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LETTER OF TRANSMITTAL

Honorable Beth G. Edmonds
President of the Senate

Honorable John Richardson
Speaker of the House

Honorable John E. Baldacci
Governor of the State of Maine

We are pleased to submit the State of Maine Management Letter and Other Reports for the Year Ended June 30, 2004. In the course of our audit of the basic financial statements of the State of Maine, and our consideration of internal control, we became aware of matters that offer opportunities for our government to improve its operations. Comments on these matters accompany the Management Letter as findings and recommendations.

This year, we have also included reports resulting from other engagements that were performed during the year ended June 30, 2004. A summary explanation of the purpose and the results of these engagements precedes each report. We previously distributed these reports to those immediately affected. However, they have not been generally distributed and are published here in order to give you additional information, and to let you know of some of the other activities of the Department of Audit.

Please feel free to contact the Department of Audit with any questions that you may have.

Respectfully submitted,

A handwritten signature in cursive script that reads "Neria R. Douglass".

Neria R. Douglass, JD, CIA
State Auditor
State of Maine

October 6, 2005



**State of Maine
Management Letter for the Year Ended
June 30, 2004**

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MANAGEMENT LETTER

In planning and performing our audit of the basic financial statements of the State of Maine for the year ended June 30, 2004, we considered the State of Maine's internal control. We did so to determine our auditing procedures for the purpose of expressing an opinion on the financial statements. We did not do so to provide assurance on internal control.

However, during our audit we became aware of several matters that offer opportunities for strengthening internal control and efficiency of operations. The following findings summarize our comments and suggestions regarding those matters. We have issued two reports, dated April 28, 2004 and June 18, 2004, which address reportable conditions and material weaknesses in internal control. These can be found in the Single Audit Report and are titled *Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards* and *Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133*. This letter does not affect these reports, nor does it affect the Independent Auditor's Report, dated April 28, 2004 on the basic financial statements.

We have included responses to our findings by the audited agencies. We would be pleased to discuss these findings in further detail at your convenience.

Neria R. Douglass, JD
State Auditor

March 18, 2005



Department of Administrative and Financial Services

1. Bureau of Finance

Child Nutrition Cluster

CFDA#: 10.553, 10.555, 10.556, 10.559

Federal Award Number: 4 ME300301

Questioned Costs: None

Finding: Excessive negative cash balance throughout State fiscal year 2004 (**Prior Year Finding**)

As of June 30, 2004, the Child Nutrition Cluster grant account had a negative cash balance of \$368,805. There was a negative balance carried throughout the fiscal year, as it was during the previous fiscal year. Inaccurate reporting in fiscal year 2001 is attributed to the negative cash balance and represents funds due the State of Maine. The Department of Administrative and Financial Services has identified the cause of the issue and is currently negotiating with the U.S. Department of Agriculture to correct the negative cash balance.

Recommendation:

We recommend that the Department of Administrative and Financial Services continue communicating with the U.S. Department of Agriculture until the issue is resolved.

Auditee Response/Corrective Action Plan:

Contact: Diane J. Williamson, Chief Accountant, 624-7406

DOE staff has submitted new reports and received a portion of the negative cash and is currently negotiating for more. The Education Accounting Group has procedures in effect that should ensure that compliance is adhered to. The Chief Accountant developed a form that is to be completed each month when a check file is to be released to MFASIS. This form calculates when cash needs to be deposited. We are also working with Treasury on a quarterly basis to ensure compliance. DFPS Chief Accountant and a Staff Accountant are working with AMS and the Office of the Controller to ensure that the upgrade to the State's accounting system will facilitate accurate, timely draws for the various funding techniques.





DEPARTMENT OF CONSERVATION

2. Bureau of Administrative Services

Questioned Costs: None

Finding: Residual Balances in the Federal Expenditure Fund (Prior Year Finding)

The Department of Conservation has a residual balance of \$1.5 million in the federal fund. It has been determined that these funds are not the result of current year transactions but are the result of past activities. The Department of Conservation did not always record expenditures and related revenue in the same fund. Certain expenditures were recorded in other funds while revenue (and associated cash) to reimburse the state for the Federal share of the expenditures was recorded in the Federal Expenditures Fund. The *Codification of Governmental Accounting and Financial Reporting Standards* Section 1300.119 dictates that expenditures and the associated revenue and cash should have been accounted for in the same fund.

Recommendation:

We recommend that the Department seek legislative direction regarding the disposition of this residual balance.

Auditee Response/Corrective Action Plan:

Contact: Will Harris, Director, General Services, 287-2215

The DOC concurs with the recommendation. We are working with the Bureau of Budget to establish a dedicated account within the Forestry Administration account to account for certain administrative costs within the Maine Forest Service in accordance with the above findings and OMB circular A-87 in order to address this issue. This should be completed by July 1, 2005.





DEPARTMENT OF DEFENSE, VETERANS AND EMERGENCY MANAGEMENT

3. Military Bureau

Readiness Maintenance Center

CFDA#: 12.999

Federal Award Number: 17-03-2-3035

Questioned Costs: None

Finding: Inadequate controls and non-compliance with suspension and debarment requirements.
(Prior Year Finding)

The Department did not obtain the required suspension and debarment certifications for two of the thirteen vendors that were required to provide them.

The Department of Defense, Veterans and Emergency Management is required to follow State purchasing requirements and take steps to ensure that vendors awarded contracts over \$25,000 are not suspended or debarred from doing business with the federal government. The 25 CFR 25.110(B) states “Any procurement contract for goods or services between a participant and a person, regardless of type, expected to equal or exceed the Federal procurement small purchase threshold fixed at 10 U.S.C 2304(g) and 41 U.S.C. 253(g) (currently \$25,000) under a primary covered transaction.”

To ensure compliance with this requirement, the Department of Defense, Veterans and Emergency Management has developed a certification statement that vendors must sign and return if they contract with the Department. However, two of thirteen vendors exceeding the threshold did not have the required certification.

Recommendation:

We recommend that the Department refine their control system and obtain the required suspension and debarment certifications for all contracts over \$25,000.

Auditee Response/Corrective Action Plan:

Contact: Robert St. Pierre, Business Manager, 626-4462

Vicki Dube (Umphrey), Director, Finance and Personnel, 328-4873

The Federal Government generally requires Suspension and Debarment Certifications for contracts of \$100,000 or more. 32 CFR Section 25 requires Suspension and Debarment Certifications for all grants utilizing National Guard Bureau funding for contracts exceeding \$25,000. The Department has confirmed that the two omitted vendors have signed and returned the required certifications. In addition, the Department will review all FY05 contracts and verify that all contracts comply with 32 CFR Section 25 requirements.



DEPARTMENT OF DEFENSE, VETERANS AND EMERGENCY MANAGEMENT

4. Military Bureau

Readiness Maintenance Center

CFDA#: 12.999

Federal Award Number: 17-03-2-3035

Questioned Costs: None

Finding: Inadequate controls and non-compliance with payroll certification requirements

The Department of Defense, Veterans and Emergency Management did not have adequate controls in place to ensure that the Department's federal payroll certifications were accurate. We noted ten instances of employees who should have been certified but who were omitted from the payroll certifications. Two of these employees worked for the entire period to be certified and eight of these employees worked for a portion of the period to be certified.

Office of Management and Budget Circular A-87, Attachment B 11.h(3) requires semi-annual certifications for all employees who work solely on a single federal program, to support amounts for salaries and wages that are charged to the program.

Recommendation:

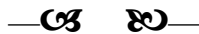
We recommend that the department refine their control system to ensure that they comply with the payroll certification requirements.

Auditee Response/Corrective Action Plan:

Contact: Robert St. Pierre, Business Manager, 626-4462

Vicki Dube (Umphrey), Director, Finance and Personnel, 328-4873

The Department misinterpreted State requirements for payroll certification. Certification is now required for all employees, regardless of the length of their service. Moreover, the Department has implemented a new spreadsheet system that lists all MMA employees who have been paid and which program the employee worked on.



DEPARTMENT OF DEFENSE, VETERANS AND EMERGENCY MANAGEMENT

5. Military Bureau

National Guard Operations and Maintenance Projects

CFDA#: 12.401

Federal Award Number: DAHA 17-03-2-1000

Questioned Costs: None

Finding: Inadequate internal controls over payroll certifications (**Prior Year Finding**)

The Department of Defense, Veterans and Emergency Management did not have adequate controls in place to ensure that the Department's federal payroll certification was accurate. National Guard O&M had four employees whose salary and fringe benefits were charged to the program, but were not listed on the payroll certifications.

OMB Circular A-87, Attachment B 11.h(3) requires that for all employees who are expected to work solely on a single federal program, changes for their salaries and wages must be supported by semi-annual certifications that the employees worked solely on the program for the period covered by the certification.

Costs will not be questioned because we obtained evidence that the employees did work 100% for the program.

Recommendation:

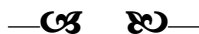
We recommend that the Department refine their system to ensure accuracy of the payroll certifications.

Auditee Response/Corrective Action Plan:

Contact: Linda Gosselin, Business Manager II, 626-4346

Roberta Creamer, Management Analyst, 626-4493

The Military Bureau will institute a payroll book which has copies of all payrolls for Air Guard personnel to ensure that when we certify the payrolls we have all the information necessary to ensure what is reported quarterly is correct. This information will be obtained from the MFASIS personnel/payroll system.



DEPARTMENT OF DEFENSE, VETERANS AND EMERGENCY MANAGEMENT

6. Military Bureau

National Guard Operations and Maintenance Projects

CFDA#: 12.401

Federal Award Number: DAHA 17-03-2-1000

Questioned Costs: None

Finding: Non-compliance with suspension and debarment certification/Inadequate controls over suspension and debarment requirements (**Prior Year Finding**)

The Department of Defense, Veterans and Emergency Management did not obtain one of the twenty required suspension and debarment certifications. The Department is required by 32 CFR Section 25 to secure suspension and debarment certifications for all contracts for goods and services exceeding \$25,000. The Department includes a suspension and debarment certification in all of their standard contracts regardless of amount; the exception was a contract that was entered into in conjunction with the Bureau of General Services of the State of Maine. The Bureau of General services uses a threshold of \$100,000 before requiring a suspension and debarment certification. Department personnel did not secure a suspension and debarment certification external to the contract even though the contract exceeded their \$25,000 threshold.

Recommendation:

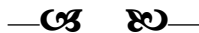
We recommend that the Department obtain the required certifications for all contracts over \$25,000.

Auditee Response/Corrective Action Plan:

Contact: Linda Gosselin, Business Manager II, 626-4346

Roberta Creamer, Management Analyst, 626-4493

The audit finding involves a Bureau of General Services contract that Directorate of Facilities Engineering can not modify. DFE will send a Suspension and Debarment certification form to the vendor for signature. DFE, Purchasing Section, will prospectively use the Bureau of Purchases "Suspension and Debarment" form for all vendors.



DEPARTMENT OF DEFENSE, VETERANS AND EMERGENCY MANAGEMENT

7. Military Bureau

National Guard Operations and Maintenance Projects

CFDA#: 12.401

Federal Award Number: DAHA 17-03-2-1000

Questioned Costs: None

Finding: Inadequate internal control over fixed assets inventory (**Prior Year Finding**)

The Department of Defense, Veterans and Emergency Management did not have controls in place to ensure that all fixed assets were properly recorded on the State's fixed asset system.

DVEM is required by 32 CFR 33.32 and 33.34 to follow State laws and procedures in the acquisition, disposal, and accounting of capital equipment purchased with grant funds. State capital equipment accountability requirements include an annual physical inventory of all items.

Agency personnel did not record the purchase of 5 of 24 capital items in a manner that ensured required reporting. This resulted in the items not being listed as part of the State's fixed assets. The department is aware that some of the state accounting system object codes failed to create "fixed asset shells" for inclusion into the fixed asset system. Additionally four of the twelve items tested were not listed on the internal spreadsheet used for inventory purposes.

Because the agency uses information from the fixed asset system to conduct annual inventory of equipment, it is essential that all capital purchases be properly recorded.

Recommendation:

We recommend that the Department refine procedures to ensure all equipment (fixed assets) are added and inventoried.

Auditee Response/Corrective Action Plan:

Contact: Linda Gosselin, Business Manager II, 626-4346

Roberta Creamer, Management Analyst, 626-4493

When the annual capital equipment inventories are conducted, the DFE Warehouse staff will ensure all equipment missing on the State's Fixed Asset system printouts are brought to the Resource Office's attention to add into the state system. The Warehouse staff will maintain a pending/suspense folder of all newly delivered equipment for fixed asset items until the bar code sticker is received. If a sticker is not received in a timely fashion the DFE Warehouse staff will work with the Resource Office to research the status of the purchase.





DEPARTMENT OF EDUCATION

8. Division of Special Services

Special Education – Grants to States

CFDA#: 84.027

Federal Award Number: H027A030109A

Questioned Costs: None

Finding: Inadequate controls over Local Education Agency's LEA entitlement allocation

Controls were not in place to ensure that LEA entitlement allocations were correctly calculated as promulgated by 34 CFR 300.707. Incorrect data was used for several schools when calculating the poverty allocation for FY04. These miscalculations were not identified until an LEA contacted the Department, stating they received twice as much as expected. These errors resulted in an amended allocation for each LEA because each school receives a relative percentage of the total funds being allocated.

Recommendation:

We recommend that controls, such as performing a review of previous to current year allocations prior to mailing the approved allocation letter, be implemented to ensure compliance with LEA entitlement allocation requirements.

Auditee Response/Corrective Action Plan:

Contact: John Kierstead, Consultant, Exceptional Children, 624-6650

The Office of Special Services does have procedures in place to perform comparisons of previous to current year allocations. There was a miscalculation of entitlement allocation for the year in question due to staff "under pressure" to post allocations within certain time constraints. This finding should not recur in the future.

Completion and implementation of corrective action occurred in fiscal year 2005.





DEPARTMENT OF HEALTH AND HUMAN SERVICES

9. Division of Program Accounting and Cash Management Operations

Immunization Program

CFDA#: 93.268

Federal Award Number: H23/CCH122558

Questioned Costs: None

Finding: Cost included as a direct billing and as a component of indirect costs

The Department of Health and Human Services charged a portion of one invoice for the Vital Statistical Unit directly to the Immunization Program as well as included those costs in the indirect cost rate. The amount double charged was \$126; total costs charged directly to the program for the Vital Statistical Unit amounted to \$1,158 for the fiscal year. The Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State and Local Governments*, Attachment A, prohibits counting costs twice as both a direct billing and as a component of indirect costs.

Recommendation:

We recommend that the Department ensure that costs charged to the Immunization Program are not charged both as a direct billing and as a component of indirect costs.

Auditee Response/Corrective Action Plan:

Contact: Annette Tibbetts, Managing Staff Accountant. 287-3172

The new cost allocation plan will be a full cost allocation plan. As such, all expenditures will run through the allocation program and be assigned to a group, either directly or through allocation methodologies. Because this process will take place via an electronic program, double counting will be eliminated.



DEPARTMENT OF HEALTH AND HUMAN SERVICES

10. Bureau of Family Independence

Child Support Enforcement

CFDA#: 93.563

Federal Award Number: N/A Collections Used to Fund Program

Questioned Costs: None

Finding: Certain standards for program operations not met (**Prior Year Finding**)

The Department of Health and Human Services (DHHS) did not meet certain prescribed standards relative to Child Support program operations.

In one of five paternity establishment cases reviewed, the case record was not established within 20 days of receipt of referral or application, as required by 45 CFR 303.2(b). The case record was not established until 25 days after the receipt of referral and was therefore established five days late.

In one of five interstate cases reviewed, DHHS did not, within 20 calendar days of determining that the noncustodial parent was in another state, refer the interstate case to the responding state's interstate case registry for action. The address confirmation date on the noncustodial parent was July 18th of 2003 while the referral date was December 12th of 2004.

In one of fifteen enforcement cases reviewed with past-due support qualifying for offset, the tax offset had been inactivated on the management information system and was not reactivated when the case was assigned to the field.

Recommendation:

We recommend that DHHS establish all case records and refer interstate case records to the responding state's interstate case registry within the required time frames. We further recommend that all cases with past-due support remain in an active mode on the enforcement system for tax refund offset purposes.

Auditee Response/Corrective Action Plan:

Contact: Stephen Hussey, Director, Division of Support, Enforcement and Recovery, 287-2886

The Division of Support Enforcement and Recovery has been affected by the Executive Order which froze ten positions in our program for the 2004/2005 biennium. The three instances cited above are all a result of limited staffing during this review period. The first case was not opened in twenty days, but rather in twenty-five days. Our case initiating unit at Central is normally fully staffed with seven positions, however, we had only one person available to perform this function for a good part of the review period. Also, the case that was an interstate case which did not

DEPARTMENT OF HEALTH AND HUMAN SERVICES

have a timely referral to the appropriate state was in a unit that had several frozen lines. The final case mentioned was concerning a federal tax offset indicator that was not activated. In this particular case, we had forwarded a list to all staff, as we do each year prior to tax offset season. The agent responsible for this section of the caseload had five cases identified as needing to be reviewed as they appeared to qualify for tax offset. The agent appropriately reviewed and activated offsets for four of the cases, but inadvertently missed one case on the list. It is clear that the review process that we have implemented is working. Each year we submit approximately 30,000 names for federal and State tax offset. DSER will be able to fill frozen lines during the next biennium. We will begin the process to fill these lines once approved.



11. Division of Program Accounting and Cash Management Operations

Medical Assistance Program

CFDA#: 93.778

Federal Award Number: 0405ME5028

Questioned Costs: None

Finding: Federal funds used for State purposes (**Prior Year Finding**)

The Department of Health and Human Services temporarily transferred State expenditures to the Federal Expenditures Fund so that Medicaid cycle payments could be paid on a timely basis.

To allow the State share of Medicaid bills to be paid, the Department artificially created General Fund allotment by temporarily transferring \$21.9 million in previously recorded General Fund expenditures to the Federal Expenditure Fund.

The entries temporarily overcharged federal funds and triggered a draw of federal cash. The Department then used the federal cash to make the cycle payments. In effect, the Department temporarily used federal funds for the State's share of program expenses. Prior to the end of the fiscal year, two of the three entries were reversed to properly allocate expenditures within the program's accounts. One entry was not reversed until state fiscal year 2005, twelve months after it was processed.

Recommendation:

We make no recommendation as the Department stopped this practice in November 2003.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Auditee Response/Corrective Action Plan:

Contact: Elizabeth Hanley, Director, 287-1861

The practice was terminated during FY 2004. Transfers between Medicaid accounts are processed by financial orders.



12. Bureau of Medical Services

Medicaid

CFDA: 93.778

Federal Award Number: 0405ME5028

Questioned Costs: None

Finding: Desk reviews of nursing facility cost reports not timely

The Department of Health and Human Services, Division of Audit does not have controls in place to ensure that it completes timely desk reviews of nursing facility cost reports. The Division did not complete 12 of 25 nursing facility audits that we examined within 180 days from the date that the provider cost reports were accepted. Of the 12, three are still in progress and three were completed more than 300 days after the initial acceptance date. Division personnel requested additional information from all 12 facilities; because additional information was requested, the 180 day requirement is not considered to commence until the Division receives all requested information. Although the Division is in compliance with the State Plan, cost settlements are not completed timely. Because the Division does not record the date that it has all necessary information, it is not possible to determine compliance with the 180 day time limit. The Division's desk reviews serve as the Department's means to close out or settle amounts due to or from Medicaid providers. In State Fiscal Year 2004, nursing facilities received approximately \$271 million from the Department (this amount does not include payments received relating to Personal Care Services and Private Non-Medical Institutions).

Title 42 CFR section 447.253 states, "the Medicaid agency must provide for the filing of uniform cost reports by such participating providers" and "the Medicaid agency must provide for periodic audits of the financial and statistical records of participating providers." Also, the Medicaid State Plan attachment 4.19D, section 34.13 provides that, "*Uniform desk reviews shall be completed within 180 days after receipt of an acceptable cost report filing, including financial statements and other information requested from the provider except in unusual situations, including but not limited to, delays in obtaining necessary information from a provider.*"

According to State Plan Attachment 4.19D, section 34.2, "*The Division of Audit will perform on-site audits as considered appropriate of the provider's financial and statistical records and*

DEPARTMENT OF HEALTH AND HUMAN SERVICES

systems. The Division of Audit will base its selection of a facility for an on-site audit on factors such as but not limited to: length of time since last audit, changes in facility ownership, management, or organizational structure, random sampling, evidence or official complaints of financial irregularities, questions raised in the uniform desk review, failure to file a timely cost report without a satisfactory explanation, and prior experience.”

Recommendation:

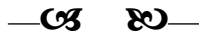
We recommend that the Division document the provider’s cost report’s actual acceptance date. We recommend that the Bureau of Medical Services review State Plan Attachment 4.19D, Section 34.2, *On-Site Audit*, and clarify when an on-site audit will be conducted. We also recommend that the Division utilize their option to conduct on-site audits.

Auditee Response/Corrective Action Plan:

Contact: Herb Downs, Assistant Director of Audits, 287-2778

The Division disagrees with this finding. The Division does have a database which reflects when cost reports are accepted. Once a cost report is accepted, the desk review process begins and if no additional information is needed, the audit is completed. However, in most cases additional information is required from the provider and a letter requesting this information is sent to the provider. Once additional information is required, the 180 day clock on the completion of the desk review no longer applies. As pointed out in the finding, the Division is in compliance with the State Plan.

While in some instances it may take several months to get all the data from the provider to complete the audit process, the Division believes it is much more cost effective to have the provider submit the information rather than performing field audits. The Division still does field audits when the circumstances warrant it, such as a new provider, a change in ownership or irregularities in the providers reporting.



DEPARTMENT OF HEALTH AND HUMAN SERVICES

13. Division of Program Accounting and Cash Management Operations

Child Support Enforcement

CFDA: 93.563

Federal Award Number: N/A Collections Used to Fund Program

Questioned Costs: None

Finding: Controls were inadequate to ensure timely processing and an adequate audit trail of data processing charges

The Department of Health and Human Services' procedures for allocating data processing charges are overly complex. The Bureau of Information Services monthly invoices approximately \$750,000. Invoices include approximately 40 line items of detail. DHHS enters this detail information into a spreadsheet used as a template to generate 450 detail amounts which are ultimately processed as payment vouchers charging various benefiting accounts and federal programs. DHHS' procedures for completing the spreadsheet are not adequately documented and current employees are not adequately trained to complete the work. Of eight selected data processing invoices examined, DHHS did not pay the majority examined until two to seven months after the generation of the original invoice. The process, both to do and verify, was inordinately time-consuming and difficult.

Recommendation:

We recommend that the Department of Health and Human Services develop and document procedures that will ensure timely and accurate processing of data processing charges. We further recommend that these procedures provide an adequate and understandable audit trail.

Auditee Response/Corrective Action Plan:

Contact: Mark Toulouse, Financial Analyst, 287-1869

DHHS agrees that the process to allocate monthly BIS invoices was overly complex. While a powerful tool for the technically adept employee who created it, the cost compilation file was overwhelming to subsequent employees attempting to update it with changes. As a result, the allocation process for paying the monthly BIS invoices has been adjusted for short-term payments, and will be re-designed in fiscal year 2006. While the file housing the BIS invoice allocation may not end up significantly smaller than the one previously used, it will be broken out into several more manageable pieces, each of which will be documented individually by charge type.



DEPARTMENT OF LABOR

14. Bureau of Employment Services

WIA Cluster

CFDA#: 17.258, 17.259, 17.260

Federal Award Number: AA12019, AA12929, EM-11650

Questioned Costs: None

Finding: Subrecipient monitoring insufficient. **(Prior Year Finding)**

Monitoring of subrecipient financial reporting procedures did not ensure that reports were presented on the appropriate basis of accounting. Per 20 CFR 667.300, the Department is required to submit financial reports to the U.S. Department of Labor on an accrual basis. To prepare the reports, the Maine Department of Labor uses expenditure information directly from the subrecipient financial reports that are submitted to the State. Adequate monitoring would ensure that these reports are presented on the appropriate basis.

Recommendation:

We recommend that monitoring procedures ensure that subrecipients are filing financial reports to the State on an accrual basis.

Auditee Response/Corrective Action Plan:

Contact: Contact: Andrew Drouin, Director of Administrative Systems, 624-6493

First, it's important to note that two of the three prior findings related to the Bureau's monitoring activities were not repeated here.

In Section IV, A, of the BES' Financial Systems monitoring tool (page 8), the following is clearly stated: "WIA subrecipients are required to submit cumulative quarterly reports on an accrual basis." On the same page, the instructions to the monitor read: "To assure that the reports contain appropriate information for the required grant or funding period, check the following: Question No. 3. Does the entity report expenses on an accrual basis? ___ yes ___ no Question No. 4. Does the method for developing accruals seem logical? ___ yes ___ no "

The BES monitors only its first tier subrecipients as required by law. These are the Local Workforce Investment Board (LWIB) administrative entities. The second-tier WIA Service Providers contract with the LWIBs. As such, the LWIBs are required to monitor their subrecipients to ensure regulatory compliance. The BES does, however, monitor the extent to which this second-tier monitoring is occurring. Completed reports are on file. For FY04, two LWIBs were monitored, as scheduled.



DEPARTMENT OF LABOR

15. Office of Administrative Services

Questioned Costs: None

Finding: Inadequate internal controls to ensure recording of computer hardware and software assets

The Office of Administrative Services did not have adequate controls in place to ensure that computer hardware and software is accounted for in accordance with the State's Fixed Asset Policy. Purchases having a useful life of two years or more with a unit value greater than \$3,000 must be accounted for as an asset. It appears that personnel have not received adequate training regarding the State Fixed Asset Policy.

Eight instances were identified when spending was accounted for as an operating expenditure rather than as an asset:

1. \$232,596 for a Blade Service Center
2. \$221,573 for Progress Software
3. \$162,617 for a FAS920 Network Attached Storage Device
4. \$102,919 for a Network Appliance F825 Filer network attached storage system
5. \$57,344 for Spectra 20K Tape Hardware.
6. \$11,500 for CIFS Software F925
7. \$6,520 for a Metaframe XP Server
8. \$3,655 for a laser jet printer

These eight items total \$798,724.

Recommendation:

We recommend that personnel employed by the Office of Administrative Services receive training regarding the State's Fixed Asset Policy, and comply accordingly.

Auditee Response/Corrective Action Plan:

Contact: Contact: Rose M. Bailey, Chief Accountant, 287-1276

The Office of Administrative Services (OAS) did code invoices properly into MFASIS to reflect capital equipment. The process to ensure the fixed asset shells were completed was not adequately documented and resulted in the above finding. Although fixed assets is handled by another unit within the Department of Labor, the OAS will take oversight responsibility to ensure all fixed asset shells are completed for capital and minor equipment as required by the State's Fixed Assets Policy.



DEPARTMENT OF LABOR

16. Office of Administrative Services

Questioned Costs: None

Finding: Unemployment compensation tax receipts were recorded as a transfer rather than as revenue

Procedures used by the Office of Administrative Services resulted in the incorrect recording of unemployment compensation tax receipts of \$44,528,500 in the unadjusted financial statements. This amount was recorded as a transfer from other State accounts without ever having been recorded as revenue received from employers.

According to Statement 33 paragraph 112 promulgated by the Governmental Accounting Standards Board (GASB) a transfer, which is a form of interfund activity occurs within and among the three fund categories (governmental, proprietary, and fiduciary).

Personnel employed by the Office of the State Controller detected the error and made an adjusting entry.

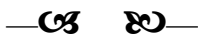
Recommendation:

We recommend that the Office of Administrative Services record unemployment compensation tax receipts as operating revenue.

Auditee Response/Corrective Action Plan:

Contact: Rose M. Bailey, 287-1276

The Office of Administrative Services (OAS) did change the coding on the Treasury Automated Management Information system (TAMI) CR statement for all unemployment compensation tax receipts to reflect operating revenue effective May 17, 2005. OAS has prepared a journal to correct revenues received between July 1, 2004 and May 17, 2005.



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17. Office of Administrative Services

Questioned Costs: None

Finding: Employee training is not adequate

The Office of Administrative Services did not adequately cross-train employees regarding a vital fiscal year end closing procedure. This procedure involves writing of adjusting journal entries that lead to the preparation of the statewide financial statements.

Adequate internal control requires that employees be properly trained in order to ensure that accurate and timely financial statements are prepared. These financial statements must be prepared even when unusual or unpredictable events occur such as sickness, accident, or retirement.

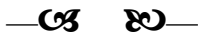
Recommendation:

We recommend that accounting employees be cross-trained regarding fiscal year end closing procedures.

Auditee Response/Corrective Action Plan:

Contact : Dennis Corliss, 287-7483

The Office of Administrative Services (OAS) Year End Plan will be updated to include the adjusting journal entries that lead to the preparation of the Statewide financial statements. The procedure for these entries will be documented and become part of the Trust Fund Year End process. The OAS has always acknowledged the importance of cross-training of staff in all areas of operations and will ensure that this responsibility is covered as well.



DEPARTMENT OF LABOR

18. Bureau of Unemployment Compensation

Questioned Costs: None

Finding: Inadequate internal control to ensure that overdue tax notices include all quarters that are overdue

The legacy electronic system used by the Tax Section does not include adequate processing controls, audit trail capabilities, and documentation. These are necessary to ensure that all required tax notices are issued.

Recommendation:

We recommend that adequate processing controls and audit trail capabilities be incorporated into the electronic system used by the Tax Section, and that proper documentation be available.

We also recognize that the Bureau of Unemployment Compensation and the Office of Information Processing are in the processing of rewriting the software used by the Tax Section.

Auditee Response/Corrective Action Plan:

Contact: Joan A. Cook, Director, UC Tax Division, 287-1248

We agree with the fact that our current systems are inadequate, which is why we are re-engineering the system. Currently, we do manually what will be done electronically by the new system. In the meantime, the Tax Division is able to reconcile, through manual intervention, 98 to 99% of any transaction it conducts and to supply documentation for same.



19. Office of Information Processing

Questioned Costs: None

Finding: Business practices utilized by the Office of Information Processing should ensure a higher level of fault tolerance

In FY04 there were four unscheduled instances when the daily mailing of unemployment benefit checks was delayed for one to two business days. These delays were the result of:

- old transactions that were inadvertently included in the production run (March 2004),
- modified applications software that caused benefit checks with a notice attached not to be printed (March 2004),

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- a hardware failure (April 2004), and
- a failed untested patch to the operating system (June 2004).

Business practices utilized by the Office of Information Processing should ensure a higher level of fault tolerance. Fault tolerance is the ability of the processing system to continue operation when part of the system fails due to hardware failure, application program error, or operator error.

Recommendation:

The Office of Information Processing should design a higher level of fault tolerance into their business practices.

Auditee Response/Corrective Action Plan:

Contact: Steve Campana, Director, OIP, 287-1293

- ***Old transactions that inadvertently included in the production run (March 2004)***

Actions taken: The change and testing procedures for payment systems have been modified to include that all program tests must be changed and tested on the Demo database which is a separate database from the production database. This restriction also applies to any associated test files, tables or work areas. This separation also has the restriction that any file string used on the Demo database must also have a different filename and format than the production files.

- ***Modified applications software that caused benefit checks with a notice attached not to be printed***

Actions Taken: Along with the changes mentioned above, the Application Change Checklist for benefit production changes has been modified to include more information about the tests and has to be approved by a supervisor.

- ***A hardware failure (April 2004) occurred***

Action Taken: Since the hardware failure occurred on a component (storage device) that was a single point of failure, the remedy is to eliminate single points of failure by providing redundant hardware. Labor has purchased and set up a pair of hardware-identical IBM servers, one of which is on line in production as "UIPROD", the BUC Oracle and Progress database server, while the other is off line but "hot", containing a fully operational operating system and database structures. This eliminates single points of hardware failure having a significant impact on business continuity.

Each server has redundant mirrored disks (RAID-10) and will keep running in the event a disk fails. A new disk can be hot-swapped in and rebuilt without system interruption. There are also dual redundant power supplies in each; and dual processors so that some processor failures can

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be stepped over without interrupting service. In the event that a hardware failure causes the server to go down and necessitates immediate repairs, spare parts are available from the offline server, or the whole operation can be moved to the offline server after bringing the data up to date. Hardware failure should no longer be a cause for significant interruption of service or failure to produce claim checks.

- ***A failed untested patch to the operating system (June 2004)***

Action Taken: *Again, the redundant server setup provides the remedy. The offline machine is used to test all patches and other changes to the operating system, databases, and applications before being applied to the production server, and the option is available to simply switch the production to the newly-changed server, leaving the former production server in operating condition in case of problems discovered in production load. A control process is in effect requiring all changes to be tested off line before being placed in production.*



20. Office of Administrative Services

Unemployment Insurance

CFDA#: 17.225

Federal Award Number: UI-12642-03-55, UI-13551-04-55

Questioned Costs: None

Finding: Inadequate internal control over the cost accounting system

The cost accounting system (DOLARS) used by the Department of Labor (DOL) to report expenditures by program is not adequately reconciled to the accounting system. This has been an ongoing accounting issue that does not materially misstate the State financial statements. MFASIS is the name of the statewide financial accounting system used to process payroll expenditures and payments to vendors.

DOL employees identified that:

- 890 transactions recorded in DOLARS from July 2002 to June 2004 amounting to \$12,503,819, have not been matched to transactions recorded in MFASIS, and
- that 827 transactions recorded in MFASIS for the same period amounting to \$12,581,646. have not been matched to transactions recorded in DOLARS, and
- that the net dollar impact of these transactions is \$77,827.

In FY04, monthly reconciling items ranged from a low \$61,398 in August 2003 to a high of \$2,265,008 in April 2004. It appears that most, but not all reconciling items pertain to payroll rather than other administrative expenditures. Prior to the fiscal year 2004 financial audit, the Department of Labor notified the Office of the State Controller about this issue and requested their assistance.

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In order to ensure strong management control of expenditures and accurate federal reporting, the cost accounting system should be promptly reconciled to the financial accounting system. All reconciling items should be resolved on a timely basis.

Recommendation:

We recommend that the DOLARS cost accounting system be reconciled to the MFASIS financial accounting system on a monthly basis, and that reconciling items be resolved on a timely basis.

Auditee Response/Corrective Action Plan:

Contact: Dennis Corliss, Assistant Director of Fiscal Operations, 287-7483

The Office of Administrative Services (OAS) has made great strides with regard to this issue. Automation, the assistance of staff from outside of OAS, along with additional staff training has been used to reconcile and correct current month activity. To meet our goal of completing all reconciliations timely, the OAS is continuing to monitor monthly our planned work around fully reconciling all accounts, as quickly as possible.



21. Employee Services

Trade Adjustment Assistance

CFDA#: 17.245

Federal Award Number: TA-12695-03-55, TA-13498-04-55

Questioned Costs: None

Finding: Internal controls over eligibility cannot be verified

In order to ensure that only eligible individuals receive Trade Adjustment Assistance (TAA) program benefits, an application and a request for employment information should be submitted for determination of eligibility.

Forty individuals were selected to test eligibility. The case file for one individual did not include an application or request for employment information.

Recommendation:

Obtain applications and request for eligibility determinations for all individuals prior to determining eligibility.

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Auditee Response/Corrective Action Plan:

Contact: Mike Cunningham, Division Director, 287-2316

When a company is determined Trade Adjustment Assistance eligible, all workers who became totally or partially separated from that company must complete a TRA -26 form and send it to the Bureau of Unemployment Compensation (UI). After each worker's application is reviewed and approved, the applicant is sent a copy of his/her determination. The CareerCenter closest to the company location is sent copies of all the workers that have been deemed TAA/TRA-eligible. Occasionally, workers do not go to the CareerCenter closest to the location of the company and might not bring his/her copy of their eligibility determination. In that instance, CareerCenter Consultants are required to get a copy of the eligibility certification from the individual or from UI. A copy of the determination is retained in the CareerCenter that provides the customer his/her services.

CareerCenter Consultants will be sent written instructions that a copy of the TAA/TRA determinations must be filed in the customer's paper file at the CareerCenter. Bureau of Employment Services monitoring staff will verify to see that all TAA customer files have a copy of the TAA/TRA determination during our CareerCenter monitoring.





DEPARTMENT OF TRANSPORTATION

22. Bureau of Transportation

Agreement Coordination Office

CFDA#: 20.205

Federal Award Number: Various

Questioned Costs: None

Finding: Inadequate internal controls over Suspension and Debarment for consultant contracts
(Prior Year Finding)

The Department of Transportation is prohibited by 49 CFR 18.35 from contracting with or making sub awards to parties that are suspended or debarred. Contractors receiving individual awards for \$25,000 or more and all subrecipients must certify that the organization and its principles are not suspended or debarred. Consultants are required to complete a Consultant Registration Form, which specifically addresses whether the consultant has been suspended or debarred. As of July 1, 2002, consultants are only required to sign a contract that references the Consultant General Conditions, which incorporates suspension and debarment language, and will no longer be required to complete a Consultant Registration Form.

Thirty consultant contracts were tested. Although all test items had the suspension and debarment language included when required, there are no consistent procedures followed. Not all contracts reference the Consultant General Conditions dated July 1, 2002, which in the future will be the only control over consultant contracts regarding suspension and debarment. Six of the consultant contract had completed the Consultant Registration Form, but made no reference to the Consultant General Conditions dated July 1, 2002.

Recommendation:

We recommend that the Department of Transportation consultant contracts should reference the Consultant General Conditions dated July 1, 2002 in order to ensure that it is not contracting with suspended or debarred parties.

Auditee Response/Corrective Action Plan:

Contact: Todd Pelletier, Director, Contract Procurement Office, 624-3324

We concur with the finding. The Department has recently formed a Contract Procurement Office (CPO) from the former Agreement Coordination Office and a portion of the Audit Office. The new CPO is responsible for ensuring quality assurance of all of the Department's consultant contracts by use of its Compliance Unit. This unit is responsible for making sure required contract language, such as the previously mentioned Consultant General Conditions, is included in all contracts prior to execution. It should be noted that the current templates for contracts have been modified to include this reference to Consultant General Conditions and have been in use for some time.



