transportation Fund</td>
<td>32</td>
</tr>
<tr>
<td>Department of Labor and Training – Employment Security and Temporary Disability Insurance Funds</td>
<td>42</td>
</tr>
<tr>
<td>Component Units – control deficiencies reported by the component unit auditors</td>
<td>44</td>
</tr>
<tr>
<td>Management Comments</td>
<td>52</td>
</tr>
</tbody>
</table>
As a result of our audit of the State’s financial statements, we communicated various deficiencies in internal control over financial reporting. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. The control deficiencies identified in our audit, which we are required to report, are briefly summarized as follows:

**Statewide Accounting Systems and Other Financial Reporting Matters -**
- full implementation of a comprehensive Enterprise Resource Planning system has stalled
- controls over financial reporting for federal program revenue and expenditures
- segregation of certain duties within the Office of the General Treasurer
- controls over the identification of capital assets, specifically project based outlays
- Eleanor Slater Hospital – Medicaid claiming
- Medicaid – manual payments by the fiscal agent
- Medicaid – program oversight and monitoring

**Information Systems Security**
- monitoring of comprehensive information system security policies and procedures
- program change controls
- RIFANS access controls and agency approval hierarchies

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

**Department of Transportation (DOT) - Intermodal Surface Transportation Fund**
- use of the RIDOT financial management system and the State’s RIFANS system results in control weaknesses and various inefficiencies
- transportation infrastructure reporting

**Department of Labor and Training (DLT) - Employment Security and Temporary Disability Insurance Funds**
- program change controls
- security of DLT’s data transmissions

The State’s response and planned corrective actions are also included in this report. Certain of these control deficiencies have been or are in the process of being addressed. Others have existed for some time and likely will require comprehensive and strategic plans, covering multiple fiscal years, to eliminate fully. These include plans to address the current status of the State’s RIFANS computer system, which falls significantly short of the enterprise resource planning system originally envisioned. Additionally, the State is challenged to maintain its complex information systems environment without sufficient resources.

We have also included 25 management comments, which are less significant findings that represent opportunities for efficiency or enhancing controls. These include recommendations concerning subrecipient monitoring, requiring payroll direct deposit for all State employees, surplus furniture and equipment, estimating the compensated absences liability, and child support collections.
INDEPENDENT AUDITOR’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Rhode Island and Providence Plantations (the State), as of and for the year ended June 30, 2012, which collectively comprise the State’s basic financial statements and have issued our report thereon dated December 20, 2012. Our report includes a reference to other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. As described in our report on the State’s financial statements, other auditors audited the financial statements of:

- a component unit which represents 1% of the assets and 1% of the revenues of the governmental activities and 1% of the assets and 4% 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 external investment trust – Ocean State Investment Pool which represents less than 1% of the assets and revenues of the aggregate remaining fund information; and

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

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

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

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: Findings 2012-2, 2012-3, 2012-7, 2012-11, 2012-13, 2012-16, 2012-18, and 2012-20. 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 2012-26, 2012-27 and 2012-37.


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 that is required to be reported under Government Auditing Standards and which is described in the accompanying schedule of findings and responses as Finding 2012-28.
Finance Committee of the House of Representatives and
Joint Committee on Legislative Services, General Assembly

We also noted certain other matters described as Management Comments 2012-1 through 2012-25 in the schedule of findings and responses that we consider to be less significant findings than those considered to be significant deficiencies, yet, in our opinion still warrant communication and the attention of the State’s management.

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

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

Dennis E. Hoyle, CPA
Auditor General

December 20, 2012
Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

Statewide Accounting Systems and Other Financial Reporting Matters
Finding 2012-1

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

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

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

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

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

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

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

- **capital projects** – the State accumulates its construction in progress component of capital assets external to RIFANS. With the implementation of a capital projects module, controls over this significant component of capital outlay could be enhanced as well as facilitate preparation of the annual capital budget.
To successfully implement additional Oracle modules, the State needs to significantly enhance its information technology resources that support RIFANS, especially in the areas of Oracle applications support and database administration. Investments in additional IT personnel should be considered within the planning for any additional Oracle module implementation to ensure project success and continued support for the RIFANS system after implementation.

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

The fiscal 2013 enacted budget provides a funding mechanism for IT projects including the completion of RIFANS. Additionally, a new Office of Digital Excellence has been added to, among other objectives, promote the use of technology within State government. The Office of Digital Excellence, Division of Information Technology and the Office of Accounts and Control should document the potential benefits to be derived from completing the RIFANS implementation and use that information to support funding requests, commitment of resources, and prioritization among other information technology projects.

RECOMMENDATIONS

2012-1a 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.

2012-1b Address deficiencies in information technology resources needed to successfully implement and support additional RIFANS modules.

2012-1c Document the potential benefits derived from completing the RIFANS ERP implementation to support funding requests, commitment of resources, and prioritization among other information technology projects.

Corrective action plan / auditee views:

2012-1a - A major accomplishment this past fiscal year was upgrading the current modules from Oracle Version 11 to Version 12. This was a significant upgrade to the E-Business Suite considering the Oracle resources that we currently have on board.

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

Though we still are looking at attaining funding and resources to implement the future modules, we also have to look strategically, if the funding is not provided, on whether or not the State needs to take a different approach at the whole Oracle implementation and whether or not there are other methods of attaining internal efficiencies. We will look at other alternatives in FY14 and develop a future strategy on the Oracle implementation.

Anticipated completion date: TBD
2012-1b - DOIT has had difficulty in recruiting and retaining Oracle resources. To address this issue, we are creating three new positions to reflect the salary requirements to attract these resources. Two of the positions are for functional and technical resources while the other position is for a database administrator. The positions are currently scheduled for public hearing. Upon receiving public hearing approval, DOIT will request FTE’s and post these positions to hire additional staff.

**Anticipated completion date:** August 2013

2012-1c - In regards to substantiating the cost/benefit relationship of completing the RIFANS implementation, this would require quite an effort to complete and is thus resource dependent and not planned in FY2014.

**Anticipated Completion Date:** N/A

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

**Phone:** 401.222.6091

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**Finding 2012-2**

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

Appropriate controls over cash receipts and disbursements require segregation of duties. Specifically, the authorization and recording of transactions should be performed by individuals totally separate from those with responsibility for the actual movement of cash and subsequent reconciliation of bank and book balances. Over time, responsibility for what should be separate functions has become less distinct, due in part to the incomplete implementation of the RIFANS ERP system (see Finding 2012-1). This results in weakened controls over the State’s cash receipts and disbursements.

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

**Recording of Payments made from Subsidiary Accounting Systems**

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

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

The State should continue to evaluate the types of transactions that are currently recorded through this process and restore appropriate segregation without disrupting the required timely movement of funds.

RECOMMENDATION

2012-2 Improve controls over cash receipts and disbursements by completing the process of analyzing transactions and better segregating certain duties currently performed by the Office of the General Treasurer.

Corrective action plan / auditee views:

The Office of the General Treasurer improved the control over cash receipts and disbursements by developing a process improvement that segregated certain duties to DLT and by creating compensating controls while meeting the required cash movement timelines. We will attempt to do the same for the TANF account and the TDI benefits payments. The time sensitivity of the required cash movements remains as a barrier.

It was noted that the initiation of the cash movement is typically performed by the agencies and as a compensating control; they reconcile the authorized cash movement to the subsequent accounting entry. Also, the initiation of cash movement, the initiation of an accounting entry, the approval of the accounting entry and the reconciliation of the cash movement to the general ledger, while all potentially performed within Treasury, is effectively segregated and all functions are performed by different individuals.

Anticipated Completion Date: June 30, 2013

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

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 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 2012-1) could reduce or eliminate such differences and significantly improve statewide controls over federal program administration.

Additionally, the newly formed Office of Management and Budget within the Department of Administration has responsibility for oversight of federal program administration. This could include building effective statewide processes to supplement accounting controls within the RIFANS accounting system. Ultimately, this could improve controls over recognition of federal revenue and statewide federal program administration.

RECOMMENDATIONS

2012-3a Improve functionality with the RIFANS accounting system to facilitate federal grant administration (grants management, cash management, and cost allocation).

2012-3b 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.
2012-3c Enforce State accounting system procedures that require timely adjustments to federal program activity once identified including appropriate segregation and coding of adjustments related to prior periods.

Corrective action plan / auditee views:

The recently formed Federal Grants Management Office (Office) within the Office of Management and Budget has been charged with the oversight of federal program administration. As a result, the Office will review the statewide federal grant administration process and implement additional controls where applicable and feasible.

Anticipated Completion Date: June 30, 2014

Contact Person: Laurie Petrone, Federal Grants Management Office
Phone: 401.574.8423

Finding 2012-4

ACCOUNTING AND PHYSICAL CONTROL OVER CAPITAL ASSETS

While the State has significantly improved processes and controls to record capital assets in recent years, RIFANS capabilities can be enhanced to better accumulate costs for “project-based” capital assets. Additionally, physical controls over capital assets can be enhanced at the departmental level by requiring periodic inventories in addition to those performed by the Office of Accounts and Control.

Accounting for “Project-Based” Capital Assets

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. “Work-arounds” have been developed which include accumulation of project costs on spreadsheets. Due to the limited effectiveness of these manual processes, capital assets totaling approximately $6.5 million, mostly building and infrastructure improvement projects in construction, were not initially capitalized at June 30, 2012. Implementation of the capital projects module would facilitate accumulation and management of project costs (reference Finding 2012-1). A near-term solution will likely need to be found through a combination of improved system coding, continued manual project tracking, and potential capital asset identification through preparation of the capital budget.

Enhancing Departmental Controls over Capital Assets

The State has increased efforts devoted to performing physical inventories of capital assets. Recent inventories have reported exceptions related to older equipment, which was disposed of but not reported to the Office of Accounts and Control as required by State policy. Controls over capital assets should be improved by emphasizing that departments have primary responsibility for the physical control over their capital assets and accordingly should perform departmental inventories in addition to those performed on a cyclical statewide basis.

Departments and agencies do not have direct access to the RIFANS capital asset module; however, reports generated from the capital assets module are available to the departments for managing their capital assets. Use of this information by the departments to manage capital assets including
performing periodic departmental inventory counts would enhance statewide accounting and physical controls over capital assets. Expanded use of this capital asset information would also assist the departments in complying with federal grant requirements when assets were purchased with federal funds.

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

RECOMMENDATIONS

2012-4a Improve controls to ensure all “project-based” capital asset acquisitions are identified for capitalization.

2012-4b Formalize and emphasize departmental responsibility for physical control over capital assets by requiring periodic departmental inventories and use of the State’s capital asset accounting information to manage those assets including the specific compliance requirements for assets acquired with federal funds.

Corrective action plan / auditee views:

The Controller’s Office disagrees with the significant deficiency characterization regarding this finding.

The $6.5 million referenced in the finding is misleading to the reader as it includes proposed adjustments by the auditors that the State did not accept as capital asset additions since the related expenditures only preserved the utility of the assets (i.e., maintenance and repairs). Furthermore, it is a minor amount considering the asset base of the reporting entity.

The Controller’s Office disagrees that there is an incremental benefit to allowing the agencies to have direct access to the Capital Asset Module, which is cumbersome to use, versus the reporting that is currently available. Particularly since the reporting was specifically developed to meet the needs of the agencies.

The Controller’s Office has significantly increased awareness regarding controls over capital assets by increasing the frequency of inventories and disagrees that the agencies should perform periodic physical inventories as well.

Anticipated Completion Date: N/A

Contact Person: Marc Leonetti, State Controller
Phone: 401.222.2271

Finding 2012-5

ELEANOR SLATER HOSPITAL – MEDICAL ASSISTANCE CLAIMING

The Department of Behavioral Healthcare, Developmental Disabilities, and Hospitals (BHDDH) operates the Eleanor Slater Hospital (the hospital), the State’s only publicly-operated hospital. The majority of patients residing in the hospital are eligible for Medical Assistance making the federal program the predominant source of hospital revenue. BHDDH bills Medicaid, through the Medicaid Management Information System (MMIS), based on an all-inclusive per diem hospital rate similar to the
manner in which nursing facilities bill for services. The hospital is reimbursed through Medicaid based on a cost reimbursement methodology that is reviewed in conjunction with their preparation of a Medicare cost report for each fiscal year. Once the report is audited by a Medicare fiscal intermediary, the final eligible per diem rate for the year is determined and the hospital performs its final settlement with the Medicaid program.

In recent years, the final reimbursement has been determined by BHDDH and reimbursed through a manual payment by the State’s Medicaid fiscal agent with no reprocessing of the detailed claims submitted by BHDDH. This has weakened the overall support for these final settlements and undermined the detailed audit trail as the underlying claims are not reprocessed at the final per diem rate amount determined for the fiscal year. In fiscal 2012, hospital per diem rates in the MMIS were not adjusted from prior years and BHDDH did not determine in a timely manner the reasonableness of the rate being reimbursed in the system based on actual costs and patient census experience. This resulted in an estimated settlement amount of approximately $11 million being recorded at June 30, 2012 by the hospital for additional amounts owed for Medicaid claims submitted during fiscal 2012. BHDDH had difficulty documenting and explaining the reasons for the large reimbursement due from Medical Assistance. In addition, the State’s cash management was negatively impacted by not claiming the federal share of this amount from Medicaid in a timely manner during the fiscal year.

BHDDH, in conjunction with the Executive Office of Health and Human Services, the State agency responsible for the administration of the Medicaid program, should examine the hospital’s current billing process to ensure more timely and accurate billing to Medicaid. Improvements to be considered should include a quarterly evaluation of the rate being charged to Medicaid, timely adjustments to rates when material changes occur, complete readjudication of claims for approved rate changes, more timely completion of hospital cost reports and final rate determination, and ensuring that claims for all Eleanor Slater Medicaid-eligible patients can be processed through the MMIS.

RECOMMENDATIONS

2012-5a  Implement improved processes to ensure more timely and accurate billing to Medicaid for Eleanor Slater Hospital.

2012-5b  Ensure that all Medicaid reimbursements to Eleanor Slater Hospital are based on claims processed through the MMIS.

Corrective action plan / auditee views:

2012-5a - BHDDH will review its billing processes and implement improved processes for more timely and accurate billing to Medicaid for Eleanor Slater Hospital.

2012-5b - BHDDH does not agree with this finding as it would require the readjudication of all claims in the MMIS to match the final rate determination and does not take into consideration the Medicaid rules which allow for billing 12 months from the date of service. Currently over 90% of claims are processed through the MMIS at the rate that is best available at the time of billing. The 10% of the claims in question are often individuals awaiting Medicaid determination and/or correction of errors in the MMIS. BHDDH agrees that there needs to be a better process and will review the final settlement process and identify the most effective and efficient procedures to assure that at least 90% of the claims are processed through the MMIS.

Anticipated Completion Date:  December 31, 2013

Contact Person:  Maureen Wu, Chief Financial Officer
Phone:  401.462.3100
Finding 2012-6

MEDICAL ASSISTANCE PROGRAM – MANUAL PAYMENTS BY FISCAL AGENT

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

- payments to the Rhode Island Public Transit Authority (RIPTA) for bus passes provided to Medicaid eligible individuals;
- Medicaid recipients share of Medicare coverage;
- payments advancing nursing home providers for the current month’s services;
- certain claims approved for payment by DHS after appeal by the provider;
- disproportionate share payments to hospitals for uncompensated care;
- certain outpatient hospital payments required by RI General Laws; and
- year-end advances to State-operated providers for services provided but unbilled.

These manual payments, which approximated $200 million in fiscal 2012 (of which $127 million relates to disproportionate share payments as listed above), are issued when the State’s fiscal agent receives formal authorization from EOHHS with detailed payment instructions. Although these authorizations are tracked with unique control numbers, manual payments essentially allow EOHHS personnel the ability to authorize payments outside expected control measures. In contrast, program payments made through regular MMIS cycles are system-determined amounts subject to all the processing controls of the system. Similarly, payments made through the State’s accounting system are subject to procurement and disbursement controls as well as multiple levels of authorization and review. While we acknowledge that there are limited instances where manual payments by the fiscal agent may be necessary, most of the payments currently made as manual payments should be disbursed subject to enhanced control mechanisms.

Overall program controls could be improved as follows:

- Payments to RIPTA for non-emergency transportation should be either fully adjudicated through the MMIS or paid through the State’s accounting system;
- Medicare coverage payments on behalf of Medicaid eligible individuals should be paid through the State Accounting System;
- Payments to inpatient hospitals for uncompensated care relating to inpatient and outpatient services, including disproportionate share payments, could be made through the State’s accounting system;
- Practices such as year-end advances to state-operated providers should be eliminated as there is no justification or benefit to such payments. State-operated provider agencies such as the Department
of Behavioral Health, Developmental Disabilities, and Hospitals (BHDDH) and the Department of Children, Youth, and Families (DCYF) should record year-end receivables in the State’s accounting system for services provided but unbilled and receive payment for the services when the actual claims are processed through the MMIS.

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

RECOMMENDATIONS

2012-6a Minimize the use of manual payments by the Medicaid fiscal agent. Process payments through RIFANS when appropriate and improve authorization controls over manual payments that must be processed through the MMIS.

2012-6b Eliminate the practice of processing advances to state-operated providers at fiscal year-end.

Corrective action plan / auditee views:

EOHHS recognizes the need review the manual payment process by the Medicaid fiscal agent.

EOHHS has already implemented an authorization hierarchy for the finance-related manual payments within the MMIS in February 2013 by requiring the approval of the EOHHS Chief Financial Officer (or designee) before payment.

EOHHS has approached the Office of Accounts and Control concerning the movement of certain manual payments from the MMIS manual payment process to the RIFANS system. EOHHS is currently reviewing which payments would be appropriate to move and expects to fully implement a new RIFANS payment process by July 1, 2013.

EOHHS has eliminated the practice of advances to state-operating providers at fiscal year end. Any such advances must now be approved by the EOHHS Chief Financial Officer through the new EOHHS manual payment hierarchy in place.

Anticipated Completion Date: July 2013

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

Finding 2012-7

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 utilized 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 utilizes 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, as the Single State Medicaid agency, 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 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.

- **Inpatient Hospital and 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. EOHHS has also been unable to review and finalize hospital settlements in recent years even though hospital providers have submitted required cost reports in a timely manner.

- **Controls over Recipient and Provider Eligibility** – EOHHS’s inability to conduct timely Medicaid Eligibility Quality Control (MEQC) reviews weakens controls over recipient eligibility. Additionally, controls over Medicaid provider eligibility were deficient due to delays in re-enrolling providers after the fiscal agent’s headquarters was destroyed by flooding in March 2010.

The State must allocate adequate personnel resources to ensure proper oversight and control over program expenditures that approximated $2 billion in fiscal 2012. Sustained reductions in personnel resources in key program areas continue to negatively impact control over program expenditures and compliance with federal program requirements.

**RECOMMENDATIONS**

2012-7a Address personnel resource deficiencies in critical program areas to ensure proper administration of and control over the Medicaid program.

2012-7b 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:**

*The fiscal agent is contractually obligated to perform a SOC II Type II audit annually by an independent third party. The report identifies any vulnerability in the controls the fiscal agent*
has in place for all aspects of its operation. The reports have indicated that all the proper controls are in place and the controls have been tested and validated by the auditors. In addition, the fiscal agent prepares monthly stewardship reports documenting recoveries made on the State’s behalf. Quarterly Contract Monitoring reports provide a summary of the fiscal agent’s activities for the prior quarter.

EOHHS agrees that there is a need to dedicate additional personnel to internal control functions to ensure proper administration and compliance with federal and program regulations and will work with the newly created Program Integrity Unit to develop processes to address the deficiencies cited in this finding.

**Anticipated Completion Date:** Ongoing

**Contact Person:** Ralph Racca, Administrator
**Phone:** 401.462.1879
Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

Information Systems Security
COMPREHENSIVE INFORMATION SYSTEMS SECURITY POLICIES AND PROCEDURES

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

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

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

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. The State may 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.

RECOMMENDATIONS

2012-8a Complete an initial assessment of compliance with systems security standards for the State’s mission critical systems.

2012-8b 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.

2012-8c Require systems security certification procedures to be performed by DoIT prior to any significantly modified application systems becoming operational.

2012-8d Consider additional information system security personnel resources to assist in the daily information systems security operational and monitoring procedures.
Corrective action plan / auditee views:

2012-8a - 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. This effort is ongoing and is resource dependent.

**Anticipated Completion Date:** TBD

2012-8b - The preparation a corrective action plan is also resource dependent and funding depending.

**Anticipated Completion Date:** TBD

2012-8c - Currently, all new projects come through the PRC (Project Review Committee). Any new project that gets approved must provide the Chief Information Security Officer (CISO) a written security plan for review and approval.

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

**Anticipated Completion Date:** TBD

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

2012-8d - Currently, DOIT has one Chief Information Security Officer (CISO) and two FTE’s assisting the CISO. One of these two additional FTE’s was hired in FY12 as part of DOIT budget request and to address a similar audit finding. We will continue to pursue adding additional FTE but are subject to budget and FTE constraints.

**Anticipated Completion Date:** On Going

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

Finding 2012-9

INFORMATION TECHNOLOGY (IT) SYSTEMS - PROGRAM CHANGE CONTROLS

Procedural Issues

Program change management controls are a critical IT control component to maintain highly reliable systems that meet the defined service levels of the organization. Almost all custom developed computer 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 of Rhode Island 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**

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 have 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.

It is imperative that a proper change management process be in place to insure 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, acceptance, and implementation and provide management with a history of what transpired. This standardized repeatable control process insures that enterprise and industry best practices are being followed for all changes made within the enterprise. This leads to consistent outcomes, efficient use of resources and enhanced integrity of the application systems which flow through the process. Automated tools vastly help control this process and make the process consistent, predictable, repeatable and aids in the reduction of “human error” in the process.

**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**

2012-9a Re-assess 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.

2012-9b 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:**

2012-9a - The current procedures and policies do need to be upgraded and improved upon. The original procedures and policies to be used with the version control and application tracking system, Clearcase/ClearQuest, were put into place in June 2006 and was meant serve as an enterprise solution. 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 the product line as the current product line has been re-marketed into another product line. We have started discussions with IBM on a migration path or alternate product line to migrate too.

The Department of Labor and Training is also addressing issues with change management in their audit finding, 2012-24. We will address this finding jointly and pool resources and available funds that DLT may have to address this finding. By pooling resources and enhancing this environment we can position these tools to server DOIT/DLT and other agencies.

2012-9b - DOIT acknowledges that improvements need to be made to the original software implementation to better improve the program change control originally put into place. We currently have maintenance and support on those products. However, these products are now a new product line. In order to implement this finding, we are dependent on funding and resources. As mentioned in 2012-9a, the quality control group in place in 2006 is no longer in existence due
to staff leaving state service. We will request funding to upgrade/replace the current environment, but will need to look at how pool resources across other state agencies to achieve the recommendation. As mentioned in 2012-24, we will be combining our efforts with DLT to address this finding.

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

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

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

**Phone:** 401.222.6091

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**Finding 2012-10**

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

Access roles are assigned to all RIFANS users and controlled through unique passwords. These roles, which are assigned based on job function and responsibility level, permit or limit access to various system capabilities. Access is further controlled by permitting only the viewing of data or the actual entry or changing of system information. Transaction level controls are also affected through agency hierarchies, which define specific functionalities and dollar authorization limits by individual within each department. Other transaction specific authorization controls are managed through workflow directories within RIFANS.

There is no current system capability that establishes and preserves a clear audit trail of additions, deletions, and changes in authorization that are routinely made to RIFANS system access. RIFANS has not activated a “versioning” functionality - the storing of data at a series of snapshots in time, rather than overwriting updates to the previous version. As such, the system cannot presently retroactively access the data tables that existed at a prior point in time, nor does it log the changes for ease of monitoring. The State should explore activating the “versioning” functionality within RIFANS as a means of providing a more comprehensive and automated means to monitor changes in system access.

The Office of Accounts and Control documents agency hierarchies periodically to reflect the authorized design of the structure at each agency for general ledger, accounts payable and purchase requisition functions. This current process is manually intensive, difficult to keep updated, and ineffective in documenting changes in user access over a period of time.

Activities of individuals with system administrator roles are logged but not reported and reviewed. These individuals have access to all critical areas in RIFANS and their activities are not required to be approved by another user. Additions, modifications, and deletions of critical data initiated by system administrators must be reviewed by authorized personnel. The Division of Information Technology’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 should develop reports that show when individuals have delegated their authority to other employees, a functionality that RIFANS allows in certain situations. In June 2012, 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. Monitoring of delegated RIFANS access authority also requires monitoring to ensure such delegations are appropriate and consistent with policy.
RECOMMENDATIONS

2012-10a  Enable the “versioning” functionality within RIFANS to allow for enhanced monitoring of system access changes.

2012-10b  Review activities of privileged users (system administrators) on a scheduled basis to ensure that additions, modifications, and deletions initiated by them are appropriate.

2012-10c  Develop procedures to monitor delegated access within RIFANS.

Corrective action plan / auditee views:

2012-10a - When the Oracle E-Business suite was implemented, the customized workflows were not built with the versioning feature enabled. If they were built with the versioning provision, versioning would have been much simpler to implement. Thus, the current work flows in the state that they are in can’t be versioned without going through each and every workflow and modifying them to use this feature. This will be a significant project and with the very limited staff that we have that is familiar with workflow, this is not feasible at this time. If we are able to get additional staff as mentioned in 2012-1b, we will put this in the project queue. However, at this time, we are not able to address this finding.

Anticipated Completion Date: N/A

2012-10b - 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 2012-10a.

Anticipated Completion Date: December 30, 2013

2012-10c - RIFANS allows users to delegate access. Such an example is a vacation rule in which a user delegates his or her authority to another user. On a given day a user can turn on or off a rule. We are not aware of any current feature within the business suite that would allow for monitoring of such features. A change was made last year to ensure that someone could not delegate to someone with lower authority. We would have to investigate if version 12 has such functionality as we do not know if this is possible in the environment we are in.

Anticipated Completion Date: February 28, 2014

Contact Person: Alan Dias, Assistant Director of IT
Phone: 401.222.6091
Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

Department of Revenue
Division of Taxation
DEPARTMENT OF REVENUE – CONTROLS OVER ELECTRONIC TRANSMISSION OF TAX PAYMENTS AND OTHER INFORMATION

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

The majority of the State’s tax revenues (approximately $2.4 billion) is received electronically. Funds are deposited automatically into the State’s bank accounts and electronic files, which contain abbreviated tax payment data (taxpayer identification number, payment amount, tax type, tax period), are transmitted by the State’s financial institutions. Through a lockbox arrangement with a financial institution, other returns and payments that are mailed to Taxation are processed and converted to electronic data files. Other initiatives have increased the receipt of data in electronic form. For example, Taxation began accepting electronic returns and payments for insurance taxes through a system called OPTins, which is operated and maintained by the National Association of Insurance Companies (NAIC).

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

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

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

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

2012-11a Perform a “data classification” review consistent with DoIT policy to ensure the proper level of data protection (e.g. encryption) is in place.

2012-11b Secure all electronic files containing taxpayer information residing on the Division of Taxation’s network to ensure data integrity.

2012-11c 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.

2012-11d Develop monitoring and reporting procedures to ensure the proper upload of data files.

2012-11e Improve controls over the processing of electronic insurance tax returns by better segregating certain duties performed by Taxation.

Corrective action plan / auditee views:

As part of the Fiscal Year 2013 budget request, the Division of Taxation received funding over the next five fiscal years for an integrated tax system. This system will, among other things, overhaul the front-end entry systems, accounting systems and processing systems. These improvements will address many of the Auditor General’s Findings and meet their recommendations.

2012-11a - The Division of Taxation has reviewed DoIT policy # 05-02 – Data Categorization and it is our feeling that the data should be classified as “sensitive” and categorized as “critical”. Data classified as sensitive requires 256 bit or higher encryption. Based on section 10.3 the Division of Taxation will work with DoIT to implement the needed security procedures base on DoIT policy #05-02.

The new integrated tax system utilizes Secure Socket Layer (SSL)/TLS for in-transit data encryption, and complies with IRS Publication 1075, FIPS 140-2, and IETF TLS (RFC 5246).

The integrated tax system’s platform implicitly supports encryption of network traffic. SSL is utilized to encrypt the solution for all communications over the HTTP protocol. SSL is public key infrastructure which relies on certificate authority for verification of certificate trust. The solution uses strong SSL Certificates in compliance with FIPS 140-2 and IRS Publication 1075.

2012-11b - The Division of Taxation has contacted DoIT to provide options for the Division of Taxation to encrypt taxpayer information on our network. The Division of Taxation has an outstanding service request number 190591. Once the Division of Taxation has received recommendations from DoIT we will start the implementation process.

2012-11c - The Division of Taxation has worked with DoIT to come up with a new process that will limit manual intervention and track any changes made to the electronic files.

This process will be temporary until the new integrated tax system is fully implemented. Due to the mainframe limitations, Taxation is unable to completely remove the manual aspect of processing these returns. When the mainframe is eliminated, Taxation will modify the current processes and remove the manual intervention required to process these returns through the mainframe.

2012-11d - The Division of Taxation has worked with DoIT to come up with a new process that
will provide a process to report on any changes to the electronic files.

This process will be temporary until the new integrated tax system is fully implemented. Due to the mainframe limitations, Taxation is unable to completely remove the manual aspect of processing these returns. When the mainframe is eliminated, Taxation will modify the current processes and remove the manual intervention required to process these returns through the mainframe.

2012-11e - As part of the Division of Taxation’s strategic plan, the Division is continually looking for ways to increase and improve electronic filing. In 2011, the Division of Taxation partnered with the National Association of Insurance Companies (NAIC) to implement electronic filing of insurance premiums tax returns. Effective January 1, 2013, the Division of Taxation amended the procedures to have E-Government Section download the files from NAIC to ensure better segregation of duties. The returns will then reviewed and verified by the Corporate Tax Section.

Anticipated Completion Date: TBD based on the availability of DoIT personnel
Contact Person: Dan Clemence, Principal Revenue Agent
Phone: 401.574.8732

Finding 2012-12

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 2011 were due February 28, 2012. During fiscal 2012, W-3 paper returns for tax years 2000 through 2011 were posted to the mainframe system. However, as of June 30, 2012, the system-generated W-3 reconciliation returns for tax years 2009 and 2011 had not yet been posted. The backlog in posting W-3 reconciliation returns delays identifying potential overpayments and underpayments of employer withholding taxes.

RECOMMENDATION

2012-12a 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

2012-12b Include refund carry-forward returns within the management refund review control procedures.

Tax Returns Remaining on the Error Register

Personal income tax returns that cannot be processed completely (due to data entry 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, 2012, there were 54,949 returns dating from 1991 through 2012. Approximately 29,000 returns include requests for refunds totaling more than $16.5 million.

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

RECOMMENDATION

2012-12c Investigate and resolve returns on the error register in a timely and efficient manner. Apply refund offsets and bill taxpayers amounts owed.

Withholding Tax Filing Frequency

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

RECOMMENDATION

2012-12d Review and update taxpayer information to ensure taxpayers are remitting tax withholdings on the required frequency.

Corrective action plan / auditee views:

As part of the Fiscal Year 2013 budget request, the Division of Taxation received funding over the next five fiscal years for an integrated tax system. This system will, among other things, overhaul the front-end entry systems, accounting systems and processing systems. These improvements will address many of the Auditor General’s Findings and meet their recommendations.

2012-12a - Over the past year, the Division of Taxation has dedicated staff from Processing and Section to focus on reconciling and processing W-3s from tax year 2009 and 2010. The Division of Taxation has generated over 200 assessments for approximately $650,000.

The new integrated tax system will include a comprehensive tax reconciliation modular that will allow the Division of Taxation to process and audit W-3 returns received from employers in a more timely manner.
2012-12b - Taxation met with DoIT programming to discuss the process to accomplish this recommendation and will be submitting a Clear Quest Request. This request will be prioritized along with the other outstanding requests.

2012-12c - While electronic returns have increased the speed of processing returns and shortened the time to issue refunds, it has created an easier method for individuals to file fraudulent returns. Over the past few tax seasons, the Division of Taxation has seen an increase in the amount of fraudulent returns filed. During the past two tax seasons, the Division of Taxation has amended the parameters used to stop returns with potential fraudulent activity. These additional measures have increase the number of errors and stops placed on returns filed. These increased fraud detection measures along with reduced staffing due to employee turnover in the personal income tax section has increased the total number of returns on error throughout the year. During the past ten months the Division of Taxation has reduced the number of error from over 64,000 to under 13,300. The Division will continue to monitor the error rate and make appropriate modifications to the business rules that flag error returns.

2012-12d - Under Regulations issued by the Division of Taxation, employers are required to file and pay withholding tax either daily, quarter/monthly, monthly or quarterly depending on the amount of withholding during the previous twelve months. The Division of Taxation ran a special automated program before issuing the withholding booklets for calendar year 2013 to update all withholding agents’ filing methods.

Anticipated Completion Date: TBD

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

Finding 2012-13

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 2012, the Division used the enhanced analytical capabilities of the data warehouse to identify taxpayers that should have filed tax returns or potentially underreported and underpaid taxes to the State. While the effort to identify unreported tax liabilities to the State is noteworthy, use of the data warehouse affected the State’s recognition of tax revenue during fiscal 2012.

“Notices” are generated from the data warehouse, which operates independently of the various mainframe tax systems. These tax systems are the official record of tax revenues and receivables for financial reporting purposes. Upon generation of the tax notice from the data warehouse, data is uploaded to the respective tax system(s). A 60-day threshold has been established before the notice results in recognition of a tax receivable balance within the tax systems. The 60-day waiting period reflects the nature of a notice as being a high likelihood but yet uncertain claim of taxes owed. The notice is in essence a request for additional information from the taxpayer to either file and pay or explain the filing discrepancy. During this time, the data can be modified or adjusted if the taxpayer provides information indicating that the notice is in error or the balance potentially owed is less. However, these changes are not subject to the same control procedures that would apply to other adjustments or entries recorded in the system.
New transaction codes detailing the original data warehouse notice total, tax amount, interest, and penalties were added to the mainframe to identify tax balances that resulted from analysis within the data warehouse (these codes are only effective for mainframe transactions processed after August 14, 2009). However, there are no codes that identify corrections or adjustments made to data warehouse notices. Consequently, correction or adjustment to tax amounts originating from the data warehouse cannot be readily identified within Taxation’s systems. Being able to segregate these amounts is necessary due to the inherently different collection characteristics of these notices versus known tax balances due. An allowance for uncollectible amounts, reflective of the unique characteristics of the data warehouse tax billings, should be developed and used for financial reporting purposes. In fiscal 2012, determination of the allowance for uncollectible taxes receivable did not reflect the unique characteristics of these balances.

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

RECOMMENDATIONS

2012-13a 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.

2012-13b Establish an allowance for uncollectible taxes receivable, which reflects the unique collection characteristics of the data warehouse notices/billings.

2012-13c 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:

As part of the Fiscal Year 2013 budget request, the Division of Taxation received funding over the next five fiscal years for an integrated tax system. This system will, among other things, overhaul the front-end entry systems, accounting systems and interface with the data warehouse. These improvements will address many of the Auditor General’s Findings and meet their recommendations.

2012-13a - Assessments created in the data warehouse which are transferred to the mainframe are coded with a special indicator. Any correction or adjustment made to these assessments can be separately identified and reported. Division of Taxation will request that DoIT separately report any correction or adjustment made to an assessment originating from the data warehouse.

2012-13b - Allowance for uncollectible taxes receivable for most tax types are determined using a weighted average over a three year period. The Division of Taxation does not have enough historical data for assessments and collections from the data warehouse to perform the same analysis. The Division of Taxation will continue to work with the Office of Accounts and Control to establish and modify the allowance for uncollectible tax receivables relating to assessments originating from the Data Warehouse.
2012-13c - 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 to appeal the assessment. The Division of Taxation will examine the feasibility of eliminating or reducing the 60-day waiting period. After the implementation of the integrated tax system, the assessments created in the data warehouse will automatically be posted to the integrated tax system.

Anticipated Completion Date: TBD

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

Finding 2012-14

DEPARTMENT OF REVENUE – CONTROLS OVER TAX RECEIVABLE WRITE-OFF BALANCES

The Division of Taxation (Taxation) analyzes tax receivable balances close to fiscal year end to “write-off” amounts deemed uncollectible. Such analysis is for financial reporting purposes and does not represent a legal discharge of the debt to the State.

During fiscal 2012, Taxation used only one criterion in identifying accounts for potential write-off – the number of days delinquent. As a result, some balances written-off were collectible as evidenced by taxpayer payment or other activity. For financial reporting purposes, tax receivable balances were understated and audit adjustments were proposed to correct the understatement. Taxation’s identification of accounts for potential write-off should include additional criteria such as evidence of recent payment activity, whether the account is in hearing or bankruptcy status, etc. as part of a comprehensive analysis of balances to be written-off.

We also noted that controls should be enhanced to ensure balances coded for write-off are recorded appropriately and timely within Taxation’s subsidiary tax receivable systems.

RECOMMENDATIONS

2012-14a Utilize comprehensive criteria in identifying tax receivable balances for potential write-off rather than just a number of days delinquent threshold.

2012-14b Enhance controls to ensure the approved written-off taxes receivable balances are appropriately posted in a timely fashion.

Corrective action plan / auditee views:

The Division of Taxation follows a detailed process to identify delinquent accounts for write-offs. The main criteria for writing off a receivable is the number of days that receivable has been active; the Division of Taxation also checks to see if the case is currently receiving payments and/or is in a hearing status. The Division of Taxation will review and evaluate the write-off procedures during fiscal year 2013 and make the appropriate modifications.

Anticipated Completion Date: June 30, 2013

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922
Finding 2012-15

DEPARTMENT OF REVENUE – RECONCILIATION OF TAXATION RECEIPTS TO RIFANS

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

RECOMMENDATION

2012-15  Develop the reporting capability to facilitate reconciliation of receipts reported by Taxation’s systems with RIFANS.

Corrective action plan / auditee views:

As part of the Fiscal Year 2013 budget request, the Division of Taxation received funding over the next five fiscal years for an integrated tax system. This system will, among other things, overhaul the front-end entry systems, accounting systems and processing systems. These improvements will address many of the Auditor General’s Findings and meet their recommendations.

The Division of Taxation balances cash receipts received to RIFANS on a daily basis. Due to the number of systems used to manage the 56 different taxes and fees administered by the Division of Taxation, it is impossible to balance these receipts to the appropriate tax system in a timely manner. The integrated tax system will allow the Division of Taxation the ability to reconcile receipts reported with RIFANS on a daily, monthly and annual basis.

Anticipated Completion Date:  TBD

Contact Person:  David Sullivan, Tax Administrator
Phone: 401.574.8922

Finding 2012-16

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 2012-17

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.
Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

Department of Transportation

Intermodal Surface Transportation Fund
Finding 2012-18

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

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

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

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

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

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

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

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

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

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

2012-18  Re-evaluate the continued operation of two separate accounting systems to support financial reporting for the IST fund. Establish short and long-term goals to ensure reliable information is available to support timely financial reporting.

Corrective action plan / auditee views:

The Department will be engaging a management consultant 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.

It must be emphasized that implementing any of the options, other than status quo, will require an investment of significant State funds, which currently are not available because of budgetary constraints. Additionally, at such point in the future that monetary resources become available, the dedication of significant staff time (i.e., RIDOT Financial Management Office, State Controller’s Office, and DOIT), as well as a commitment that this initiative will be a top priority, will be required for the duration of the project.

Anticipated Completion Date: To be determined.

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

Finding 2012-19

INTERMODAL SURFACE TRANSPORTATION FUND - FINANCIAL REPORTING

The Intermodal Surface Transportation (IST) Fund, a special revenue fund, includes financial reporting for transportation related activities of the State, including highway construction programs, and the expenditure of proceeds from the State’s Grant Anticipation Revenue Vehicle (GARVEE) bonds and matching Motor Fuel bonds for specific highway construction related projects.

Controls over the Preparation of Financial Statements

Controls can be improved over the preparation of financial statements to ensure consistent and accurate reporting of fund activity in accordance with generally accepted accounting principles. Several account balances reflected in the fiscal 2012 draft financial statements required material adjustment due to weaknesses in controls over financial reporting as described below:

- Controls over the reporting of accounts payable and amounts due from the federal government can be improved to ensure all material amounts are included in the financial statements.
RIDOT’s process to accumulate accounts payable is manually intensive and therefore susceptible to omitting, incorrect posting or duplicating payables. RIDOT’s controls over estimating and recording the liability at fiscal year-end for legal claims and settlements can improve. Additionally, the process to match legal settlements to purchase order/contract data can be improved.

☐ 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 unrecorded federal receivables and 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.

Reconciliation between the GARVEE Trustee, RIDOT FMS and RIFANS

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

The trustee maintains separate accounts for each GARVEE bond issue and various subaccounts consistent with the bond indenture. Accounts have also been established in RIFANS for each of the three GARVEE bond issuances. During fiscal 2012, the individual RIFANS accounts did not reconcile to the respective Trustee accounts, although the balances reconciled in total. RIDOT’s reconciliation focused on the total asset balances rather than the specific asset accounts. RIDOT’s reconciliation process can be further improved by reconciling the detailed RIFANS accounts to the respective accounts established by the trustee.

RECOMMENDATIONS

2012-19a 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.

2012-19b Improve controls over the estimation of the liability at fiscal year-end for legal settlements and the process to match legal settlements to purchase order/contract data.

2012-19c 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.

2012-19d Enhance the GARVEE trustee statement to RIFANS reconciliation process by reconciling the detailed RIFANS accounts to the respective accounts established by the trustee.
Corrective action plan / auditee views:

2012-19a - 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 2012-20a through 2012-20e, the RIDOT Financial Management Unit hired a senior-level accountant position in October 2012, which was part of RIDOT’s FY 2011 corrective action plan. However, this individual has been assigned to address critical financial issues at the Rhode Island Public Transit Authority and, to date, has not been available to assist in implementing these corrective actions.

Anticipated Completion Date: December 31, 2013

2012-19b - Financial Management will continue to improve controls over the estimation of the liability at fiscal year-end for legal settlements. Where applicable, Financial Management will review its controls related to purchase order items that are part of a legal settlement and revise if warranted.

Anticipated Completion Date: December 31, 2013

2012-19c - 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 2012-20a through 2012-20e, the RIDOT Financial Management Unit hired a senior-level accountant position in October 2012, which was part of RIDOT’s FY 2011 corrective action plan. However, this individual has been assigned to address critical financial issues at the Rhode Island Public Transit Authority and, to date, has not been available to assist in implementing these corrective actions.

Anticipated Completion Date: December 31, 2013

2012-19d - Financial Management has made great strides in improving controls over the GARVEE reconciliation process over the past few fiscal years, and will continue to improve the process.

Anticipated Completion Date: June 30, 2013

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

Finding 2012-20

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 2012. Certain completed projects totaling $19.6 million were still included in construction in progress and $16.4 million was excluded from construction in progress at June 30, 2012. 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.

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 2012-18 which describes the use of two incompatible accounting systems to prepare financial statements for the IST Fund. Due to the use of the two systems, accumulation of infrastructure outlays meeting the State’s capitalization criteria is performed independent of either system. Data is drawn from both systems into massive spreadsheets which eventually yield the amounts needed for financial reporting purposes. The design of RIDOT’s FMS envisioned that system providing capital asset (infrastructure) financial reporting information; however, the use of the two systems in the current configuration necessitates the inefficient and error-prone spreadsheet approach.

The Department of Transportation and 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

2012-20a Improve controls over the recording of infrastructure investment in the State’s financial statements.

2012-20b Improve controls for determining when infrastructure assets are placed in service.
Accumulate and link actual design as well as construction costs related to a project. Include all project costs from design through project completion in the amounts capitalized as infrastructure.

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.

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

Corrective action plan / auditee views:

2012-20a - Financial Management will continue to improve controls over the recording of infrastructure investment in the State’s financial statements.

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

2012-20b - Financial Management will continue to improve controls for determining when infrastructure assets are placed in service.

For FY 2012, 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’s Financial Management Office is aware that better coordination between RIDOT units is required to ensure that it possesses a complete list of infrastructure assets that have been placed into service during each fiscal year.

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

2012-20c - Financial Management will continue to refine, wherever possible, its methodology of accumulating and linking actual design and construction costs related to a project. As noted by the Auditor General’s Office, the current process is necessary primarily because of certain systems limitations.

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

2012-20d - The Department does not dispute the auditors’ observation that a properly aligned automated systems approach would be a more efficient way to account for infrastructure assets. RIDOT is currently in the process of implementing a comprehensive Asset Management initiative that includes assessing information technology needs.

An internal RIDOT Asset Management Council has recently been established to implement this initiative. One of the Council’s standing subcommittees is charged with evaluating infrastructure accounting issues, including how to integrate an automated systems approach.

**Anticipated Completion Date:** To be determined
2012-20e - Financial Management is in the process of establishing an impairment policy that conforms with the criteria outlined in generally accepted accounting principles applicable to governmental entities.

Anticipated Completion Date: June 30, 2013

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

Finding 2012-21

RIDOT - DISASTER RECOVERY AND CONTINGENCY PLAN

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

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

RECOMMENDATION

2012-21 Develop and implement a comprehensive disaster recovery and contingency plan for all RIDOT systems. Upon approval, periodically test and review the plan in accordance with DoIT published policies.

Corrective action plan / auditee views:

DoIT currently has a Disaster Recovery and Contingency plan in place. Schedule Disaster Recovery tests are performed in New Jersey for testing and improving recovery methods on critical systems. Both the FMS and PMP systems are scheduled for Disaster Recovery tests in April 2013.

Anticipated Completion Date: April 30, 2013

Contact Person: Keith Graham, DoIT
Phone: 401.222.6935
RIDOT – CONTROLS OVER PROGRESS PAYMENT DATA FILES

Controls should be enhanced to ensure that data integrity is maintained over progress payment data as it moves from the Project Management Portal (PMP) to RIDOT’s Financial Management System (FMS) and ultimately RIFANS (the State’s accounting system) for vendor payment. Some data elements are manually altered after being transmitted from the PMP but prior to posting to the FMS accounting system.

While the need to manually verify and modify data was explained, the lack of adequate compensating controls increases the risk of inaccurate payments and unauthorized changes. A review of the entire file transfer process, from progress payment file creation in PMP to invoice creation in FMS to vendor disbursement in RIFANS, should be performed to identify critical points where automated controls should be implemented to eliminate all manual involvement.

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

In addition to implementing more automated controls over data transmission between RIDOT’s systems, controls could be further enhanced by ensuring that final vendor payments as disbursed through the RIFANS system are consistent with progress payments initiated through the PMP.

RECOMMENDATIONS

2012-22a Review the progress payment file transfer process to identify critical points where automated controls could be implemented to eliminate the need for manual intervention.

2012-22b Create and implement appropriate approval hierarchies. Automatically identify RIFANS/FMS payment discrepancies for review.

Corrective action plan / auditee views:

2012-22a - 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
Material Weakness and Significant Deficiency Findings

Office of the Auditor General

State of Rhode Island – Fiscal 2012

2012-22b - 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.

Anticipated Completion Date: June 30, 2014

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

Finding 2012-23

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). These modifications to the file are required since RIDOT’s Financial Management system (FMS) does not fully provide the level of data required to draw federal funds as required by the Federal Highway Administration. 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 and send it to FMIS.

- 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 Federal Management Information System (FMIS) from RIDOT’s Financial Management System (FMS).

RECOMMENDATIONS

2012-23a Modify the FMS to maintain an audit log of award information.

2012-23b Improve controls over the RIDOT federal billing process to include transferring files without modification.

2012-23c 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:

2012-23a - In many cases, projects authorized by the Federal Highway Administration (FHWA) are funded with multiple appropriation codes or program codes referred to as FSAN’s within the Department of Transportation’s Financial Management System (FMS). Typically the program codes available to States are changed by Federal Highway Administration each time the Congress passes a new Transportation Bill.
Over the last several years, funding to the states has been provided in the form of numerous continuing resolutions, which many times has resulted in changes to the program codes. Since the passage of MAP-21, new program codes have been created, making it difficult to fund a single project with a single program code.

When a federal project funded with a specific program code exceeds the available funds within that code, the project must be modified with a different program code that the project qualifies for.

It is inevitable that, when requesting reimbursement from FHWA, the billing may need to be split by multiple program codes. This occurs when a billing is uploaded to FHWA through its billing system and a specific project (or projects) exceeds the federal amount programmed for the respective project(s). This generates an error log within the billing system which requires action on RIDOT’s part in order to successfully upload the billing into FHWA system.

The split must take place on the billing text file and performed manually. Currently, when such manual intervention takes place, RIDOT Grants Unit staff undertakes the process of performing the billing, printing the error log, and filing the error log with the individual billing file, along with any changes that have been made to the text file.

The text file is updated manually by changing the program code on the text file. If there is an amount of funds available in the older program code, RIDOT bills all available funds remaining in that code and the excess is billed to the new code. If the all of the lines in the modified text file do not equal the information in the project header record and if the dollar amount does not reconcile with that same header information, the FHWA billing will report a fatal error and the billing is not uploaded.

Financial Management, in order to further tighten control over such changes, will create a log that will be stored on the RIDOT “S” drive in the Grants folder that will indicate when a project charge is moved from one program code to another. It will delineate which program code the charge was moved to, along with the date and header information of the particular billing.

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

2012-23b - 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

2012-23c - 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, memorandum and paper-based forms in documenting and controlling the program change process. There is no automated control system that could be queried to offer pertinent information regarding changes made to the application. An automated system could improve controls over the change management process by providing:

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

DLT’s lack of an automated system to control, track and report upon all application program changes made by the DLT programming staff is a control weakness in financial reporting for the Employment Security Fund.

RECOMMENDATION

2012-24 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:

2012-24 - The Department of Labor and Training’s DoIT Staff with work with DoIT’s Enterprise Staff to jointly address this finding by working to meet the requirements set forth in Finding 2012-24. DLT’s DoIT Staff will address the issues of change management by working together using a combined group of resources and funding to implement Clearcase/ClearQuest, if this is the toolset used to meet the requirements set forth. In addition DLT’s DoIT staff will investigate a change management solution for use on the IBM I5 computer systems.

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.

Anticipated Completion Date: June 30, 2014

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

Finding 2012-25

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

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

RECOMMENDATION

2012-25 Secure the TDI data files that are currently being transmitted in an unsecure format by implementing encryption and originating the transmission from a dedicated secure PC or directly from the mainframe computer system.

Corrective action plan / auditee views:

2012-25 - As of January 31, 2013, TDI direct deposit transmissions are being sent to the Bank of America using secure FTP with PGP. The files are sent directly from the TDI I5 using Linoma Software's GoAnywhere Director.

We are currently in the process of modifying the TDI pospay and Employer Tax Refund pospay transmissions, converting them from dial-up modem to Linoma Software's GoAnywhere Director. We have been in contact with the Bank of America and have exchanged file format requirements. We anticipate these transmissions to be tested before the end of March 2013

Anticipated Completion Date: March 31, 2013

Contact Person: Robert M. Genest, Administrator, MIS
Phone: 401.462.8012
Schedule of Findings and Responses

Material Weaknesses and Significant Deficiencies in Internal Control over Financial Reporting

Component Units

(findings reported by the auditor of each component unit)
Finding 2012-26

CENTRAL FALLS SCHOOL DISTRICT – FINANCIAL REPORTING

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

The financial reports prepared by the Central Falls School District for the year ended June 30, 2012 had misstatements that resulted in the proposal of several audit adjustments. The misstatements resulted from inadequate review of the financial statement accounts throughout the year and in particular, at year-end. The School District’s Finance Director position was vacant for the last six months, leading to no formal review and reporting procedures. Central Falls School District’s internal controls over financial reporting are not operating as intended and did not prevent and detect misstatements in the financial statements.

The School District’s procedures do not include formal preparation and review of monthly and year-end financial reports including budget to actual revenue and expenditure reports, and the distribution of monthly financial reports to the Board of Trustees and Superintendent. The School District has approved a written policy that includes monthly financial reporting, but it has not been implemented.

RECOMMENDATION

2012-26 We recommend that the School District implement internal control procedures that include monthly reconciliation of all significant account balances. The procedures should also include the preparation and review of monthly and year-end financial reports for all funds. The financial reports should include a balance sheet, and a detail budget to actual report for the revenues and expenditures. The monthly reconciliations and financial reports should also be reviewed and approved by the Director of Finance and the financial reports should be submitted to the Superintendent and the Board of Trustees.

Corrective action plan / auditee views:

Effective 4/19/2012, the RI Commissioner of Education assumed control of the District’s finances. Soon after, in conjunction with the Superintendent of Schools, a new Finance Director was hired beginning 9/1/2012.

The Finance Director will prepare and submit to the RI Department of Education, by the 15th of each month, a detailed budget to actual financial report for revenues and expenditures for all funds. In addition, weekly meetings will be held between the RI Department of Education and the Central Falls Administration to discuss the status of the current years’ budget especially the financial impact on recent developments.

The Finance Director will provide the same monthly financial reports to the Central Falls Board of Trustees accompanied by a written narrative, summarizing the status of the fiscal year’s budget. A budget update will be a regular agenda item each month at the Board meeting.

Contact Person: Michael Petrarca, Finance Director
Phone: 401.727.7700
Finding 2012-27

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, 2012, 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

2012-27 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 will develop a Fixed Asset Management Policy that will establish fundamental guidelines and practices for properly accounting for and reporting of assets. The policy will include: 1) roles and responsibilities; 2) capitalization guidelines; 3) classification of capital assets; and 4) recordkeeping requirements.

The District will transfer all fixed asset data that it presently maintains in Microsoft Excel to the Unifund capital asset accounting system. The district will also perform annually, a physical inventory of each department’s fixed assets.

Contact Person: Michael Petrarca, Finance Director
Phone: 401.727.7700

Finding 2012-28

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

During the fiscal year ended June 30, 2012, the Convention Center Authority was unable to fund the Operating Reserve and Debt Service Reserve components of its restrictive covenants pursuant to the bond indentures.

Corrective action plan / auditee views:

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

Contact Person: James McCarvill, Executive Director
Rhode Island Convention Center Authority
Phone: 401.351.4295
Finding 2012-29

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

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

RECOMMENDATION

2012-29 We understand that the Authority’s Board of Directors and Executive Director review monthly financial reports prepared by the CFO. However, to strengthen existing internal control over financial reporting we recommend that the Authority:

• Assign wire authorization to the Executive Director and the Chairman of the Board of Directors only.

• Assign to the Executive Director the function of reviewing the month-end reconciliations of each bank and investment account, and comparing the reconciled bank and investment account balances to the respective balances reported in the general ledger.

Corrective action plan / auditee views:

The Authority has set up a fax notification process from the bank directly to the Executive Director for all wires affecting Authority accounts.

The Authority implemented a system of reporting bank and general ledger balances to the Executive Director and the Board on a monthly basis.

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

Finding 2012-30

RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – RECONCILIATION OF INVESTMENTS

During our audit, we noted a significant increase in the recorded amount of investment fees and investment income compared to amounts recorded in the prior year. The differences resulted principally from the misclassification of recording investment income and expenses. Although correcting entries were required to be recorded, the entries did not have an effect on total net assets.
RECOMMENDATION

2012-30 We recommend that the Authority’s management prepare a monthly detailed investment reconciliation for each investment account summarizing sales, purchases, investment income, and investment fees. Also, as part of each month-end closing, the CFO should reconcile the amounts recorded in each general ledger account to the respective activity within the reconciliation to determine whether all transactions occurring within all investment accounts have been completely and accurately recorded.

Corrective action plan / auditee views:

The Authority agrees with this recommendation. New procedures for the reconciliation process have been implemented.

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

Finding 2012-31

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

During our procedures to reconcile net assets reported at the beginning of the year under audit to the total of net assets reported in the prior year’s audited financial statements, we noted that certain expense and accounts payable transactions occurring during the year ended June 30, 2012 were incorrectly recorded as 2011 transactions.

RECOMMENDATION

2012-31 We recommend that a person independent of the person recording accounts payable activity in the Authority’s General Ledger reconcile the amounts and determine whether such amounts have been reported in the period to which they relate. We also recommend that controls be implemented to mitigate the potential for recording activity in a period other than the period to which the transactions relate.

Corrective action plan / auditee views:

The Authority agrees with the recommendation. We are currently researching financial systems to replace our current accounting package that will ensure that this issue is rectified.

Contact Person: Buddy Croft, Executive Director
Rhode Island Turnpike and Bridge Authority
Phone: 401.423.0800
Finding 2012-32

RHODE ISLAND TURNPIKE AND BRIDGE AUTHORITY – RECORDING OF NONRECURRING TRANSACTIONS

During our audit, we noted that the Turnpike and Bridge Authority (the Authority) recorded as revenue amounts received from a vendor in settlement of disputed costs that were capitalized by the Authority, rather than as a reduction of previously capitalized costs.

RECOMMENDATION

2012-32 We recommend that the Authority review the nature of recurring transactions and the applicable accounting guidance to determine whether amounts for recurring transactions are recorded in the general ledger in accordance with accounting principles generally accepted in the United States.

Corrective action plan / auditee views:

The Authority agrees with the recommendation.

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

Finding 2012-33

RHODE ISLAND PUBLIC TELECOMMUNICATIONS AUTHORITY – RECONCILIATION OF NET ASSETS

The opening net asset balance as of July 1, 2011 did not agree to the ending net asset balance reported on the Public Telecommunications Authority’s (the Authority) audited financial statements as of June 30, 2011.

RECOMMENDATION

2012-33 Revise policies and procedures to include a procedure to reconcile net assets as recorded to the audited financial statements.

Corrective action plan / auditee views:

Management has augmented its year-end closing procedures to include a reconciliation of net assets between the Authority’s internal financial records and the audited financial statements.

Contact Person: David Piccerelli, Executive Director
Rhode Island Public Telecommunications Authority
Phone: 401.222.3636
Finding 2012-34

RHODE ISLAND PUBLIC TELECOMMUNICATIONS AUTHORITY – YEAR-END CUT-OFF

During the fiscal 2012 audit, the auditors of the Rhode Island Public Telecommunications Authority (Authority) noted that amounts related to auction and membership revenue related to the year ended June 30, 2012, totaling approximately $38,500, were not recorded at June 30, 2012.

Additionally, we noted expenses related to a termination agreement, certain prepaid expenses, and other amounts related to operating expenses related to the year ended June 30, 2012, totaling approximately $52,800 in the aggregate, were not recorded at June 30, 2012.

RECOMMENDATION

2012-34 Refine year-end procedures to ensure that a proper cut-off is attained.

Corrective action plan / auditee views:

Management has augmented its year-end closing procedures so that all revenues and expenses will be recognized and recorded appropriately. Management was not aware of the proper treatment of severance payments that span fiscal years. Going forward, if severance payments are to be made that cross fiscal years, a liability will be recorded to account for the portion due.

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

Finding 2012-35

RHODE ISLAND PUBLIC TELECOMMUNICATIONS AUTHORITY – RECORDING INVENTORY ACTIVITY

During the fiscal 2012 audit, the auditors of the Rhode Island Public Telecommunications Authority (Authority) noted that the receipt and issuance of membership premiums inventory occurring throughout the year are not recorded within the Authority’s inventory system.

RECOMMENDATION

2012-35 Implement procedures that would require entering the movement of membership premium inventory into the inventory system.

Corrective action plan / auditee views:

Management has refined the Authority’s physical inventory count and tracking procedures so that an accurate reflection of the membership premium inventory will be maintained at all times.

Contact Person: David Piccerelli, Executive Director
Rhode Island Public Telecommunications Authority
Phone: 401.222.3636
Finding 2012-36

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY – CONTROLS OVER FINANCIAL REPORTING

During the fiscal year ended June 30, 2012, 9 of 40 cash disbursements did not have proper approval in accordance with policies and procedures of the Higher Education Assistance Authority (the Authority). Due to the significant amount of exceptions noted during this test, the Authority’s auditors recommended 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 fiscal year ended June 30, 2012, there were times where the Chief Financial Officer (CFO) prepared, reviewed and approved certain transactions; has access to blank check stock; and can transfer cash between financial institutions. Properly segregated duties minimize the risk of potential material financial statement misstatement, whether due to error or fraud. The Authority’s auditors recommended that the Authority evaluate its current human resources and segregate the above functions such that the CFO can independently exercise his review responsibilities.

RECOMMENDATIONS

2012-36a 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.

2012-36b Evaluate the current human resources and segregate the above functions such that the CFO can independently exercise his review responsibilities.

Corrective action plan / auditee views:

2012-36a - RIHEAA has strengthened the oversight process to assure that all check payments have proper documentation prior to being presented to authorized signers. (Note that RIHEAA requires two signatures on each check issued.)

2012-36b - RIHEAA has been authorized by the State Department of Personnel to add an accountant position which will lessen the need for the Chief Financial Officer to perform some of those functions.

Contact Person: Marc M. Lacroix, Chief Financial Officer
Rhode Island Higher Education Assistance Authority
Phone: 401.736.1139
Finding 2012-37

RHODE ISLAND ECONOMIC DEVELOPMENT CORPORATION – UNDERSTATEMENT OF EXPENSE AND REVENUE

During the audit of the Small Business Loan Fund trial balance, the auditors of the Economic Development Corporation (Corporation) noted that the Corporation booked a $1,500,000 grant expense as an asset. An entry was proposed and made to reduce the investment and increase the grant expense, causing a net decrease in income of $1,500,000.

The Corporation has programs where grant funds are recognized as income, only as related expenses are incurred. Unexpended funds are reported as deferred revenue. During fiscal year ended June 30, 2012, we noted that $3,200,000 of expenses that should have been recognized as revenue. As a result, an entry was proposed and made to increase grant revenue and decrease deferred revenue for $3,200,000 as of June 30, 2012.

RECOMMENDATION

2012-37 Take steps to ensure that the general ledger accounts are reconciled during the year to minimize significant year-end adjustments.

Corrective action plan / auditee views:

Management intends to implement the following controls, effective immediately:

• Require dual signatures for entries made into the general ledger that exceed $250,000, and

• Perform a monthly reconciliation of bank statements by staff accountant and a quarterly review of general ledger accounts by the Chief Financial Officer, and make adjustments as needed.

In addition, management will present corporate financial statements to the Board of Directors on a quarterly basis beginning March 2013.

Contact Person: Adam N. Quinlan, Chief Financial Officer
RI Economic Development Corporation
Phone: 401.278.9100
Schedule of Findings and Responses

Management Comments
Management Comment 2012-1

ESTIMATING THE COMPENSATED ABSENCES LIABILITY

The procedures used to estimate the compensated absences liability for State employees at fiscal year-end should be reexamined to (1) ensure that amounts reported accurately reflect the newly enacted pension reform measures and (2) simplify the process wherever possible.

The compensated absences liability estimate is derived through a complex calculation that utilizes accrued vacation, sick and other leave hours by employee, hourly wage rates, and whether an employee is eligible for retirement - cash payments for accrued but unused sick leave are only available upon retirement. Recently enacted pension reforms modified retirement eligibility for State employees. In prior years, retirement eligibility could be easily estimated based on years of service and/or age. Going forward, determination of retirement eligibility requires a more detailed analysis of various factors. Ultimately, retirement eligibility is determined through the Employees’ Retirement System of Rhode Island (ERSRI). While such information is determinable, the data is not readily available for use as a data input to the compensated absence calculation.

For fiscal 2012, the compensated absences estimation process used retirement eligibility factors based on the previous retirement eligibility provisions. If continued, this will result in an increasingly inaccurate estimate since retirement eligibility is generally delayed under the new provisions.

The Office of Accounts and Control (Office) should explore utilizing retirement eligibility information from ERSRI for the compensated absences liability estimation process. Additionally, the Office should consider whether retirement eligibility is the appropriate measure for the estimate of expected payouts at retirement. Lastly, the estimation process has become complex and time-consuming. Reexamination efforts should include simplifying the estimation process to the extent possible.

RECOMMENDATION

MC-2012-1 Explore using ERSRI data regarding retirement eligibility for State employees in the compensated absences liability estimation. Reexamine the criteria for measuring the liability and simplify the process to the extent possible.

Corrective action plan / auditee views:

We will reevaluate the current process used to calculate the compensated absence liability in an effort to streamline and simplify the process.

Anticipated Completion Date: July 31, 2013

Contact Person: Peter B. Keenan, Associate Controller-Finance
Phone: 401.222.6408
Management Comment 2012-2

UNRECEIPTED FEDERAL FUNDS

At June 30, 2012, approximately $3.7 million of federal grant receipts deposited in the State’s bank accounts remained unidentified for accounting purposes. These unidentified receipts increased by approximately $2 million from the prior fiscal year-end. 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.

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 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 2012-5, unidentified federal program receipts could be eliminated if the draw of federal funds was automated and centralized.

RECOMMENDATIONS

MC-2012-2a Enhance current procedures to resolve unrecorded deposits in a timely manner with the responsible State agencies.

MC-2012-2b Implement new procedures to 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 will initiate an intra-state agency communications campaign to drive better conformance with RIFANS accounting and entry standards. Additionally, we will attempt to develop a procedure which improves the initial request, bank deposit, and receipt accounting procedures at the agency and department level.

Anticipated Completion Date: June 30, 2013

Contact Person: Chris Feisthamel, COO, Office of the Treasurer
    Phone: 401.462.7640

Management Comment 2012-3

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 the balance of undistributed collections. This accumulated balance totaling $1.2 million of undistributed collections is not identifiable to specific child support cases.

The variance had been static, indicating that current activity was reconciled appropriately and the variances likely occurred many years prior. However, unexpected fluctuations occurred during fiscal 2012, indicating that some elements of current activity may not be recorded consistently between the two systems.

In fiscal 2012, the State declared a portion of the unidentified and undistributed collections as unclaimed property, which allowed an amount to be recognized as general revenue. Since the undistributed collections are unidentifiable as to a specific child support case, there is no practical way that a party to a child support case could learn of the unclaimed property and claim any of the amounts.

Given that the previously static variance is now increasing, further reclassification of the unresolved balance as unclaimed property should be suspended until the balances can be fully reconciled. Additionally, the process of eliminating the variance by declaring some of the unreconciled amounts unclaimed property should be reconsidered since that process is only appropriate when the “owner” of the property is or was known. A permanent resolution to this long-standing variance should be obtained.

RECOMMENDATION

MC-2012-3 Resolve the balance of unidentified child support collections reported at year-end.

Corrective action plan / auditee views:

Over the past three years the reconciliation process for the child support collections escrow account has been thoroughly analyzed and significant improvements have been made to all aspects of the process. As a result of these process improvement efforts the dollar amount of the longstanding variance was stabilized and a decision made in fiscal 2012 to escheat a significant portion of it. The decision to escheat the funds was made out of caution because there is a possibility that owners of some of the funds could come forward claiming a portion of these funds.

We will continue to actively monitor the variance (which has been stable for the past 2 calendar quarters) and evaluate the causes of any material changes in it. If the variance remains constant it will be resolved by an adjustment at the end of fiscal 2014.

Anticipated Completion Date: June 30, 2014

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

Management Comment 2012-4

SUBRECIPIENT MONITORING – CENTRALIZED REVIEW OF SINGLE AUDIT REPORTS

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

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

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

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

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

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

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

RECOMMENDATIONS

MC-2012-4a 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-2012-4b Build a database of all subrecipient entities that receive state and/or federal grant funding.

Corrective action plan / auditee views:

The Federal Grants Management Office will explore the possibility of centralizing the subrecipient monitoring process.

Anticipated Completion Date: June 30, 2014

Contact Person: Laurie Petrone, Federal Grants Management Office
Phone: 401.574.8423
Management Comment 2012-5

**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 $2.7 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-2012-5 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, 2013

Contact Person: Anne-Marie Fink, CIO, Office of the Treasurer
Phone: 401.462.7640

Management Comment 2012-6

**REQUIRE PAYROLL DIRECT DEPOSIT FOR ALL EMPLOYEES**

State employees currently have the option of being paid by check or direct deposit to their financial institution. Approximately 80% of state employees have opted for direct deposit. The costs to disburse employee payroll through direct deposit are significantly less than for traditional paper checks. Savings accrue from eliminating 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-2012-6a Require all state employees to be paid through direct deposit.

MC-2012-6b Implement an employee portal to allow access to direct deposit payroll “stub” information in lieu of printing and distributing such information on a biweekly basis.

Corrective action plan / auditee views:

The Department of Administration agrees that this is an area that could be enhanced and has researched a similar initiative. The department’s initiative includes a self-service portal for employees to view and print their advices. It is important to note that this initiative may require legislative change and / or a change in the collective bargaining agreements to move forward. The department will continue to research this project.

Anticipated Completion Date: June 30, 2013

Contact Person: Marc Leonetti, State Controller
Phone: 401.222.2271

Management Comment 2012-7

PAYROLL ACCOUNTING SYSTEM – SYSTEMS DOCUMENTATION AND MONITORING

The State’s payroll information system, for fiscal 2012, 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.

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

RECOMMENDATION

MC-2012-7 Improve formalized documentation of the State’s payroll system.

Corrective action plan / auditee views:

The State’s payroll system is a legacy application written in COBOL in an IBM mainframe environment. In FY 2012 payroll codes and other incremental steps were taken in documenting
the payroll system. In FY2013 and FY 2014 we will continue to take incremental steps in documenting the payroll system.

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

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

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### Management Comment 2012-8

**VENDOR REGISTRATION DOCUMENTATION**

The Division of Purchasing in conjunction with the Office of Accounts and Control is responsible for maintaining the State’s list of approved vendors, including appropriate controls over the addition of vendors to the file, tax identification numbers, and vendor banking information for those who have opted for electronic payment (ACH - automated clearing house). Appropriate disbursement controls include maintaining supporting vendor documentation (e.g., W-9 forms and other vendor enrollment documentation) to support information contained in the vendor file.

We tested 56 vendor files to assess compliance with vendor registration procedures. We were unable to obtain vendor registration documentation for seven vendors (14% of our sample). Additionally, we were unable to obtain vendor banking documentation for three of the 14 vendors in our sample which had opted to be paid through ACH. In fiscal 2012, the State’s compliance with required vendor registration documentation procedures remained deficient due to a continued vacancy in a staff position responsible for these activities.

At present, the vendor documentation is maintained in paper form. On-line vendor enrollment and/or an electronic file of scanned vendor enrollment documentation should be explored to enhance compliance in this area.

**RECOMMENDATION**

MC-2012-8 Ensure that current vendor documentation is maintained for all active RIFANS vendors.

**Corrective action plan / auditee views:**

*The Supplier Coordinator position has been filled. Furthermore, Central Purchasing and Accounts & Control Offices are working together to improve the efficiency of the vendor registration process. We are also looking at options for the electronic remittance and storage of W-9 forms.*

**Anticipated Completion Date:** December 31, 2013

**Contact Person:** Louise Anderson, Associate Controller-Operations  
**Phone:** 401.222.2704
Management Comment 2012-9

BANK SERVICE CHARGES

Bank service charges for transaction fees and other bank services are currently budgeted and recorded in the State’s accounting system as reductions to General Fund investment income rather than expenditures. This understates investment income within the General Fund and is inconsistent with generally accepted accounting principles, which requires gross rather than net presentations of revenues and expenditures.

For fiscal 2012, investment income for the State’s General Fund is understated due to the netting of more than $400,000 in bank service charges. Specifically, payments for bank service charges are recorded on the accounting system as reductions (contra-revenue transactions) to General Fund investment income rather than expenditures.

Proposed audit adjustments to reclassify the presentation of these expenditures were not accepted primarily because such amounts are not budgeted expenditures for the Office of the General Treasurer. Bank service charges should be budgeted and accounted for as expenditures rather than offsets to investment income.

RECOMMENDATION

MC-2012-9  Budget and record bank service charges as expenditures.

Corrective action plan / auditee views:

We agree with the comment and have taken steps to re-establish the budget and related accounting as described.

Anticipated Completion Date:  June 30, 2013

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

Management Comment 2012-10

IMPROVE CASH RECONCILIATION EFFICIENCY

The General Treasurer’s Office should continue to explore options to further automate the cash reconciliation process between the State’s accounting records 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 as recommended in Finding 2012-1.
RECOMMENDATION

MC-2012-10 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, 2013

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

Management Comment 2012-11

ENTERPRISE OPERATIONS CENTER (EOC) PHYSICAL SECURITY

The Enterprise Operations Center (EOC) security policies and procedures over physical access to the data center and protection of critical components should be enhanced and enforced.

During an audit visit to the State’s new data center (which became operational during fiscal 2012), we were able to gain access to the server room while being escorted by a contractor. Throughout our visit, we were not required to sign-in nor were we questioned as to the purpose of our visit or our need to be in the server room. DoIT Policy 10-06, §5.3.10 indicates that “Contract maintenance personnel and others not authorized unrestricted access but who are required to be in the controlled area, will be escorted by an authorized person at all times when they are within the controlled area”. Furthermore, DoIT Policy 10-06, §5.3.11 indicates that “All access to the computer room will be logged, and logs reviewed monthly by the Information Security Officer to determine if access is still required”.

We also observed that the backup generator and cooling fans did not have any type of “perimeter” protection. Industry best practices indicate that critical components of a data center (i.e., the backup generator and cooling fans) should be protected physically from vandalism and/or theft.

RECOMMENDATIONS

MC-2012-11a Enforce DoIT policies and procedures regarding server room access and visitor access, log-in and escort protocols.

MC-2012-11b Protect critical components of the data center, specifically the backup generator and cooling fans. The use of walls and/or fencing should be considered.

Corrective action plan / auditee views:

MC2012-11a - Effective immediately, policies and procedures will be reviewed and DOIT policies at the EOC will be enforced to adhere to policy handbook.

Anticipated Completion Date: June 30, 2013
MC2012-11b - DOIT has requested the fencing and perimeter protection through Capitol Projects and we are awaiting a time line and approval. This perimeter protection was to be originally part of the building but was not completed and we following up to make sure that this is done.

Anticipated Completion Date: December 30, 2013
Contact Person: Alan Dias, Assistant Director of IT
Phone: 401.222.6091

Management Comment 2012-12

LEGACY SYSTEMS – ACCOUNT STRUCTURE CONVERSION

Various subsidiary accounting systems (e.g., employee payroll and departmental cost allocation) which process material classes of expenditures have not been converted to the current account structure used within the RIFANS accounting system. These subsidiary accounting systems continue to use an old account structure that has not been utilized within RIFANS 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-2012-12a Complete conversion of subsidiary accounting systems using the legacy account structure to the new RIFANS account structure.

MC-2012-12b 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:

MC2012-12a - This has been an ongoing project and due to other projects or system changes has been delayed. In FY 2012 the file layouts were increased to account for the pension changes and at the same time changed to accommodate the RIFANS account number. We continue to work on the conversion, but due to staff resources and other projects that may impact this project, cannot guarantee a completion date, though we will continue to make as many changes as possible and target a completion date in FY2014.

Anticipated Completion Date: December 30, 2013
MC2012-12b - We would still need to complete the legacy account conversion as Payroll is not currently part of the remaining modules in the overall RIFANS implementation. So our strategy would still be to complete this recommendation, especially if the future modules get approved.

Anticipated Completion Date: March 31, 2013

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

Management Comment 2012-13

CONTROLS OVER DISADVANTAGED BUSINESS ENTERPRISE (DBE) LOAN PROGRAM

The Department of Transportation (RIDOT) established a loan program, Mission 360, with a $1 million grant from the Federal Highway Administration (FHWA) to facilitate DBE firms to develop into viable, self-sufficient businesses capable of competing for and performing on federally assisted highway and bridge projects. A vendor administers this loan program and is responsible for writing checks for loans approved by RIDOT, servicing the loans (i.e., collections, loan delinquency, asset verification, etc.) and providing a report of activity to RIDOT.

Through June 30, 2012, the vendor had custody of the revolving loan fund and utilized a bank account outside of State control to disburse and receive funds. No bank reconciliations were performed and program activity was not recorded within the State’s accounting system. We identified activity on the bank statement that differed from the activity reported to RIDOT. The differences between the reported activity and bank statements related to the vendor advancing itself the monthly contract fee.

RIDOT should regain custody of the loan program bank account and all program funds. Program receipts and disbursement should be controlled through the State accounting system. Oversight and monitoring of the loan program should be enhanced to ensure appropriate controls are in place over the loan program activities performed by the vendor.

RECOMMENDATIONS

MC-2012-13a Establish control procedures to ensure accountability and oversight of the DBE Loan Program activities performed by the vendor.

MC-2012-13b Regain custody of the loan program bank account and all State funds that are deposited in the name of the vendor servicing the loan program.

Corrective action plan / auditee views:

MC-2012-13a - RIDOT will require the prime contractor to prepare monthly bank reconciliations and forward them, along with copies of the respective monthly bank statements, to the RIDOT Financial Management Office for review.

MC-2012-13b - RIDOT has regained custody of all funds in the aforementioned bank account and has deposited them in the State’s Fund 12 bank account. All loan program activity is now being accounted for in a RIFANS escrow liability account.
Additionally, all loan program participants have been directed to send their payments to the prime contractor, who in turn forwards the payments to the RIDOT Financial Management Office for deposit in the State’s Fund 12 bank account.

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

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

### Management Comment 2012-14

#### 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 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** - DoIT security policy states that 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** - DoIT security policy states that 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** - DoIT security policy states that 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). DoIT security policy states that 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, §5*).
Additionally, DoIT security policy states that agencies are responsible for developing an incident reporting program in accordance with DoIT policy (Policy 10-06: IT Security Handbook Operational Controls, §2). Further, RIDOT indicated that incident handling is a subset of contingency planning. DoIT security policy states that 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, §5.4.1.9).

- 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). DoIT security policy states that 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 - DoIT security policy states that 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 office 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 - DoIT security policy states that 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 - DoIT security policy states that 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-2012-14 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:

The Agency IT manager and Technical Support Manager will work with the office of the Chief Information Security Officer to review DoIT Security policies 10-05 and 10-06. It will be requested to have a resource from the CISO assigned to assist the department in identifying and assisting with the policies and procedures.

Anticipated Completion Date: June 30, 2014

Contact Person: Thomas Lewandowski, Agency IT Manager
Phone: 401.222.6935
Management Comment 2012-15

RIDOT – DATA CLASSIFICATION

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

RECOMMENDATION

MC-2012-15 Classify all data in accordance with DoIT Policy 05-02 (Data Categorization).

Corrective action plan / auditee views:

In accordance with DoIT Policy 05-02 (Data Categorization), the level of confidentiality for data within the Project Management Portal system will be classified as “Private.” Security threats to this data include unauthorized access, alteration, and destruction concerns. The availability of data within the Project Management Portal system is classified will be classified as “Necessary.” Data can be down and/or not available for up to a period of one (1) week.

Anticipated Completion Date: June 30, 2013

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

Management Comment 2012-16

DEPARTMENT OF REVENUE – CONTROLS OVER TAX REVENUE RECOGNITION

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

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

RECOMMENDATION
MC-2012-16 Improve controls over processing taxpayer data (i.e., returns, payments, etc.) to ensure timely and accurate posting to taxpayer accounts particularly at fiscal year-end.

Corrective action plan / auditee views:

As part of the Fiscal Year 2013 budget, 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: To be determined.

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

ACCOUNTING FOR AGENCY FUND DEPOSITS

The State reported $102.3 million in agency fund deposits at June 30, 2012 that constituted pledged securities for certain entities doing business in the State and court deposits held by the Judiciary.

In fiscal 2012, in response to a prior year audit management comment, the State began recording the underlying transaction activity for these deposits within the State’s accounting system. In prior years, the State would adjust year-end accounting system balances based on amounts reported at year-end for financial reporting purposes. The fiscal 2012 recorded transaction activity resulted in duplicated deposit balances on the general ledger. An audit adjustment totaling $12.2 million was required to ensure that general ledger balances properly reflected June 30, 2012 deposit amounts.

The Judiciary implemented procedures to reconcile certain general ledger escrow account balances to the Judiciary’s case management system and bank deposit activity. Not all balances were included within the reconciliation process - approximately $4.3 million in cash balances related to bail and punitive fines not recorded on the case management system were excluded from the reconciliation process. Controls should be enhanced to ensure that all agency funds are reported and reconciled between the RIFANS general ledger and underlying case-level data.

RECOMMENDATION

MC-2012-17 Enhance reconciliation controls over agency balances reported by the Judiciary to ensure inclusion of all balances and full reconciliation to Judiciary’s case management system or underlying records.

Corrective action plan / auditee views:

The Judicial Finance Office has implemented a process to ensure that balances for agency accounts reflected in the general ledger, the Judiciary’s case management system and the bank are reconciled on a regular basis (i.e. several times each month).
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-2012-18  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, 2014
Contact Person: Bernard Lane, Associate Director – Financial Management
Phone:  401.222.6603
Management Comment 2012-19

ACCOUNTS PAYABLE MODULE TRANSACTION DATES

We noted negative amounts (debit balances) totaling approximately $15 million in the accounts payable listing at June 30, 2012 which, before correction, netted and misstated the General Fund accounts payable balance reported on the draft financial statements. Upon investigation, we found that the negative or debit balances were caused by an unusual situation where the liquidation of the payable balance occurred in fiscal 2012 whereas the expenditure and creation of the payable balance occurred in fiscal 2013. At fiscal year-end, the module has the capability of having multiple accounting periods open simultaneously. The subsequent fiscal period is open to allow for recording purchase orders and to post recurring transactions with a scheduled (advance) payment date.

With both fiscal periods open and through an unusual combination of events, the accounts payable liquidation transaction and the expenditure transaction posted in different fiscal periods. The Office of Accounts and Control should review the situation and determine if a system modification is needed to enhance controls to prevent this type of occurrence.

RECOMMENDATION

MC-2012-19 Implement additional controls to prevent unintended and/or inappropriate accounts payable transactions within the RIFANS accounting system.

Corrective action plan / auditee views:

The instance of having the July AP period open prior to July 1 was a unique circumstance. The Central Accounts Payable section will review policy and procedure to ensure that proper controls are in place to avoid these circumstances in the future.

Anticipated Completion Date: June 30, 2013

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

Management Comment 2012-20

DCYF - OPERATING SYSTEM AND APPLICATION DEVELOPMENT SOFTWARE SUPPORT

The DCYF RICHIST system is currently running on an unsupported network operating system and unsupported application development software. Each of these products has been “sun-setted” by the vendors who will no longer service the product if a critical error or security concern is found.

Critical system applications should be running on a fully supported network operating system and application development software to properly ensure system and data integrity, confidentiality, and availability. Continuing to run these unsupported products presents two critical risks: (1) both vendors no longer issuing patches and fixes to support the proper operation of these products and (2) future technology advances could expose these products to possible exploitable vulnerabilities.

DCYF IT management is aware of these risks associated with the unsupported network operating system and development software environments and has developed a plan to migrate each to a supported
version. However, IT management indicated that due to budgetary cuts and the lack of staff resources, it has been unable to execute their plan.

**RECOMMENDATION**

MC-2012-20 Undertake the actions necessary to move the RICHIST system to a supported and scalable network operating system and development software environment as soon as possible.

*Corrective action plan / auditee views:*

DCYF IT management is aware of these risks associated with the unsupported network operating system and development software environments and has developed and implemented a project plan to migrate each to a supported versions. DCYF IT management is working with DCYF Management and Budget Office to mitigate or resolve the budgetary cuts. DCYF IT is also working to supplement network staff with technical school interns to help with the lack of staff resources. The migration project plan is dependent upon staffing and budgetary resource issues being resolved.

*Anticipated Completion Date: TBD*

*Contact Person:* David R. Allenson, DoIT Agency IT Manager for DCYF  
*Phone:* 401.528.3858

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**Management Comment 2012-21**

**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-2012-21 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.
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 reviewed the controls over data entry for the employee payroll system and found that established procedures now mandate the assignment of unique passwords for each user to control and restrict access to the system. However, the existing password control system does not record user identification information within the data files to identify individuals making specific file changes, thereby preventing a clear audit trail. System access controls need to be improved by utilizing the user identification to track all transactions initiated by an individual user. Management may decide to identify key data fields to track transactions by specific user identification.

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

RECOMMENDATIONS

MC-2012-22a  Improve formalized documentation of the State’s payroll system.

MC-2012-22b  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:

MC2012-22a - This was addressed previously in MC 2012-7.

Anticipated Completion Date:  N/A

MC2012-22b - Division of Information Technology will assign a team to implement this capability using current available technology. This audit finding will be implemented after audit finding MC2012-12a and is thus resource dependent.

Anticipated Completion Date:  TBA

Contact Person:  Alan Dias, Assistant Director of IT
Phone:  401.222.6091
Management Comment 2012-23

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

The Division of Taxation (Taxation) should strengthen controls over Accounts Receivable Correction (ARC) transactions posted to their mainframe systems. 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

MC2012-23 Improve data entry controls over ARC transactions.

Corrective action plan / auditee views:

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

Anticipated Completion Date: To be determined.

Contact Person: David Sullivan, Tax Administrator
Phone: 401.574.8922

Management Comment 2012-24

DEFINED CONTRIBUTION PLAN – FINANCIAL REPORTING CONSIDERATIONS

The Retirement Security Act enacted in November 2011, created a defined contribution plan to supplement the existing ERS and MERS defined benefit plans. Employers and employees began contributing to the defined contribution plan on July 1, 2012.

The manner in which the defined contribution plan should be presented both within the System’s financial statements and the State’s financial statements must be explored and resolved consistent with generally accepted accounting principles. This should be done expeditiously to allow sufficient time to accumulate the information needed for financial reporting purposes. Options include presenting the defined contribution plan within the System’s financial statements, presenting it separately, or providing note disclosures about the plan in both the System’s and State’s financial statements without a full presentation of the financial activity of the defined contribution plan.

RECOMMENDATION

MC2012-24 Ascertain the appropriate financial statement presentation for the newly implemented defined contribution plan.
Corrective action plan / auditee views:

We will ascertain the appropriate future financial statement presentation for the newly implemented defined contribution plan.

Anticipated Completion Date: June 30, 2013

Contact Person: Frank Karpinski, ERSRI Director
Office of the General Treasurer
Phone: 401.462.7610

Management Comment 2012-25

ACCOUNTING FOR NEW CONTRIBUTIONS FROM NON-MEMBER JUDGES

Pension reform legislation enacted in November 2011 required that active judges who were appointed prior to December 31, 1989, have a “retirement contribution” of 8.75% withheld (effective July 1, 2012) from their salary similar to the employee contribution for other State employees. These judges (active non-member judges) are not members of the Judicial Retirement Benefits Trust but instead will receive a pension that is appropriated and paid from the annual budget of the Judiciary.

The “retirement contribution” withheld from compensation paid to the judges is currently treated as a “pre-tax” contribution similar to the manner in which the employee share of retirement contributions for other State employees is treated. In order for the “retirement contribution” to be treated as a “pre-tax” deduction (deducted before the determination of income tax withholding amounts) the contributions must be made to a qualifying governmental pension trust. These active non-member judges are not members of the Judicial Retirement System plan that would qualify the contributions to be treated as a pre-tax item.

Presently, the contributions are being withheld from compensation paid to the active non-member judges in compliance with the Retirement Security Act. However, the contributions are now only being held in a separate bank account rather in a qualifying governmental pension trust until various issues can be resolved.

While the dollar amount of such contributions is minimal, compliance with the General Laws and IRS regulations presents an accounting and financial reporting conundrum. Placing the active non-member judges contributions within an existing or new trust implies that these judges should likely be included in an actuarial valuation of the existing judicial plan (or a new “plan”). Their inclusion in the valuation would impact the funded status and required employer contribution. On the other hand, not depositing the employee withheld contributions in a qualifying trust jeopardizes the “pre-tax” status of the contributions for tax withholding purposes.

RECOMMENDATION

MC2012-25 Resolve the tax withholding, accounting, and financial reporting issues associated with the employee contributions required of active non-member judges.

Corrective action plan / auditee views:
Working with multiple resources, we will attempt to resolve the tax withholding, accounting, and financial reporting issues associated with the employee contributions required of active non-member judges.

Anticipated Completion Date: June 30, 2013

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