STATE OF RHODE ISLAND
AND PROVIDENCE PLANTATIONS

FINDINGS AND MANAGEMENT COMMENTS

Resulting from the Audit of the State of Rhode Island's Fiscal 2019 Financial Statements

Dennis E. Hoyle, CPA, Auditor General

Office of the Auditor General

General Assembly

State of Rhode Island and Providence Plantations

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March 3, 2020

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

We have audited the financial statements of the State of Rhode Island for the year ended June 30, 2019 and have issued our report thereon dated December 31, 2019 (as included in the State's Comprehensive Annual Financial Report for fiscal 2019).

As required by *Government Auditing Standards,* we have also prepared a report, dated December 31, 2019 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. That report includes identification of control deficiencies that are significant deficiencies or material weaknesses in internal control over financial as well as instances of material noncompliance. Our findings related to the financial statements are categorized below:

- 35 findings considered significant deficiencies or material weaknesses in internal control over financial reporting;

- 1 finding concerning compliance or other matters required to be reported by *Government Auditing Standards;*

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

This communication also includes 14 management comments resulting from our audit of the financial statements which are less significant issues that still warrant the attention of management.

Our *Single Audit Report* for fiscal 2019 is in progress and is scheduled to be completed on March 31, 2020. That report will include findings related to controls over compliance with federal program requirements and the administration of federal programs.

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

Sincerely,

Dennis E. Hoyle, CPA
Auditor General

State of Rhode Island and Providence Plantations

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Audit of the Fiscal 2019 Financial Statements

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The strategic plan report details the need for, and the benefits to be derived from, an enterprise applications modernization effort. The report highlights that "the risks of inaction far outweigh the cost of upgrades in capability".

Prior and current year audit findings highlight that important functionalities are minimally met through legacy systems and multiple departmental processes without intended integration and efficiencies. This results in business continuity risk, decreased efficiency and effectiveness, and control weaknesses. The State has already experienced such integration issues and halted work on a time and effort reporting system and a grants management system. The State had expended nearly $3 million on those projects.

Weaknesses identified in the State's internal control over financial reporting, result from our annual audit of the State's financial statements for the year ended June 30, 2019. The State's management has responsibility for, and maintains internal control over, financial reporting. *Government Auditing Standards* require that we communicate deficiencies in internal control over financial reporting and material noncompliance based on our audit.

Findings repeated from prior years are identified. When corrective actions are underway but incomplete, we note the incremental progress.

Management focus, training and implementation resources have been insufficient to ensure that departments and agencies are assessing and documenting internal control consistent with management's overall responsibility for the adequacy of the design and operation of internal control. Internal controls safeguard public resources and support accurate financial reporting.

The State should commit to providing additional training and implementation materials to assist departments and agencies in documenting their internal control. An internal control assessment and documentation effort should be implemented to coincide with the implementation of a fully integrated ERP system.

The State can continue to improve its consideration of controls over functions performed by external parties by enhancing use and documentation of Service Organization Control (SOC) reports. These improvements are necessary and consistent with management's responsibility for the overall adequacy of the design and operation of internal control.

The complexity of Medicaid program operations adds to the challenge of accurately accounting for all Medicaid financial activity within the State's financial statements. This complexity increases each year through new federal regulations, various State initiatives, and additional challenges resulting from implementation of its RIBridges eligibility system. Medicaid is the State's single largest activity - representing nearly 40% of the annual budgeted outlays of the State's General Fund.

The State did not comply with its spending hierarchy policy for the RI Veterans' Home where multiple funding sources existed for a single activity.

Responsibility for monitoring the investment activity and other compliance aspects of funds on deposit with a fiscal agent (trustee) can be improved and should be vested with the Office of the General Treasurer.

The Executive Office of Health and Human Services (EOHHS) authorized more than $188 million in system payouts and manual disbursements in fiscal 2019, representing provider advances, payments to managed care organizations for contract settlements and/or non-claims based financial activity, and other program disbursements. The reporting and internal control processes relating to these types of disbursements are manual in nature and external to other established control procedures.

The processes followed for periodic physical inventories of capital assets and the evaluation of inventory results can be improved to ensure that accurate capital asset records are maintained. An asset was erroneously reported as unlocated and removed from the inventory records.

The State can improve controls over recording federal revenue to ensure (1) amounts are consistent with the limitations of grant awards from the federal government and (2) federally claimed expenditures are consistent with amounts recorded in the State's accounting system. We found a grant award deferral had not been recognized and a request for additional grant award funding was still pending for fiscal 2019 program costs.

Controls can be improved within the accounting system to better track the distinct components of fund balance required for presentation in the fund level financial statements.

For the newly established Information Technology internal service fund, policies should be enhanced to provide for consistent recognition of revenue and expense thereby ensuring the fund operates on as close to a break-even model as possible.

All bank account reconciliations should be performed by the Office of the General Treasurer Business Office - Reconciliation Team.

Controls over cash disbursements can be strengthened by ensuring authorized signers on State bank accounts are current and faithful performance bonds are maintained for key Treasury personnel.

Overall, the State has not sufficiently addressed information technology (IT) security risks. The State needs to ensure its IT security policies and procedures are current and assessments of compliance for all critical IT applications - systems posing the most significant operational risk - are prioritized.

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

Processing functionalities within Division of Taxation's STAARS system result in a volume of returns held in suspense pending resolution. This complicates financial reporting estimates due to the uncertain effect of returns that had not fully processed at fiscal year end.

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

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

Controls to ensure accurate and consistent reporting of investment income and expenses within the pension trusts require enhancement at both the custodian and System management level.

The resources necessary to effectively manage and administer the OPEB (retiree healthcare) System to ensure all System functions are met and adequately controlled should be assessed. A unified database or computer application is needed to maintain membership data for each of the State's OPEB plans. This would improve controls over the administration of the benefit programs and the process to accumulate data necessary for periodic actuarial valuations of the OPEB plans for both funding and accounting purposes.

Our report includes control deficiencies and material noncompliance reported by the independent auditors of component units included within the State's financial statements. Their accounting and control procedures are generally independent of the State's control procedures.

Our report also includes ***14 management comments***, which are less significant findings that highlight opportunities for enhancement of financial-related operational, policy or accounting control matters.

The Tobacco Settlement Financing Corporation requires additional administrative support and should periodically update its projected debt service requirements to reflect operating and other economic factors.

Legal case tracking software must be acquired and implemented organization-wide to enhance the administrative management and control of pending legal matters.

The State budget officer performs a variety of accounting-related tasks that should be reassigned to other State operating units.

Certain operating and long-term liability metrics for the Rhode Island Public Transit Authority warrant enhanced oversight by the State to ensure the sustainability and availability of public transit service.

Monitoring of escrow liability account balances can be further enhanced to ensure timely reconciliation of balances and compliance with newly established control procedures.

A formal funding policy should be adopted for the State's OPEB plans which incorporates statutory provisions and key actuarial funding policies.

Other management comments address the accounting for capital assets, converting more disbursement transactions to ACH to reduce the volume of checks and wire transfers, subrecipient monitoring, accumulation of significant commitments, and other accounting and financial reporting issues.

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

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

and

SCHEDULE OF FINDINGS AND RESPONSES

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Rhode Island and Providence Plantations (the State), as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the State's basic financial statements and have issued our report thereon dated December 31, 2019. Our report includes a reference to other auditors who audited the financial statements of:

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

- the Convention Center Authority, a major fund, which also represents 24% of the assets and deferred outflows and 2% of the revenues of the business-type activities;

- the HealthSource RI Trust, an agency fund, the Ocean State Investment Pool, an investment trust fund, and the Rhode Island Higher Education Savings Trust, a private-purpose trust fund, which collectively represent 35% of the assets and 23% of the revenues of the aggregate remaining fund information; and

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

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

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant

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

deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed in the accompanying schedule of findings and responses, we and the other auditors identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the State's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: Findings: 2019-002, 2019-003, 2019-004, 2019-013, 2019-020, and 2019-029. 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 2019-031 and 2019-033.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies: Findings: 2019-001, 2019-005, 2019-006, 2019-007, 2019-008, 2019-009, 2019-010, 2019-011, 2019-012, 2019-014, 2019-015, 2019-016, 2019-017, 2019-018, 2019-019, 2019-021, 2019-022, 2019-023, 2019-024, 2019-025, 2019-026, 2019-027, 2019-028, 2019-034, 2019-035 and 2019-036. Other auditors of the discretely presented component units considered the deficiency described in the accompanying schedule of findings and responses to be a significant deficiency: Finding: 2019-032.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests and those of the other auditors disclosed an instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as Finding: 2019-030.

State's Response to Findings

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

Purpose of this Report

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

Dennis E. Hoyle, CPA
Auditor General

December 31, 2019

Finding 2019-001 ***(significant deficiency – repeat finding – 2018-001)***

IMPLEMENTATION OF THE STRATEGIC PLAN FOR CRITICAL FINANCIAL AND ADMINISTRATIVE COMPUTER SYSTEMS

The State recently completed a strategic plan to coordinate needed replacements/enhancements to its key statewide financial and administrative systems. Implementation and funding of the strategic plan is essential to ensure that critical legacy financial systems, such as the payroll system, which pose a business continuity risk, will be available to support State operations.

Background: Following continued audit recommendations, the State recently completed a strategic plan to assess options and to develop a path forward to coordinate needed replacements/enhancements to its key statewide financial and administrative systems. The strategic plan report details the need for, and the benefits to be derived from, an enterprise applications modernization effort highlighting that "the risks of inaction far outweigh the cost of upgrades in capability".

The State's Oracle E-Business Suite – the original platform for the State's RIFANS accounting system - was not fully implemented, and, therefore critical needs such as Human Resources and Payroll were not addressed. The intent of an Enterprise Resource Planning (ERP) system is to optimize integration thereby enhancing efficiency and facilitating strong internal controls. More recently, the State attempted to implement separate software solutions without a comprehensive plan for achieving a fully integrated ERP system – this resulted in wasted resources and failed integration. The State halted work on a time and effort reporting system project due to an inability to interface the system with other State information systems ($2 million expended through fiscal 2017). The State also terminated the implementation of a Grants Management system ($974 thousand expended through fiscal 2018).

Criteria: Management needs well-designed financial systems that support comprehensive internal controls over financial reporting, enable organization-wide efficiencies, and promote business continuity.

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

Many of the needed financial functionalities are interdependent and, consequently, the risk of failed integration is increased absent appropriate strategic planning and sequencing.

Examples of deficiencies in the current RIFANS system include but are not limited to; a.) a lack of integrated time and effort reporting needed to support centralized cost allocation processes and federal grants management, b.) a grants management system that ensures that the State does not overspend federal grant authorizations, and c.) inefficient cash management and reconciliation tools that support critical management functions.

Use of two computer systems to account for the activities of the Intermodal Surface Transportation (IST) Fund is unduly complex and weakens controls over financial reporting. While recording transactions in two accounting systems is inherently duplicative, this process would be less challenging if the configuration and accounting conventions were the same.

Cause: The State's current accounting and financial reporting system lacks the integration and functionality of a comprehensive ERP system. Prior to the recent strategic plan development, the State was attempting functional enhancements without sufficient consideration of overall system requirements, design, and needed integration.

Effect: Business continuity risks, deficiencies in internal control over financial reporting, and the lack of organization-wide efficiencies exist and are exacerbated due to the lack of an integrated ERP system.

RECOMMENDATION

2019-001 Implement the comprehensive strategic plan to address the business continuity risks, deficiencies in controls over financial reporting and operational inefficiencies identified in the State's current financial systems.

Management's Views and Corrective Actions:

Division of Information Technology leadership agrees with the need to implement a commercial off the shelf (COTS) enterprise resource planning (ERP) system in a comprehensive and strategic manner. The Enterprise Applications Strategic Plan is the foundation for Rhode Island's multi-year effort to transform its enterprise technology and business processes to better meet the needs of the State, its residents, and its partners. The State wants to improve efficiencies, integrate multiple systems, automate manual processes, increase the quality and timeliness of data to decision makers and replace and modernize its current enterprise technologies. The objectives of modernizing obsolete enterprise applications will:

- *Address audit findings*
- *Reduce risk*
- *Enable business improvements, provide expanded functionality, and information for managing*
- *Address manual processes that are more prone to errors*

Anticipated Completion Date: *The following dates are directional pending funding approval for the Enterprise Applications Strategic Plan program. Moreover, a systems integrator / software vendor will need to confirm these dates after the Request for Proposal (RFP) is released, a SI/software vendor is then selected, and a comprehensive project plan is created:*

- *HR/Payroll Go-Live on 12/31/2022*
- *Grants Management Release 1 Go-Live on 12/31/2022*
- *Finance Go-Live on 6/30/2024*
- *Grants Management Release 2 Go-Live on 6/30/2024*

Contact Person: *Chirag Patel, Chief of Agency IT teams and Enterprise Applications*
Chirag.patel@doit.ri.gov

Finding 2019-002 *(material weakness – repeat finding – 2018-002)*

MEDICAID PROGRAM COMPLEXITY AFFECTS FINANCIAL REPORTING AND OVERALL PROGRAM CONTROLS

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

Background: The complexity of the Medicaid program increases each year through new federal regulations, various new State initiatives, and additional challenges resulting from its implementation of an eligibility system, RIBridges. Medicaid is the State's single largest program activity - representing nearly 40% of the annual budgeted outlays of the State's General Fund. Consequently, the financial aspects of this program are material to the State's financial reporting objectives.

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

- New program initiatives have changed the way services are reimbursed through the program;

- Program changes are often implemented through managed care organizations (MCOs) increasing an already significant segment of Medicaid that is being administered outside of the Executive Office of Health and Human Services' (EOHHS) direct financial systems and controls;

- Contracts with MCOs are subject to complex settlement provisions. These settlements are increasingly dependent on data received from the MCOs and require substantial data analysis and evaluation prior to determining if additional payments or recoveries are due for financial reporting purposes. EOHHS is largely dependent on contractors to conduct the data analysis and tracking of these settlement provisions;

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

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

- The RIBridges eligibility system has caused uncertainties in eligibility determinations which results in claims processing issues including duplicate MCO capitation payments and the inability to process claims for long-term care providers. This required estimated payments to providers in lieu of actual claims processing.

Criteria: Management is responsible for establishing and maintaining internal control over financial reporting to ensure accurate and complete reporting of transactions in accordance with generally accepted accounting principles.

Condition: Significant Medicaid program activity as detailed above is currently being accounted for external to the systemic controls and processes of normal Medicaid activities. In addition, the State relies on contract services to manually accumulate, evaluate and determine settlements and/or payments relating to these program activities. Due to the length of settlement periods, the extended duration of eligibility system issues, and the volume of transactions being accumulated and evaluated independent of regular program controls, risks relating to inaccurate financial activity and federal compliance have increased.

Several issues related to RIBridges implementation issues (e.g., newborn eligibility, long-term care eligibility) have negatively impacted the MCOs and severely complicated settlement processes between the State and those entities. Significant managed care financial activity (most notably, final contract year settlements) and final settlements with federally qualified health centers (FQHC) within the Medicaid program remain reliant on claims and financial data submitted by those respective entities. Substantial manual analysis by the State's managed care consultant is required to validate the underlying expenditures reported by these entities. Controls (procedures employed by EOHHS) over these processes are not deemed sufficient to identify when errors are made in the underlying manual processes.

Cause: Ensuring all financial activity is properly and completely recorded in the State's financial statements is an increasingly complex task. MCO risk and gain share settlements, settlements with FQHC providers, outstanding amounts due MCOs for eligible births and stop loss expenditures for services reimbursed outside of capitation all required manual accumulation by consultants as part of the year-end accrual process. The financial effect of these settlements and program provisions totaled in the hundreds of millions of dollars. Much of this activity is higher risk from a financial reporting and federal program compliance perspective as it is less subject to systemic controls and instead is accounted for through manual independent processes.

Effect: Potential effects of this control deficiency include unrecorded or inaccurately recorded financial transactions, incorrect reimbursements to providers or managed care organizations, and noncompliance with federal regulations.

RECOMMENDATIONS

2019-002a Evaluate and document control processes to meet the financial reporting objectives for the Medicaid program. Delineate those responsibilities delegated to contractors and how those responsibilities are integrated in the overall control structure.

2019-002b Improve financial oversight of the MCOs as a basis for enhancing program compliance objectives and enhancing data available for financial reporting purposes.

Management's Views and Corrective Actions:

2019-002a - EOHHS acknowledges the complexity of our financial activities and that there are payments based on manual calculations. The finding most notably focused on our managed care organizations (MCO) risk share settlements. Monthly, the health plans submit to EOHHS cumulative risk/gain share statements for the open contract periods up until the contract run-out period occurs. These financial statements are reviewed by EOHHS and reconciled with the MCOs' Finance team monthly and annually. Generally, there are three fiscal years' worth of contracts open at any time (current state fiscal year (SFY), prior SFY awaiting the allowed run-out, and SFY currently being reconciled). EOHHS currently has five or six products per contract and two to three health plans per product, the number of discrete liabilities being routinely monitored is significant. Further, each product may have multiple risk shares programs. The risk share *contract run-out period occurs 12 months after the contract end date. Final risk/gain share settlements are based on claims paid experience only. No allowance is provided for incurred but not reported (IBNR) claims. At the end of the 12-month claims run-out period, the contracts require a final risk/gain share contract settlement agreement with the MCO. Notwithstanding previous reviews and/or interim payments, the risk share reports received from the health plans at the end of the run-out period undergo a thorough systematic review and analysis of claims and financial reporting to determine the final settlement amounts.*

EOHHS has documented the control processes and delineated the responsibilities carried out by contractors to ensure that the risk for error is minimized. EOHHS' consultants compare the total member months, the medical premiums paid to the MCOs, and the actual medical expenses, as reported in the risk/gain share statements, to the derived member months, medical premiums, and medical expenses provided from EOHHS' MMIS system. If required, EOHHS may request the health plan to submit a claims file that supports the claims dollar payments that appear on its risk/gain share statements. The difference, after any reconciliation, must be within one percent. Once the health plan's final risk/gain share contract settlement statement is deemed to be accurate by the contractors and EOHHS Finance staff, the risk/gain share final contract settlement is presented to EOHHS senior management for final review and approval prior to final monetary settlement with the MCOs. EOHHS' Deputy Medicaid Program Director, Finance and Deputy Medicaid Program Director, Managed Care and Oversight sign-off on all financial transactions with the MCOs.

2019-002b - Approximately 90 percent of all members eligible for Rhode Island Medicaid are enrolled in a managed care plan responsible for the delivery and payment of all eligible medical services. In total, over $1.6 billion in capitation is paid to the managed care plans. Given the magnitude of these expenditures, EOHHS has sought to improve its financial oversight of these Health Plans.

EOHHS finance staff and its contractors continually review all the financial controls governing the claims processing and financial accounting system of the State's major managed care plan partners—United Healthcare Community Plan of New England, Neighborhood Health Plan of Rhode Island (NHPRI), and Tufts Health Public Plan. The Health Plans' controls include the following: annual audited financial statements, including opinions, from external auditors; annual actuarial opinions from external auditors; NAIC and DBR statutory filings, including risk-based capital reports; model audit rule compliance; monthly and annual financial result reviews with senior management, including general ledger account reconciliations; comprehensive financial account analyses; various internal and external systems controls including claims processing, accounts payable, and general ledger systems. UnitedHealthcare and Tufts Health Public Plan conduct System and Organization Controls (SOC)-type audits; UnitedHealthcare is compliant with the Sarbanes-Oxley Act; NHPRI is now fully compliant with the Department of Business Regulations Model Audit Rule. Also, NHPRI retains an outside firm to finalize the company's overall risk assessment, including implementation, and has staff dedicated to ensure on-going MAR compliance.

To further ensure the integrity of the Health Plans' controls and financial reporting, EOHHS' contracts with the health plans require that the external auditors, in their annual report of independent auditors, specifically address their review and testing of the health plans' risk/gain share financial statements and the health plans' various receivables and/or payables to/from EOHHS, as of December 31 of each year. EOHHS also requires that all financial statements provided to EOHHS be accompanied by an attestation document, signed by an officer or senior administrator of the MCO, attesting to the accuracy and completeness of the financial statements. The reports are utilized to estimate EOHHS' outstanding liabilities to the Health Plans for purposes of caseload estimating conference and year-end accruals. The above controls and reporting requirements adhered to by the Health Plans give EOHHS confidence in the financial reporting by the Health Plans.

Anticipated Completion Date: *Ongoing*

Contact Person: *Katie Alijewicz, Deputy Medicaid Program Director, Finance*
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Finding 2019-003 ***(material weakness – repeat finding – 2018-003)***

SYSTEM PAYOUTS AND MANUAL DISBURSEMENTS BY THE MEDICAID FISCAL AGENT

The Executive Office of Health and Human Services (EOHHS) authorized in excess of $188 million in system payouts and manual disbursements in fiscal 2019, representing provider advances, payments to managed care organizations for contract settlements and/or non-claims based financial activity, and other program disbursements. The reporting and internal control processes relating to these types of disbursements are manual and external to other established control procedures. Such amounts are not easily identified or quantified by the Medicaid Management Information System (MMIS).

Background: As indicated in Finding 2019-002, a significant amount of Medicaid program financial activity has commenced external to the normal internal control processes of the program (claims processing and adjudication) and is more reliant on manual control processes for determination of payment amounts and recording of financial activity, most of which is performed by consultants.

Advances to nursing home providers (and to a lesser extent, assisted living and hospice providers) during fiscal 2019 (approximately $28 million) were necessary due to significant delays in processing eligibility through RIBridges. These advances were largely made through manual checks issued by the fiscal agent upon authorization by EOHHS (via Fiscal Agent Control Notes – FACN). These advances were (1) tracked manually (in Excel) by the fiscal agent for purposes of identifying receivables pending recoupment (2) recorded in the State accounting system by a journal entry prepared by EOHHS, and (3) required additional journal entries to properly report these transactions in the State's financial statements. The level of manual processes employed in the recording of these transactions is characteristic of these types of payments. Other significant categories of system/manual payments include payments to MCOs for accountable entities, risk share and stop loss payments to MCOs, retroactive capitation adjustments, and FQHC transition payments.

Criteria: Management is responsible for establishing and maintaining internal control over financial reporting to ensure accurate and complete reporting of transactions in accordance with generally accepted accounting principles. Such processes should support the validity and accuracy of all payments made by the fiscal agent, the completeness of reported program activity, and to ensure compliance with federal regulations for allowable cost principles and activities allowed or unallowed.

Condition: System payouts and manual disbursements are authorized by EOHHS through the FACN process. EOHHS executes FACN authorizations to the Medicaid fiscal agent for various financial related activities including direction of system payouts and manual disbursements to providers and managed care organizations. FACN authorizations require manual recording and tracking and do not interface into the MMIS.

The MMIS lacks formalized reporting that details system payouts and manual disbursements. During fiscal 2019, EOHHS began receiving a log of FACN authorizations processed by the fiscal agent and reviewed the log for authorized financial transactions. While this improved oversight of authorized financial transactions, it would not identify if unauthorized payments were processed by the fiscal agent.

Cause: The significant disbursements (and other related financial transactions) represented by system payouts and manual disbursements coupled with inadequate reporting and management oversight of these types of payments pose a significant risk to internal control over financial reporting and federal compliance.

Effect: Improper payments, errors or omissions in financial reporting and federal noncompliance are possible effects of this control deficiency.

RECOMMENDATIONS

2019-003a Consider alternatives to issuing system payouts and manual disbursements through the State fiscal agent when possible.

2019-003b Develop comprehensive reporting for system payouts and manual disbursements to improve oversight and monitoring by EOHHS.

Management's Views and Corrective Actions:

2019-003a - EOHHS continues to review all manual and system payments and identify those that occur with enough frequency predictability to be processed through the regular MMIS cycles or the State's procurement financial system, RIFANS. When issues with processing eligibility through RIBridges are finally resolved, we expect both the current frequency and dollar volume of the FACNs to diminish considerably.

Anticipated Completion Date: *December 31, 2020*

2019-003b - The fiscal agent has developed and submits for EOHHS's review a monthly report recapping all Fiscal Agent Control Notes (FACNs) processed that month, including financial FACNs. EOHHS Finance also maintains a monthly log of all FACNs it approves, capturing all pertinent data, and reconciles this log with the fiscal agent's monthly report. Any discrepancy is promptly researched and resolved.

Anticipated Completion Date: *Ongoing*

Contact Person: *Corsino Delgado, Associate Director, Financial Management*
Executive Office of Health and Human Services
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Finding 2019-004 ***(material weakness - repeat finding – 2018-004)***

COMPREHENSIVE DOCUMENTATION OF THE STATE'S INTERNAL CONTROL STRUCTURE

Management focus, training and implementation resources have been insufficient to ensure that departments and agencies are assessing and documenting internal control consistent with management's overall responsibility for the adequacy of the design and operation of internal control. Internal controls safeguard public resources and support accurate financial reporting.

Background: The State's management has responsibility for the design and operation of internal control. The Committee of Sponsoring Organizations (COSO) has designed a framework for internal control that consists of three categories of objectives – *operations, reporting and compliance* – and five components – *control environment, control activities, risk assessment, information and communication, and monitoring*. The Government Accountability Office's "Green Book" - *Standards for Internal Control in the Federal Government* tailors this conceptual framework to the public environment. The "Green Book" is required for federal agencies and is useful to other governments when applying the principles of an internal control framework.

Criteria: An internal control framework, such as COSO and/or the Green Book, provides an overall structure for management to design, document, and monitor its internal control policies and procedures. Both within and outside government, management has responsibility for the adequacy of design and operation of an entity's control structure.

Condition: While certain control policies and processes have been documented, there is a lack of formalized documentation and comprehensive internal control structure throughout State government that complies with an accepted framework such as COSO and/or the Green Book. Opportunity exists for a coordinated effort to implement the revised internal control framework and to reassess the design of its current control structure (both statewide and at the individual agency level) with emphasis on risk assessment and monitoring - both essential components of internal control. As the State considers implementing a fully integrated ERP system, which will likely include modification of certain processes and related controls, opportunities exist to evaluate and document amended control procedures consistent with the internal control framework.

Cause: Management focus, training and implementation resources have been insufficient to ensure that departments and agencies are adequately documenting their internal control structures to reflect an understanding of its required elements as prescribed by the revised framework.

Effect: Control weaknesses could exist and go undetected either through inadequate design or through noncompliance resulting from insufficient monitoring.

RECOMMENDATIONS

2019-004a Commit additional resources to training and implementation materials to ensure that departments and agencies are adequately documenting their internal control structures to reflect an understanding of its required elements as prescribed by the revised framework.

2019-004b Implement an internal control assessment and documentation effort to coincide with the implementation of a fully integrated ERP system.

Management's Views and Corrective Actions:

We will request funds in the next budget request to retain a firm with COSO implementation expertise to assist us in developing and implementing a methodology to document major business process flows and identify the internal controls in each of these major processes. It is expected that this project will span several fiscal years. We agree that this initiative should be done in connection with the implementation of the fully integrated ERP system as that project will bring with it the opportunity to embed numerous internal controls in the software applications themselves. Further, existing training materials will be updated, and training will be conducted again.

Anticipated Completion Date: *June 30, 2021 (for initial funding decision and training components)*

Contact Person: *Peter Keenan, Controller*
Phone:401.222.6408

Finding 2019-005 ***(significant deficiency - new finding)***

EVALUATION OF CONTROLS OVER FUNCTIONS PERFORMED BY EXTERNAL PARTIES

The State can continue to improve its consideration of controls over functions performed by external parties by enhancing use and documentation of Service Organization Control (SOC) reports provided by the external parties. These improvements are necessary and consistent with management's responsibility for the overall adequacy of the design and operation of internal control.

Background: SOC reports are provided by service organizations to assure customers/clients that controls are sufficiently designed and in operation over relevant activities. Management of the user entity should use these reports as part of their overall consideration and documentation of the adequacy of the design and operation of internal control.

Criteria: Management has responsibility for the adequacy of design and operation of an entity's control structure including functions performed by external parties.

Condition: The State made significant enhancements during fiscal 2019 by training employees and implementing a uniform SOC report assessment tool to document the consideration of controls at the service organizations. Further training and monitoring are needed to ensure all SOC reports are appropriately and consistently evaluated. Additionally, the State must ensure that relevant complimentary user entity (State) controls identified by service organizations are also in place and operating effectively.

When SOC reports identify exceptions, or auditors' reports on the operation of internal controls are modified due to exceptions, evaluation of such matters must be timely and thorough. The SOC auditor's report for one of the State's electronic benefit providers was qualified for multiple exceptions.

Cause: The enhancements to the State's SOC report evaluation process were newly implemented in fiscal 2019 and will improve with continued emphasis and training. Continued training is recommended along with specific monitoring and follow-up with departments and agencies where warranted.

Effect: Many functions performed by external parties are material to the State's overall operations. Deficiencies in the design or operation of controls at service organizations could materially impact the State's overall controls over financial reporting and compliance.

RECOMMENDATIONS

2019-005a Enhance training and monitoring to ensure compliance with newly implemented SOC report evaluation procedures.

2019-005b Ensure that relevant complimentary user entity (State) controls identified by service organizations are also in place and operating effectively.

2019-005c Ensure exceptions and auditor report modifications included in SOC reports are evaluated timely and documented regarding the impact on the State's overall control procedures.

Management's Views and Corrective Actions:

2019-005a - We agree with this finding. The training presented in 2019 is in the process of being updated and enhanced to provide more comprehensive guidance. Training will be scheduled in the final quarter of FY 2020 for the CFOs. A SOC Document of Reliance on SOC Report (checklist) has been created to be completed by each of the CFOs and returned to the Office of Accounts and Control along with their SOC Report. The CFO is responsible for the review of the SOC and the checklist provides Accounts and Controls the tool to monitor that the entire SOC has been reviewed by the CFO.

2019-05b We agree with this finding. Included in the enhanced training for the CFOs, they will be provided information to assist in their review of the complementary user entity (state) controls to ensure that the controls are in place and operating effectively. The Document of Reliance on SOC Report (checklist) provides a section "User Entity Controls" to assist the CFO reviewer guidance in providing that assurance. The checklist provides the assurance to the Office of Accounts and Control that the CFOs are reviewing the SOC reports.

2019-05c - We agree with this finding. Included in the enhanced training for the CFOs, they will be provided information to assist in their review of the exceptions and modifications noted in the SOC Reports are being evaluated timely and proper documentation is provided regarding the impact on the State's control process. The section of the Document of Reliance on SOC Report (checklist) entitled "Exceptions" assist the CFO reviewer with the guidance to ensure they review any exceptions or modifications and how these changes/modifications will impact their organization and if any mitigations are properly addressed. The completed checklist provides the Office of Accounts and Control the assurance the CFOs are reviewing the SOC report.

Anticipated Completion Date: *June 2020*

Contact Person: *Gail LaPoint, Administrator, Financial Management*
Phone: 401.222.5098

Finding 2019-006 ***(significant deficiency - new finding)***

PERIODIC INVENTORY OF CAPITAL ASSETS

The processes followed for periodic physical inventories of capital assets and the evaluation of inventory results can be enhanced to ensure that accurate capital asset records are maintained.

Background: The Office of Accounts and Control requires departments to perform agency-specific inventory verification for capital assets on a three-year cycle. Inventories are conducted by departmental staff without staff participation from the Office of Accounts and Control. Inventory results are reported to the Office of Accounts and Control which prompts any required accounting adjustments.

Criteria: Periodic physical capital asset inventories are a best-practice and important control procedure to ensure the accuracy of the State's capital asset accounting records.

Condition: Cyclical departmental inventories are conducted without participation by the Office of Accounts and Control to ensure completeness and consistency. Inventory results are accepted without sufficient review and inquiry before adjusting the State's capital asset records. A fiscal 2019 capital asset inventory conducted by the Department of Environmental Management identified a total of $3.1 million (net book value) of assets that could not be located. Documentation forwarded to the Office of Accounts and Control included required certification by the DEM Director. As a result of the inventory results forwarded by DEM to the Office of Accounts and Control, the assets were removed from the capital asset records. Among the assets that could not be located was a building acquired in 2013 at a recorded cost of $883,000.

Upon audit inquiry, it was subsequently discovered that the building had been mis-identified by street address which led to the erroneous "asset not found" status. Significant capital assets reported as "asset not found" should prompt robust inquiry and investigation by both the Department and the Office of Accounts and Control before the asset is written-off or removed from the capital asset inventory system.

Cause: The Office of Accounts and Control does not actively participate in observing and monitoring the performance of physical capital asset inventories performed by departments. Over-reliance is placed on the certification provided by the departments when assets are not located without sufficient inquiry and investigation for material assets reported as not found.

Effect: Capital asset records and the State's financial statements could be misstated. Physical control of capital assets is diminished when there is insufficient follow-up and consequence for lost material assets.

RECOMMENDATIONS

2019-006a Include staff from Office of Accounts and Control on the team performing each cyclical, departmental capital asset inventory.

2019-006b Enhance review and inquiry for material capital assets reported as not found before assets are removed from the State's capital asset inventory records.

Management's Views and Corrective Actions:

Accounts and Control agrees with the finding and will take a number of steps to increase the accuracy of the physical inventory reporting. First, Accounts and Control has worked with DoIT to improve the inventory report provided to agencies and the report now includes all descriptive fields from the fixed asset database. Had this data been available for FY2019 physical inventories, DEM would have seen the correct address for the building misidentified/noted above. Second, although the Office of Accounts and Control is in contact with agencies throughout their inventory process, an Accounts and Control staff member will meet with the appropriate level agency member to review findings and answer any questions before the final report is submitted and approved. The initial results of the inventory will determine what position in the agency hierarchy Accounts and Control would want to attend the meeting. Finally, write-off thresholds will be established based on asset category. If an asset meets the established threshold, additional documentation would be required to illustrate the disposition of the asset.

Anticipated Completion Date: *June 30, 2020*

Contact Person: *Sandra Morgan, Supervising Accountant, Fixed Asset Unit*
Office of Accounts and Control
Phone: 401.222.6403

Finding 2019-007 **(significant deficiency - new finding)**

CONTROLS OVER HIERARCHY OF SPENDING RESOURCES

The State did not comply with its spending hierarchy policy when multiple funding sources existed for a single activity.

Background: Many state activities are funded by multiple funding sources such as federal and restricted revenue sources in addition to general revenue. When multiple funding sources exist, a spending hierarchy must be established which prescribes which source(s) are used first.

Criteria: The Office of Accounts and Control has established a spending hierarchy policy, as disclosed in the notes to the financial statements, which establishes the order in which multiple resources are used for a single activity. In general, restricted sources, including federal funds, are used before general revenue or unrestricted sources.

Condition: During fiscal 2019, the Department of Human Services adjusted expenditures totaling $534,000 from a restricted revenue source to a general revenue account with a preexisting deficit (actual expenditures exceeded final budgeted expenditures). The Rhode Island Veterans' Home is funded by a combination of federal grants, restricted revenue and general revenue appropriations. This action increased the fiscal 2019 deficit for general revenue sources and decreased the allocation of expenditures to restricted sources. This was inconsistent with the stated spending hierarchy policy.

Cause: There are no systemic controls within the RIFANS accounting system to ensure compliance with the spending hierarchy policy. The order in which expenditures are applied to multiple funding sources can be complicated by matching requirements for federal funds and specific limitations on the use of federal and restricted funds.

Effect: The State is not fully complying with its established spending hierarchy policy, and, in the case of the Rhode Island Veterans' Home for fiscal 2019, restricted sources were available, but not used, to avert a general revenue deficit for that budget line item.

RECOMMENDATION

2019-007 Develop controls to ensure departments and agencies comply with the hierarchy of spending resources policy. Provide additional training and guidance to departmental and agency users as required.

Management's Views and Corrective Actions:

We want to emphasize that this was an isolated occurrence and there is no evidence this is a recurring pattern of agency behavior.

We will explore adding a requirement for the new integrated ERP system to ensure that, where applicable, non-general revenue sources of funding are used before general revenue. As an interim step, guidance will be distributed to clarify this requirement

Anticipated Completion Date: *September 30, 2020*

Contact Person: *Steven Blazer, Supervisor of Fiscal Services*
Phone: 401.222.2267

Finding 2019-008 ***(significant deficiency – repeat finding – 2018-006)***

CONTROLS OVER FUND BALANCE COMPONENTS WITHIN THE GOVERNMENTAL FUNDS

Controls can be enhanced within the accounting system to better track the distinct components of fund balance required for presentation in the fund level financial statements.

Background: Generally accepted accounting principles require that the financial statements reflect fund balance within the governmental funds in the following categories:

- Nonspendable
- Restricted
- Unrestricted:
  - Committed
  - Assigned
  - Unassigned

These classifications signify fund balance that is earmarked for specific purposes and amounts ultimately available for future appropriation. Such classifications are important not only for financial reporting purposes but also from an operational and budget planning perspective.

Criteria: GASB Statement No. 54 prescribed the required components of fund balance for governmental funds. Fund balance must be arrayed in these required components to demonstrate amounts available to support future governmental operations including any specific restrictions or amounts earmarked by management or those charged with governance.

Building more functionality into the State's accounting system to support fund balance presentation by, for example, tracking fund balance changes by source of funds (e.g., general revenues, federal, restricted, etc.) would enhance controls. Building other reconciliation control processes to substantiate the changes in fund balance components between years would also enhance controls.

Condition: The process of determining the components of fund balance for financial reporting purposes is more of an "offline" process rather than supported by the accounting system. While the Office of Accounts and Control implemented procedures designed to enhance controls over the calculation of fund balance components, further improvement is required to ensure the completeness and appropriate presentation of fund balance components and to ensure fiscal year activity supports the changes in fund balance components between fiscal years.

Cause: These functionalities have not been programmed into the State's accounting system and other comprehensive reconciliation controls are not currently sufficient to ensure that all known factors are incorporated in the appropriate component of fund balance.

Effect: Fund balance components could be misstated in the financial statements. The amount of unassigned fund balance available for appropriation could be over or understated which could result in an inappropriate use of such resources in subsequent budgets.

RECOMMENDATIONS

2019-008a Continue to modify fiscal closing procedures within the RIFANS accounting system to support the presentation of fund balance components.

2019-008b Review and reassess established reconciliation processes to validate the change in fund balance components between fiscal years.

Management's Views and Corrective Actions:

Management agrees with this finding. Prior to the preparation of the FY 2019 CAFR the Office of Accounts and Control performed a comprehensive review of the process used to calculate and determine the components of fund balance which resulted in the process being completely redesigned. Due to certain limitations within the accounting system it was determined that an "offline" process would be the best *alternative. Immediately after preparation of the FY 2019 CAFR was complete the Office of Accounts and Control reviewed the results of the newly implemented process to identify weaknesses as well as any areas that could be improved. These results specifically addressed the audit recommendations as follows:*

2019-008a: The RIFANS accounting system will continue to be used to support the calculation of fund balance components in an "offline" capacity. Closing procedures will be modified as deemed needed.

2019-008b: As discussed above the Office of Accounts and Control has reviewed and assessed the established reconciliation process and made changes as considered necessary.

In addition, an analytical procedure has been developed to detect certain fund balance component reconciliation issues that have occurred in the past which will allow us to identify, evaluate and implement corrective action in a timely manner.

Anticipated Completion Date: *Completed as of February 14, 2020*

Contact Person: *Margaret Carlson, Associate Controller - Finance*
DOA, Office of Accounts and Control
phone: 401.222.5771

Finding 2019-009 ***(significant deficiency – new finding)***

ACCOUNTING POLICY FOR INFORMATION TECHNOLOGY INTERNAL SERVICE FUND

Policies need to be further enhanced to guide the manner in which costs are charged to and reimbursed from the Information Technology internal service fund.

Background: The Information Technology internal service fund was created during fiscal 2018 to distribute various centralized information technology costs of the State to departments and agencies. The costs included in the internal service fund are generally for costs of the Division of Information Technology (Department of Administration) including the operations of the State Data Center. The Information Technology internal service fund accounted for activity totaling $38.4 million during fiscal 2019.

Criteria: Internal service funds are created as a means to distribute common costs to multiple departments and agencies. Internal service funds are intended to operate on a break-even basis and therefore there needs to be appropriate and consistent matching of expenses and charges to user agencies.

Condition: The State purchased 4,700 personal computers (desktops and laptops) to replace existing outdated computer equipment and recorded the expense totaling approximately $3.1 million in the Information Technology internal service fund. Because the cost of each individual computer was less than the State's capitalization threshold for computer equipment, the asset purchase was not capitalized and was expensed in fiscal 2019. The computers were distributed to departments and agencies in fiscal 2020 and charges to the departments and agencies will commence in fiscal 2020 and for the succeeding four years.

Had the asset purchase been capitalized, the depreciation expense each year would be matched by the user charges to each agency. In this instance, the expense is in 2019 and the user charge revenue will be in fiscal years 2020 through 2024 which is inconsistent with the intent of a break-even operating model for internal service funds. It will also distort operating results in future years.

Accounting policies should be established which provide for consistent recognition of revenue and expense to ensure the internal service fund operates on as close to a break-even model as possible.

Cause: The internal service fund was newly established in fiscal 2018 and comprehensive policies are still evolving.

Effect: Expenditures within the operating funds of the State (e.g., General Fund) could be misstated due to inappropriate accounting policies employed within the Information Technology internal service fund.

RECOMMENDATION

2019-009 Develop policies consistent with the State's accounting policies and generally accepted accounting principles to provide for consistent recognition of revenue and expense to ensure the internal service fund operates on as close to a break-even model as possible.

Management's Views and Corrective Actions:

Management believes the accounting treatment of the 4,700 computers was in line with the State's fixed asset policy as well, as federal guidelines relating to the use of working capital and therefore would not be treated as a capital asset. However, Accounts &Control will document a policy establishing expense reimbursement to the DoIT internal service fund from agencies when goods or services are received unless the item meets the fixed asset thresholds.

Anticipated Completion Date: *June 30, 2020*

Contact Person: *Ben Quattrucci, Financial Reporting Manager*
Phone: 401.222.6406

Finding 2019-010 ***(significant deficiency - repeat finding – 2018-009)***

MONITORING RIFANS ACCESS PRIVILEGES AND AGENCY APPROVAL HIERARCHIES

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

Background: Authorizing and monitoring access to RIFANS, the State's centralized accounting system, is a key control over financial reporting. Access roles for all RIFANS users are assigned and controlled through unique passwords. Ensuring access is consistent and appropriate with each individual's responsibilities is an important control process. Individuals with "Super User" access require specific monitoring procedures due to their unlimited system access and the ability to potentially override established control procedures.

Criteria: Controls over system access by users and system administrators is critical to ensure that transactions in RIFANS are properly authorized and recorded for financial reporting purposes.

Condition: The State's lack of adequate monitoring of user and administrator access represents a collective weakness in internal control over financial reporting. There are three distinct, but interrelated areas where the State can improve its monitoring of RIFANS access privileges by implementing reporting functionalities that allow for the periodic review of RIFANS user and administrator access:

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

- *Agency Hierarchies* - Access roles for all RIFANS users are controlled through unique passwords. These roles, which are assigned based on job functions and responsibilities, permit access to various system capabilities. Agency hierarchies permit specific transaction types and dollar authorization limits. Other transaction-specific authorization controls are managed through workflow directories within RIFANS. The Office of Accounts and Control (Accounts and Control) is responsible for the design and control of system access by RIFANS users. This "blueprint" of the RIFANS control structure is periodically documented through hierarchies detailing access and approval flows for each department or agency and system workflows documenting the routing of certain types of transactions.

- *RIFANS Delegated Authority* - RIFANS users may delegate their authority to other users in certain situations (e.g., vacation rules). The State implemented a policy that restricts employees from delegating their authority to others with a lower level of authority and requiring notification of the delegation to Accounts and Control in certain circumstances.

The State created a report designed for monitoring changes to the agency hierarchies, authorization thresholds, and other systemic changes; however, there were no procedures in place requiring periodic review of the report by DoIT IT Security personnel who possess sufficient knowledge in IT security protocols to monitor "super user" activity. Further refinements to the report are required to capture all "super user" activity on the system. For example, there are no existing policies restricting super users from effecting changes to their own access or authorization levels. We observed during fiscal 2019 that a super user modified their access and authorization levels without prior authorization.

Cause: The State did not have sufficient reporting to allow for comprehensive "super user" access monitoring during fiscal 2019. Using the current accounting system, the tracking of all changes made by "super users" may exceed current capabilities. The State should consider incorporating the need for adequate audit tracking of super user activities when completing its strategic ERP plan.

While the use of reports designed to identify and review changes made to RIFANS access was improved during fiscal 2019, additional efforts are required to ensure that system access is designed properly and is implemented in accordance with that design. Additionally, further modifications are required to existing procedures to ensure that delegated authority, as documented in the new report, is being monitored timely.

Effect: Potential for unauthorized transactions being recorded in RIFANS.

RECOMMENDATIONS

2019-010a Enhance current procedures for reviewing the activities of "super users" (system administrators) on a scheduled basis to ensure that additions, modifications, and deletions initiated by them are appropriate. Assess the potential for systemic changes when completing the State's strategic plan for designing and implementing a fully-integrated ERP system.

2019-010b Implement policies regarding "super users'" modification of their own access and authorization.

2019-010c Improve controls over RIFANS access by ensuring consistent use of the reporting functions and by modifying existing procedures to ensure that all changes are being properly authorized and reflected in agency hierarchies and system workflows.

Management's Views and Corrective Actions:

2019–010a - Management agrees with this recommendation. The Office of Accounts and Control will work with DoIT to enhance procedures for monitoring "super user" activities. In addition, when completing the strategic plan for designing and implementing a fully-integrated ERP system, consideration will be given to systematic changes that will address this issue.

2019–010b - Management agrees with this recommendation. The Office of Accounts and Control will work with DoIT to ensure that super users do not have the ability to modify their own access and authorization.

2019 –010c - Management agrees with this recommendation. The Office of Accounts and Control will review procedures currently in place for the review of audit trail reporting functions to ensure that those procedures are consistent throughout the office. Regarding the agency hierarchies and system workflows, due to system limitations real-time updates are not possible. Currently updates are scheduled for three times a year. The Office of Accounts and Control will review procedures related to these periodic updates to ensure they are being done accurately and efficiently.

Anticipated Completion Date: *December 2020*

Contact Person: *Margaret Carlson, Associate Controller - Finance*
Office of Accounts and Control, DOA
phone: 401.222.5771

Finding 2019-011 ***(significant deficiency – repeat finding – 2018-010)***

COMPREHENSIVE GENERAL LEDGER CONTROLS OVER RECEIVABLES

Statewide accounting controls over receivables should be enhanced.

Background: Revenues are collected at many points throughout the State and, in many instances, due to volume and complexity (e.g., tax revenues), independent systems must be maintained to control and account for those revenues and related receivables.

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

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

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

During fiscal 2019, a Central Collections Unit (CCU) was created as a separate division within the Department of Revenue. This unit was formed with the intent to collect delinquent debt owed to Rhode Island state agencies through litigation. Debt is referred to the CCU for collection, but receivable balances and revenue ultimately remain with the originating agency. Upon collecting on assigned debt, the CCU remits the funds from their bank account to the agencies.

Criteria: Controls are enhanced when there are effective general ledger controls over all receivable balances with periodic reconciliation to detailed subsidiary accounts receivable systems. Additions and reductions (receipts) of receivables should be recorded in aggregate at the general ledger level with the detailed recording at the customer/taxpayer level within the various subsidiary receivable systems.

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

Controls can also be enhanced over the newly formed CCU. Certain of the balances referred for collection to the CCU had never been reflected within the State's general ledger or financial statements as receivables. We also believe that depositing CCU collection receipts in a separate bank account prior to being reflected as cash receipts in the RIFANS accounting system is unnecessary and may result in untimely recognition and require additional reconciliation. Upon collection, receipts can be directly posted and deposited to RIFANS and RIFANS-linked bank accounts.

Cause: Inadequate general ledger controls over accounts receivable.

Effect: Potential for misstatement or omission of accounts receivable and related revenue in the State's financial statements.

RECOMMENDATIONS

2019-011a Explore options to enhance statewide general ledger controls over receivables. Ensure all balances referred to the CCU for collection have been reflected in the RIFANS general ledger and financial statements.

2019-011b Eliminate use of the separate bank account maintained for the CCU collections.

Management's Views and Corrective Actions:

The requirements being developed for the new integrated ERP system will include one for a receivable module which will be used to account for all non-tax related receivables. This will significantly improve controls over these receivables.

As an interim step we will include balances referred to the CCU in RIFANS and the State's financial statements at year end at net realizable value which, incidentally, has been very immaterial.

Finally, we will work with DOR-CCU staff to explore the feasibility of eliminating the separate bank account now used for CCU collections. If that is feasible and controls will be enhanced, the account will be closed.

Anticipated Completion Date: *December 31, 2020*

Contact Person: *Ben Quattrucci, Financial Reporting Manager*
Phone: 401.222.6406

Finding 2019-012 ***(significant deficiency – repeat finding – 2018-011)***

FORMAT OF ENACTED BUDGET TO FACILITATE BUDGETARY CONTROL AND REQUIRED BUDGETARY FINANCIAL REPORTING

The form and content of the State's annual operating budget should be enhanced to facilitate alignment with the specific funds used to account for activities and to provide more effective planning, management and monitoring tools.

Background: The State's financial statements include budgetary schedules to compare budgeted to actual results. The State prepares budgetary comparison schedules on a fund basis while the budget is enacted on a comprehensive, state-wide basis. Budgetary comparison schedules are included in the State's financial statements for the General Fund, Intermodal Surface Transportation Fund (IST), Temporary Disability Insurance Fund and RI Capital Plan Fund.

Criteria: Generally accepted accounting principles require budgetary comparison schedules be included in governmental financial statements. Effective budgetary control requires continual measurement of actual to budgeted amounts. The format of budgets should reflect current operations and provide meaningful information to measure performance.

Condition: Because the enacted budget is presented on a comprehensive, state-wide basis, significant effort is required to disaggregate the budget data for comparison with the fund level information reported in the State's financial statements. In addition, certain budgetary resources and outlays on an individual fund budget presentation are omitted from the comprehensive budget presentation to avoid duplication.

Net income from the Lottery is a General Fund "revenue" source for the State budget; however, the enacted budget also includes certain operational expenses of the Lottery. This is an example of a budget presentation component that doesn't align with financial reporting practices. Inclusion of a separate proforma operating statement for the Lottery in the annual budget which supports the budgeted net income transfer to the General Fund may be more appropriate.

Transportation activities included in the annual budget are so highly summarized (e.g. infrastructure-engineering) that it limits effective analysis of the budget as a financial compliance and management tool. Transportation funding and activities have significantly changed in recent years without changes in the budget presentation. The enacted budget does not include all the transportation related activity which is now accounted for within five separate special revenue funds which for financial reporting purposes, are combined. A complete transportation budget which corresponds with all activity reported in the IST Fund is needed for this significant component of overall State operations.

Cause: The State's annual enacted budget is prepared on a comprehensive basis by governmental function which encompasses multiple funds. The format of the budget and the budgetary comparison schedules required for financial reporting purposes are not aligned. The format of the budget information for transportation activities is highly aggregated and hasn't been revised to reflect current operations and to serve as a meaningful management tool.

Effect: The current format of the operating budget and the budgetary comparison schedules limits the effectiveness of the information provided as planning, management and monitoring tools. The budgetary comparison schedule preparation process is prone to error and requires significant year-end effort to ensure that the information is correct and corresponds to financial statement amounts and the enacted budget.

RECOMMENDATIONS

2019-012a Improve the presentation of the budget amounts for transportation activities. Consider changes in the level of detail and include all transportation activity.

2019-012b Modify how the Lottery operations are included in the annual budget by including a separate pro forma operating statement supporting the net transfer to the General Fund.

2019-012c Include fund information within the budget to facilitate recording the budget in the accounting system and preparing budget-to-actual comparisons.

Management's Views and Corrective Actions:

The Office of Management and Budget (OMB) is open to improving the presentation of budget information in the annual appropriations act and/or budget documents to facilitate budget to actual comparisons and reporting. It should be noted that the Appropriations Act is not intended to be an accounting document and thus may not be the place to identify certain information but adding new information that may be useful to all parties that use this document. Alternatively, more detailed information on transportation and Lottery activities could be provided in published budget supporting documents. The OMB will meet with the Auditor General and the State Controller to seek sample presentation formats for the budget information seen as requiring additional detail that can be a basis for discussion with the Legislative fiscal offices and for consideration in the next annual Appropriations Act.

Anticipated Completion Date: *October 2020*

Contact Persons: *Thomas A. Mullaney, State Budget Officer*
Daniel Orgel, Chief Budget and Policy Analyst
Phone: 401.222.6300

Finding 2019-013 ***(material weakness – repeat finding – 2018-014)***

CONTROLS OVER FEDERAL PROGRAM FINANCIAL ACTIVITY

The State can improve controls over recording federal revenue to ensure (1) amounts are consistent with the limitations of grant awards from the federal government and (2) claimed expenditures on federal reports are consistent with amounts recorded in the State's accounting system.

Background: Federal programs represented 39% of fiscal 2019 General Fund expenditures. Financial reporting risks include categorizing expenditures as federally reimbursable when grant funds have either been exhausted or the expenditures do not meet the specific program limitations. Further, the State can improve its overall centralized monitoring of federal program operations to ensure compliance with federal requirements.

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

Criteria: Federal revenue and expenditures recorded by the State must be consistent with the limitations of grant awards from the federal government and claimed expenditures on federal reports must be consistent with amounts recorded in the State's accounting system.

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

The Office of Accounts and Control requires departments to complete a Federal Grants Information Schedule (FGIS) to reconcile RIFANS program activity with amounts drawn and claimed on federal reports. The FGIS process is not effective and there is no other statewide control measure to ensure that grant expenditures do not exceed available award authority.

In conjunction with our audits of federal programs, we have observed the following examples that highlight the lack of adequate controls over recording federal activity:

Medicaid – During fiscal 2019, we became aware of a CMS Medicaid program deferral totaling $11.2 million relating to expenditures claimed in prior years. Due to a lack of accounting control over federal grant authorizations, the State did not make the necessary adjustments in the accounting system and federal reports to reflect this funding deferral. The deferral related to compliance with time limitations for a program initiative funded by Medicaid. Reversal of the deferral is now being pursued, but the deferral went unrecognized due to inadequate controls over grant awards.

Supplemental Nutrition Assistance Program (SNAP) – At fiscal year end June 30, 2019, the State recorded a federal receivable for the SNAP program of $4.9 million. Available award authority was just $576,000 at that date. Upon audit inquiry, requests for a supplemental award were made.

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

Cause: Sufficient controls have not been implemented within the statewide accounting system to ensure amounts are consistent with the limitations of grant awards from the federal government and claimed expenditures on federal reports are consistent with amounts recorded in the State's accounting system. The current FGIS process is ineffective.

Enhanced statewide accounting functionalities that support time reporting/payroll, grants management, and cost allocation are being contemplated through the strategic plan initiative which recognizes the need for a grants management component within the overall planned ERP implementation.

Effect: Federal revenue could be overstated and not detected for financial reporting purposes. The share of program costs allocable to funding sources (e.g., general revenue vs. federal) could be misstated.

RECOMMENDATION

2019-013 Implement controls to ensure that the allocable share of federal program expenditures is consistent with grant award limitations. Reassess the current FGIS process with the goal of enhancing compliance and effectiveness.

Management's Views and Corrective Actions:

We agree. The ERP strategic plan that was recently finalized includes both a Grants Management Module and a Time & Attendance Module. These modules, along with the other components of the ERP, will address the control weaknesses discussed above.

Anticipated Completion Date: *December 31, 2022*

Contact Person: *Peter Keenan, State Controller*
Phone: 401.222.6408

Finding 2019-014 ***(significant deficiency – repeat finding – 2018 - 012)***

MONITORING RESPONSIBILITY FOR FUNDS ON DEPOSIT WITH FISCAL AGENTS

Responsibility for monitoring the investment activity and other compliance aspects of funds on deposit with a fiscal agent (trustee) should be vested with the Office of the General Treasurer.

Background: At June 30, 2019, $329 million was on deposit with fiscal agents (trustees). These amounts generally are bond or certificate of participation proceeds pending disbursement for projects. Amounts are invested pending disbursement. At June 30, 2019, investments included government debt securities, commercial paper, certificates of deposit and money market funds.

Criteria: The safety and liquidity of investments made from undisbursed debt proceeds, as well as compliance with permitted investment limitations, should be actively monitored. The Office of the General Treasurer has similar responsibilities for other State funds and is the appropriate choice to effect appropriate oversight of these balances.

Condition: Responsibility among various State agencies for monitoring investment activity for funds on deposit with a fiscal agent remains fragmented without sufficient oversight and monitoring. Efforts to improve oversight and monitoring by the Office of the General Treasurer during fiscal 2019 were incomplete and require additional effort. The nature and timing of specific monitoring procedures can be better defined and coordinated.

We noted cash reserves of $97 million of the $329 million balance at June 30, 2019 were uninsured and uncollateralized.

Cause: The Office of the General Treasurer generally has responsibility for investment of State funds. Because these amounts are held by trustees and invested independently, they have not historically been included within the oversight of the Office of the General Treasurer and no other State agency has been designated specific responsibility. During fiscal 2019, the Office of the General Treasurer began discussion of required procedures, but oversight was not fully implemented.

Effect: Funds held by fiscal agents are insufficiently monitored to ensure safety, liquidity and compliance with debt related covenants.

RECOMMENDATION

2019-014 Complete implementation of effective oversight and monitoring responsibilities for funds on deposit with fiscal agents.

Management's Views and Corrective Actions:

The Office of the General Treasurer agrees that our office should assume this duty. We worked to identify all funds on deposit with fiscal agents in FY2019 and began basic quarterly monitoring to ensure compliance with debt covenants. We are in the process of designing a more robust oversight and monitoring program to implement in FY20.

Anticipated Completion Date: *June 30, 2020*

Contact Person: *Jeffrey Thurston, Cash Manager*
Phone: 401.462.7642

Finding 2019-015 ***(significant deficiency –new finding)***

BANK RECONCILIATIONS - SEGREGATION OF DUTIES

The State can enhance controls by assigning all bank account reconciliations to the Office of the General Treasurer Business Office - Reconciliation Team.

Background: Two new bank accounts were opened in fiscal year 2019 for (1) collection of Department of Transportation Rhode Island Turnpike and Bridge Authority (RITBA) bridge maintenance tolls and (2) collection of delinquent debts by the Department of Revenue Central Collection Unit (CCU).

The Office of the General Treasurer Business Office - Reconciliation team typically performs the function of reconciling State bank accounts to the general ledger. The State also has 106 accounts (collateralized deposit, insured cash sweep municipal money market, and Ocean State Investment Pool) for short term investments maintained by the Office of the General Treasurer as of June 30, 2019.

Criteria: Appropriate controls over cash receipts and disbursements require proper segregation of duties. Authorization of transactions and movement of funds should be separate from functions related to the reconciliation of bank and general ledger balances.

Condition: Bank to general ledger reconciliations for RITBA and CCU accounts are not being prepared by the Office of the General Treasurer Business Office - Reconciliation Team.

The Office of the General Treasurer Cash Management employees who are directly involved in the authorization and movement of funds in short term investment accounts are currently preparing the bank to general ledger reconciliations for short term investments.

Cause: The Office of the General Treasurer Business Office - Reconciliation team has not been assigned the responsibility of reconciling the bank to general ledger accounts for these accounts.

Effect: Lack of adequate segregation of duties within the reconciliation function could result in unauthorized transactions and increases the risk of material misstatement due to fraud or error.

RECOMMENDATION

2019-015 Assign the bank to general ledger reconciliation process for RITBA, CCU, and short-term investment accounts to the Office of the General Treasurer Reconciliation team.

Management's Views and Corrective Actions:

The Office of the General Treasurer agrees that our office should assume responsibility for the general ledger reconciliation of these funds, and will work with the relevant agencies to transition those responsibilities to our reconciliation group. In addition, we will work with the Office of Accounts and Control to put a process in place to ensure that in the future all new accounts opened by state agencies are reconciled by our office.

Anticipated Completion Date: *April 30, 2020*

Contact Person: *Brian S. Conklin, Chief Fiscal Officer*
Phone: 401.462.7687

Finding 2019-016 ***(significant deficiency –new finding)***

BANK ACCOUNTS – AUTHORIZED SIGNERS

The State can enhance controls over cash disbursements by ensuring authorized signers on State bank accounts are current.

Background: Authorized signatories for bank accounts under the control of the General Treasurer are provided to each financial institution.

Criteria: Authorized signers on bank accounts should be limited to appropriate designated signatories who are active employees to ensure there is no misappropriation of assets.

Condition: There are eleven State deposit accounts with six banks under the control of the General Treasurer that continue to have a former Office of the General Treasurer employee listed as an authorized signer well after their termination from the Office of the General Treasurer.

Cause: The process to ensure timely removal of terminated employee signers from State bank accounts was not followed.

Effect: Maintaining State bank accounts with terminated authorized signers on the accounts could result in unauthorized transactions and increases the risk of material misstatement due to fraud or error.

RECOMMENDATION

2019-016 Maintain current authorized signers for all State bank accounts and make timely notification and adjustments when personnel changes occur.

Management's Views and Corrective Actions:

The Office of the General Treasurer agrees with this finding and is in the process of updating the list of signatories for all accounts identified during the audit. Going forward, the Cash Manager will maintain a list of signatories across all accounts and ensure that the signatories are kept up to date.

Anticipated Completion Date: *April 30, 2020*

Contact Person: *Jeffrey Thurston, Cash Manager*
Phone: 401.462.7642

Finding 2019-017 ***(significant deficiency –new finding)***

FAITHFUL PERFORMANCE BONDS – OFFICE OF THE GENERAL TREASURER

The State must ensure faithful performance bonds are maintained for key public officials performing critical treasury functions.

Background: Public officials are required to be bonded as a way to hold them financially accountable for decisions and actions.

Criteria: State General Law 42-10-3 states that "the general treasurer is hereby empowered, from time to time, to appoint one or more deputies under him or her who shall be engaged to the faithful performance of his or her duties, and shall, before entering the duties of his or her office, give bond to the state with sufficient sureties to the satisfaction of the governor, in the sum of five hundred thousand dollars ($500,000) for the true and faithful performance of the duties of his or her office; which bond shall be deposited with and kept by the secretary of the state. The general treasurer shall be liable for any misconduct, neglect, or default of those deputies".

Condition: As of June 30, 2019, faithful performance bonds had not been obtained for two key Office of the General Treasurer positions – the Chief of Staff and Cash Manager who entered these positions during fiscal year 2019.

Cause: The required bonding process was not completed before the Chief of Staff and Cash Manager began their duties.

Effect: Failure to maintain faithful performance and honesty bonds for key individuals could expose the State to potential loss in the event of misconduct or misappropriation.

RECOMMENDATION

2019-017 Maintain current public official bonds when personnel changes occur in the Office of the General Treasurer.

Management's Views and Corrective Actions:

The Office of the General Treasurer maintains faithful performance bonds in compliance with RIGL § 42-10-3, but notes that the law is vague as to which employees of the Office should be bonded.

As of June 30, 2019, the Office of the General Treasurer had one employee with the title of "deputy treasurer", Kelly Rogers, and she was bonded at that time. In addition, the Office maintains bonds for other key personnel who do not hold a deputy treasurer title. The office has maintained bonds for General Treasurer Seth Magaziner, Chief Investment Officer Alec Stais, and Chief Operating Officer Andy Manca from their time of hire through the present. Bonds were also obtained for Chief of Staff Kate Brock and Cash Manager Jeff Thurston effective January 2020.

Due to the vagueness in RIGL § 42-10-3 about which employees of the Office should be bonded, a new office-level policy on faithful performance bonds will be introduced effective immediately to ensure consistent interpretation of the law going forward. The policy of the Office of the General Treasurer will be to obtain bonds upon hire for the positions of Chief Investment Officer, Chief Operating Officer, Chief of Staff, Cash Manager, and any staff with a "Deputy Treasurer" title. The General Treasurer will also continue be bonded.

Anticipated Completion Date: *Complete*

Contact Person: *Andy Manca, Chief Operating Officer*
Phone:401.462.7664

Finding 2019-018 ***(significant deficiency – new finding)***

DEPARTMENT OF LABOR AND TRAINING - TDI BENEFIT OVERPAYMENTS RECEIVABLE

The Department of Labor and Training (DLT) Business Affairs Office should improve procedures to ensure that accurate receivable balances are maintained and reported to the Office of Accounts and Control for financial reporting purposes.

Background: The DLT Business Affairs Office is responsible for maintaining accurate accounts receivable balances and transmitting these balances to the Office of Accounts and Control for inclusion in the State's financial statements. Receivables result from overpayments to temporary disability beneficiaries.

Criteria: Detailed subsidiary receivable balances should be maintained and reconciled to general ledger balances and cash receipt collections.

Condition: The TDI Benefit Overpayment receivable balance at June 30, 2019, as originally submitted to the Office of Accounts and Control, was negative and unsupported by other departmental reporting. A material audit adjustment was required to correct the balance for financial reporting purposes.

Cause: DLT was transitioning receivable balances to a new system. Department management did not sufficiently review and consider the appropriateness of reporting negative receivables to the Office of Accounts and Control. Reconciliation of subsidiary to control balances were ineffective for this receivable balance.

Effect: Without correction the financial statement for the TDI Benefit Fund would have been materially misstated.

RECOMMENDATION

2019-018 Monitor accounts receivable balances, including recoveries, so that accurate balances can be maintained and submitted to Accounts and Control for financial reporting purposes.

Management's Views and Corrective Actions:

Corrective action has already been taken. Department management have implemented a new procedure that requires a review and sign off on FYE receivables prior to submission to Accounts and Control.

Anticipated Completion Date: *December 31, 2019*

Contact Person: *Denise Paquet, Assistant Director of Business Affairs*
Phone: 401.462.8178

Finding 2019-019 ***(significant deficiency – repeat finding – 2018-015)***

DIVISION OF INFORMATION TECHNOLOGY – DISASTER RECOVERY TESTING

The State should formalize identification of major systems, standardize application testing, and incorporate business continuity planning within its overall disaster recovery testing.

Background: Periodic tests of the disaster recovery plan are a vital component of an overall business continuity plan to increase the likelihood that critical systems can be restored should a disaster disable or suspend operations at the State's data center. DoIT has a designated disaster recovery facility in New Jersey (operated by a vendor).

Criteria: Industry best practices stipulate that disaster recovery testing be performed twice a year to accommodate the ever-changing systems environment. The State should perform a full disaster recovery test at least annually. Also, off-site storage of backups should be geographically diverse enough to successfully recover from a regional disaster.

Condition: The State continued tests of its disaster recovery plan during fiscal 2019; however, a list of prioritized major systems needs to be developed. In addition, while further progress was noted in restoration of specific applications not all aspects of major systems were sufficiently tested. For example, due to time limitations, in some instances the system and database were recovered, but there was insufficient time to fully validate the application functionality.

Cause: Major system identification and prioritization has not been formalized. Sufficient time was not allotted to test all systems thoroughly. In addition, a repeatable level of application testing has not been formally established nor has business continuity planning been incorporated in disaster recovery testing.

Effect: Incomplete disaster recovery testing reduces the assurance that all mission critical systems can be restored, should a disaster disable or suspend operations.

RECOMMENDATIONS

2019-019a Formalize the identification and prioritization of major applications within disaster recovery tests at the State's designated disaster recovery site.

2019-019b Establish a repeatable level of application testing and incorporate business continuity planning within periodic disaster recovery testing.

Management's Views and Corrective Actions:

2019-019a - DOIT made great strides in 2019; successfully executing a Disaster Recovery (DR) test in March 2019 of Agency IT Manager (AIM) defined critical applications. Documentation of this exercise and related recovery procedures are now stored in a Secure SharePoint Online location which is accessible by authorized users from anywhere with an internet connection. To mature this process, DoIT will be seeking Agency business leadership guidance on the identification and prioritization of their specific application stack. This will result in an enterprise-wide understanding of the critical business processes and technology that must then be prioritized for order of recovery by the Director, Department of Administration. DoIT is also seeking to re-solution current DR capabilities in order to support full DR and restoration of all applications.

Anticipated Completion Date: *This effort will require a phased approach for execution:*

Phase 1, Agency Engagement for application and BCP process identification: November 1, 2020
Phase 2, Director, DOA prioritization of enterprise applications: December 1, 2020
Phase 3, Enterprise Disaster Recovery Plan published: April 30, 2021
Phase 4, Disaster Recovery Solution Selected and Implemented: June 30, 2021

2019-019b - DoIT performs an annual Disaster Recovery (DR) test, and will again be performing a DR test in April 2020. A template for high level application testing across all agencies will be created and maintained to support a standardized, repeatable process for annually scheduled DR testing. Agency business leadership collaboration is required to define business critical processes, the applications that support those processes, and the Agency plan for business continuity requiring technology support from DoIT. This collaboration will be treated as a project by DoIT, applying our stringent project governance and tracking for success; integration of the work from finding 2019-019a will be leveraged to achieve success.

Anticipated Completion Date: *November 1, 2021*

Contact Person: *Cesar Mendoza, Chief of IT Infrastructure & Operations*
cesar.mendoza@doit.ri.gov

Finding 2019-020 ***(material weakness – repeat finding – 2018-016)***

DIVISION OF INFORMATION TECHNOLOGY – PROGRAM CHANGE CONTROLS

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

Background: Program change controls are a critical component of any IT control environment, which ensures that only authorized changes are made to programs (after adequate and sufficient user acceptance testing) before being placed into a production environment. Additionally, program change control procedures prevent and detect unauthorized program modifications from being made.

Almost all custom-developed computer applications require changes and/or updates throughout their production lifecycles. Consequently, these customized, home-grown applications require a formalized change management system to ensure that only authorized changes are made.

While some agencies have formally implemented program change controls, a standardized statewide approach has not been implemented.

Criteria: The State's change management process should be standardized so that all movement of code, modifications, testing, acceptance, and implementation provide management with a tracking history and record of approvals. This leads to consistent outcomes, efficient use of resources, auditability, and enhanced integrity of the application systems, which flow through the process. Automated tools help control this process and make the process consistent, predictable, repeatable and aids in the reduction of "human error" in the process.

DoIT should develop procedural guidance that details the correct use of change management software and mandated internal control practices and procedures, thus ensuring a documented, monitored, auditable, and repeatable process.

Condition: The State lacks a uniform enterprise-wide program change control management process for the various IT applications operating within State government. This led to inconsistent methods, as well as noncompliance and circumvention of DoIT's change control policy and procedures. In a number of instances, automated change control system procedures were lacking to substantiate that only authorized and proper changes had been implemented.

Cause: Various methods are used to control program change management which rely mostly upon manual and semi-automated procedures that incorporate emails, memorandums and other paper-based forms to document application changes. In response to prior audit recommendations made since fiscal 2007, DoIT has attempted to implement change control software.

Effect: A lack of a uniform enterprise-wide program change control management process increases the risk that unauthorized or inappropriate changes could be made to IT applications without detection.

RECOMMENDATIONS

2019-020a Develop and implement procedures detailing specific requirements for program change control and disseminate and train DoIT support staff in its proper execution.

2019-020b Determine the appropriate combination of operational, procedural and/or technical adjustments required to use change management software to result in adequate program change control for the entire enterprise.

Management's Views and Corrective Actions:

In 2019, DoIT deployed the ITSM Service Delivery Tool, Service Now. The Change Management Process Module has been used to formalize and train staff on a Change Management Process, with establishment of a Change Advisory Board. All submitted changes with operational impact are reviewed and approved during the weekly CAB meeting. The application teams are involved in the CAB's; with enterprise level software and application changes being integrated into the CAB process. DoIT will continue to mature this process by inventorying vendor and Agency change management processes

Anticipated Completion Date: *Phase 1, ITSM Implementation: Complete*
Phase 2, Change Control Process Implementation: Complete
Phase 3, Inventory and Document Vendor & Agency Change Processes: November 1, 2020
Phase 4, Implement Governance for Vendor & Agency CAB Integration: December1, 2020

Contact Person: *Cesar Mendoza, Chief of IT Infrastructure & Operations*
cesar.mendoza@doit.ri.gov

Finding 2019-021 ***(significant deficiency – repeat finding – 2018-017)***

DIVISION OF INFORMATION TECHNOLOGY – COMPREHENSIVE INFORMATION SYSTEMS SECURITY POLICIES AND PROCEDURES AND PERIODIC RISK ASSESSMENTS

The State can enhance its enterprise-wide security policies and procedures and communication of these policies and procedures with State agencies. Additionally, the State can enhance its ongoing security posture by periodically performing risk assessments to identify if mission critical systems comply with IT policies and procedures.

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

A cybersecurity review which included a comprehensive risk assessment of information technology security was completed during fiscal 2018 by an external vendor.

Periodic comprehensive technology risk assessments are key to uncovering underlying vulnerabilities in the environment as well as providing guidance on where to best spend limited assets to reduce risk. Recent cybersecurity attacks demonstrate the ongoing need to periodically assess the technology infrastructure for threats.

During our audit we focused on the following mission critical systems due to their impact on the State's financial reporting: RIFANS, STAARS, RIBridges, MMIS, DMV- RIMS, and DLT Benefit and Revenue systems.

Criteria: Risk assessment policies and procedures must be documented (National Institute of Standards and Technology – NIST RA-1). Risk assessments should be performed every three years or whenever there are significant changes (e.g. new system implementations) (NIST RA-3).

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

Assessments of compliance to IT policies and procedures for all critical IT applications should be performed on a periodic basis as part of the risk assessment.

Condition: The State has updated and created new policies and procedures for its critical information systems; however, it has lagged in approving, communicating, and implementing these policies. Further, the State has not implemented a practice of conducting security risk assessments on a cyclical basis to determine whether its IT systems comply with State IT security policies and procedures.

Due to the number and complexity of systems within State government, a risk-based approach should be employed where those systems deemed most critical, or most at risk, are prioritized.

The State should make continued use of external system assessments and reviews to complement on-going risk assessment monitoring. When State systems are operated by external parties or interface with external processing entities, these entities often provide Service Organization Controls (SOC) reports, which describe key controls within the application or organization and testing of the operational effectiveness of those controls. These reports should be accumulated and reviewed within DoIT as part of a risk-based approach to assessing and ensuring IT security compliance. Any user-entity controls identified in the SOC reports should be considered, evaluated and documented. This may assist in expanding coverage of the State's many systems considering the minimal resources allocated to this function.

Cause: The State maintains IT security policies and procedures; however, they are not regularly updated and appropriately communicated with State agencies.

Policy and practice to perform comprehensive information security risk assessments is improving but can be further enhanced.

Effect: Critical systems may be exposed to security vulnerabilities and cyber-attacks when comprehensive information security risk assessments are not performed routinely. This could impact the State's ability to ensure continued operation of mission critical systems,

<u>RECOMMENDATIONS</u>

2019-021a Continue to update IT security policies and procedures to ensure such policies and procedures conform to current standards and address all critical systems security vulnerabilities.

2019-021b Perform risk assessments at least once every three years with the results documented and communicated to management for action. Contract for the performance of IT security compliance reviews and make use of available Service Organization Control reports to extend IT security monitoring of critical systems.

2019-021c Prepare a plan that prioritizes significant system security risks with the goal of achieving compliance with DoIT's formalized system security standards for all significant State systems.

Management's Views and Corrective Actions:

2019-021a - The enterprise IT policies, procedures, and guidelines are in a continuous cycle of publish, review, and update. These policies are built upon the (National Institute of Standards and Technology) NIST 800-53 family of controls and are tailored to the IT systems operated and maintained within the enterprise domain.

Anticipated Completion Date: *May 2020*

2019-021b- With the adoption of the NIST Risk Management Framework (RMF), DoIT is building a system(s) risk assessment program for all enterprise operated platforms. This assessment process will be executed in a cyclical fashion; utilizing inputs from audits (internal, and external) and State hosted vulnerability and risk measuring technology and processes. External assessments will be scheduled and conducted on State critical systems.

Anticipated Completion Date: *May 2021*

2019-21c - The categorization of systems through the implementation of the RMF will provide the ability to prioritize mitigation of identified security risks. A running risk register is maintained at the enterprise level, and will be created for all assessed systems; with plans of actions and milestones (POAM's) and corrective action plan's (CAP's) developed for each system after the initial, and each recurring system assessment.

Anticipated Completion Date: *September 2021*

Contact Person: *Brian Tardiff, CISO*
brian.tardiff@doit.ri.gov

Finding 2019-022 ***(significant deficiency – repeat finding – 2018-019)***

DIVISION OF TAXATION – STAARS FINANCIAL REPORTING IMPACTS

Processing functionalities within the Division of Taxation's STAARS system result in a volume of returns held in suspense pending resolution. This complicates financial reporting estimates due to the uncertain effect of returns that had not fully processed at fiscal year end.

Background: The Division's State Tax Administration and Revenue System (STAARS) system functionalities suspend returns from complete processing when any variety of conditions exist. A significant volume of returns remains in suspense (posted exceptions report) until workers resolve the issue thereby allowing the return to complete processing. The volume of returns has decreased as the system matures and additional system experience is gained.

Criteria: Revenue recognition for financial reporting purposes involves estimating the effect of returns received but awaiting full processing to determine the likely revenue impact. Other revenue estimates are developed on historical filing patterns which are impacted by complete processing of returns and system data for a tax year.

Condition: For returns held in suspense at fiscal year end, the cause for suspension is not easily used as a basis for estimating the revenue impact (i.e., result in no revenue impact, a refund liability or a receivable) upon final processing. Worker intervention is required to clear system processing edits and exceptions.

Based on our testing, the amounts listed and cause for return suspension continue to be unreliable as an appropriate indication of taxes owed or refunds due. This indicates that suspended return information must be carefully evaluated when considered for financial reporting purposes.

The Division asserts that the suspension of returns is an intended consequence of the STAARS system design which has enhanced screening to suspend invalid returns. The Division claims that suspended return activity is now approaching a normally expected volume. The Division is better utilizing the system functionalities to prioritize worker efforts based on seasonal demands and other operational considerations. Systemic clearance of suspended returns has also been effectively employed. However, the volume of returns still requires consideration for financial reporting purposes. As part of the fiscal closing process additional analysis can be performed to identify unusual items requiring immediate correction, reduce the overall volume where possible, and to support year-to-year comparison of the volume of suspended returns pending clearance by category.

Cause: STAARS employs higher-level edits for more effective and controlled processing; however, the volume of returns pending resolution/clearance can be significant. The Division can continue to increase its use of advanced analytical tools, in concert with the STAARS development vendor, to (1) prioritize resolution efforts for items included on the posted exceptions report, and (2) apply “system” resolutions to groups of returns to reduce the number of returns requiring staff intervention.

Effect: The resolution of returns held in suspense could affect revenue amounts used for financial reporting.

<u>RECOMMENDATIONS</u>

2019-022a Continue to utilize advanced analytical tools to (1) prioritize resolution efforts for items included on the posted exception report, and (2) potentially apply a system resolution to groups of returns to reduce the number of returns requiring staff intervention.

2019-022b Perform additional analysis at fiscal close to identify unusual items requiring immediate correction, reduce the overall volume where possible, and to support year-to-year comparison of the volume of suspended returns pending clearance by category.

Management’s Views and Corrective Actions:

Management respectfully disagrees with this finding.

The Division of Taxation’s pending suspense queues have been reduced using system processes and weekly business processes. There are no estimates used for financial reporting purposes that are based on items in suspense. The financial reporting estimates are derived from 5-year averages and other percentages which are re-evaluated every year using actual data regarding billing and collections. The Division of Taxation will continue to work with Accounts and Controls to review its data to confirm estimation methodology.

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

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

Auditors Response:

We recognize the progress the Division has made in reducing the volume of returns held in suspense but believe items in suspense at fiscal close must be evaluated to assess the likely financial reporting impact - specifically to what extent those items may result in material taxes receivable or refund liabilities. We also acknowledge there will always be a volume of returns which are pending resolution at any point in time. Our recommendations are directed at applying appropriate analytical measures to assess and estimate likely financial reporting outcomes upon resolution.

Finding 2019-023 *(significant deficiency – repeat finding – 2018-022)*

DIVISION OF TAXATION – STAARS SYSTEM ACCESS

Monitoring of STAARS system user access rights can be further enhanced to ensure access is consistent with and appropriate for each employee's responsibilities. User access rights should be modified timely when responsibilities change and terminated immediately when terminating employment.

Background: User access roles control the specific functions that an employee may perform within their scope of duties and the data within a system that they are allowed to access.

In fiscal 2019, an oversight function was added to better monitor access to STAARS.

Criteria: System access controls should be designed and monitored such that users have access tailored to their specific job functions and duties yet maintain appropriate segregation of duties.

Condition: While there was noted improvement in timely monitoring and modification of system access when required, we found one individual with "super-user" access which was inappropriate and unintended and two temporary employees who were found to have access that continued in excess of one-month after their last log-in date.

Cause: During a system implementation, user access is often broader than ultimately necessary. A Security Management Plan was developed that outlines access control policies and procedures and the use of role management within STAARS. Full review and mitigation of STAARS access management is expected to be completed by December 2020.

Effect: Excessive system access could lead to unauthorized access to restricted data and/or data manipulation.

RECOMMENDATION

2019-023 Complete a thorough review of system access for all STAARS users to ensure user access is appropriately limited and consistent with each user's specific job function and responsibilities.

Management's Views and Corrective Actions:

The Division of Taxation acknowledges its improvements in monitoring STAARS System Access and that it has established business process protocols of checks and balances to limit the scope of user access and remove system access as necessary. Given improvements to date, the Division of Taxation disagrees with the Auditor General's assessment that the finding constitutes a significant deficiency.

Anticipated Completion Date: *Completed December 2020; however, will continue to be further refined with automated checks and alerts as possible.*

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

Finding 2019-024 *(significant deficiency – repeat finding – 2018-023)*

DIVISION OF TAXATION – CONTROLS OVER COUNTER TAX COLLECTIONS

Controls should be improved over the counter tax collections accepted at the Division of Taxation by upgrading the cashiering technology and integrating that functionality into the Division's STAARS system.

Background: The vast majority of tax payments are received electronically or through mail payments, however, some taxpayers make payments in person at the Division of Taxation. Such payments totaled approximately $50.8 million in fiscal 2019. A cashiering application was internally developed more than a decade ago that lacks appropriate information technology controls. Additionally, the cashiering application is not integrated with the Division's new STAARS system.

The necessary funding to replace the existing counter tax collection application was secured and a Request for Proposal was issued in fiscal 2019 to procure a replacement system.

Criteria: Adequate application controls must be in place to ensure taxpayer payments are properly recorded and identifiable to the individual employee processing the transaction. Per National Institute of Standards and Technology (NIST) – Information Technology Lab (ITL) bulletin 1997-03, "Audit trails are a technical mechanism that help managers maintain individual accountability".

Condition: The cashiering application lacks an appropriate audit trail to identify the employee performing the transaction, sufficient password access controls, and data back-up procedures. The system is not integrated with STAARS. A manual process is required to create the transaction record so it can be scanned and processed to post to the taxpayer's account.

Funds were approved and responses to requests for proposals are being evaluated for a project to replace the counter cashiering system.

Cause: This results from outdated technology and lack of integration and upgrade upon implementation of the new STAARS system.

Effect: Controls over tax collections made in person at the Division of Taxation are weakened.

RECOMMENDATION

2019-024 Complete the planned application implementation and related technology upgrades used to process counter payments at the Division of Taxation and ensure the cashiering application is integrated to the Division's STAARS system.

Management's Views and Corrective Actions:

The Division of Taxation agrees with this recommendation and has selected a vendor to install an integrated cashier solution with STAARS. The plan is for this system to go live during the 2021 fiscal year.

Anticipated Completion Date: *June 30, 2021*

Contact Persons: *Neena S. Savage, Rahul Sarathy, and Kristin Cipriano*
Division of Taxation – Department of Revenue
Phone: 401.574.8922

Finding 2019-025 ***(significant deficiency – repeat finding – 2018-025)***

DIVISION OF MOTOR VEHICLES - REVENUES COLLECTED FOR USE WITHIN THE INTERMODAL SURFACE TRANSPORTATION (IST) FUND

Controls can be improved over the recording of license, registration and surcharge fees collected by the Division of Motor Vehicles (DMV) and deposited in the IST Fund.

Background: The DMV collected and remitted revenues totaling $72.9 million of taxes and $24.0 million of licenses, fines, sales and services revenue for recording in the IST Fund during fiscal 2019.

Criteria: DMV must have controls in place to ensure the completeness of revenue reflected within the IST Fund. RI General Law 39-18.1 designates certain fees to be deposited in the IST Fund for transportation purposes.

Condition: DMV lacks effective controls to ensure that all revenues collected by the DMV for deposit within the IST Fund have been recorded. RIDOT should have procedures in place to provide reasonable assurance that the appropriate fees have been earmarked for the IST Fund and have been received and recorded as revenue. This should include documentation of the fee structure identified by RI General Law 39-18.1, the surcharge amount being applied to each DMV transactions code, and how the DMV computer system is programmed to identify such amounts for the IST Fund. RIDOT and the DMV should periodically assess the reasonableness of the actual revenue recognized for recording in the IST Fund. We identified the following control deficiencies:

- There is no monthly or yearly reconciliation performed between RIFANS and the Rhode Island Modernization System – (RIMS) to ensure that RIMS data supports the revenue recorded in RIFANS.

- There is no "cross-walk" of the fee structure identified by RI General Law for licenses, registrations, surcharges, etc. and how the DMV computer system is programmed to identify such amounts. Changes to the General Laws affecting fees should be documented to ensure RIMS programming changes are appropriate and consistent with the law.

- Overages/Shortages are not tracked separately in RIFANS but are netted against registration fee revenue. A RIFANS account number should be created to track these separately.

- Manual write offs are not recorded in RIMS; they are maintained outside of the system. Manual write offs should be recorded within RIMS to maintain a log of the adjustments and to facilitate RIMS/RIFANS reconciliation.

- Deposit date within the RIMS system is pre-populated – the date should reflect the actual deposit date to allow matching RIMS activity to RIFANS receipt entries.

Cause: The DMV's focus has been on successful system implementation, while using the system for enhanced monitoring of compliance with statutory revenue requirements and enhancing the control environment has not been fully explored.

Effect: Controls to ensure the completeness of the DMV revenues earmarked for transportation purposes within the IST Fund are ineffective.

RECOMMENDATIONS

2019-025a Strengthen and document control procedures over the fees collected by the Division of Motor Vehicles (DMV) and transferred to RIDOT to ensure compliance with RI General Law Chapter 39-18.1. Implement monitoring procedures to assess the reasonableness of revenue amounts collected by the DMV for deposit in the IST Fund.

2019-025b Perform a reconciliation between RIFANS and RIMS on a monthly and annual basis to ensure the data in RIMS supports the revenue recorded in RIFANS.

2019-025c Establish a process and control structure to document the DMV's review of the General Laws related to changes in its fee structure and ensure any changes are properly made to RIMS and any relevant excel files used to support the recording of revenue into RIFANS.

2019-025d Establish new accounts to record overages and shortages. Record the actual deposit date in the RIMS deposit date field.

Management's Views and Corrective Actions:

The DMV agrees that a periodic reconciliation of the funds transferred to the DOT is needed and will work to reconcile the funds transferred on a semi-annual and annual basis. We will work to reconcile for the period(s) of July 1 thru December 31 and July 1 thru June 30. We will work with Accounts and Control and Treasury to allow us extra time to close the month of December in order to post the transactions thru December 31 into December. We expect this will ensure that the data from RIMS coincides with the data from RIFANS.

The DMV will work to implement the use of the Overages and Shortages account to record all manual adjustment for errors such as checks written incorrectly. We will work on developing a procedure for using *the using the Overages/Shortages account in the daily balancing and journaling of deposits. We anticipate starting this procedure on July 1, 2020, the start of FY 2021. After developing this procedure, we will need to train the Branch Supervisors on the correct way to us the Overages/Shortages account.*

<u>*Anticipated Completion Date:*</u> *We expect to start utilizing the Overages/Shortages account on July 1, 2020. We expect to complete the first reconciliation in January 2021.*

<u>*Contact Person(s):*</u> *Paul Dombrowski and Brad Booth*
Division of Motor Vehicles, Department of Revenue
Phone: 401.462.4638

Finding 2019-026 ***(significant deficiency – repeat finding – 2018-028)***

<u>DIVISION OF MOTOR VEHICLES – SYSTEM SECURITY PLAN - RIMS</u>

A comprehensive system security plan should be implemented to guide timely consideration of all critical system security requirements.

Background: Security procedures and related documentation are still being developed for the DMV RIMS system which was implemented during fiscal 2019. A strong and well-designed information security program is essential for protecting an organization's communications, systems, and assets from both internal and external threats.

Criteria: Per NIST 800-53, PM-2, "The organization appoints a senior information security officer with the mission and resources to coordinate, develop, implement, and maintain an organization-wide information security program."

Per NIST SP800-18, "The purpose of the system security plan is to provide an overview of the security requirements of the system and describe the controls in place or planned for meeting those requirements. The system security plan also delineates responsibilities and expected behavior of all individuals who access the system."

A data inventory is essential for identifying and tracking an organization's financial data, intellectual property as well as other sensitive data such as personally identifiable information, in addition to helping organizations apply required access controls and security safeguards.

Condition: A draft System Security Plan has recently been developed in conjunction with DoIT but has not yet been completed and implemented.

There was no assigned Senior Information Security Officer in place during fiscal 2019.

A sensitive data inventory should be maintained for the DMV RIMS database.

Formal Incident Response training (such as handling a data breach) was not provided for employees.

Cause: The DMV had been focused on the complete implementation of RIMS - additional focus is needed on the key elements of a well-designed information security program.

Effect: The lack of a documented System Security Plan places the DMV at risk as no one person in the organization has the full overvall understanding of the required security controls in place. Without such a document, it is also difficult to assess where deficiencies may exist, and additional controls are needed.

The overall information security program is weakened in the absence of a senior information security officer.

The lack of a sensitive data inventory leaves data susceptible to unauthorized access, theft, and loss. Understanding the type of data collected, where it is held, whom has access, and how it is transferred is a critical component of data privacy and data security programs. In the event of a data breach, the organization would not be able to quickly and accurately identify which data was accessed and/or lost. Additionally, if data is not properly classified, inventoried, and stored, unauthorized users within the organization may be able to access sensitive/confidential data.

RECOMMENDATIONS

2019-026a Complete the development, review and approval of the System Security Plan and once implemented, assess compliance with the designated security program.

2019-026b Establish a senior information security officer function to manage security oversight.

2019-026c Implement procedures to classify and inventory sensitive data within the RIMS database.

Management's Views and Corrective Actions:

2019-026a - The DMV has an established plan in place to utilized when validation of RIMS functionality is required. Attached is the Production Smoke Test Guidelines which have been in use since RIMS go-live in July 2017.

2019-026b - This responsibility will be retained by the RIMS project manager. The current role is filled, and the Project Manager works regularly with DOIT management regarding security oversight.

2019-026c - The DMV will work with DOIT to establish best practices.

Anticipated Completion Date: *July 1, 2020*

Contact Person: *Maureen McDaniel*
Division of Motor Vehicles, Department of Revenue
Phone: 401.462.4638

Finding 2019-027 *(significant deficiency – repeat finding – 2018-027)*

DIVISION OF MOTOR VEHICLES - BUSINESS CONTINUITY PLAN

The Department of Revenue – Division of Motor Vehicles should finalize and test a Business Continuity Plan (BCP) to ensure that critical business processes can continue during a time of emergency or disaster.

Background: Business Continuity Plans help to ensure that critical business processes can continue during a time of emergency or disaster. By documenting and testing business contingency plans that would be performed by agency personnel in the event of an emergency, they complement disaster recovery plans so business operations can continue as IT applications and infrastructure are recovered.

A successful recovery of agency IT systems per the disaster recovery plan by itself is insufficient to fully resume key business operations. Key personnel identified in the BCP are necessary to communicate information to agency employees (e.g. where to report for work, changes in connection and login information) to continue agency business operations.

Criteria: NIST Special Publication 800-34 discusses key items needed for contingency planning including having a Business Continuity Plan. This is also an industry best practice.

Condition: A draft Business Continuity Plan was developed during fiscal 2019 but has not yet been finalized or tested. The RIMS system is a critical State system with multiple interfaces to other state agencies, that, in the event of disruption, could impact critical state operations.

Cause: The DMV was focused on various competing priorities in fiscal 2019.

Effect: Without a fully implemented BCP plan, there is increased risk of failure to resume normal business operations in the event of an incident or disaster.

RECOMMENDATION

2019-027 Finalize and test a Business Continuity Plan covering critical DMV operations and focusing specifically on RIMS system functionalities.

Management's Views and Corrective Actions:

The DMV has finalized and distributed the Continuity of Operations Plan (COOP) to senior staff responsible for executing the plan. This plan will be reviewed and maintained annually. A copy is on file at DMV and DOR Director's Office.

Anticipated Completion Date: *Completed*

Contact Person: *Walter Craddock, Administrator*
Division of Motor Vehicles, Department of Revenue
Phone: 401.462.4638

Finding 2019-028 ***(significant deficiency - repeat finding - 2018-029)***

INTERMODAL SURFACE TRANSPORTATION FUND – FINANCIAL REPORTING

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

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

Criteria: Controls over the preparation of financial statements should ensure consistent and accurate reporting of fund activity in accordance with generally accepted accounting principles. Additionally, fund balance components are to be presented in accordance with generally accepted accounting principles (GASB codification section 1800 paragraphs 177 and 179) reflecting any restrictions on use or commitments by management. Classification of fund balance components, particularly within the IST Fund, demonstrates amounts available to support the transportation program consistent with any limitations or restrictions on use.

Condition: During our audit, we identified misclassifications of various fund balance categories which were corrected in the financial statements.

Due to the multiple computer systems used by RIDOT, the department must identify accounts payable within each subsystem. The use of those systems makes the identification of accounts payable more challenging. There were several transactions included in accounts payable, which the Department subsequently determined were either previously paid or not liabilities. Additionally, the accounting structure between RIFANS and the other systems are not the same, causing the department to manually assign RIFANS accounting structures to thousands of detailed transactions to record the accounts payable.

Accounts payable were booked to clearing accounts, causing the expenditures to be associated with an incorrect funding source. This resulted in incorrect federal revenue and federal receivable amounts reflected in the draft financial statements.

RIDOT recorded debt service principal payments of $37,580,000 as interest and other charges in error.

The Department recorded expenditure reimbursements totaling $355,315 as Departmental Restricted Revenue, when it is the Department's policy to record such collections as expenditure credits.

RIDOT did not record an adequate allowance for uncollectible tolls receivable – an allowance of $615,072 ($258,050 for tolls and $357,022 for administrative costs) was established through audit adjustment for financial reporting purposes.

Cause: Financial reporting for the IST Fund grows in complexity as additional funding sources are added to support the State's transportation program. Certain of the distinct funding sources are maintained in separate funds; however, for financial reporting purposes all the transportation related funds are combined. Although combined for financial reporting purposes, each activity or funding stream requires separate analysis to ensure amounts (revenue and expenditures) 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 (federal, Highway Maintenance Fund, RICAP, Gas Tax, etc.). RIDOT did not fully reconcile all the funding sources to fund balance components. A full reconciliation is necessary to identify expenditures and/or revenue booked to incorrect funding sources in addition to ensuring that the fund balance is properly recorded for financial statement purposes.

The accounts payable identification process for fiscal closing is manual, complex, labor-intensive and susceptible to error. For example, due to the timing of processing expenditures through the multiple systems, the fiscal year accounts payable process increases the risk of including the same expenditure in multiple accounts payable journal entries. This process should be re-assessed with the goal of streamlining and simplifying the process. Greater use of estimates should be considered when appropriate.

Truck tolls largely commenced during fiscal 2019 and RIDOT lacked collection history for billed tolls to establish an appropriate allowance for uncollectible amounts.

Effect: Account balances within the IST financial statements could be misstated.

RECOMMENDATIONS

2019-028a Ensure the transactions identified through the analysis of each activity and/or funding source within the IST Fund result in the appropriate categorization and reporting of fund balance components on the financial statements and general ledger. Ensure a complete reconciliation of activity by funding source to the fund balance components included on the financial statements is performed.

2019-028b Re-assess policies, procedures and controls to identify and record accounts payable at fiscal close with the aim of streamlining and simplifying where possible. Consider increased use of estimates where appropriate.

2019-028c Enhance fiscal closing procedures to ensure all expenditures recorded in clearing accounts are properly allocated to the correct accounts by fiscal year end. Consider whether recording accrual entries to the clearing accounts is appropriate.

2019-028d Generate an accounts payable aging report on a periodic basis and document the reasons for older invoices being unpaid.

2019-028e Improve controls over the FMS to RIFANS mapping table by ensuring all FMS accounts have an associated RIFANS account.

2019-028f Accumulate collection history for billed toll receivables and develop an appropriate allowance for uncollectible amounts for financial reporting purposes.

Management's Views and Corrective Actions:

2019-028a:

Short Term: During FY 2019, RIDOT did work to improve the fund balance procedure. During this process fund activity was reconciled by RIFANS line items for all Federal accounts to ensure accuracy and consistency. Any inconsistencies found are adjusted at that time. However, due to turnover in the section improvements were not made to the extent RIDOT was hoping. During late FY 2019 into FY 2020, a working group has been working to develop policies and procedures to improve the fund balance reconciliation and *ensure the process is compliant with GASB 54 standards. The short-term goal will include implementing the adopted policies and procedures to all Federal fund balance accounts.*

Anticipated Completion of Short Term: *September 30, 2020*

Long Term: Once the adopted policies and procedures have been implemented for all Federal fund balance accounts, RIDOT will expand the reconciliation to include all State fund balance accounts. This expansion of the process will ensure all fund balance accounts regardless of funding source are being reconciled monthly.

Anticipated Completion Date Long Term: December 31, 2020

2019-028b:

Short Term: RIDOT has evaluated its policies and procedures to identify where additional controls can be put in place to ensure accurate identification of accounts payable at fiscal close. RIDOT will implement a procedure in which after the fiscal close deadline any invoice in excess of $100,000 will be assessed to ensure it is classified in the correct fiscal year. This procedure will apply for invoices received after July 15th until August 31st.

Anticipated Completion Date of Short Term: Implemented

Long Term: RIDOT will research the use of estimates with regards to the fiscal close process. This will take time as it will consist of analysis and research.

Anticipated Completion Date of Long Term: TBD

2019-028c: During FY 19, RIDOT revised our fiscal close policies to ensure clearing accounts would be reevaluated once accrual entries are posted. RIDOT will do one final accrual entry to address clearing accounts should any accruals be posted in the clearing accounts. RIDOT will also consider posting directly to accurate accounts instead of the clearing accounts where possible.

Anticipated Completion Date: *Implemented*

2019-028d: RIDOT will run the Accounts payable report on a quarterly basis to evaluate why older invoices remain unpaid. Reasons why will be documented quarterly.

Anticipated Completion Date: *Implemented*

2019-028e: RIDOT is evaluating the FMS to RIFANS mapping table to determine if all mapping tables can be streamlined to a consolidated mapping table or if a Master mapping table needs to be developed.

Anticipated Completion Date: *September 30, 2020*

2019-028f: Now that toll gantries have been live and collecting for more than a year, a history for uncollectible has been better established. Dedicated staff have been assigned to the financial aspect of tolling and will be able to better determine uncollectible amounts for toll revenue in the upcoming fiscal year.

Anticipated Completion Date: *Implemented*

Contact Person: *Loren Doyle, DOT Acting Chief Operating Officer/Chief Financial Officer*
Phone: 401.563.4524

Finding 2019-029 ***(material weakness – repeat finding – 2018-030)***

TRANSPORTATION INFRASTRUCTURE REPORTING

Controls over the identification of transportation infrastructure assets have been improved but can be further enhanced to ensure the accuracy of such amounts. Controls should be improved to identify impaired infrastructure assets as well as removing infrastructure costs when assets are retired or replaced.

Background: RIDOT implemented a process in fiscal 2017 to identify transportation infrastructure assets which was a significant enhancement. The new process uses the RIDOT Financial Management System (FMS) to identify each project and ensures that total project costs (e.g., design and construction costs) are included in the capitalized amount. Since the source of the information used to identify capitalized infrastructure is FMS and the financial statements are based on RIFANS (statewide accounting system), the data used must be reconciled between the two systems.

Criteria: Generally accepted accounting principles (GAAP) require recording the State's investment in infrastructure assets to be reflected on the government-wide financial statements. Such amounts should be capitalized and depreciated consistent with the State's adopted accounting policies. Amounts are recorded as construction in progress until placed in service at which time depreciation commences.

GAAP also requires 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.

The cost and related accumulated depreciation associated with infrastructure assets that have been replaced or are no longer in service should be removed from the infrastructure amounts included on the financial statements.

Condition: RIDOT did not document its consideration of transportation infrastructure assets that may be impaired and provide such documentation to the Office of Accounts and Control for the purpose of preparing the State's financial statements.

The cost and related accumulated depreciation associated with infrastructure assets that have been replaced or are no longer in service has not been removed from the infrastructure amounts included on the State's financial statements.

The infrastructure process does not include accrued project costs (accounts payable) at fiscal year-end since those amounts are not included in RIDOT's FMS.

We proposed audit adjustments to correct balances at June 30, 2019 – construction in progress was overstated by $12 million, infrastructure was overstated by $5.4 million and Road Maintenance was understated by $17.4 million as follows:

- 3 projects identified as substantially complete prior to fiscal 2019 remained in construction in progress causing construction in progress to be overstated and infrastructure to be understated by $1.2 million
- 4 projects transferred from construction in progress to infrastructure in a previous fiscal year were reclassified again in fiscal 2019 totaling $5.5 million causing construction in progress to be understated by $5.5 million and infrastructure to be overstated by the same amount.
- 2 projects transferred from construction in progress to infrastructure in a prior year were for an amount greater than the amounts expended causing negative construction in progress balances for those projects totaling $1.1 million (construction in progress was understated and infrastructure was overstated).
- Accrual entries were not reclassified to road maintenance categories causing construction in progress to be overstated by $20 million.
- 1 project was reclassified from construction in progress to road maintenance twice causing construction in progress to be understated and road maintenance to be overstated by $2.4 million.

Projects classified as infrastructure are assigned to 1 of 8 infrastructure codes, the infrastructure codes were established to identify the infrastructure type (road, bridge, etc.) and the useful life of the infrastructure. The useful life of the infrastructure determines the period (ranging from 7 to 75 years) over which the asset will be depreciated.

We identified 2 projects with the incorrect infrastructure code. Although these 2 projects were still in construction in progress and depreciation had not commenced in fiscal 2019, the use of incorrect codes affects the categorization and useful life and depreciation expense. RIDOT policy requires the Project Manager to assign the infrastructure code. This policy was implemented in fiscal 2018 but only applied to projects beginning after the implementation date.

Cause: RIDOT's infrastructure asset identification process can be further enhanced going forward by documenting the process and refining the reconciliation between FMS and RIFANS. A process to remove estimated costs for retired/replaced infrastructure has not been implemented. The consideration and documentation of impaired infrastructure assets has not been formalized.

Effect: Infrastructure assets and related depreciation expense may be misstated in the State's financial statements.

RECOMMENDATIONS

2019-029a Enhance controls over the recording of transportation infrastructure assets by documenting RIDOT's related policies, procedures and controls. Document the policies, procedures and control over the RIDOT Infrastructure Report to RIFANS reconciliation and simplify the reconciliation to ensure completeness.

2019-029b Enhance controls over the identification of infrastructure in RIFANS by including the RIDOT project number in the RIFANS project code field.

2019-029c Enhance controls over the assignment of the project infrastructure code, by documenting the project management - scoping team's code assignment.

2019-029d Enhance controls over the identification of projects determined to be substantially complete. Include the infrastructure code and substantially complete date for projects in the FMS hierarchy.

2019-029e Enhance controls over the accuracy of amounts reclassified from construction in progress to infrastructure including designating the infrastructure code classification.

2019-029f Document consideration of whether any of the State's transportation infrastructure has been impaired consistent with GAAP criteria.

2019-029g Implement a process to remove estimated infrastructure assets and related accumulated depreciation when assets have been replaced or taken out of service.

Management's Views and Corrective Actions:

2019-029a: RIDOT has begun creating policies, procedures and controls related to the Infrastructure process. The policies and procedure will include all processes related to infrastructure including RIDOT Infrastructure Report to RIFANS reconciliation.

Anticipated Completion Date: *June 30, 2020*

2019-029b: The RIFANS project code field does not allow for information to be electronically interfaced into the field. With that system limitation in RIFANS, RIDOT does not have the resources to manually enter the project numbers individually into RIFANS. RIDOT will look at alternative ways of accomplishing the recommendation.

Anticipated Completion Date: *TBD*

2019-029c: In FY 18, Finance along with Project Management developed a process to enhance the controls over the assignment of project infrastructure codes. The infrastructure code is now identified during the scoping phase of the project by the project managers and scoping team. It has been added as a field on the Project Definition and Scoping Document. The Project Funding Request template was also modified to include the infrastructure code so that it is part of the request for funding. Finance then receives the approved funding authorization with the infrastructure code and inputs the code into the Financial Management System.

Anticipated Completion Date: *Implemented*

2019-029d: During FY 2019, RIDOT has revised the procedures to implement a process where the project completion dates entered into FMS are compared to the substantial completion forms on a quarterly basis for accuracy by the Administrator of Financial Administration. In addition, a tracking sheet will be maintained by fiscal year to list all projects which the Finals section indicate are substantially complete. This tracking sheet will be used to ensure the substantial completion forms are received from construction. RIDOT Finance has also worked with Construction to ensure all substantial completion forms are sent to Finance in a timely manner.

Anticipated Completion Date: *June 30, 2020*

2019-029e: RIDOT will improve controls to ensure the accuracy of amounts reclassified from CIP to Infrastructure. The improved controls will be reflected in the procedures.

Anticipated Completion Date: *June 30, 2020*

2019-029f: RIDOT will review the criteria for impairment of assets and from there develop a policy and a procedure for determining if any of the State's transportation infrastructure assets have been impaired. Finance will coordinate with the necessary sections to develop and implement this policy.

Anticipated Completion Date: *June 30, 2020*

2019-029g: RIDOT will work develop a policy and a procedure for removing infrastructure assets that have been replaced or taken out of service. RIDOT will work with Accounts and Control to ensure the appropriate amounts are removed.

Anticipated Completion Date: *December 31, 2020*

Contact Person: *Loren Doyle, DOT Acting Chief Operating Officer/Chief Financial Officer*
Phone: 401.563.4524

Finding 2019-030 ***(material noncompliance – repeat finding 2018-036)***

COMPONENT UNIT – RHODE ISLAND CONVENTION CENTER AUTHORITY - RESTRICTIVE COVENANTS

Criteria: Bond indentures require that the Authority fund the Operating Reserve requirement of the restrictive covenants for the RICC and the DDC.

The 2018 Series A Bonds require annual deposits to be made by May 15th to the Renewal and Replacement Fund related to the parking facility adjacent to the Garrahy Courthouse.

Condition: During the year ended June 30, 2019, the Authority was unable to fund the Operating Reserve requirement of the restrictive covenants for the RICC and the DDC pursuant to the indentures.

The fiscal year 2019 Renewal and Replacement requirement included in the 2018 Series A Bonds was funded in August 2019.

Context: The Authority is currently in violation of certain debt indentures with respect to the Operating Reserve requirement.

Effect: As a result of this fund not being funded, the Authority is in noncompliance with certain bond indentures.

Cause: The Authority does not have sufficient cash flow to fund the Operating Reserve.

RECOMMENDATION

2019-030 We recommend that the Authority fund the Operating Reserve and make required deposits to the Renewal and Replacement Fund related to the parking facility adjacent to the Garrahy Courthouse prior to May 15th each year.

Management's Views and Corrective Actions:

The Authority will fund the Operating Reserve provided there is sufficient cash flow. The Authority will make required deposits to the Renewal and Replacement Fund related to the parking facility adjacent to the Garrahy Courthouse prior to May 15th each year.

Given that the Authority continues to make timely and complete debt service payments, it would make little sense for the trustee to declare a default for reserve fund noncompliance. In fact, this has been the practical practice over several years as the Authority has failed to maintain adequate reserves due to insufficient State appropriations. If a default was declared, the Authority would have 90 days to cure and would seek a legislative appropriation to remedy the default. Of course, annual appropriations in excess of debt service requirements would assist in building reserves and reaching the requirements.

Anticipated Completion Date: *undetermined*

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

Finding 2019-031 ***(material weakness –repeat finding 2018-034)***

COMPONENT UNIT - CENTRAL FALLS SCHOOL DISTRICT - SIGNIFICANT ADJUSTMENTS

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

Condition: Material adjustments to year-end balances and current year activity were necessary for the financial statement to be fairly presented in accordance with generally accepted accounting principles.

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

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

RECOMMENDATION

2019-031 A comprehensive plan to coordinate all District financial accounting recording and reporting activities is in the process of being developed and implemented. This plan should include the development of a comprehensive policies and procedures manual; adequate staffing including training of all staff as to both the processes and the software involved; appropriate controls related to authorization and review of recorded transactions; timely recording of transactions, reconciliations and reviews of reconciliations so as to detect and correct errors in a timely manner, and a comprehensive review of the District's organizational structure to ensure adequate levels of supervision and clear reporting paths for all staff involved.

Management's Views and Corrective Actions:

The District agrees with the finding. The District also agrees with the recommendation, please see below for action taken.

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

Anticipated Completion Date: *April 30, 2020*

Contact Person: *Keree J. Simmons, Director of Finance*
Central Falls School District
Phone: 401.721.2893 ext. 2006

Finding 2019-032 ***(significant deficiency – repeat finding 2018-035)***

COMPONENT UNIT - CENTRAL FALLS SCHOOL DISTRICT – CAPITAL ASSETS

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

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

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

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

RECOMMENDATION

2019-032 We recommend that the District implement an integrated software package that will enable capital assets to be recorded when the asset is acquired rather than being captured at year end. We further recommend that the capital asset inventory be updated to include the location of the asset and a code to identify all assets that are acquired with federal funds. Management should utilize this capital asset inventory listing, as well as the controllable asset listing, to conduct periodic inventories of the assets.

Management's Views and Corrective Actions:

The District agrees with the finding. The District also agrees with the recommendation, please see below for action taken.

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

Anticipated Completion Date: *March 31, 2020*

<u>*Contact Person:*</u> *Keree J. Simmons, Director of Finance*
Central Falls School District
Phone: 401.721.2893 ext. 2006

Finding 2019-033 **_(material weakness – new finding)_**

<u>COMPONENT UNIT - RHODE ISLAND HEALTH AND EDUCATIONAL BUILDING CORPORATION - STATE APPROPRIATION TO SCHOOL BUILDING AUTHORITY CAPITAL FUND (SBACF)</u>

Condition: Revenue recognized in the SBACF for the year ended June 30, 2019 was understated by $1.224 million. A proposed adjustment to the financial statements and underlying accounting records was provided to management for recording this year-end accrual, and management has agreed to record the entry to correct the matter.

Criteria: Information and Communications is a recognized key component of a sound system of internal control. As the SBACF is managed by the Rhode Island Department of Education (RIDE), with the support of the Corporation for assigned administrative duties, effective and consistent communication between RIDE and the Corporation is imperative to help ensure that all activity of the SBACF, including activity and funding between the parties, is properly reflected in the accounting records and ultimately in its financial statements.

Cause: Ineffective communication between RIDE and the Corporation regarding the transfer of fiscal 2018-19 appropriated funds occurring subsequent to year-end resulted in the revenue being omitted from SBACF and Corporation's accounting records.

Effect: This omission caused the recorded revenue from state appropriations to be understated by $1.224 million for the year ended June 30, 2019.

<u>RECOMMENDATION</u>

2019-033 We recommend that personnel at RIDE and the Corporation ensure that timely and effective communication of all financial matters required to be reflected in the SBACF financial statements occur on an ongoing basis, with periodic reconciliations of inter-entity activity being performed on at least a quarterly basis, and a formal agreement on state appropriation revenue being prepared at each year-end date. Such procedures will mitigate the risk that errors relating to funding transfers and inter-entity activity will occur without being corrected in a timely manner.

Management's Views and Corrective Actions:

Due to year-end commitments, the Corporation's bank statements are not reviewed in as timely a manner as in other months. As a result, the Corporation's auditors found a $1.2 million transfer on the State's payment system that had not yet been discovered by the Corporation. The bank statement showing the transfer was in fact reviewed by the Corporation within a week of the auditor's discovery. The Corporation will put procedures in place to ensure that transfers from the State are communicated to the Corporation in a timelier manner.

<u>*Anticipated Completion Date:*</u> *June 30, 2020*

<u>*Contact Person:*</u> *Scott O'Malley, CFO*
Rhode Island Health and Educational Building Corporation
Phone 401.831.3770

Finding 2019-034 **(significant deficiency – new finding)**

EMPLOYEES' RETIREMENT SYSTEM - POOLED INVESTMENT TRUST – PLAN ACCOUNTING AND DISTRIBUTION OF INVESTMENT INCOME AND EXPENSE

Each of the Employees' Retirement System's defined benefit plans are participants in a Pooled Investment Trust. The pooled investment trust was created for ease in administering the pooled assets and related investment activity of the System's seven defined benefit pension plans. The custodian for the pooled investment trust (Bank of New York Mellon) has custody and accounts for the investment activity of the pooled trust on a collective basis. Each month the custodian prepares plan accounting reports which delineate each plan's proportionate share of the pooled investment trust and related income and expense.

In essence, the Pooled Investment Trust acts like a mutual fund with seven participants – each plan is assigned units – units are "purchased" or redeemed as amounts are contributed or withdrawn reflecting on the unique cash needs of each plan. The cash flow profile of each of the participant plans in the pooled investment trust is unique and consequently some plans are withdrawing or selling units while others are purchasing new units. Because the custodian is preparing plan accounting reports on a monthly basis and distributing income and expense on that basis, cash was typically only contributed or withdrawn from the pooled investment trust once per month to avoid any distortion in the proportionate distribution of investment income and expense.

More recently, new contributions to the pooled investment trust were being made more frequently during the month rather than just at the defined once-per-month original interval. The custodian continues to prepare monthly plan accounting reports which distribute each plan's proportionate share of income and expense based on each plan's units on the last day of the month. This current process does not sufficiently reflect the changing number of units owned by each plan during the month.

While the effect of the imprecision in allocating income and expense is likely immaterial, the System should modify its processes to ensure a more precise allocation of assets, investment income, and investment expense among the participant plans.

In response to identification of this issue during the audit, the System has worked with the custodian to explore options for enhancing precision in the plan accounting. One option is to limit all movements of cash to and from the plans and the pooled investment trust to just one day per month. The other is for the custodian to compute an average daily unit balance for each of the plans and use that average to distribute aggregate pooled trust investment income and expense for the month to each of the plans. We believe either option would sufficiently address the issue; however, the average daily balance proposal would allow for more flexibility of the timing of cash movements yet still result in an accurate proportionate distribution of investment income and expense.

RECOMMENDATION

2019-034 Implement planned revisions to the plan accounting process employed by the custodian to enhance the precision over the distribution of investment income and expense to the participating plans.

Management's Views and Corrective Actions:

Approximately two years ago, in order to maximize returns to the System, we began to transfer significant deposits to the long-term portfolio. These deposits occurred upon payroll dates, approximately one/two per month, while withdrawals still occurred on the last business day each month. Once the concern regarding multiple movements was raised, the System immediately limited the movement of cash to and from the plans and the pooled investment trust to just one day per month. We believe any effects from intra-month cash flows during that time period were minimal.

To enhance precision in the plan accounting going forward, the System's Investment and Accounting teams will work with the Custodian to implement using an average daily unit balance computation for the plans as a basis for allocating monthly income and expense. It is anticipated that this process will be fully operational during the third quarter of fiscal 2020.

Anticipated Completion Date: *June 30, 2020*

<u>*Contact Person:*</u> *Alec Stais, CIO*
Phone 401.222.2397

Finding 2019-035 ***(significant deficiency – repeat finding – 2018-031)***

<u>EMPLOYEES' RETIREMENT SYSTEM - ACCOUNTING FOR INVESTMENT EXPENSES</u>

The System has implemented a "transparency policy" for investment related expenses within the pension investment portfolio. In essence, investment expenses are reported on a gross rather than net basis. When investment expense detail isn't readily reported by investment managers, additional analysis is performed to extract investment income and expenses on a basis more consistent with gross reporting.

While this investment expense transparency objective is clear and laudable, controls need to be enhanced to improve the accuracy and reliability of investment expenses reported on the System's financial statements. Certain of these processes were first developed on an "ad-hoc" basis for informal reporting before investment expenses were recorded on a gross basis on the System's financial statements.

The System's accounting for investment activity is mostly derived from custodian reporting. Investment management fees are disbursed by the custodian and recorded within the custodial accounting system. In addition, the custodian has implemented enhanced reporting for private equity, infrastructure and real estate partnerships to record related investment income and expenses in the appropriate categories within their custodial reporting system. Hedge Fund activity is further analyzed externally by System investment staff and direction letters are later provided to the custodian to "adjust" investment income and expense within the custodial accounting system. System investment staff also analyze other investment categories to identify investment expenses that were originally recorded on a net basis. As a result, investment income and expenses reported on the System's annual financial statements are derived through a composite of standardized custodian controls, custom processes designed specifically for private equity type investment, and analytical processes employed independent of the custodian. Analytical processes that are independent of the custodian include those for hedge funds and other investment types as well as the identification and accrual of private equity and hedge fund investment activity effective for quarters ended June 30 and prior but not available until months later.

The material investment expense amounts reported on the System's financial statements relate to private equity and hedge funds including the accrual of activity through June 30.

The System needs to formalize its processes for deriving amounts to be included in the financial statements and also implement enhanced review and monitoring controls to ensure the consistency and reliability of these amounts.

For fiscal 2019, System processes to derive the investment expense amounts for financial reporting purposes yielded different amounts. Subsequent reconciliation identified direction letters which had not been either provided or recorded by the custodian. Reversal of prior year accruals had also not been accurately reflected in the initial accumulation of investment expenses. Queries of custodial activity recorded after fiscal year end but relating to June 30 or prior have not been standardized. Analysis and monitoring of custodian recorded activity during the fiscal year is insufficient to ensure consistency and reliability of such amounts. For example, hedge fund investment expense reclassifications for the quarter ended September 30, 2018 (via direction letter) were not recorded by the custodian; however, that hadn't been identified by System investment staff.

Procedures need to be formalized to document the process for accumulating investment expenses for each asset category. When processes are independent of the custodian's control processes, additional supervisory review and monitoring controls should be employed to strengthen controls over these material balances. These investment accounting processes should be better coordinated with and overseen by the System's accounting and finance staff.

<u>RECOMMENDATIONS</u>

2019-035a Formalize the investment income and expense processes that are external to the investment custodian and result in amounts recorded on the financial statements. Enhance monitoring and review of these processes.

2019-035b Integrate certain investment accounting functions that are now external to oversight of the System's Chief Financial Officer with the System's other accounting functions.

Management's Views and Corrective Actions:

The Employees' Retirement System of Rhode Island (ERSRI) and The Office of the General Treasurer remain committed to the highest level of transparency in disclosing investment expenses. The process was transformed in Fiscal 2018 to enhance details on all expenses highlighted by the inclusion of indirect expenses. This level of disclosure puts ERSRI at the forefront of public pension transparency.

Over the last year we have worked closely with our consultant and custodian to further refine the process. Our consultant now monitors all the Plan's private asset expenses to ensure what we are charged adheres to the partnership agreements. Our custodian has worked closely with staff to ensure that all partnership data is captured accurately and on a timely basis. We have completed one year under this process and the interaction and reporting are improved relative to prior years.

For Fiscal 2020, we look to further enhance the process as follows:

To improve proper posting of all investment expenses, enhance coordination between the Investment and Accounting teams by performing a monthly reconciliation to ERSRI's financial statements with ERSRI's Chief Financial Officer.

To ensure proper posting of quarterly expenses for absolute return funds, implement an electronic confirmation process with the custodian and perform a timely reconciliation of these expenses on a monthly basis.

It should be noted that nothing that transpired in FY 2019 had any impact on the System's net position.

Anticipated Completion Date: *June 30, 2020*

Contact Person: *Alec Stais, CIO*
Phone 401.222.2397

Finding 2019-036	***(significant deficiency – repeat finding – 2018-032)***

ASSESS THE RESOURCES AND SYSTEMS NECESSARY TO EFFECTIVELY ADMINISTER THE OPEB SYSTEM

The resources necessary to effectively manage and administer the OPEB System to ensure all System functions are met and adequately controlled should be assessed. A unified database or computer application is needed to maintain membership data for each of the State's OPEB plans. This would improve controls over the administration of the benefit programs and the process to accumulate data necessary for periodic actuarial valuations of the OPEB plans for both funding and accounting purposes.

Background: The Rhode Island State Employees' and Electing Teachers OPEB System (the System), acts as a common investment and administrative agent for post-employment health care benefits provided by six plans covering state employees and certain employees of the Board of Education.

When the State began to advance fund its retiree health benefits, OPEB trusts were established for each of the plans and a formalized governance structure was established by statute; however, no dedicated personnel were specifically tasked with administering the System and no administrative systems were implemented at that time, or subsequently, to capture and control membership data for the various OPEB plans. Instead membership data, the determination of eligibility for benefits and any required retiree copays are administered through a variety of processes which largely lack the controls needed to administer plans of this size and complexity. In prior years, certain plan benefit functions were administered through the member benefit system used by the Employees' Retirement System of Rhode Island

(ERSRI) for pension benefits; however, the ERSRI's newly implemented member benefit system no longer includes those functionalities.

The System's functions are managed through various units within State government. The Department of Administration's Office of Employee Benefits (OEB) currently determines eligibility and manages member benefits for the State Employees, Teachers, Judges, State Police and Legislator plans. The Human Resources Department at the University of Rhode Island, separately determines eligibility, calculates benefits and manages member subsidy receivables for the Board of Education plan. The Office of Accounts and Control handles the accounting and financial reporting aspects of the System and coordinates the actuarial valuations. The Office of the General Treasurer oversees the investment activity of the System.

Census data for each plan is provided annually to the System's actuary to prepare required actuarial valuations of the plans. Each plan has unique benefit eligibility and healthcare coverage provisions.

Criteria: As the System grows in size and matures, the administrative infrastructure supporting the System should be assessed to ensure adequate resources and systems with appropriate controls are in place to manage the System effectively.

Maintaining membership data and determining the eligibility for benefits and required co-pays should be managed through systems and processes with adequate controls to ensure that membership data is reliable, benefits are accurately and consistently determined consistent with plan provisions, and plan census data is maintained to facilitate extraction for actuarial valuations. Duties should be appropriately segregated to ensure that no one individual is responsible for determining eligibility and required copays, enrolling the individual for coverage, collecting and accounting for copay amounts, and maintaining plan census data.

Condition: We identified control deficiencies over the various disjointed processes used to administer the OPEB plans as follows:

- Insufficient resources have been allocated and centralized to administer the System effectively. Knowledge of key System benefit provisions, administrative operations and operating procedures are dispersed among too many separate units of State government without effective coordination.

- The accumulation of census data provided to the actuary for plan valuation purposes is derived from multiple sources and requires analysis of other external source data to establish the active and retiree plan members for each plan. Because much of the analysis is done on spreadsheets, controls over data validity, data protection, and completeness are lacking. Controls are inadequate to prevent duplicate or inaccurate census data from being provided to the actuary.

- Inadequate segregation of duties exists between eligibility determinations, benefit calculations, copay receivable billings and collections, healthcare plan enrollment, and maintenance of the plan census information.

- Periodic reconciliations between the plans' records and healthcare providers enrollment data is not documented.

- Procedures for identifying and terminating coverage for deceased members, spouses and dependents are inconsistent and can be improved.

Cause: The State and System have not implemented System specific administrative processes and computer applications to effectively support the overall administration of the OPEB System, accumulate plan census data, manage and control the eligibility, copay determination, and plan enrollment functions. Existing processes used to support healthcare plan enrollment for active employees have generally been used to support the OPEB System but lack certain functions and controls that are unique to and requisite for the administration of the OPEB System.

Effect: Inadequate controls over key plan administrative functions could impact the reliability of amounts (e.g., member co-pays and member benefits) reported on the System's financial statements as well as the accuracy of census data used by the actuary to determine each plan's annual actuarially determined contribution amount and the net OPEB liability or asset for each plan.

<u>RECOMMENDATIONS</u>

2019-036a Assess the resources necessary to effectively manage and administer the OPEB System to ensure all System functions are met and adequately controlled.

2019-036b Implement a member benefit computer application to accumulate and manage plan membership data to support the overall administration of the OPEB System with enhanced controls.

2019-036c Evaluate assigned responsibilities for key functions and segregate certain responsibilities for incompatible functions to enhance controls over critical plan administrative functions.

2019-036d Establish consistent procedures to identify deceased plan members and prompt timely termination of coverage.

Management's Views and Corrective Actions:

The OPEB Board agrees with the recommendations presented by the Auditor General. The Board will explore hiring at least one dedicated staff member to be responsible for key functions of the OPEB system. The Board believes implementing a stand-alone computer application to accumulate and manage plan membership data will be too expensive for the system to finance within its authorized administrative funding. To address this recommendation, the Board will engage with the Employee Retirement System to see if there is an opportunity to partner on the development of a computer application to achieve the desired outcome.

<u>Anticipated Completion Date:</u> *September 1, 2020*

<u>Contact Persons:</u> *Peter Keenan, State Controller and Thomas Mullaney, Budget Officer*
Phone: 401.222.6408 and 401.222.6300

Management Comments

Management Comment 2019-01 ***(new comment)***

TOBACCO SETTLEMENT FINANCING CORPORATION

The Tobacco Settlement Financing Corporation requires additional administrative support and should periodically update its projected debt service requirements to reflect operating and other economic factors.

The Tobacco Settlement Financing Corporation (TSFC) is a blended component unit of the State. The TSFC is unique in that it has no dedicated staff and meets its administrative and financial reporting responsibilities through staff within the Budget Office and Office of Accounts and Control. The Office of Attorney General manages specific legal issues related to the compliance and enforcement of the multi-state tobacco settlement agreement. For fiscal 2018 and again for fiscal 2019, TSFC engaged a CPA firm to help prepare the financial statements. While this is necessary and appropriate assistance, that firm cannot step into the role of management for the TSFC and serves only to compile the annual financial statements. Similarly, the TSFC's external auditor serves an important but limited role that can't extend to managing the entity or providing other administrative support.

We believe there is a need for greater administrative support for the TSFC to manage and coordinate required financial reporting tasks, act as a liaison to the Attorney General's office, stay current with bond rating changes for the various states that have issued tobacco settlement debt, and act as a liaison to bond counsel, the Corporation's fiscal advisor, and board members. These tasks likely don't require a full-time position but do require more attention than the current shared, but fragmented approach, to meeting the Corporation's responsibilities allows. Additionally, the Board meets infrequently, often just once annually to accept the annual audit.

Additionally, review of the TSFC's financial statements highlights the need to obtain an independent financial analysis of the TSFC's ability to support long-term debt service, specifically the deep discount debt that matures in more than 30 years. While projections of future tobacco settlement revenues have been prepared and used to support recent refinancing of certain tobacco bonds – an updated comprehensive analysis is necessary to provide board members and other state leaders with a current projection of the likelihood that sufficient resources will be available to support that future debt service.

The Corporation's financial statements at June 30, 2019 detail future debt service requirements totaling $2.5 billion with more than $1.6 billion due after year 2049. Currently, beyond required debt service reserves, the Corporation does not accumulate resources for future debt repayment – tobacco settlement amounts received in excess of required debt service are used for "turbo" or early redemptions.

The TSFC's accounting policy requires recognition of accreted interest on the deep-discount debt as an expense on the Corporation's full accrual statements but there is no "funding policy" in place to accumulate financial resources for the future balloon payments, including the accreted interest, at maturity.

The analysis should integrate the projections for US tobacco consumption and related settlement revenues with projections of the impact of turbo principal reductions and the amounts needed to ultimately satisfy the deep-discount debt balloon payments at maturity.

RECOMMENDATIONS

MC-2019-01a Perform periodic analyses of projected debt service requirements reflecting actual operating experience and other economic factors.

MC-2019-01b Seek administrative support for the TSFC to facilitate financial reporting and other operating requirements.

Management's Views and Corrective Actions:

The TSFC Board agrees with the recommendations and is working to establish an administrative support function separate from the State Budget Officer. Once in place, this new support will enable the TSFC to undertake projections and facilitate financial reporting requirements.

Anticipated Completion Date: *April 2020*

Contact Person: *Thomas A. Mullaney, Chair, TSFC*
Phone: 401.222.6300

Management Comment 2019-02 **(repeat comment)**

LEGAL CASE TRACKING

Legal case tracking software must be acquired and implemented organization-wide to enhance the administrative management and control of pending legal matters.

There are inherent challenges in managing State legal matters due to the number of cases, multiple points of origination and the decentralized approach to controlling the caseload. However, enhancements in the processes used to administer the legal caseload are clearly indicated, not only to ensure timely and appropriate actions, but also to ensure legal case information can be completely inventoried and analyzed for financial reporting purposes and to meet investor disclosure requirements.

As part of the State's annual financial reporting and audit process, significant effort is spent gathering data about the legal challenges against the State with inquiries of both internal and external counsel. Internally, data is gathered from the various departmental legal counsels and accumulated within the Department of Administration. That current process to periodically accumulate and report pending legal matters is almost entirely dependent on the completeness of each department's inventory and reporting of its legal matters. The Department of Administration lacks a software application to inventory and manage the statewide caseload. Certain of the legal matters garnering recent media attention were not included in information provided to the State Controller and the auditors as part of requests for such data, and consequently, were not considered in the evaluation of matters potentially requiring accrual and/or note disclosure within the State's financial statements.

Each department currently employs unique processes and procedures to track its legal cases without any uniformity. Use of a computerized application, appropriate for the State's needs, could be helpful in addressing the multiple risks recently highlighted involving the State's administration of legal matters.

Legal case tracking software should be fully explored, acquired, and then implemented organization-wide. Consistent use of the case tracking software should significantly improve management's ability to (1) ensure key case actions are met timely, (2) enhance overall monitoring of the State's legal matters both departmentally and at a state-wide level, and (3) facilitate comprehensive reporting of pending legal matters when required. Implementation should be coordinated with the Office of Attorney General to ensure all legal case information is available organization-wide. Additionally, electronic interface with the various court systems should be explored to bring the court notice information into the software application and essentially align the State's processes with those of the Courts.

RECOMMENDATION

MC-2019-02 Acquire and implement organization-wide legal case tracking software to facilitate tracking and oversight of State legal matters throughout the organization.

Management's Views and Corrective Actions:

The Department of Administration, together with support from DoIT, is exploring the possibility of acquiring a cost-effective enterprise legal case tracking software program. After developing criteria, a solicitation was issued with proposals being reviewed. It is anticipated that reviews will be finalized by June 2020.

Anticipated Completion Date: *Fiscal 2021*

Contact Person: *Frederick W. Stolle*
Phone: 401.222.8880

Management Comment 2019-03 ***(new comment)***

REASSIGNMENT OF CERTAIN ACCOUNTING TASKS CURRENTLY PERFORMED BY BUDGET OFFICER

The State budget officer performs a variety of accounting-related tasks that should be reassigned to other State operating units.

Through a long evolutionary process, various accounting related tasks have been performed by the Budget Officer without reconsideration of whether that continues to be the appropriate assignment from a functional and control perspective. These include initiation and authorization of certain debt service payments, accounting and billing for the State Fleet Replacement Revolving Loan Fund, and initiation and authorization of certain disbursements from long-term debt proceeds held by trustees.

These tasks have been performed by the Budget Office due to their familiarity with these processes and functions and how they impact budgetary operations. However, they are recurring operational tasks that are distinct from budgetary functions and should be reassigned to divisions within the Department of Administration.

RECOMMENDATION

MC-2019-03 Reassign certain accounting functions currently performed within the Budget Office to other operation units within the Department of Administration.

Management's Views and Corrective Actions:

With the impending retirement of the current State Budget Officer, many functions currently performed by this position and others in the State Budget Office will need to be reassigned. The determination of where such responsibilities will be assigned will be part of the transition process for this position. Documentation of such functions and responsibilities has begun, with a determination of assignments to follow.

Anticipated Completion Date: *July 2020*

Contact Person: *Thomas A. Mullaney, State Budget Officer*
Phone: 401.222.6300

Management Comment 2019-04 ***(new comment)***

RHODE ISLAND PUBLIC TRANSIT AUTHORITY

Certain operating and long-term liability metrics for the Rhode Island Public Transit Authority warrant enhanced oversight by the State to ensure the sustainability and availability of public transit service within the State.

The Rhode Island Public Transit Authority (RIPTA) receives significant State support for its operations and is reported as a discretely presented component unit within the State's financial statements. Total State support (gas tax allocations) during fiscal 2019 to RIPTA was approximately $51 million.

The separately issued financial statements for RIPTA detail the status of the pension and retiree health care (OPEB) plans covering its employees. The financial statements detail that required employer contributions to the pension plan, totaling more than $10.6 million for the last two years, have been recognized for financial reporting purposes but were still owed to the pension plan at June 30, 2019. RIPTA provides retiree health care benefits on a pay-as-you-go basis and has not established a trust fund nor committed to funding OPEB benefits on an advance or actuarially funded basis.

RIPTA's net pension liability at the June 30, 2018 measurement date was $64 million (68% funded) at the June 30, 2018 measurement date and the total OPEB liability at the same date was $75 million (0% funded).

Even with substantial federal and state assistance, RIPTA has incurred operating deficits in each of the last two fiscal years - $13.6 million in 2019 and $22.3 million in 2018. Due to the importance of providing statewide public transit services, the State should enhance its oversight of RIPTA and explore options to address the critical financial operating challenges and related funding issues facing the Authority.

RECOMMENDATION

MC-2019-04 Enhance oversight of RIPTA and explore options to address the critical operating and long-term liability funding issues facing the Authority.

Management's Views and Corrective Actions:

The Administration agrees that financial oversight of RIPTA needs to be enhanced and has publicly indicated it is exploring options which would help meet this goal.

Anticipated Completion Date: *undetermined*

Contact Person: *Jonathan Womer, Director*
Office of Management and Budget
Phone: 401.574.8430

Management Comment 2019-05 ***(previously reported as finding 2018-005)***

ESCROW LIABILITY ACCOUNT BALANCES

Monitoring and reconciliation of escrow liability account balances can be enhanced.

Various General Fund escrow liability accounts have been established to account for funds on behalf of others and/or pending distribution - General Fund escrow liability balances totaled $42.3 million at June 30, 2019. For escrow liability accounts, the assets and offsetting liabilities are included on the State's General Fund balance sheet but increases/decreases in these balances are not reported as fund revenues and expenditures nor are these balances subject to appropriation or budgetary controls.

During fiscal 2019, the Office of Accounts and Control reviewed control procedures over the monitoring and reconciliation of escrow accounts and issued a revised policy effective February 1, 2019. In addition, all escrow liability accounts were reassessed to ensure that the activity was being appropriately accounted for as such. Various accounts were reclassified, mostly as restricted revenue source accounts.

While significant improvement was noted in the administration of escrow liability accounts, for multiple escrow liability accounts, reconciliations were not prepared and reviewed prior to the close of the fiscal year in accordance with policies and procedures to ensure that such amounts were accurately and appropriately reflected in the general ledger. Debit balances existed for multiple accounts indicating that disbursements exceeded funds on deposit or activity was mis-posted. Debit balances in escrow liability accounts are indicative of a potential problem and warrant prompt investigation.

Timely review and reconciliation of escrow liability accounts is important to ensure that transactions and balances in RIFANS are properly recorded for financial reporting purposes and to exercise appropriate fiduciary control over amounts held for others. When other agencies fail to support the reconciliation effort or there are unreconciled variances, the Office of Accounts and Control should have the authority to suspend account disbursements until resolved.

Monitoring of the escrow liability balances, including timely reconciliation to subsidiary detail or other supporting information can be enhanced through enforcement of the Office of Accounts and Control's recently implemented escrow account policies and control procedures.

RECOMMENDATION

MC-2019-05 Enforce monitoring and reconciliation control procedures for escrow liability account balances.

Management's Views and Corrective Actions:

Policy OAC-Liability Escrow Accounts and Related Controls was sent to Agency CFOs and other cognizant individuals and posted on the DOA Policy website and the Accounts and Control website on February 1, 2019. This policy allows the Office of Accounts and Control to enforce the reconciliation of escrow liability account balances. A tracking system has been developed to track responses and allows the monitoring of outstanding responses, thus allowing follow up on reconciliations not received.

Anticipated Completion Date: *Completed December 31, 2019*

Contact Person: *Gail LaPoint, Administrator, Financial Management*
Phone: 401.222.5098

Management Comment 2019-06 ***(repeat comment)***

FINAL APPROVAL OF RIFANS JOURNAL ENTRIES

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

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

In RIFANS, the category code for Electronic Benefit Transfer (TANF) funding transactions allows those transactions to be initiated by the departmental users without being routed for final approval to the Office of Accounts and Control. Because this category code is, by policy, limited to certain types of journal entries, there is no systemic workflow routing the transactions to final approval at the Office of Accounts and Control. Journal entries that are initiated using this category code and exceed the initiator's general ledger authorization limit will route to secondary approval with certain individuals within the Department of Human Services, the State agency administering the TANF program. However, journal entries using the TANF Funding category code below the initiator's threshold will not route for such secondary approval.

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

RECOMMENDATION

MC-2019-06 Modify procedures for reviewing and approving transactions through the TANF Funding category code to ensure that journal entries do not inappropriately circumvent final review and approval.

Management's Views and Corrective Actions:

Management agrees with this recommendation. Procedures have been modified to correct this issue. Specifically, all journal entries using the TANF Funding category, regardless of who the initiator is or the initiators' threshold, will route for secondary approval of certain individuals within the Department of Human Services.

Anticipated Completion Date: *Completed*

Contact Person: *Steven Blazer*
Office of Accounts and Control, DOA
Phone: 401.222.2267

Management Comment 2019-07 ***(previously reported as finding 2018-018)***

DIVISION OF TAXATION – DATA USED TO CALCULATE SIGNIFICANT ESTIMATES

Historical data used to support significant financial reporting estimates for tax revenues should be reassessed periodically to ensure continued validity. Enhanced data for multiple tax years is accumulating within Taxation's STAARS system to refine and support those estimates going forward.

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

As the system accumulates data for multiple tax years, STAARS data can be used to refine and support certain estimates. The Office of Accounts and Control and Division of Taxation continue to enhance their use of STAARS data as more information becomes available in each succeeding fiscal year.

Accounting estimates should be continually reassessed and reflect the most current and relevant data available.

Many of the estimates reflect historical patterns experienced over multiple tax years. Due to the recent implementation of STAARS, historical data continues to accumulate to support development of financial reporting estimates. In some instances, data from the previous tax systems is combined with STAARS data which affects consistency. Over time, the STAARS system should provide better data to support collection, final return and refund estimates for each tax type. The Division of Taxation continues to refine its use of data within the system for operational and financial reporting objectives.

STAARS historical data for multiple tax years continues to accumulate but has been insufficient to fully support all the estimates needed for financial reporting purposes.

The estimates used to account for tax revenues could be insufficiently supported by current tax filing and tax collection experience.

RECOMMENDATION

MC-2019-07 Continue to utilize newly available historical data contained in STAARS to develop significant tax revenue and refund accrual estimates for financial reporting purposes. Refine estimates where necessary to reflect the enhanced data provided by STAARS.

Management's Views and Corrective Actions:

The Division of Taxation confirms that with the new STAARS system, more data is readily accessible and can be used in end-of-year estimation in conjunction with the Office of Accounts & Controls. The Division of Taxation and Office of Accounts & Controls have been meeting throughout the transition from Mainframe to STAARS to discuss Mainframe historical data versus STAARS historical data and perform a comparative analysis between the two, including but not limited to the assumptions and distinctions between legacy mainframe data and STAARS data, timing issues. Given the transition issues including, but not limited to, timing and workflow of returns (and related revenue impacts), it has been the position of the Division of

Taxation and Accounts and Controls that we will review historical trends in STAARS before relying solely on additional STAARS data.

For FY 2018 and 2019, the Division of Taxation provided comparative data to Accounts and Controls for its evaluation and use and will continue to provide data. During FY 2019 and FY 2020, the Division of Taxation and Office of Accounts and Controls continue to actively evaluate more targeted data sets to allow for Office of Accounts and Controls to reevaluate certain methodologies. It is not within the Division of Taxation's authority to comment on or determine whether the estimates used for financial reporting purposes could be insufficiently supported by current tax filing and tax collection experience. This is a continuing iterative process that will take a few more years to complete. The Division of Taxation continues to collaborate with the Office of Accounts and Controls.

Anticipated Completion Date: *June 30, 2021*

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Management Comment 2019-08 ***(repeat comment)***

OTHER POSTEMPLOYMENT BENEFIT (OPEB) FUNDING POLICIES

A formal funding policy should be adopted for the State's OPEB plans which incorporates statutory provisions and key actuarial funding policies including the frequency of actuarial audits and experience studies.

Comprehensive Funding Policy

Previously, accounting guidance was also used as the basis for "acceptable" funding policies with GASB defining acceptable actuarial methods, amortization periods, etc. Under current guidance (GASB Statements 74 and 75) GASB only defines the **accounting** and disclosure requirements for OPEB liabilities to be included in the financial statements of governments. For example, the accounting measures for determining the net OPEB liability to be included in a government's financial statements reflects the fair value of OPEB plan assets at that date. For funding purposes, most plans use "asset smoothing" that tempers the volatility in required contribution rates due to significant market valuation changes in any one year.

Consequently, most governments need a separate policy statement to guide their funding decisions over time, while using the accounting measures in their financial statements prepared in accordance with generally accepted accounting principles. Best practices include recommending that governments establish and adopt comprehensive OPEB funding policies, which outline all the key provisions designed to responsibly fund an OPEB plan and calculate the employer actuarially determined contribution.

In Rhode Island, OPEB funding policies are a combination of legislatively enacted statutes and other measures adopted by the Board of the State Employees' and Electing Teachers OPEB System. This requires accumulation of comprehensive OPEB funding policies that include statutory measures and other provisions adopted by the Board.

Policy for Actuarial Experience Studies and Actuarial Audits

Best practices for benefit plan administration include requiring periodic actuarial experience studies and actuarial audits. Experience studies are a regularly scheduled review of the reasonableness of the assumptions used in making the actuarial valuations of the plans and involves a more comprehensive investigation of actual experience and assumptions used in the valuations. The Employees' Retirement System of Rhode Island (ERSRI) directs its actuary to perform experience studies of the pension system every three years. Actuarial audits are also recommended and involve engagement of another independent actuary to either reperform or review the actuarial valuations results. ERSRI has an actuarial audit performed at five-year intervals. These practices ensure that the assumptions used to measure the net OPEB liability (asset) of the plans and determine annual employer contributions are appropriate and that such measures have been determined consistent with the Actuarial Standards of Practice.

RECOMMENDATIONS

MC-2019-08a Develop and adopt a formal OPEB funding policy that incorporates statutory provisions as well as funding and actuarial policies approved by the Board of the State Employees' and Electing Teachers OPEB System.

MC-2019-08b Adopt a formal policy for requiring periodic actuarial experience studies and actuarial audits for the OPEB plans within the State Employees' and Electing Teachers OPEB System.

Management's Views and Corrective Actions:

The OPEB Board agrees with the recommendations presented by the Auditor General. Since its inception, the OPEB System has piggy-backed with the Employee Retirement System for actuarial valuations, primarily because the valuation of both systems requires the use of very similar data on state employees and retirees. The OPEB system has not, however, performed experience studies or actuarial audits since its inception. Now that the OPEB System has been in existence for several years, the OPEB Board believes it is time to implement experience studies and actuarial audits. As with the valuations, the System will work with the Employee Retirement System to piggyback on their RFPs for such services to assure that the same vendors are used which should be result in the best price.

Anticipated Completion Date: *September 1, 2020*

Contact Persons: *Peter Keenan, State Controller and Thomas Mullaney, Budget Officer*
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Management Comment 2019-09 ***(repeat comment)***

INCREASE USE OF AUTOMATED CLEARINGHOUSE (ACH) PAYMENTS

The State should continue to convert more disbursements to ACH and reduce the volume of checks and wire transfers.

The State utilizes checks, ACH payments, and wire transfers to disburse payments. The processing and banking costs vary for each payment type with wire transfers being the most costly. ACH bank processing costs, per transaction, are the lowest at $.02 per item. Wire transfers are typically utilized for the most time sensitive payments. Checks involve printing, mailing, and reconciliation costs in addition to a higher per transaction banking cost.

ACH payments are controlled entirely through the accounting system and require the least amount of other administrative processing steps. The majority of disbursements can be scheduled for payment as ACH transactions adding predictability to the State's overall cash management objectives.

Recently implemented industry-wide enhancements to the ACH process allow more flexibility in scheduling and the subsequent settlement of ACH payments such that same-day ACH is achievable (for individual ACH transactions up to $25,000). Exploring these features may enhance the State's ability to enhance the volume of payment made through ACH.

RECOMMENDATION

MC-2019-09 Explore options to increase the use of ACH payments in lieu of checks and wire transfers. Utilize industry-wide changes which allow same-day ACH to facilitate timely payments and funds transfer.

Management's Views and Corrective Actions:

Management agrees with this recommendation and will explore options to assess the feasibility and expected costs/benefits of increasing the use of ACH payments in lieu of checks and wire transfers.

Anticipated Completion Date: *December 2020*

Contact Person: *Margaret Carlson, Associate Controller - Finance*
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Management Comment 2019-10 ***(repeat comment)***

ACCOUNTING CONTROLS OVER CAPITAL PROJECTS

Controls over accumulating capital asset additions for project-based, multi-year projects can be improved. Certain project-based expenditures are reclassified in the accounting system to meet capital asset system processing requirements. This results in a change to the original and appropriate expenditure object classification.

Many of the State's material capital assets are project-based rather than single item acquisitions. The process developed within the RIFANS accounting system to identify capital expenditures is based on activity in specific natural accounts. Consequently, expenditures are frequently reclassified to the specific capital outlay natural accounts to trigger recording in the capital assets module. For project-based expenditures that involve a variety of types of expenditures, the original character of the underlying expenditures is subsequently lost in the accounting system. For example, on a building project, amounts spent for architectural and engineering services would be reclassified and lose their original character. Similarly, on a large IT development project like UHIP/RIBridges, many of the project-based expenditures were reclassified to the capital outlay natural accounts from information technology and consulting natural accounts.

As many of the State's material capital asset acquisitions involve project-based expenditures, the State's procedures for accumulating such costs should accommodate a project based rather than individual asset acquisition approach. The original character of expenditures should remain even when accumulated as a project-based capitalized item.

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

RECOMMENDATION

MC-2019-10 Implement a project-code accumulation of capital outlay expenditures within the capital asset module.

Management's Views and Corrective Actions:

Management agrees that it would be more efficient if the capital assets module afforded the flexibility to automatically accumulate capital asset project expenditures in enough detail to capture the underlying character of the various expenditures. However, given the inherent limitations of the capital asset module software and time constraints, management does not consider it practical to pursue this recommendation at this time. In addition, management believes the independent processes which are mentioned in the management comment are sufficient to mitigate risks of material error or omission.

Anticipated Completion Date: *Resolved*

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Management Comment 2019-11 **(repeat comment)**

STATE FLEET REPLACEMENT REVOLVING LOAN FUND

Operating and accounting procedures for the State Fleet Replacement Revolving Loan Fund require review to ensure that fund operations are consistent with its statutory purpose as a revolving loan fund.

The State Fleet Replacement Revolving Loan Fund was created to act as an internal financing mechanism for vehicles by state agencies. The fund was capitalized by a transfer of $7,350,000 from the State's General Fund in fiscal 2013. Use of the fund mitigates the budgetary impact of purchasing a vehicle in one fiscal year and spreads the cost over the vehicle's service period. The fund records an internal loan receivable from the state agency acquiring the vehicle. Loan payments replenish funds available for new loans and vehicle acquisitions. Most of the functions of the fund are currently performed by the Budget Office in connection with its responsibilities for capital budgeting.

Establishment of loans receivable and repayments terms should be formalized and documented to enhance controls over the operation of the revolving loan fund. Operating and accounting procedures for vehicles acquired/financed through the revolving loan fund should be consistent with the State's capital asset accounting procedures and the process to prepare the State's government-wide financial statements.

Operating and accounting procedures need to be reviewed and aligned to formalize loan repayment terms and avoid unintended complications in the State's capital asset reporting and government-wide financial statement preparation. Responsibility for the fund's accounting procedures and records should be transferred from the Budget Office to the Central Business Office or the Office of Accounts and Control.

Operating and accounting procedures were not appropriately established at fund creation. In most instances, the department or agency acquiring the vehicle purchases through their accounts and an expenditure credit is later processed to reimburse the expenditure from the revolving loan fund. This results in an unintended misstatement in the State's government-wide (full accrual) financial statement as the fund level activity is collapsed and converted to the full-accrual accounting basis.

RECOMMENDATION

MC-2019-11 Perform a comprehensive review of the operational and accounting procedures for the State Fleet Replacement Revolving Loan Fund. Transfer responsibility for the daily operations of the fund to the Central Business Office or the Office of Accounts and Control.

Management's Views and Corrective Actions:

The State Budget Office is reviewing the current operations of the State Fleet Replacement Revolving Loan Fund with the intent of transferring certain responsibilities to other Offices within the Department of Administration. Determination of loans for new vehicles will likely be performed cooperatively with the State Fleet Office. Establishment of loans and annual billing and accounting functions will likely be transferred to the DOA Central Business Office.

Anticipated Completion Date: *September 1, 2020*

Contact Persons: *Bernie Lane and Thomas Mullaney, Budget Office*
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Management Comment 2019-12 ***(repeat comment)***

FINANCIAL STATEMENT DISCLOSURE OF SIGNIFICANT COMMITMENTS

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

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

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

In fiscal 2019, the Office of Accounts and Control manually accumulated significant commitments mostly by obtaining information from project managers at various State departments and agencies. This process is inefficient and lacks appropriate controls to ensure completeness of the State's commitments disclosed at year-end.

Commitments for transportation projects are accumulated from the Department of Transportation's Financial Management System (FMS). Negative unit price change orders are not recognized by FMS, therefore overstating the reported contract or encumbrance amount. Without adjustment this would overstate the reported dollar value of transportation related construction commitments.

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

RECOMMENDATION

MC-2019-12 Improve systems and procedures to enhance the disclosure of significant commitments within the State's annual financial statements.

Management's Views and Corrective Actions:

Management agrees with the recommendation. The State is in the process of implementing a new procurement system. Once that that new system is in place and fully operational, we will review the feasibility of using that system to obtain supporting information for commitment disclosures.

Anticipated Completion Date: *December 2020*

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Management Comment 2019-13 ***(repeat comment)***

SUBRECIPIENT AND GRANTEE MONITORING - CENTRALIZED REVIEW OF AUDIT REPORTS

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

Subrecipients and grantees assist the State in carrying out various programs funded with State and/or federal monies and include entities such as municipalities, community action programs, local educational agencies and non-profit organizations. Monitoring of subrecipients, which is required when the State passes through federal funds to another entity, varies depending on the nature of the program or activity but always should include review of subrecipient audit reports. Federal regulations require any entity that expends $750,000 or more in federal assistance [direct or pass-through (e.g., State)] to have a Single Audit performed. Copies of the Single Audit Reports must be provided to the pass-through entity and the federal government.

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

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

- Specific agencies reviewing the audit reports do not consider noted deficiencies from the perspective of the risks that they pose to all state and federal funds passed through to the subrecipient or grantee. One large subrecipient of the State, which receives significant funding from multiple departments and agencies, has been very late in presenting its audit reports and those audit reports have highlighted serious deficiencies. Another entity, also receiving significant funding from multiple state agencies, reported fraud and misappropriation of assets by a key employee.

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

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

The State is planning a grants management system which includes specific functionalities to enhance controls over grant awards and monitoring activities for subrecipients. Centralized review of subrecipient audit reports would appear to be consistent with the planned functionalities of the new grants management system.

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

RECOMMENDATIONS

MC-2019-13a Centralize subrecipient and grantee monitoring procedures related to receipt and review of Single Audit Reports and other audit reports within one agency. This function should be staffed with individuals trained in governmental accounting and auditing matters to allow effective review of the audit reports.

MC-2019-13b Build a database of all subrecipient and grantee entities that receive state and/or federal grant funding.

Management's Views and Corrective Actions:

The Grants Management Office recognizes the risks and control weaknesses noted.

The Uniform Grant Guidance (UGG) (2 CFR 200.331) defines the requirements for pass through entities for subrecipient monitoring, including single audit review. The federal Office of Management and Budget in revisions to the Uniform Grant Guidance (Federal Register Notice 2019-OMB-0005) provides further clarification on these requirements and responsibilities.

Specifically, the Office of Management and Budget clarifies that pass though entities are only responsible for resolving audit findings specifically related to their subaward. In addition, if a subrecipient has a current single audit report posted in the Federal Audit Clearinghouse and has not otherwise been excluded from receipt of federal awards, the pass though entity may rely on the subrecipient's auditors and cognizant agency's oversight for routine audit follow-up and management decisions. Finally, the UGG states that such reliance does not eliminate the responsibility of the pass-through entity to manage risk through subaward monitoring.

Given the UGG changes, we will not be adopting the recommendation as stated. However, we will mitigate risk and increase controls through the development and implementation of a statewide continuous subrecipient monitoring protocol which will include risk assessment, desk and/or onsite monitoring, and follow-up on relevant audit findings. A pilot of the risk assessment tools and monitoring protocols is planned to start by June 2020. One the pilot is complete, we will develop a timeline to roll out to remaining agencies.

The implementation of the Grant Management System will result in a comprehensive database of state grantee awards, subrecipients, and subawards, including monitoring activities. Subrecipients will be users of the Grants Management System. Subrecipient data, i.e., risk assessments, monitoring, and single audits and alternative financial audits will be in the system and viewable to all state agency grant managers. We expect the implementation of the Grant Management System will facilitate coordination and communication among state agencies, and between state agencies and subrecipients.

Anticipated Completion Date: *GMS Go Live 12/31/22*

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Management Comment 2019-14 ***(repeat comment)***

SURPLUS FURNITURE AND EQUIPMENT

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

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

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

RECOMMENDATION

MC-2019-14 Implement a statewide network or database of "surplused" furniture and equipment assets to facilitate notification and use by other state or local entities.

Management's Views and Corrective Actions:

Management agrees with the recommendation and is in the process of researching an appropriate software package to allow for establishing a searchable database of surplus property that can be accessed by state agencies and local entities.

We are currently maintaining a database but it is not searchable. We also make certain surplus property items available through Gov Deals. We are able to generate reports on the disposition of all received and distributed items.

Anticipated Completion Date: *January 2021*

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