

**STATE OF OKLAHOMA
REPORT ON INTERNAL
CONTROL OVER FINANCIAL
REPORTING AND ON
COMPLIANCE**

**FOR THE FISCAL YEAR ENDED
JUNE 30, 2010**



Oklahoma State Auditor
& Inspector

STATE OF OKLAHOMA
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
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

STATE AUDITOR AND INSPECTOR

STEVE BURRAGE, CPA
State Auditor

MICHELLE R. DAY, ESQ.
Chief Deputy



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January 6, 2011

**TO THE GOVERNOR AND MEMBERS
OF THE LEGISLATURE OF THE STATE OF OKLAHOMA**

Transmitted is our report on the internal control over financial reporting and on compliance and other matters for the State of Oklahoma for the fiscal year ended June 30, 2010. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States.

We wish to take this opportunity to express our appreciation for the assistance and cooperation extended to our office during the course of the audit.

The Office of the State Auditor and Inspector is committed to serving the public interest by providing independent oversight and issuing reports that serve as a management tool to the State to ensure a government which is accountable to the people of the State of Oklahoma.

Sincerely,

A handwritten signature in blue ink that reads "Steve Burrage".

STEVE BURRAGE, CPA
STATE AUDITOR & INSPECTOR

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OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*
FOR THE YEAR ENDED JUNE 30, 2010

Table of Contents

	Page
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	1
Schedule of Findings and Responses.....	3

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**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***

**TO THE GOVERNOR AND MEMBERS
OF THE LEGISLATURE OF THE STATE OF OKLAHOMA**

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information for the State of Oklahoma as of and for the year ended June 30, 2010, which collectively comprise the State's basic financial statements and have issued our report (*under separate cover*) thereon dated December 30, 2010, which included an emphasis paragraph on the unfunded actuarial accrued liability of the Teachers' Retirement System and an emphasis paragraph for the Multiple Injury Trust fund for a net deficit related primarily to court awards that exceeded the apportionment of special tax revenue collected. Our report was modified to include a reference to other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements noted below:

- the financial statements of the Commissioners of the Land Office, the Oklahoma Department of Commerce, the Native American Cultural and Educational Authority, the Oklahoma Insurance Department, the EDGE Fund, and the Oklahoma Department of Wildlife Conservation, which in the aggregate represent thirteen percent and five percent, respectively, of the assets and revenues of the governmental activities, and seven percent of the assets and two percent of the revenues of the general fund.
- the financial statements of the Water Resources Board and the Oklahoma Lottery Commission which in the aggregate represent seventy-five percent of the assets and twenty-three percent of the revenues of the business-type activities and the enterprise funds;
- the financial statements of the aggregate discretely presented component units;
- the financial statements of the Commissioners of the Land Office permanent fund, the Oklahoma Department of Wildlife Conservation Lifetime Licenses permanent fund, and the Tobacco Settlement Endowment permanent fund, which in the aggregate represent one hundred percent of the permanent funds; and
- the financial statements of the Oklahoma Firefighter's Pension and Retirement System, the Oklahoma Law Enforcement Retirement System, the Oklahoma Police Pension and Retirement System, the Oklahoma Public Employees Retirement System, the Oklahoma Teachers' Retirement System, the Uniform Retirement System for Judges and Justices, and the Oklahoma Department of Wildlife Conservation Retirement Plan, which in the aggregate represent ninety-eight percent of the assets and one hundred percent of the revenues of the aggregate remaining fund information.

This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

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

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

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 combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses. [10-265-001IT, 10-807-002 and 10-090-002, 10-345-009, 10-090-010, and 10-290-012 and 10-090-012].

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Oklahoma'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 disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

This report is intended solely for the information and use of management of the State of Oklahoma and federal awarding agencies and should not be used for any other purpose. This report is also a public document pursuant to the Oklahoma Open Records Act (51 O.S. § 24A.1 et seq.), and shall be open to any person for inspection and copying.



Steve Burrage, CPA
State Auditor and Inspector

December 30, 2010

**SCHEDULE OF FINDINGS AND RESPONSES
FINANCIAL STATEMENT FINDINGS
(INTERNAL CONTROL)**

REF NO: 10-265-001IT

STATE AGENCY: Oklahoma State Department of Education (OSDE)

OTHER: Internal Control Information Security

Criteria: According to CobiT (Plan and Organize 4), an IT organization is defined by considering requirements for staff, skills, functions, accountability, authority, roles and responsibilities, and supervision. This organization is embedded into an IT process framework that ensures transparency and control as well as the involvement of senior executives and business management. A strategy committee ensures board oversight of IT, and one or more steering committees in which business and IT participate determine the prioritization of IT resources in line with business needs. Processes, administrative policies and procedures are in place for all functions, with specific attention to control, quality assurance, risk management, information security, data and systems ownership, and segregation of duties. To ensure timely support of business requirements, IT is to be involved in relevant decision processes.

Condition: OSDE has a significant weakness with regard to segregation of duties within the IT division.

Effect: The lack of adequate segregation of duties creates a high risk of fraud and/or waste for the agency.

Recommendation: We recommend that OSDE evaluate the current position requirements as they are currently filled. Job descriptions and requirements need to be written for each position. Some positions need to be created and/or altered to provide adequate segregation of duties. There needs to be continuing education to ensure that one individual does not have too many critical responsibilities. OSDE should perform an evaluation to check if the current staff is sufficient to meet current agency demands.

Agency Management Response: The OSDE Data/Research Services is very aware of the risks created by insufficient staff to cover and segregate duties within the IT division. The State Superintendent-elect, scheduled to take office on Jan. 10, 2010 has stated her intention to audit all sections of the OSDE upon taking office. Data/Research Services will use this as an opportunity to share 2010 IT audit findings and discuss staffing needs, roles, responsibilities and salaries so that administration can create a plan to staff OSDE Data Services to be able to adequately support agency IT systems and security.

Reference Number: 10-807-002 and 10-090-002

State Agency: Oklahoma Health Care Authority (OHCA) and Office of State Finance (OSF)

Account: Accounts Payables/Accrued Liabilities, Federal Receivables, Federal Revenue and Deferred Revenue

Condition: A basic objective of Generally Accepted Accounting Principles (GAAP) is to provide accurate and reliable information.

The State of Oklahoma Administrative Plan states: "A component objective of an adequate internal control system is to provide accurate and reliable information".

The OSF GAAP Conversion Manual states that each agency's executive director and finance director are responsible for submitting OSF conversion package forms that are accurate, complete and timely.

Condition: During our testing of Accounts Payable and Federal Grants Receivable, we noted the amounts reported on OSF Form Q-1 GAAP Conversion – Medicaid Summary-Medicaid Payable and Receivable package were not accurate. The reason for the inaccuracies was largely due to OHCA picking up last year's "Total Encumbered Funds" on their Calculation for Medicaid Payable and Receivable spreadsheet and failing to record Title XIX and

Title XXI drug rebate receivables. Since OHCA was using the incorrect Total Encumbered Funds, it caused “Payments after September” on their spreadsheet to be incorrect since this calculation was the difference between July-September (Subtotal) payments and Total Encumbered Funds. The total encumbered funds by date of service reported by OHCA and the correct total are shown as follows:

	<u>Amt. Entered by Agency</u>	<u>Correct Amount</u>
July 2010	\$176,039,167	\$176,039,167
Aug 2010	\$ 56,039,144	\$ 56,039,144
Sept 2010	<u>\$ 35,661,576</u>	<u>\$ 35,661,576</u>
Subtotal	\$267,739,887	\$267,739,887
Payments after Sept	<u>\$194,493,176</u>	<u>\$101,635,612</u>
Total Encumbered Funds	\$462,233,063	\$369,375,499

Once OSF received the Encumbered Funds totals by Date of Service listed above, the analyst responsible for entering the totals picked up the total encumbered funds amount as the amount that should be reported as Payments after September. Below are the amounts shown by OSF on the OHCA Calculation of Primary Recipient’s Medicaid Receivable and Payable spreadsheet and the correct totals:

	<u>Amt. Entered by OSF</u>	<u>Correct Amount</u>
July 2010	\$176,039,167	\$176,039,167
Aug 2010	\$ 56,039,144	\$ 56,039,144
Sept 2010	<u>\$ 35,661,576</u>	<u>\$ 35,661,576</u>
Subtotal	\$267,739,887	\$267,739,887
Payments after Sept	<u>\$462,233,063</u>	<u>\$101,635,612</u>
Total Encumbered Funds	\$729,972,950	\$369,375,499

Based on the Total Encumbered Funds used of \$729,972,950 (instead of the correct amount of \$369,375,499) for OHCA, the following amounts were recorded by OSF for each account:

- Accounts Payable - \$728,440,007
- Federal Receivable - \$498,939,888
- Federal Revenue - \$150,128,345
- Deferred Revenue - \$348,811,543

Cause: OHCA did not properly review the Medicaid Payable and Receivable spreadsheet to ensure the correct amounts got reported on the OSF GAAP Form Q-1 GAAP Conversion – Medicaid Summary-Medicaid Payable and Receivable package. In addition, it appears there was not a sufficient review at OSF of the OHCA Calculation of Primary Recipient’s Medicaid Receivable and Payable spreadsheet to ensure the correct entry was made for each of the four accounts.

Effect: Based on using the incorrect Total Encumbered Funds along with not figuring Drug Rebate receivables into the calculation, it caused Accounts Payable to be overstated by \$359,840,197; Federal Receivables was overstated by \$338,760,952; Federal Revenue was overstated by 33,549,049; and Deferred Revenue was overstated by \$305,211,903.

Recommendation: We recommend OHCA perform necessary procedures to ensure all amounts presented on the OSF Form Q-1 GAAP Conversion – Medicaid Summary-Medicaid Payable and Receivable package are properly presented. Management should also implement additional review procedures of GAAP Package Q-1 to ensure changes are properly implemented and report amounts are accurate and reliable.

We recommend OSF develop and implement additional procedures related to the Calculation of Primary Recipient's Medicaid Receivable and Payable spreadsheet for OHCA to ensure amounts recorded from the GAAP Package Q-1 are accurate.

OHCA Response: We concur with the finding and agree that errors were made by OHCA staff in the calculation of the Form Q-1 GAAP Conversion Package. However, the adjusting entry to correct the misstated Form Q-1 is largely due to an input error by the Office of State Finance staff. OHCA will ensure for future periods that the report will be reviewed by both the Comptroller and the Director of General Accounting. In addition, further care will be given in the completion of the audit package, review of reporting instructions and that submission dates have been set in order to allow time for adequate supervisory review of all reports.

OSF Response: OSF concurs with this adjustment. OSF will add several new review steps to the review process of GAAP Package Q-1 including 2nd verification to the spreadsheet provided by OHCA, and trend analysis of the federal receivable, federal revenue and deferred revenue over a 3 year rolling period to ensure that any significant changes seem valid and flag any significant variances for further review with OHCA.

Reference Number: 10-345-009

State Agency: Oklahoma Department of Transportation

Account: Accounts Payable/Federal Grants Receivable

Criteria/Condition: The Office of State Finance (OSF)'s GAAP Conversion Manual states "accounts payable consists of amounts owed for goods and services that your agency both: (1) Received on or before June 30, and (2) Paid for or will pay for after June 30, including payments from agency special accounts, if applicable."

OSF's GAAP Conversion Manual further states, "since the normal business cycle for most agencies has been shown to be approximately 30 days, it may be acceptable to use July expenditures from prior year funds as June 30 accounts payable. If your agency's business cycle is other than 30 days, you should use that time period. In all cases, consider whether this approach will produce an accounts payable total that is materially correct. If you are aware of significant payments made or to be made beyond the normal business cycle which fit the above definition of accounts payable, these should be included in the total."

The Oklahoma Department of Transportation (ODOT) included all expenses with a budget reference of prior to June 30, 2010 that had been paid for prior to August 20, 2010 in its calculation of accounts payable. The accounts payable amount of \$209,607,027 originally reported to OSF on GAAP Package I includes \$113,985,134 expended for goods and services received after June 30, 2010. Therefore, Accounts Payable is overstated by \$113,985,134.

ODOT receives Federal revenue on a reimbursement basis. The federal grants receivable amount of \$165,112,480 originally reported to OSF on GAAP Package D includes \$93,750,873 for related federal expenditures and/or federal accounts payable for which the date of service was after June 30, 2010. Therefore, Federal Grants Receivables on GAAP Package D is overstated by \$93,750,873.

Cause/Effect: The method used to calculate accounts payable did not produce an accounts payable that is materially correct. The federal payables – capital outlay amount was based on expenditures after June 30, 2010 and prior to August 20, 2010 in ODOT's Financial Management System (FMS) for which the budget year was prior to 2011. The budget year in FMS is the year the project was approved and not the budget year for the expenditure. ODOT did not review the dates of service for the expenditures to exclude those for which the date of service was after June 30, 2010. Therefore, Accounts Payable was materially overstated by 54.38 percent ($113,985,134/209,607,027$). Federal Grants Receivable was materially overstated by 56.78 percent ($93,750,873/165,112,480$).

Recommendation: We recommend the Department annually re-evaluate the method used to estimate accounts payable, and ensure an adequate evaluation of the resulting accounts payable calculation is performed. The Department should consider incorporating a 'received date' in their accounting systems to enable more accurate identification of payments subsequent to year end for goods or services received prior to year end.

Agency Management Response: The Comptroller Division will evaluate accounts payable annually. After visiting with Department personnel, the Department will not be modifying our current system since we expect to convert to a new Accounts payable system. Going forward the Department will evaluate the PeopleSoft system to see if it accommodates a receiving date.

Reference Number: 10-090-010

State Agency: Office of State Finance

Account: Cash

Criteria/Condition: A key part of the internal controls established by the Office of State Finance (OSF) is the performance of a cash reconciliation of treasury funds between the CORE general ledger and the Office of the State Treasurer (OST). The reconciliation process is essential because it ensures that accounting records are accurate and that errors are detected and corrected in a timely manner. Although it appears the agencies have made improvements in reducing the differences from prior years by reconciling cash monthly and actively resolving aged differences, there is still an outstanding difference of \$69,798,688.90 between OSF and OST.

Cause/Effect: The delay in resolving the outstanding difference between OSF and OST appears to be due to the size of both the aged differences and approximately 2700 funds affected. Although OSF has been able to reduce the prior year's total considerably in the current fiscal year by devoting someone full-time to the monthly reconciliations (including aged differences), the un-reconciled funds from prior years continue to be an issue. Without material cash reconciling items being resolved between OSF and OST, the financial information provided by these agencies could be incomplete, inaccurate, and/or unreliable for users of the OSF general ledger system.

Recommendation: We recommend the cash reconciliation of treasury funds between OSF and OST continue to be performed and reconciled on a timely basis and that all remaining funds with aged differences be reconciled to ensure the financial information is complete, accurate, and reliable for users of the OSF general ledger system.

Agency Management Response: OSF currently reconciles the treasury funds between OSF and OST on a monthly basis. Over the past year OSF reduced the outstanding difference for all funds by nearly half and significantly reduced the number of funds with un-reconciled differences. Staff members have expanded their approach to reconciling the aged differences and anticipate making substantial progress in reducing both the difference outstanding and the number of funds that are out of balance by fiscal year end.

Reference Number: 10-290-012 and 10-090-012

State Agency: Oklahoma Employment Security Commission (OESC) and the Office of State Finance (OSF)

Account: Benefit Payments for Unemployment Insurance (UI) Program

Criteria/Condition: A basic objective of Generally Accepted Accounting Principles (GAAP) is to provide accurate and reliable information.

The State of Oklahoma Administrative Plan states: "A component objective of an adequate internal control system is to provide accurate and reliable information".

An essential part of the internal controls over Agency Special Account (ASA) Form 11A reconciliations are the review of agency to OSF records (Section B) to ensure the accuracy of the accounting records and to ensure that errors are detected and corrected in a timely manner. This reconciliation should consist of tying benefit payments per the agency to the Summary of Receipts and Disbursements report at OSF.

While performing a review of the benefit payments or disbursements per the Form 11A reconciliations to Six Digit Expenditure report and the Combining Trial Balance (account 514xxx) at OSF for state fiscal year '10, we noted that the OSF reports had \$100,385,838.81 less in benefit payments than the agency recorded.

Cause/Effect: OESC made an entry (journal 0002010879) on 2/23/10 where they debited (increased) cash and credited (reduced) expenditures for \$100,385,838.81. However, also on 2/23/10 an entry (journal 0002010882) was

made to reverse the earlier entry by crediting (reducing) cash and debiting (increasing) expenditures for the \$100,385,838.81. According to journal 0002010882 the status was "edit required" and no budget check had been performed. OSF informed us that for ASA accounts the agency sets up the journal, but is required to notify OSF before an entry can be edited for posting. OSF stated they were not informed of journal 0002010882; therefore, the entry was never posted. As a result, when the actual benefit payments for February '10 were posted in the amount of \$96,129,216.29; the net result of expenditures for the month was \$(4,256,622.50).

The lack of a comparison made to OSF records on the ASA Form 11A reconciliation resulted in the agency not being aware that journal 0002010882 had not posted; therefore, overstating cash and understating expenditures by \$100,385,838.81 per OSF accounting records.

The Office of State Finance (OSF) was not reviewing ASA journals to ensure that all entries got posted.

Recommendation: We recommend OESC implement a process where they reconcile not only their internal records to OST on the Form 11A, but also to the Office of State Finance. Further, we recommend OSF develop and implement a process whereby they review journals for the ASA accounts to ensure all entries get posted in a timely manner.

OESC Response: We agree with your finding and we are working with OSF and OST to make sure this issue is resolved and standardized processes are established so that everyone in the State will be on the same page.

OSF Response: OSF has changed the process for reviewing entries not posted. Previously, the ASA disbursement entries were not researched since they usually stay in a not posted status on the system for awhile until the Form 11 comes into our office. Our process for reviewing entries not posted will now include researching items for ASA disbursements if they are still not posted within two weeks of the journal date.



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