REPORT OF THE STATEWIDE SINGLE AUDIT OF THE COMMONWEALTH OF KENTUCKY
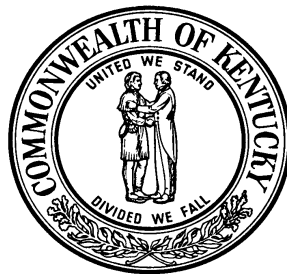
VOLUME I

**For the Year Ended
June 30, 2011**

ADAM H. EDELEN
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Embargo Until 10am February 14, 2012

The Statewide Single Audit of the Commonwealth of Kentucky
Volume I
For the Year Ended June 30, 2011

Background

The Single Audit Act of 1984, subsequent amendments, and corresponding regulations, requires an annual audit of the financial statements and compliance with requirements applicable to major federal programs. The Auditor of Public Accounts (APA) meets these requirements and submits audit findings required to be reported by auditing standards generally accepted in the United States of America, *Government Auditing Standards* and OMB Circular A-133, *Audits of States*, *Local Governments, and Non-Profit Organizations*, through our opinion on the Commonwealth's Comprehensive Annual Financial Report (CAFR) and through the Statewide Single Audit of Kentucky (SSWAK). Our SSWAK report is contained in two volumes as noted below.

SSWAK - Volume I contains financial reporting information based on our audit of the CAFR. It includes the APA's opinion on the Schedule of Expenditures of Federal Awards (SEFA) in relation to the financial statements, the *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*, and financial statement findings related to internal control and compliance.

SSWAK - Volume II will present elements required under OMB Circular A-133, including the *Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133*, and the Schedule of Findings and Questioned Costs.

Comprehensive Annual Financial Report

The CAFR, including our report thereon based on our audit and the reports of other auditors, has been issued under separate cover. We identified in our Independent Auditor's Report on the CAFR the percentages of various funds and component units audited by other auditors. The agencies and funds audited by other auditors, as well as contact information, are presented in the Appendix of this report.

The scope of the CAFR audit included:

- An audit of the basic financial statements and combining financial statements;
- Limited procedures applied to required supplementary information;
- An audit of the SEFA sufficient to give an opinion in relation to the basic financial statements; and,
- Tests of compliance with certain provisions of laws, regulations, contracts, and grants, and tests of internal controls, where applicable.

The Statewide Single Audit of the Commonwealth of Kentucky
Volume I
For the Year Ended June 30, 2011

Schedule of Expenditures of Federal Awards

The SEFA presented within this report is organized by federal grantor. The Catalog of Federal Domestic Assistance (CFDA) numbers and program names are listed under the federal grantor administering the program. The state agencies expending the federal funds are listed beside each CFDA number. The notes to the SEFA provide more detailed information on certain aspects of the expenditures. Clusters of programs are indicated in the schedule by light gray shading. The identification of major federal programs and our report thereon will be presented in our report *SSWAK - Volume II*.

For fiscal year ended June 30, 2011, the total federal dollars expended by the Commonwealth of Kentucky was $ 9,721,694,344 in cash awards and $ 1,326,865,002 in noncash awards. For fiscal year 2011, the total federal cash expenditures as reported on the SEFA decreased in comparison with the total for fiscal year 2010.

Component Units

The reporting entity of the Commonwealth of Kentucky for the purposes of the CAFR includes various discretely presented component units, including state universities, identified in accordance with GASB No. 14 and 39. However, except for CAFR reporting, the Commonwealth has elected to exclude discretely presented component units from the statewide single audit. Thus, these discretely presented component units, including state universities, are not included in the accompanying SEFA and reports on internal control and compliance over financial reporting. These entities are still required to have audits performed in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, if applicable, based on their total federal expenditures.

ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

February 14, 2012

Honorable Steven L. Beshear, Governor
Cabinet Secretaries and Agency Heads
Members of the Commonwealth of Kentucky Legislature

As Auditor of Public Accounts, I am pleased to transmit herewith our report of the Statewide Single Audit of Kentucky - Volume I for the year ended June 30, 2011. Volume I contains financial statement findings identified during our audit of the Comprehensive Annual Financial Report (CAFR), the Schedule of Expenditures of Federal Awards (SEFA), related notes, and our opinion thereon, as well as the 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*.

We will subsequently report to you the required elements of the Federal government's Office of Management and Budget (OMB) Circular A-133 in Volume II of this report upon completion of our audit of the Commonwealth's major federal programs.

On behalf of the Office of Financial Audits of the Auditor of Public Accounts, I wish to thank the employees of the Commonwealth for their cooperation during the course of our audit. Should you have any questions concerning this report, please contact Libby Carlin, Assistant Auditor of Public Accounts.

Respectfully submitted,

Adam H. Edelen
Auditor of Public Accounts

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LIST OF ABBREVIATIONS/ACRONYMS

**COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2011**

ACH	Automated Clearing House
ADB	Agriculture Development Board
AFR	Annual Financial Report
AGR	Department of Agriculture
AOC	Administrative Office of the Courts
APA	Auditor of Public Accounts
ARRA	American Recovery and Reinvestment Act
BCP	Business Contingency Plan
BFY	Budget Fiscal Year
BHDID	Behavioral Health, Developmental and Intellectual Disabilities
BPP	Business Process Procedures
CA	Clearing Account
CA	Cost Accounting
CAFR	Comprehensive Annual Financial Report
CAMRA	Complete Asset Management Reporting and Accounting
CD	Compact Disc
CDC	Centers for Disease Control
CED	Cabinet for Economic Development
CFDA	Catalog of Federal Domestic Assistance
CHFS	Cabinet for Health and Family Services
CIO	Chief Information Officer
CMA	Commission on Military Affairs
Commonwealth	Commonwealth of Kentucky
CORR	Department of Corrections
COT	Commonwealth Office of Technology
CPA	Certified Public Accountant
CT	Contract
CT2	Contract 2-Way Match
CTT1	Contract KYTC
CTT2	Contract 2-Way Match KYTC
CW	Checkwriter
CWC	Checkwriter Cancellation
DBHID	Department for Behavioral Health and Developmental and Intellectual Disabilities
DCJT	Department of Criminal Justice Training
DCTRL	Document Control
DDS	Division of District Support
DEI	Department of Employee Insurance
DEM	Department of Employee Management
DHRA	Department of Human Resources Administration
DLA	Department of Libraries and Archives
DLG	Department for Local Government
DMA	Department of Military Affairs
DNHS	Division of Nutrition and Health Services
DO	Delivery Order
DO2	Delivery Order 2-Way Match

COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2011
(Continued)

DOC	Department of Corrections
DOR	Department of Revenue
DRP	Disaster Recovery Plan
DSCN	Division of School and Community Nutrition
DTS	Division of Technology Services
DWI	Department for Workforce Investment
EDU	Department of Education
EEC	Energy and Environment Cabinet
EFT	Electronic Funds Transfers
eMARS	enhanced Management Administrative Reporting System
ePAY	ePayment Gateway
EPPC	Environmental and Public Protection Cabinet
EPSB	Education Professional Standards Board
ERQ	Event Requirements
ERRP	Early Retiree Reinsurance Program
ESS	Employee Self Service
ETL	Extract Transform Load service
F&W	Department of Fish and Wildlife Resources
FAC	Finance and Administration Cabinet
FAP	Finance and Administration Cabinet Policy
FEMA	Federal Emergency Management Agency
FICA	Federal Insurance Contributions Act
Finance	Finance and Administration Cabinet
FNS	Food and Nutrition Service
FSA	Flexible Spending Account
FTP	File Transfer Protocol
FY	Fiscal Year
GAIP	General Accounting Intercept Payment
GASB	Governmental Accounting Standards Board
GAX	General Accounting Expense/Expenditure
GHI	Group Health Insurance
GOV	Office of the Governor
GSA	Government Services Administration
HHS	U.S. Department of Health and Human Service
HR	Human Resource
HRA	Health Reimbursement Account
HRC	Kentucky Commission on Human Rights
HRG	Human Resource Generalist
HTTP	Hyper Text Transfer Protocol
ID	Identification
IRS	Internal Revenue Service
IT	Information Technology
IT	KHRIS Information Type (InfoType)
ITSM	Information Technology Service Management

COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2011
(Continued)

JUST	Justice and Public Safety Cabinet
JUV	Department of Juvenile Justice
KAC	Kentucky Arts Council
KAR	Kentucky Administrative Regulations
KBE	Kentucky Board of Elections
KCR	KHRIS Change Request
KDE	Kentucky Department of Education
KEHP	Kentucky Employee Health Plan
KEWS	Kentucky Emergency Warning System
KHC	Kentucky Heritage Council
KHEAA	Kentucky Higher Education Assistance Authority
KHP	Kentucky Horse Park
KHRIS	Kentucky Human Resource Information System
KHS	Kentucky Historical Society
KIDS	Office of Knowledge, Information, and Data Services
KOHS	Kentucky Office of Homeland Security
KOMS	Kentucky Offender Management System
KRS	Kentucky Revised Statute
KSP	Kentucky State Police
KST	Kentucky State Treasury
KVE	Kentucky Vehicle Enforcement
KY	Kentucky
KYDEM	Division of Emergency Management
KY OSCAR	Kentucky On-line System for Collection of Accounts Receivable
KYTC	Kentucky Transportation Cabinet
LABOR	Labor Cabinet
LWIA	Local Workforce Investment Area
MIL	Military Affairs
MSF	Microsoft Solutions Framework
MUNIS	Municipal Information System
NA	Not Applicable
NHS	Nutrition and Health Services
NIST	National Institute of Standards and Technology
OAG	Office of Attorney General
OB1	Management Budget
OC	Office of the Controller
OET	Office of Education Technology
OET	Office of Employment Training
OMB	Office of Management and Budget
OSBD	Office of the State Budget Director
PAN	Personnel Action Number
PARKS	Department of Parks
PC	Personnel Cabinet
PDR	Payroll Distribution Report

COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2011
(Continued)

Personnel	Personnel Cabinet
PO	Purchase Order
PO2	Purchase Order 2-Way Match
PON2	Proof of Necessity Agreement
PPC	Public Protection Cabinet
PRC	Commodity Based Purchase Request
PRCI	Commodity Based Internal Payment Requisition
PSC	Personal Service Contract
PUBAD	Department of Public Advocacy
QA	Quality Assurance
QC	Quality Control
R&D	Research and Development
RACF	Resource Access Control Facility
RCW	Record of Control Weakness
REV	Department of Revenue
RFC	Request for Change
RFP	Request for Proposal
SAS	Statewide Accounting Services
SCN	School and Community Nutrition
SCNP	School and Community Nutrition Payment
SCR	System Change Request
SEFA	Schedule of Expenditures of Federal Awards
SERO	Southeast Regional Office
SME	Subject Matter Expert
SNAP	Supplemental Nutritional Assistance Program
SOS	Secretary of State
SP	State Park
SR	Solicitation Response
SRW	Solicitation Response Wizard
SSL	Secure Socket Layer
SSWAK	Statewide Single Audit of Kentucky
TAH	Tourism, Arts, and Heritage Cabinet
TBD	To Be Determined
TC	Transportation Cabinet
TED	Transportation Enterprise Database
TM	Time Management
Treasury	Kentucky State Treasury
UI	Unemployment Insurance
UIA	Unemployment Insurance Accounts
UNIX	Uniplexed Information and Computing System
UPPS	Uniform Personnel and Payroll System
UPS	Unified Prosecutorial System
US	United States
USDA	United States Department Of Agriculture

COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2011
(Continued)

VA	Department of Veterans' Affairs
VPN	Virtual Private Network
WBS	Work Breakdown Structure
WIA	Workforce Investment Act
WORK	Online Reporting of Kentucky
WRX	Wage Records Systems
YTD	Year To Date

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ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

Honorable Steven L. Beshear, Governor
Cabinet Secretaries and Agency Heads
Members of the Commonwealth of Kentucky Legislature

<u>Independent Auditor's Report</u>

We have audited the financial statements of the governmental activities, business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Kentucky as of and for the year ended June 30, 2011, and have issued our report thereon dated December 16, 2011. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements taken as a whole.

The schedule of expenditures of federal awards is prepared on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed and not when incurred.

In our opinion, except for the effects of the application of a different basis of accounting, as explained above, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the Commonwealth's basic financial statements taken as a whole.

This report is intended solely for the information and use of management, members of the legislature, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

Adam H. Edelen
Auditor of Public Accounts

December 16, 2011

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SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011

CFDA	Program Title	State Agency	Expenditures Cash	Expenditures Noncash	Provided to Subrecipient
U.S. Department of Agriculture					
Direct Programs:					
10.025	Plant and Animal Disease, Pest Control, and Animal Care (Note 7)	AGR	$ 473,398	$	$
		F&W	65,899		
10.028	Wildlife Services (Note 15)	F&W			
10.066	Livestock Assistance Program (Note 15)	AGR			
10.069	Conservation Reserve Program (Note 15)	EEC			
10.086	ARRA-Aquaculture Grants Program (AGP) (Note 14)(Note 15)	ADB			
10.093	Voluntary Public Access and Habitat Incentive Program	F&W	83,668		
10.103	2009 Aquaculture Grant Program	ADB	36,545		
10.153	Market News	AGR	2,086		
10.156	Federal- State Marketing Improvement Program (Note 15)	AGR			
10.163	Market Protection and Promotion	AGR	213,335		
10.169	Speciality Crop Block Grant Program	AGR	90,011		
10.170	Specialty Crop Block Grant Program-Farm Bill	AGR	293,632		
Supplemental Nutrition Assistance Program Cluster:					
10.551	Supplemental Nutrition Assistance Program (Note 2) (Note 11) (Note 16)	CHFS		1,246,973,544	
10.561	State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (Note 2)	CHFS	48,178,722		7,016,714
10.561	ARRA-State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (Note 2) (Note 14)	CHFS	423,726		2,111
Child Nutrition Cluster:					
10.553	School Breakfast Program (Note 2)	EDU	57,250,143		57,250,143
		JUV	428,720		
10.555	National School Lunch Program (Note 2) (Note 11)	EDU	159,139,503		159,139,503
		AGR		22,080,669	
		JUV	743,353		
10.556	Special Milk Program for Children (Note 2)	EDU	61,450		61,450
10.559	Summer Food Service Program for Children (Note 2)	EDU	6,798,709		6,655,513
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children (Note 2)	CHFS	127,919,101		24,982,070
10.558	Child and Adult Care Food Program (Note 2)	EDU	32,602,754		32,181,205
10.560	State Administrative Expenses for Child Nutrition	EDU	1,696,693		
		AGR	339,320		
10.565	Commodity Supplemental Food Program (Note 11)(Note 12)	AGR	1,831,089	4,122,796	
Emergency Food Assistance Cluster:					
10.568	Emergency Food Assistance Program (Administrative Costs)	AGR	985,264		
10.568	ARRA-Emergency Food Assistance Program (Administrative Costs) (Note 14)	AGR	500,540		
10.569	Emergency Food Assistance Program (Food Commodities) (Note 11)	AGR		9,584,117	
10.572	WIC Farmers' Market Nutrition Program (FMNP) (Note 15)	CHFS	156,622		
		AGR			
10.574	Team Nutrition Grants (Note 15)	EDU			
10.576	Senior Farmers Market Nutrition Program	AGR	314,594		
10.578	ARRA-WIC Grants to States (WGS) (Note 14)	CHFS	1,695,194		
10.579	Child Nutrition Discretionary Grants Limited Avaliability	EDU	404,629		404,629
10.579	ARRA-Child Nutrition Discretionary Grants Limited Avaliability (Note 14)	EDU			
10.582	Fresh Fruit and Vegetable Program	EDU	1,469,921		1,469,920
10.652	Forestry Research	EEC	233,571		
10.664	Cooperative Forestry Assistance (Note 11)	EEC	2,619,260	125,072	960,854
10.676	Forest Legacy Program	EEC	365,044		
10.678	Forest Stewardship Program	EEC	835		
10.680	Forest Health Protection	EEC	95,417		20,000
10.769	Rural Business Enterprise Grants	AGR	85,470		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Expenditures Noncash	Provided to Subrecipient
U.S. Department of Agriculture (Continued)					
Direct Programs (Continued):					
10.771	Rural Cooperative Development Grants (Note 15)	AGR			
10.902	Soil and Water Conservation	EEC	468,408		10,000
		F&W	403,486		
10.913	Farm and Ranch Lands Protection Program	AGR	789,570		
10.914	Wildlife Habitat Incentive Program (Note 15)	EEC			
		F&W			
10.923	Emergency Watershed Protection Program (Note 15)	EEC			
10.NA(1)	Rural Rehabilitation Student Loan Program (Note 3)	AGR	93,949		
10.NA(2)	Conservation Farm Bill Program	EEC	75,000		
	Total U.S. Department of Agriculture		$ 449,428,631	$ 1,282,886,198	$ 290,154,112
U.S. Department of Commerce					
Direct Programs:					
Public Works and Economic Development Cluster:					
11.307	Economic Adjustment Assistance	DLG	$ 1,608	$	$
11.468	Applied Meteorological Research	KOHS	26,204		26,204
11.469	Congressionally Identified Awards and Projects (Note 15)	PARKS			
11.555	Public Safety Interoperable Communications Grant Program	KSP	3,753,126		
		KOHS	964,283		837,013
11.557	ARRA-Broadband Technology Opportunities Program (BTOP) (Note 14)	DLA	387,047		341,392
11.558	ARRA-State Broadband Data and Development Grant Program (Note 14)	COT	1,018,114		
	Total U.S. Department of Commerce		$ 6,150,382	$ 0	$ 1,204,609
U.S. Department of Defense					
Direct Programs:					
12.002	Procurement Technical Assistance For Business Firms	CED	$ 118,773	$	$
12.113	State Memorandum of Agreement Program for the Reimbursement of Technical Services	EEC	94,427		
12.400	Military Construction, National Guard	MIL	8,139,213		
12.401	National Guard Military Operations and Maintenance (O & M) Projects	MIL	20,944,456		
12.401	ARRA-National Guard Military Operations and Maintenance (O & M) Projects (Note 14)	MIL	854,249		
12.404	National Guard ChalleNGe Program	MIL	2,394,632		
12.607	Community Economic Adjustment for Establishment,Expansion,Realignment,or Closure of a Military Installation	CMA	307,399		
12.700	Donations/Loans of Obsolete DOD Property (Note 11)	KSP		315,994	
12.NA(1)	Chemical Demilitarization and Remediation Activity for Hazardous Waste Activities at Chemical Demilitarization Facilities	EEC	378,428		47,442
12.NA(2)	Monitoring of Wildlife	F&W	600,966		
12.NA(3)	Teacher and Teacher's Aide Placement Assistance Program	EPSB	78,718		
	Total U.S. Department of Defense		$ 33,911,261	$ 315,994	$ 47,442
U.S. Department of Housing and Urban Development					
Direct Programs:					
Community Development Block Grants-State-Administered Small Cities Program					
14.228	Community Development Block Grants/State's Program and Non- Entitlement Grants in Hawaii (Note 2)(Note 8)	DLG	$ 45,804,618	$	$ 45,736,781
14.255	ARRA-Community Development Block Grants/State's program and Non-Entitlement Grants in Hawaii (Note 2)(Note 14)	DLG	3,828,089		3,784,348
14.262	ARRA-Homeless Prevention and Rapid Re-Housing Program Technical Assistance (Note 14)	DLG	17,084		
14.401	Fair Housing Assistance Program-State and Local	HRC	97,030		
14.408	Fair Housing Initiatives Program (Note 15)	HRC			
14.251	Economic Development Initiative -Special Project,Neighborhood Initiative and Miscellaneous Grants	PARKS	472,569		
	Total U.S. Department of Housing and Urban Development		$ 50,219,390	$ 0	$ 49,521,129

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Noncash	Provided to Subrecipient
U.S. Department of the Interior					
Direct Programs:					
15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining (Note 11)	EEC	$ 11,696,033	$	$ 46,598
15.252	Abandoned Mine Land Reclamation (AMLR) Program	EEC	27,777,825		14,494,379
15.255	Applied Science Program Cooperative Agreements Related to Coal Mining and Reclamation	EEC	37,553		
Fish and Wildlife Cluster:					
15.605	Sport Fish Restoration Program (Note 7)	F&W	5,058,020		
15.611	Wildlife Restoration and Basic Hunter Education (Note 9)	F&W	7,759,050		
15.614	Coastal Wetlands Planning, Protection and Restoration Act	F&W	13,316		
15.615	Cooperative Endangered Species Conservation Fund (Note 7)	F&W	156,033		
		EEC	58,611		
15.616	Clean Vessel Act	F&W	37,906		
15.622	Sportfishing and Boating Safety Act (Note 15)	F&W			
15.623	North American Wetlands Conservation Fund (Note 15)	EEC			
15.632	Conservation Grants Private Stewardship for Imperiled Species	F&W	30,880		
		EEC	26,939		
15.633	Landowner Incentive Program (Note 15)	F&W			
15.634	State Wildlife Grants (Note 7)	F&W	891,456		
15.657	Endangered Species Conservation - Recovery Implementation Funds (Note 11) (Note 15)	EEC			
15.656	ARRA-Recovery Act Funds-Habitat Enhancement, Restoration and Improvement (Note 14) (Note 15)	F&W			
15.808	U.S. Geological Survey Research and Data Collection	EEC	8,912		
		COT			
15.809	National Spatial Data Infrastructure Cooperative Agreements Program	COT	10,404		
15.904	Historic Preservation Fund Grants-In-Aid	KHC	910,568		
15.916	Outdoor Recreation-Acquisition, Development and Planning (Note 10) (Note 6)	DLG	261,633		261,633
		PARKS	404		
	Total U.S. Department of the Interior		$ 54,735,543	$ 0	$ 14,802,610
U.S. Department of Justice					
Direct Programs:					
16.003	Law Enforcement Assistance-Narcotics and Dangerous Drugs Technical Laboratory Publications (Note 15)	COT	$	$	$
16.017	Sexual Assault Services Formula Program	JUST	132,959		132,959
16.202	Prisoner Reentry Initiative Demonstration	CORR	450,905		
16.203	Comprehensive Approaches to Sex Offender Management Discretionary Grant (CASOM)	JUV	1,893		
		CORR	147,194		
		JUST			
16.523	Juvenile Accountability Block Grants	JUV	685,239		44,102
		AOC	28,505		
		UPS	50,000		
		PUBAD			
16.540	Juvenile Justice and Delinquency Prevention Allocation to States	JUV	633,902		500,130
16.543	Missing Children's Assistance	KSP	297,828		
16.548	Title V Delinquency Prevention Program	JUV	52,667		52,496
16.549	Part E-State Challenge Activities (Note 15)	JUV			
16.550	State Justice Statistics Program for Statistical Analysis Centers	JUST	64,815		
16.554	National Criminal History Improvement Program (NCHIP)	KSP	237,660		
		KOHS			
		JUST			
16.560	National Institute of Justice Research, Evaluation, and Development Project Grants	KSP	455,116		
		JUST	108,782		
16.575	Crime Victim Assistance	JUST	5,579,494		5,307,562
		UPS	346,871		
16.576	Crime Victim Compensation	PPC	485,858		
16.579	Edward Byrne Memorial Formula Grant Program	JUST	16		
		CORR			
		KSP	7,171		
		JUV	98,871		
		PUBAD			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Noncash	Provided to Subrecipient
U.S. Department of Justice (Continued)					
Direct Programs (Continued):					
16.580	Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary				
	Grants Program	CHFS	518,436		
		KSP			
		JUST			
		PUBAD			
16.585	Drug Court Discretionary Grant Program	AOC	151,179		
		CHFS			
16.586	Violent Offender Incarceration and Truth in Sentencing				
	Incentive Grants (Note 15)	JUST			
16.588	Violence Against Women Formula Grants	JUST	1,428,489		1,297,902
		UPS	124,423		
		OAG	30,085		
		CHFS	26,038		
16.588	ARRA-Violence Against Women Formula Grants (Note 14)	JUST	1,255,148		1,255,148
16.589	Rural Domestic Violence, Dating Violence,Sexual Assualt, and Stalking Assistance				
	Program (Note 15)	JUST			
16.592	Local Law Enforcement Block Grants Program (Note 15)	KSP			
		JUST			
16.593	Residential Substance Abuse Treatment for State Prisoners	CORR	105,341		
		JUST			
		JUV	4,701		
16.606	State Criminal Alien Assistance Program	CORR	53,668		
16.607	Bulletproof Vest Partnership Program	KSP	89,952		
		CORR			
		JUST	9,710		
16.609	Project Safe Neighborhoods	UPS			
		KSP	286		
16.610	Regional Information Sharing Systems (Note 15)	COT			
16.710	Public Safety Partnership and Community Policing Grants	JUST	1,576		
		KSP	385,292		
16.727	Enforcing Underage Drinking Laws Program	KSP	372,429		226,056
16.728	Drug Prevention Program (Note 15)	TC			
16.735	Protecting Inmates and Safeguarding Communities Discretionary Grant				
	Program (Note 15)	CORR			
16.738	Edward Byrne Memorial Justice Assistance Grant Program	JUST	3,125,594		2,741,104
		KSP	782,078		
		CORR	218,780		
		AOC	5,536		
		JUV	7,012		
		UPS	31,552		
		DCJT	69,953		52,132
		PUBAD	7,612		
16.738	ARRA-Edward Byrne Memorial Justice Assistance Grant				
	Program (Note 14)(Note 15)	CORR			
		DCJT			
16.740	Statewide Automated Victim Information Notification (SAVIN) Program	CORR	274,354		
16.741	Forensic DNA Backlog Reduction Program	KSP	527,452		
16.748	Convicted Offender and/or Arrestee DNA Backlog Reduction Program (Note 15)	JUST			
16.743	Forensic Casework DNA Backlog Reduction Program	PUBAD	352,060		
		JUST	707,277		
16.744	Anti-Gang Initiative (Note 15)	KSP			
16.745	Criminal and Juvenile Justice and Mental Health Collaboration Program (Note 7)	AOC	41,795		
16.746	Capital Case Litigation	JUST			
		OAG	47,317		
		PUBAD	91,090		
16.750	Support for Adam Walsh Act Implementation Grant Program	KSP	32,380		
16.800	ARRA-Recovery Act-Internet Crimes Against Children Task Force				
	Program (ICAC) (Note 14)	KSP	168,343		
16.801	ARRA-Recovery Act-State Victim Assistance Formula Grant Program (Note 14)	JUST	595,365		595,365
16.802	ARRA-Recovery Act-State Victim Compensation Formula Grant				
	Program (Note 14) (Note 15)	PPC			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
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(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Noncash	Provided to Subrecipient
U.S. Department of Justice (Continued)					
Direct Programs (Continued)					
16.803	ARRA-Recovery Act-Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to States and Territories (Note 14)	KSP	977,325		
		JUST	2,791,104		2,058,889
		UPS	245,464		
		F&W			
		AOC	179,844		
		PUBAD	313,598		
		JUV	42,835		
		CHFS	77,578		
16.804	ARRA-Recovery Act-Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to Units of Local Government (Note 14)	OAG	5,719		
16.808	ARRA-Recovery Act-Edward Byrne Memorial Competitive Grant Program (Note 14)	KSP	1,181,799		
		CORR	2,581,370		
16.810	ARRA-Recovery Act-Assistance to Rural Law Enforcement to Combat Crime and Drugs Competitive Grant Program (Note 14)	OAG	1,661,368		
		UPS	92,851		
16.812	Second Chance Act Prisoner Reentry Initiative	CORR	9,970		
16.NA(1)	Drug Enforcement Administration	KSP	1,263,223		
16.NA(2)	Federal Bureau of Investigation	KSP	109,388		
16.NA(3)	Federal Methamphetamine Initiative (Note 15)	KSP			
16.NA(4)	Bureau of Alcohol, Tobacco, Fireamrs & Explosives (ATF) Program	KSP	14,153		
16.NA(5)	Prescription Drug Monitoring Program (Note 15)	CHFS			
16.NA(6)	District Fugitive Task Force	KSP	25,938		
16.NA(7)	Equitable Sharing-Asset Forfeiture	KSP	1,413,777		
	Total U.S. Department of Justice		$ 34,495,353	$ 0	$ 14,263,845
	U.S. Department of Labor				
	Direct Programs:				
17.002	Labor Force Statistics	DWI	$ 970,516	$	$
17.005	Compensation and Working Conditions	LABOR	160,320		
	Employment Services Cluster:				
17.207	Employment Service/Wagner-Peyser Funded Activities	DWI	8,526,063		
17.207	ARRA-Employment Service/Wagner-Peyser Funded Activities (Note 14)	DWI	2,340,329		
17.801	Disabled Veterans' Outreach Program (DVOP)	DWI	710,245		
17.804	Local Veterans' Employment Representative Program	DWI	1,154,881		
17.225	Unemployment Insurance (Note 2)(Note 4)	DWI	650,667,685		
17.225	ARRA-Unemployment Insurance (Note 2)(Note 4)(Note 14)	DWI	921,091,077		
17.235	Senior Community Service Employment Program	CHFS	2,220,396		2,172,984
17.235	ARRA-Senior Community Service Employment Program (Note 14)	CHFS			
17.245	Trade Adjustment Assistance	DWI	20,163,538		16,686,840
	Workforce Investment Act Cluster:				
17.258	WIA Adult Program (Note 2)	DWI	15,087,067		14,343,549
		EDU	482,097		482,053
17.258	ARRA-WIA Adult Program (Note 2)(Note 14)	DWI	1,876,845		1,537,937
17.259	WIA Youth Activities (Note 2)	DWI	12,599,481		11,959,274
		EDU			
17.259	ARRA-WIA Youth Activities (Note 2)(Note 14)	DWI	2,569,867		1,834,297
		DLA	183,656		
17.260	WIA Dislocated Workers (Note 2)	DWI	10,328,622		9,778,174
		EDU	392,590		321,418
		LABOR	26,438		
17.260	ARRA-WIA Dislocated Workers (Note 2)(Note 14)	DWI	7,316,033		6,761,453
17.261	WIA Pilots, Demonstrations, and Research Projects (Note 15)	DWI			
17.267	Incentive Grants-WIA Section 503	DWI	1,024,780		
17.268	H-1B Job Training Grants	DWI	779,391		777,449
17.271	Worker Opportunity Tax Credit Program (WOTC)	DWI	369,200		
17.272	Permanent Labor Certification for Foreign Workers (Note 15)	DWI			
17.273	Temporary Labor Certification For Foreign Workers	DWI	293,316		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Expenditures Noncash	Provided to Subrecipient
U.S. Department of Labor (Continued)					
Direct Programs (Continued)					
17.275	ARRA-Program of Competitive Grants for Worker Training and Placement in High Growth and Emerging Industry Sectors (Note 14)	DWI	1,841,304		
17.276	ARRA-Health Coverage Tax Credit(HCTC) (Note 14)	DWI	865,689		
17.277	Workforce Investment Act (WIA) National Emergency Grants	DWI	679,815		679,815
17.278	WIA Dislocated Worker Formula Grants	DWI	10,115,146		9,445,635
17.503	Occupational Safety and Health-State Program (Note 4)	LABOR	3,457,840		162,681
17.504	Consultation Agreements (Note 4)(Note 15)	LABOR			
17.505	OSHA Data Initiative	LABOR	709		
17.600	Mine Health and Safety Grants	EEC	557,069		
17.603	Brookwood-Sago Grant (Note 15)	EEC			
	Total U.S. Department of Labor		$ 1,678,852,005	$ 0	$ 76,943,559
U.S. Department of Transportation					
Direct Programs:					
20.106	Airport Improvement Program	TC PARKS	$ 82,390	$	$
Highway Planning and Construction Cluster:					
20.205	Highway Planning and Construction (Note 2)(Note 5)	TC PARKS KSP REV	503,726,440 4,398		31,017,310
20.205	ARRA-Highway Planning and Construction (Note 2) (Note 14)	TC KHP	152,123,148 1,050,509		
20.219	Recreational Trails Program (Note 2) (Note 6)	DLG PARKS	685,518		658,877
20.218	National Motor Carrier Safety	KSP TC	4,205,628 310,220		160,358
20.232	Commercial Driver License Programs Improvement Grant (Note 15)	TC			
20.238	Commercial Drivers License Information System (CDLIS) Modernization Grant	TC	294,151		
20.240	Fuel Tax Evasion-Intergovernmental Enforcement Effort	KSP TC	103,616 12,375		
20.505	Metropolitan Transportation Planning	TC	504,802		504,802
Federal Transit Cluster:					
20.500	Federal Transit-Capital Investment Grants	TC	1,538,828		1,538,828
20.507	Federal Transit-Formula Grants	TC	1,858,914		1,858,914
20.507	ARRA-Federal Transit-Formula Grants (Note 14)	TC	108,851		108,851
20.509	Formula Grants for Other Than Urbanized Areas	TC	12,684,438		11,971,528
20.509	ARRA-Formula Grants for Other Than Urbanized Areas (Note 14)	TC	489,229		489,229
Transit Services Programs Cluster:					
20.513	Capital Assistance Program for Elderly Persons and Persons with Disabilities	TC	576,670		526,670
20.516	Job Access-Reverse Commute	TC	1,348,862		1,348,862
20.521	New Freedom Program	TC	1,200,838		1,200,838
20.514	Public Transportation Research	TC	159,797		159,797
Highway Safety Cluster:					
20.600	State and Community Highway Safety	TC KSP OAG AOC DCJT	3,563,405 196,131 170,440 90,385		2,080,464
20.601	Alcohol Impaired Driving Countermeasures Incentive Grants I	KSP TC	386,498 106,877		
20.602	Occupant Protection Incentive Grants	TC KSP	109,927 319,910		106,817
20.604	Safety Incentive Grants for Use of Seatbelts (Note 15)	KSP			
20.605	Safety Incentives to Prevent Operation of Motor Vehicles by Intoxicated Persons (Note 15)	TC			
20.609	Safety Belt Performance Grants	TC	299,483		252,856
20.610	State Traffic Safety Information System Improvement Grants	KSP TC	60,600 431,153		401,651
20.612	Incentive Grant Program to Increase Motorcyclist Safety (Note 15)	TC			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Noncash	Provided to Subrecipient
U.S. Department of Transportation (Continued)					
Direct Programs: (Continued)					
20.700	Pipeline Safety Program Base Grants	EEC	246,555		
20.703	Interagency Hazardous Materials Public Sector Training and Planning Grants	MIL	366,388		
20.932	ARRA-Surface Transportation-Discretionary Grants for Capital Investment (Note 14)	TC	7,100,581		
	Total U.S. Department of Transportation		$ 696,517,955	$ 0	$ 54,386,652
	U.S. Department of Treasury				
	Direct Programs:				
21.NA(1)	Internal Revenue Service	KSP	$ 21,029	$	$
21.NA(2)	Equitable Sharing-Asset Forfeiture	KSP	35,776		
	Total U.S. Department of Treasury		$ 56,805	$ 0	$ 0
	U.S. Appalachian Regional Commission				
	Direct Programs:				
23.002	Appalachian Area Development	DLG TAH	$ 692,133	$	$ 692,133
23.011	Appalachian Research, Technical Assistance, and Demonstration Projects	DLG AOC	976,044 21,517		880,250
	Total U.S. Appalachian Regional Commission		$ 1,689,694	$ 0	$ 1,572,383
	U.S. Equal Employment Opportunity Commission				
	Direct Programs:				
30.002	Employment Discrimination-State and Local Fair Employment Practices Agency Contracts	HRC	$ 179,017	$	$
	Total U.S. Equal Employment Opportunity Commission		$ 179,017	$ 0	$ 0
	U.S. General Services Administration				
	Direct Programs:				
39.003	Donation of Federal Surplus Personal Property (Note 11)	FAC	$	$ 489,229	$
39.011	Election Reform Payments (Note 13)	KBE	210,011		
	Total U.S. General Services Administration		$ 210,011	$ 489,229	$ 0
	National Aeronautics and Space Administration				
	Direct Programs:				
43.002	Aeronautics (Note 15)	COT	$	$	$
	Total National Aeronautics and Space Administration		$ 0	$ 0	$ 0
	U.S. National Foundation on the Arts and the Humanities				
	Direct Programs:				
45.024	Promotion of the Arts-Grants to Organizations and Individuals	KHS KAC	$ 6,500	$	$ 6,500
45.025	Promotion of the Arts-Partnership Agreements	KAC KHS	660,260		660,260
45.025	ARRA-Promotion of the Arts-Partnership Agreements (Note 14)(Note 15)	KAC			
45.161	Promotion of the Humanities-Research (Note 15)	HRC			
45.310	Grants to States	DLA	2,117,646		123,813
	Total U.S. National Foundation on the Arts and Humanities		$ 2,784,406	$ 0	$ 790,573
	U.S. Department of Veterans Affairs				
	Direct Programs:				
64.005	Grants to States for Construction of State Home Facilities	VA	$ 3,417,269	$	$
64.015	Veterans State Nursing Home Care	VA	18,165,493		
64.203	State Cemetery Grants	VA	417,705		
	Total U.S. Department of Veterans Affairs		$ 22,000,467	$ 0	$ 0

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Expenditures Noncash	Provided to Subrecipient
U.S. Environmental Protection Agency					
Direct Programs:					
66.001	Air Pollution Control Program Support (Note 4)	EEC	$ 928,374	$	$
66.032	State Indoor Radon Grants	CHFS	491,348		365,115
66.034	Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act (Note 4)(Note 11)	EEC	538,279	141,854	
66.040	State Clean Diesel Grant Program (Note 4)(Note 19)	EEC	71,722		26,286
66.040	ARRA-State Clean Diesel Grant Program (Note 14)	EEC	602,645		516,717
66.418	Construction Grants for Wastewater Treatment Works	EEC	92,850		
66.419	Water Pollution Control State, Interstate, and Tribal Program Support	EEC	585,839		26,980
66.432	State Public Water System Supervision	EEC	151,757		
66.436	Surveys, Studies, Investigations, Demonstrations, and Training Grants and Cooperative Agreements-Section 104(b)(3) of the Clean Water Act (Note 4) (Note 15)	EEC			
66.454	Water Quality Management Planning	EEC	316,505		63,562
66.454	ARRA-Water Quality Management Planning (Note 14)	EEC	156,199		156,160
66.458	Capitalization Grants for Clean Water State Revolving Funds	EEC	289,935		
		PARKS	1,046,866		
66.458	ARRA-Capitalization Grants for Clean Water State Revolving Funds (Note 14)	EEC	197,638		
		KHP	950,000		
66.460	Nonpoint Source Implementation Grants	EEC	4,071,715		3,803,878
66.461	Regional Wetland Program Development Grants	EEC	146,113		46,071
66.463	Water Quality Cooperative Agreements (Note 15)	EEC			
66.467	Wastewater Operator Training Grant Program (Note 15)	EEC			
66.468	Capitalization Grants for Drinking Water State Revolving Funds	EEC	2,863,855		
66.468	ARRA-Capitalization Grants for Drinking Water State Revolving Funds (Note 14)	EEC	391,818		
66.471	State Grants to Reimburse Operators of Small Water Systems for Training and Certification Costs	EEC	114,436		
66.474	Water Protection Grants to the States	EEC	108,267		15,692
66.608					
	Environmental Information Exchange Network Grant Program and Related Assistance	EEC	75,188		
		COT			
66.605	Performance Partnership Grants	AGR	555,747		
		EEC	2,562,442		
66.701	Toxic Substances Compliance Monitoring Cooperative Agreements	EEC	98,026		
66.707	TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	CHFS	254,812		32,385
66.708	Pollution Prevention Grants Program	EEC	70,919		33,373
66.709	Multi-Media Capacity Building Grants for States and Tribes	EEC	247,424		
66.717	Source Reduction Assistance	EEC	18,517		
66.801	Hazardous Waste Management State Program Support	EEC	1,811,210		
66.802	Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	EEC	129,519		
66.804	Underground Storage Tank Prevention, Detection and Compliance Program	EEC	828,968		
66.805	Leaking Underground Storage Tank Trust Fund Corrective Action Program	EEC	1,338,346		
66.805	ARRA-Leaking Underground Storage Tank Trust Fund Corrective Action Program (Note 14)	EEC	1,881,512		
66.809	Superfund State and Indian Tribe Core Program-Cooperative Agreements	EEC	152,857		
66.817	State and Tribal Response Program Grants	EEC	749,479		
66.940	Environmental Policy and State Sustainability Grants	EEC	31,941		
66.951	Environmental Educational Grants (Note 15)	EEC			
Total U.S. Environmental Protection Agency			$ 24,923,068	$ 141,854	$ 5,086,219
U.S. Department of Energy					
Direct Programs:					
81.039	National Energy Information Center	EEC	$ 6,746	$	$
81.041	State Energy Program	EEC	490,269		43,330
81.041	ARRA-State Energy Program (Note 14)	EEC	22,941,097		9,449,965
		FAC	343,419		
		EDU			
		ADB	859,913		
		CED	2,066,169		
		DWI	105,327		
81.042	Weatherization Assistance for Low-Income Persons (Note 15)	FAC			
		CHFS			
81.042	ARRA-Weatherization Assistance for Low-Income Persons (Note 14)(Note 15)	FAC			
81.086	ARRA-Conservation Research and Development (Note 14)	EDU	3,430,554		3,361,104

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
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(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Expenditures Noncash	Provided to Subrecipient
U.S. Department of Energy (Continued)					
Direct Programs (Continued):					
81.104	Office of Environmental Waste Processing (Note 4)	EEC	996,936		205,909
		CHFS	594,274		229,542
81.119	ARRA-State Energy Program Special Projects (Note 14)	EEC	287,122		265,421
81.122	ARRA-Electricity Delivery and Energy Reliability, Research, Development and Analysis (Note 14)	EEC	522,404		
81.127	ARRA-Energy Efficient Appliance Rebate Program (EEARP) (Note 14)	EEC	2,315,222		2,264,509
81.128	ARRA-Energy Efficiency and Conservation Block Grant Program (EECBG) (Note 14)	DLG	1,604,970		1,535,421
		EEC	1,501,368		1,330,500
		PPC	1,029,330		
81.502	Paducah Gaseous Diffusion Plant Environmental Monitoring and Oversight (Note 15)	CHFS			
81.NA(1)	Department of Energy (Note 15)	F&W			
81.NA(2)	Building Energy Codes-Adoption, Training and Compliance	PPC	18,879		
81.NA(2)	ARRA-Building Energy Codes-Adoption, Training and Compliance (Note 14)	EEC	159,906		143,247
	Total U.S. Department of Energy		$ 39,273,905	$ 0	$ 18,828,948
U.S. Department of Education					
Direct Programs:					
Title I, Part A Cluster:					
84.010	Title I Grants to Local Educational Agencies (Note 2)	EDU	$ 205,048,599	$	$ 203,691,986
84.389	ARRA-Title I Grants to Local Education Agencies, Recovery Act (Note 14) (Note 2)	EDU	51,368,703		51,362,780
84.011	Migrant Education-State Grant Program	EDU	7,718,886		7,633,708
84.013	Title I Program for Neglected and Deliquent Children and Youth	JUV	899,089		722,386
		CORR	62,780		
		EDU	8,157		
Special Education Cluster:					
84.027	Special Education-Grants to States (Note 2)	EDU	148,577,968		146,972,106
84.173	Special Education-Preschool Grants (Note 2)	EDU	8,492,954		8,204,750
84.391	ARRA-Special Education Grants to States, Recovery Act (Note 2)(Note 14)	EDU	56,274,030		53,735,589
84.392	ARRA-Special Education-Preschool Grants, Recovery Act (Note 2)(Note 14)	EDU	4,168,129		4,168,129
84.048	Career and Technical Education-Basic Grants to States	DWI	9,576,250		8,446,575
		EDU	7,884,666		7,489,016
		EPSB	156,394		
		CORR	55,073		
Vocational Rehabilitation Services Cluster:					
84.126	Rehabilitation Services-Vocational Rehabilitation Grants to States (Note 2)	DWI	39,675,013		1,217,888
84.390	ARRA-Rehabilitation Services-Vocational Rehabilitation Grants to States, Recovery Act (Note 2)(Note 14)	DWI	6,116,190		79,015
84.128	Rehabilitation Services-Service Projects	DWI	197,705		191,621
84.144	Migrant Education-Coordination Program (Note 15)	EDU			
84.161	Rehabilitation Services-Client Assistance Program	DWI	144,400		
84.169	Independent Living-State Grants	DWI	283,078		208,565
84.177	Rehabilitation Services-Independent Living Services for Older Individuals Who are Blind	DWI	520,008		
84.181	Special Education-Grants for Infants and Families	CHFS	1,659,591		
84.181	ARRA-Special Education-Grants for Infants and Families (Note 14)	CHFS			
84.393	ARRA-Special Education-Grants for Infants and Families,Recovery Act (Note 14)	CHFS	2,489,482		22,551
84.186	Safe and Drug-Free Schools and Communities-State Grants	EDU	1,416,583		1,339,774
		JUST			
		CHFS	468,169		468,169
84.187	Supported Employment Services for Individuals with the Most Significant Disabilities	DWI	186,072		
Education of Homeless Children and Youth Cluster:					
84.196	Education for Homeless Children and Youth	EDU	1,307,710		1,307,710
84.387	ARRA-Education for Homeless Children and Youth, Recovery Act (Note 14)	EDU	469,982		449,115
84.213	Even Start-State Educational Agencies	EDU	1,012,969		990,842
84.215	Fund for the Improvement of Education (Note 10)	KHS	173,539		
		EDU			
84.224	Assistive Technology	DWI	479,688		315,897
84.240	Program of Protection and Advocacy of Individual Rights	PUBAD	246,006		

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COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
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(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Noncash	Provided to Subrecipient
U.S. Department of Education (Continued)					
Direct Programs (Continued):					
84.243	Tech-Prep Education	DWI	1,567,446		119,804
		EDU	292,684		267,429
84.265	Rehabilitation Training-State Vocational Rehabilitation Unit In-Service Traning	DWI	169,414		
84.287	Twenty-First Century Community Learning Centers	EDU	12,164,247		12,097,782
84.298	State Grants for Innovative Programs	EDU	8		
Educational Technology State Grants Cluster:					
84.318	Educational Technology State Grants	EDU	3,282,660		3,149,888
84.386	ARRA-Education Technology State Grants, Recovery Act (Note 14)	EDU	5,474,582		5,229,133
84.323	Special Education-State Personnel Development	EDU	1,207,302		1,179,288
84.326	Special Education-Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	EDU	159,719		159,445
84.330	Advanced Placement Program (Advanced Placement Test Fee; Advanced Placement Incentive Program Grants)	EDU	1,059,459		693,526
84.331	Grants to States for Workplace and Community Transition Training for Incarcerated Individuals	CORR	191,089		
84.336	Teacher Quality Partnership Grants (Note 15)	EPSB			
84.343	Assistive Technology-State Grants for Protection and Advocacy	PUBAD	33,207		
84.350	Transition to Teaching	EDU	166,766		72,174
84.357	Reading First State Grants	EDU	4,202,442		3,918,189
84.358	Rural Education	EDU	5,344,603		5,344,603
84.365	English Language Acquisition Grants	EDU	3,394,183		3,252,261
84.366	Mathematics and Science Partnerships	EDU	3,319,583		3,163,371
84.367	Improving Teacher Quality State Grants (Note 2)	EDU	42,479,177		41,911,891
84.369	Grants for State Assessments and Related Activities	EDU	1,922,767		204,348
84.371	Striving Readers	EDU	962,723		884,554
84.372	Statewide Data Systems	EDU	706,076		
84.410	Education Jobs Fund (Note 2)	EDU	36,715,231		36,704,097
School Improvement Grants Cluster:					
84.377	School Improvement Grants	EDU	3,859,966		3,662,446
84.388	ARRA-School Improvement Grants,Recovery Act (Note 14)	EDU	12,040,264		11,386,836
State Fiscal Stabilization Fund Cluster:					
84.394	ARRA-State Fiscal Stabilization Fund (SFSF) - Education State Grants, Recovery Act (Note 14) (Note 2)	GOV	57,272,683		57,272,683
		EDU	182,486,200		182,486,200
84.397	ARRA-State Fiscal Stabilization Fund (SFSF) - Government Services, Recovery Act (Note 14)(Note 2)	CORR	16,209,900		
		KSP	12,072,687		
		FAC			
84.398	ARRA-Independent Living State Grants, Recovery Act (Note 14)	DWI	143,406		37,564
84.399	ARRA-Independent Living Services for Older Individuals Who Are Blind, Recovery Act (Note 14)	DWI	416,631		
Passed Through From the Powell County Board of Education:					
84.215	Fund for the Improvement of Education Pass Through Grantor - Various (Note 10)(Note 15)	KHS			
Passed Through From the Letcher County Board of Education:					
84.215	Fund for the Improvement of Education Pass Through Grantor - Various (Note 15)	KHS			
Passed Through From the Civic Education Center:					
84.304	Civic Education- We the People and the Cooperative Education Exchange Program Pass Through Grantor - Various	AOC	87,830		
Passed Through From the Center for Civic Education:					
84.929	We the People Pass Through Grantor - Various (Note 15)	AOC			
Total U.S. Department of Education			$ 966,542,798	$ 0	$ 872,215,684

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Noncash	Provided to Subrecipient
U.S. National Archives and Records Administration					
Direct Programs:					
89.003	National Historical Publications and Records Grants	DLA	$ 4,882	$	$
	Total U.S. National Archives and Records Administration		$ 4,882	$ 0	$ 0
U.S. Election Assistance Commission					
Direct Programs:					
90.401	Help America Vote Act Requirements Payments	KBE	$ 1,739,463	$	$ 1,719,608
90.402	Help America Vote Mock Election Program	SOS	41,744		
	Total U.S. Election Assistance Commission		$ 1,781,207	$ 0	$ 1,719,608
U.S. Department of Health and Human Services					
Direct Programs:					
93.003	Public Health and Social Services Emergency Fund (Note 15)	CHFS	$	$	$
93.041	Special Programs for the Aging -Title VII, Chapter 3 -Programs for Prevention of Elder Abuse, Neglect, and Exploitation	CHFS	66,690		66,690
93.042	Special Programs for the Aging -Title VII, Chapter 2 -Long Term Care Ombudsman Services for Older Individuals	CHFS	224,991		141,546
93.043	Special Programs for the Aging -Title III, Part D -Disease Prevention and Health Promotion Services	CHFS	294,385		218,588
Aging Cluster:					
93.044	Special Programs for the Aging -Title III, Part B -Grants for Supportive Services and Senior Centers	CHFS	5,815,049		5,029,303
93.045	Special Programs for the Aging-Title III, Part C -Nutrition Services	CHFS	8,595,984		7,313,828
93.053	Nutrition Services Incentive Program	CHFS	1,222,079		1,222,079
93.705	ARRA-Aging Home-Delivered Nutrition Services for States (Note 14) (Note 15)	CHFS			
93.707	ARRA-Aging Congregate Nutrition Services for States (Note 14) (Note 15)	CHFS			
93.048	Special Programs for the Aging-Title IV and Title II Discretionary Projects	CHFS	224,472		180,163
93.051	Alzheimer's Disease Demonstration Grants to States	CHFS	209,283		205,982
93.052	National Family Caregiver Support, Title III,Part E	CHFS	2,341,247		1,784,763
93.069	Public Health Emergency Preparedness (Note 2)(Note 11)	CHFS	11,896,076	244,801	9,656,652
93.070	Environmental Public Health and Emergency Response	CHFS	367,858		192,466
93.071	Medicare Enrollment Assistance Program	CHFS	268,641		231,959
93.087	Enhance the Safety of Children Affected by Parental Methamphetamine or Other Substance Abuse	CHFS	485,992		270,650
93.089	Emergency System for Advance Registration of Volunteer Health Professionals	CHFS	44,146		
93.092	Affordable Care Act (ACA) Personal Responsibility Education Program	CHFS	10,717		4,004
93.103	Food and Drug Administration_Research	CHFS	1,834		
93.104	Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances (SED)	CHFS	2,010,837		1,575,778
93.110	Maternal and Child Health Federal Consolidated Programs	CHFS	679,799		364,108
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs (Note 11)	CHFS	642,991	97,981	405,388
93.130	Cooperative Agreements to States/Territories for the Coordination and Development of Primary Care Offices	CHFS	114,520		22,784
93.134	Grants to Increase Organ Donations (Note 15)	CHFS			
93.136	Injury Prevention and Control Research and State and Community Based Programs	CHFS	643,638		643,638
93.138	Protection and Advocacy for Individuals with Mental Illness	PUBAD	443,865		
93.150	Projects for Assistance In Transition from Homelessness (PATH)	CHFS	475,000		475,000
93.197	Childhood Lead Poisoning Prevention Projects-State and Local Childhood Lead Poisoning Prevention and Surveillance of Blood Lead Levels in Children	CHFS	502,601		387,981
93.217	Family Planning-Services	CHFS	6,580,359		5,850,276
93.230	Consolidated Knowledge Development and Application (KD&A) Program (Note 15)	CHFS			
93.234	Traumatic Brain Injury State Demonstration Grant Program	CHFS	1		
93.235	Abstinence Education Program	CHFS	407,967		
93.236	Grants for Dental Health Residency Training	CHFS	149,186		113,133
93.242	Mental Health Research Grants (Note 15)	CHFS			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Expenditures Noncash	Provided to Subrecipient
U.S. Department of Health and Human Services (Continued)					
Direct Programs (Continued):					
93.243	Substance Abuse and Mental Health Services-Projects of Regional and National Significance (Note 7)	CHFS	1,023,121		1,007,169
		AOC	1,966,295		
		JUV			
		JUST			
93.251	Universal Newborn Hearing Screening	CHFS	357,720		
93.262	Occupational Safety and Health Program (Note 15)	CHFS			
93.267	State Grants for Protection and Advocacy Services	PUBAD	29,054		
93.270	Adult Viral Hepatitis Prevention and Control	CHFS	111,802		
Immunization Cluster:					
93.268	Immunization Grants (Note 11) (Note 2)	CHFS	3,664,314	42,429,993	1,934,756
93.712	ARRA-Immunization (Note 14) (Note 2)	CHFS	349,791		
93.276	Drug-Free Communities Support Program Grants (Note 15)	KVE			
93.414	ARRA-State Primary Care Offices (Note 14)	CHFS	79,284		
93.283	Centers for Disease Control and Prevention Investigations and Technical Assistance	CHFS	5,834,357		4,527,274
93.296	State Partnership Grant Program to Improve Minority Health	CHFS	29,809		
93.505	Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	CHFS	16,172		1,365
93.507	Strengthening Public Health Infrastructure for Improved Health Outcomes	CHFS	35,260		28,716
93.511	Affordable Care Act (ACA) Grants to States for Health Insurance Premium Review	PPC	275,261		
93.518	Affordable Care Act - Medicare Improvements for Patients and Providers	CHFS	81,774		81,554
93.519	Affordable Care Act (ACA) - Consumer Assistance Program Grants	PPC	191,807		
93.521	The Affordable Care Act: Building Epidemiology, Laboratory, and Health Information Systems Capacity in the Epidemiology and Laboratory Capacity for Infectious Disease (ELC) and Emerging Infections Program (EIP) Cooperative Agreements	CHFS	121,725		
93.525	State Planning and Establishment Grants for the Affordable Care Act (ACA)'s Exchanges	CHFS	261,095		
93.556	Promoting Safe and Stable Families	CHFS	5,458,336		5,125,941
Temporary Assistance for Needy Families Cluster:					
93.558	Temporary Assistance for Needy Families (Note 2)	CHFS	148,806,386		22,266,550
93.714	ARRA-Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program (Note 2)(Note 14)	DWI	23,932,636		23,925,407
		CHFS	13,684,975		6,640,153
93.563	Child Support Enforcement (Note 2)	CHFS	39,779,499		22,198,954
		OAG			
93.563	ARRA-Child Support Enforcement (Note 2)(Note 14)	CHFS	3,135,607		3,127,720
93.564	Child Support Enforcement Research	CHFS	55,782		55,782
93.568	Low-Income Home Energy Assistance (Note 2)	CHFS	67,566,886		67,470,310
Community Services Block Grant Cluster:					
93.569	Community Services Block Grant	CHFS	11,645,572		11,386,256
93.710	ARRA-Community Services Block Grant (Note 14)	CHFS	5,972,820		5,972,820
93.571	Community Services Block Grant Formula and Discretionary Awards Community Food and Nutrition Programs (Note 15)	CHFS			
93.585	Empowerment Zones Program (Note 15)	OC			
Child Care and Development Block Grant Cluster:					
93.575	Child Care and Development Block Grant (Note 2)	CHFS	101,404,905		4,372,274
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund (Note 2)	CHFS	72,240,963		9,990,810
93.713	ARRA-Child Care and Development Block Grant (Note 2) (Note 14)	CHFS	2,637,787		1,746,135
93.586	State Court Improvement Program (Note 7)	AOC	533,394		
93.590	Community-Based Child Abuse Prevention Grants	CHFS	2,476,224		2,280,641
93.597	Grants to States for Access and Visitation Programs	CHFS	123,853		123,840
93.599	Chafee Education and Training Vouchers Program (ETV)	CHFS	693,607		
Head Start Cluster:					
93.600	Head Start	EDU	129,410		
93.708	ARRA-Head Start (Note 14)	DWI	337,651		
93.603	Adoption Incentive Payments	CHFS	974,273		974,273
93.617	Voting Access for Individuals with Disabilities-Grants To States	KBE	101,677		101,677
93.618	Voting Access for Individuals with Disabilities-Grants for Protection and Advocacy Systems	PUBAD	61,305		
93.630	Developmental Disabilities Basic Support and Advocacy Grants	CHFS	1,317,210		460,615
		PUBAD	597,474		
93.643	Children's Justice Grants to States	CHFS	111,897		16,439
		AOC	67,984		
		OAG	48,560		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Noncash	Provided to Subrecipient
U.S. Department of Health and Human Services (Continued)					
Direct Programs (Continued):					
93.645	Stephanie Tubbs Jones Child Welfare Services Program	CHFS	4,249,884		
93.647	Social Services Research and Demonstration (Note 15)	CHFS			
93.652	Adoption Opportunities	CHFS	429,451		428,124
93.658	Foster Care-Title IV-E (Note 2)	CHFS	38,453,376		2,811,039
		JUV	1,496,101		
		AOC	276,237		
93.658	ARRA-Foster Care-Title IV-E (Note 2)(Note 14)	CHFS	1,273,379		
93.659	Adoption Assistance (Note 2)	CHFS	44,924,118		
93.659	ARRA-Adoption Assistance (Note 2)(Note 14)	CHFS	2,357,061		
93.667	Social Services Block Grant	CHFS	15,541,564		48,879
		JUV	9,424,108		
		FAC			
93.667	ARRA-Social Services Block Grant (Note 14)(Note 15)	CHFS			
93.669	Child Abuse and Neglect State Grants	CHFS	359,042		267,724
93.671	Family Violence Prevention and Services/Grants for Battered Women's Shelters Grants to State and Indian Tribes	CHFS	1,457,591		1,453,721
93.674	Chafee Foster Care Independence Program	CHFS	1,940,442		1,125,125
93.717	ARRA-Preventing Healthcare-Associated Infections (Note 14)	CHFS	118,868		112,916
93.719	ARRA- State Grants to Promote Health Information Technology (Note 14)	CHFS	1,197,306		
93.720	ARRA-Survey and Certification Ambulatory Surgical Center Healthcare-Associated Infection (ASC-HAI) Prevention Initiative (Note 14)	CHFS	13,051		
93.725	ARRA-Communities Putting Prevention to Work:Chronic Disease Self-Management Program (Note 14)	CHFS	178,763		134,015
93.723	ARRA-Prevention and Wellness-State, Territories and Pacific Islands(Note 14)	CHFS	786,011		484,061
93.767	Children's Health Insurance Program (Note 2)	CHFS	133,297,464		102,820
Medicaid Cluster:					
93.775	State Medicaid Fraud Control Units (Note 2)	OAG	2,058,889		
93.777	State Survey and Certification of Health Care Providers and Suppliers (Note 2)	CHFS	7,409,292		
93.778	Medical Assistance Program (Note 2)	CHFS	4,181,254,673		2,185,386
93.778	ARRA-Medical Assistance Program (Note 2)(Note 14)	CHFS	437,211,319		
93.779	Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	CHFS	9,680,207		1,097,192
93.780	Grants to States for Operation of Qualified High-Risk Pools	PPC	1,669,302		623,700
93.793	Medicaid Transformation Grants	CHFS	4,169,834		
93.889	National Bioterrorism Hospital Preparedness Program	CHFS	5,093,357		4,564,434
		MIL	160,410		
93.917	HIV Care Formula Grants	CHFS	11,259,137		3,569,756
93.938	Cooperative Agreements to Support Comprehensive School Health	EDU	498,571		68,365
	Programs to Prevent the Spread of HIV and Other Important Health Problems	CHFS	79,066		9,335
93.940	HIV Prevention Activities Health Department Based	CHFS	2,071,896		1,458,189
93.941	HIV Demonstration, Research, Public and Professional Education Projects	CHFS	287,198		84,249
93.944	Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance (Note 15)	CHFS			
93.945	Assistance Programs for Chronic Disease Prevention and Control (Note 15)	CHFS			
93.958	Block Grants for Community Mental Health Services	CHFS	5,210,042		4,848,920
		DWI	75,000		
		CORR	48,875		
93.959	Block Grants for Prevention and Treatment of Substance Abuse	CHFS	21,421,969		20,951,765
		KSP	33,903		
		JUST			
93.975	National All Schedules Prescription Electronic Reporting Grant	CHFS	48,370		
93.977	Preventive Health Services Sexually Transmitted Diseases Control Grants (Note 11)	CHFS	830,452	258,952	173,700
93.988	Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems (Note 15)	CHFS			
93.991	Preventive Health and Health Services Block Grant	CHFS	1,082,517		667,472
93.994	Maternal and Child Health Services Block Grant to the States	CHFS	7,699,199		7,100,304
93.NA(1)	Other Federal Assistance	CHFS	263,384		
Total U.S. Department of Health and Human Services			$ 5,520,436,201	$ 43,031,727	$ 286,545,381

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Expenditures Noncash	Provided to Subrecipient
U.S. Corporation for National and Community Service					
Direct Programs:					
94.003	State Commissions	CHFS	$ 212,100	$	$
94.004	Learn and Serve America School and Community Based Programs	EDU	288,065		286,000
94.006	AmeriCorps	CHFS	4,517,549		4,303,789
		CORR	7,245		
94.006	ARRA-AmeriCorps (Note 14)	CHFS	61,684		61,684
94.007	Program Development and Innovation Grants	CHFS	62,116		
94.009	Training and Technical Assistance	CHFS	100,014		
Foster Grandparents/Senior Companion Cluster:					
94.011	Foster Grandparent Program	CHFS	580,175		60,583
94.NA(1)	Clinical Laboratory Improvement Act (Note 15)	CHFS			
	Total U.S. Corporation for National and Community Service		$ 5,828,948	$ 0	$ 4,712,056
U.S. Office of National Drug Control Policy					
Direct Program:					
95.001	High Intensity Drug Trafficking Areas Program	KSP	$ 1,042,543	$	$
	Total U.S. Office of National Drug Control Policy		$ 1,042,543	$ 0	$ 0
U.S. Social Security Administration					
Direct Programs:					
Disability Insurance/Supplemental Security Income Cluster:					
96.001	Social Security-Disability Insurance (Note 2)	CHFS	$ 46,995,771	$	$
96.009	Social Security State Grants for Work Incentives Assistance to Disabled Beneficiaries	PUBAD	95,524		
	Total U.S. Social Security Administration		$ 47,091,295	$ 0	$ 0
U. S. Department of Homeland Security					
Direct Programs:					
Homeland Security Cluster:					
97.004	Homeland Security Grant Program (Note 15)	KOHS	$	$	$
		DCJT			
		MIL			
		KSP			
		EPPC			
97.067	Homeland Security Grant Program (Note 15)	KOHS	11,524,131		10,511,369
		DCJT			
		TC			
		F&W			
		KSP	33,514		
		MIL			
		KVE			
		COT			
		AGR			
		JUST			
		EPPC			
97.001	Pilot Demonstration or Earmarked Projects (Note 15)	KOHS			
97.012	Boating Safety Financial Assistance	F&W	1,914,408		
97.017	Pre-Disaster Mitigation (PDM) Competitve Grants	MIL	251,198		219,428
97.023	Community Assistance Program State Support Services Element (CAP-SSSE) (Note 4)	EEC	188,156		13,598
97.029	Flood Mitigation Assistance	MIL	195,204		195,204
		TC			
97.032	Crisis Counseling	MIL	49,630		47,238
97.036	Disaster Grants-Public Assistance (Presidentially Declared Disasters) (Note 2)	MIL	38,918,641		32,971,179
		TC	2,948,903		
		PARKS			
		KSP	415,752		
97.039	Hazardous Mitigation Grant	MIL	2,785,432		2,539,220
97.040	Chemical Stockpile Emergency Preparedness Program	MIL	12,408,086		10,917,494
		CHFS			
97.041	National Dam Safety Program	EEC	187,133		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures Cash	Noncash	Provided to Subrecipient
U.S. Department of Homeland Security (Continued)					
Direct Programs (Continued):					
97.042	Emergency Management Performance Grants	MIL	4,327,247		2,512,583
		KOHS			
97.045	Cooperating Technical Partners	EEC	3,590,129		
97.047	Pre Disaster Mitigation	MIL	1,185,935		896,098
97.052	Emergency Operations Center	KOHS	7,797		
97.055	Interoperable Emergency Communications	KOHS	580,727		566,969
97.056	Port Security Grant Program	F&W	39,691		
		KSP	37,456		
97.070	Map Modernization Management Support (Note 15)	EEC			
97.076	National Center for Missing and Exploited Children (NCMEC) (Note 15)	KSP			
97.077	Homeland Security Research Testing, Evaluation, and Demonstration of Technologies Related to Nuclear Detection (Note 15)	TC			
97.078	Buffer Zone Protection Program (BZPP)	KOHS	143,777		101,171
		F&W			
		KSP	129,088		
		TC	23,484		
97.082	Earthquake Consortium	MIL	61,240		
97.089	Driver's License Security Grant Program	TC	1,503,605		
97.116	ARRA-Port Security Grant Program (Note 14)	KSP	29,690		
Total U.S. Department of Homeland Security			$ 83,480,054	$ 0	$ 61,491,551
Other Federal Assistance					
Direct Programs:					
NA(1)	Tennessee Vally Authority	F&W	$ 8,523	$	$
NA(2)	State Justice Institute	AOC	50,000		
Total Other Federal Assistance			$ 58,523	$ 0	$ 0
Total All State Agencies			$ 9,721,694,344	$ 1,326,865,002	$ 1,754,286,361

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011

Note 1 - <u>Purpose of the Schedule and Significant Accounting Policies</u>

<u>**Basis of Presentation**</u> - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance.* The accompanying schedule includes all federal grant activity for the Commonwealth, except those programs administered by state universities and other discretely presented component units, and is presented primarily on the basis of cash disbursements as modified by the application of Kentucky Revised Statute (KRS) 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. The Commonwealth elected to exclude state universities and other discretely presented component units from the statewide single audit, except as part of the audit of the basic financial statements.

KRS 45.229 provides that the Finance and Administration Cabinet may, "for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose." However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

The basic financial statements of the Commonwealth are presented on the modified accrual basis of accounting for the governmental fund financial statements and the accrual basis of accounting for the government-wide, proprietary fund, and fiduciary fund financial statements. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

Noncash assistance programs are not reported in the basic financial statements of the Commonwealth for FY 2011. The noncash expenditures presented on this schedule represent the noncash assistance expended using the method or basis of valuation described in Note 11.

Clusters of programs are indicated in the schedule by light gray shading.

Programs that do not have CFDA numbers are identified using the two-digit federal identifier prefix, and the letters "NA" to denote that no specific number is applicable. Each program is numbered in parentheses, following the NA for each federal grantor.

The state agencies' schedule is presented on the cash, modified cash, or accrual basis of accounting.

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

Note 1 - Purpose of the Schedule and Significant Accounting Policies (Continued)

Inter-Agency Activity - Certain transactions relating to federal financial assistance may appear in the records of more than one (1) state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of the schedule:

(a) Federal funds may be received by a state agency and passed through to another state agency where the moneys are expended. Except for pass-throughs to state universities and discretely presented component units as discussed below, this inter-agency transfer activity is reported by the agency expending the moneys.

State agencies that pass federal funds to state universities and discretely presented component units report those amounts as expenditures.

(b) Federal funds received by a state agency and used to purchase goods or services from another state agency are reported in the schedule as an expenditure by the purchasing agency only.

Note 2 - Type A Programs

Type A programs for the Commonwealth is any program for which total expenditures of federal awards exceeded $30 million for FY 2011. The Commonwealth had the following programs (cash and noncash) that met the Type A program definition for FY 2011, some of which were administered by more than one state agency. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds. The Commonwealth identified clusters among the Type A programs by gray shading. Programs with both ARRA and non-ARRA funding sharing the same CFDA number and not included as part of a cluster are presented as a combined amount, in this note and denoted with an asterisk (*). These Type A programs and clusters were:

CFDA	Program Title	Expenditures
Supplemental Nutrition Assistance Program Cluster:		
10.551	Supplemental Nutrition Assistance Program	$ 1,246,973,544
10.561	State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	48,178,722
10.561	ARRA-State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	423,726
Child Nutrition Cluster:		
10.553	School Breakfast Program	57,678,863
10.555	National School Lunch Program	181,963,525
10.556	Special Milk Program for Children	61,450
10.559	Summer Food Service Program for Children	6,798,709
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children	127,919,101

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

Note 2 - <u>Type A Programs (Continued)</u>

CFDA	Program Title	Expenditures
10.558	Child and Adult Care Food Program	32,602,754
Community Development Block Grant-State-Administered Small Cities Program Cluster:		
14.228	Community Development Block Grants/States Programs and Non-Entitlement Grants in Hawaii	45,804,618
14.255	ARRA-Community Development Block Grants/States Programs and Non-Entitlement Grants in Hawaii	3,828,089
17.225	Unemployment Insurance	650,667,685
17.225	ARRA-Unemployment Insurance	921,091,077
Workforce Investment Act Cluster:		
17.258	WIA Adult Program	15,569,164
17.258	ARRA-WIA Adult Program	1,876,845
17.259	WIA Youth Activities	12,599,481
17.259	ARRA-WIA Youth Activities	2,753,523
17.260	WIA Dislocated Workers	10,747,650
17.260	ARRA-WIA Dislocated Workers	7,316,033
Highway Planning and Construction Cluster:		
20.205	Highway Planning and Construction	503,730,838
20.205	ARRA-Highway Planning and Construction	153,173,657
20.219	Recreational Trails Program	685,518
Title I, Part A Cluster:		
84.010	Title I Grants to Local Educational Agencies	205,048,599
84.389	ARRA-Title I ARRA Grants to Local Education Agencies, Recovery Act	51,368,703
Special Education Cluster:		
84.027	Special Education - Grants to States	148,577,968
84.173	Special Education - Preschool Grants	8,492,954
84.391	ARRA-Special Education - Grants to States	56,274,030
84.392	ARRA-Special Education - Preschool Grants	4,168,129
Vocational Rehabilitation Services Cluster:		
84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States	39,675,013
84.390	ARRA-Rehabilitation Services - Vocational Rehabilitation Grants to States, Recovery Act	6,116,190

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

Note 2 - <u>Type A Programs (Continued)</u>

CFDA	Program Title	Expenditures
84.367	Improving Teacher Quality State Grants	42,479,177
State Fiscal Stabilization Fund Cluster:		
84.394	ARRA-State Fiscal Stabilization Fund (SFSF)- Education State Grants, Recovery Act	239,758,883
84.397	ARRA-State Fiscal Stabilization Fund (SFSF)- Government Services, Recovery Act	28,282,587
84.410	Education Jobs Fund	36,715,231
Immunization Cluster:		
93.268	Immunization Grants	46,094,307
93.712	ARRA-Immunization	349,791
Temporary Assistance for Needy Families Cluster:		
93.558	Temporary Assistance for Needy Families	148,806,386
93.714	ARRA-Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program	37,617,611
93.563*	Child Support Enforcement	42,915,106
93.568	Low-Income Home Energy Assistance	67,566,886
Child Care Cluster:		
93.575	Child Care and Development Block Grant	101,404,905
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund	72,240,963
93.713	ARRA- Child Care and Development Block Grant	2,637,787
93.658*	Foster Care-Title IV-E	41,499,093
93.659*	Adoption Assistance	47,281,179
93.767	Children's Health Insurance Program	133,297,464

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

Note 2 - Type A Programs (Continued)

CFDA	Program Title	Expenditures
Medicaid Cluster:		
93.775	State Medicaid Fraud Control Units	2,058,889
93.777	State Survey and Certification of Health Care Providers and Suppliers	7,409,292
93.778	Medical Assistance Program	4,181,254,673
93.778	ARRA-Medical Assistance Program	437,211,319
Disability Insurance/Supplemental Security Income Cluster:		
96.001	Social Security - Disability Insurance	46,995,771
97.036	Disaster Grants-Public Assistance (Presidentially Declared Disasters)	42,283,296
	Total Type A Programs	**$ 10,358,326,754**

Note 3 - Rural Rehabilitation Student Loan Program (CFDA 10.NA (1))

The Kentucky Rural Rehabilitation Student Loan Program was initially awarded $672,629 in 1970 by the U. S. Farmers Home Administration. Since 1970, the program has operated on interest from student loans outstanding and on income from investments administered by the Office of Financial Management. The Department of Agriculture is no longer in the business of making student loans and reassigned all loans in payment compliance to the Kentucky Higher Education Assistance Authority (KHEAA). The Department of Agriculture retained only those loans that had a delinquent payment history. This program is currently in phase-out status, with authorization from the U. S. Department of Agriculture (USDA) to eliminate the principal through issuance of specific grants and scholarships. Most outstanding loans have been classified as contingent uncollectible liabilities; however, if loan payments are received, they are directly deposited into the principal account. The total amount of money in the investment account as of June 30, 2011 was $1. Student loans and investment earned interest of $1,698. Outstanding student loans totaled $64,466. There were no new grants or scholarships authorized by the USDA in FY 11.

Note 4 - Unemployment Insurance (CFDA 17.225)

The Commonwealth paid out $1,534,288,217 in benefits in FY 2011. The amounts shown on the accompanying schedule reflect both the amount expended for benefits from the Trust Fund and an additional $37,470,545 of federal funds expended for administration of the program, resulting in a combined total of $1,571,758,762 in federal expenditures. Included in this amount is $916,381,959 in benefit payments funded by the American Recovery and Reinvestment Act (ARRA).

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

Note 5 - Highway Planning and Construction (CFDA 20.205)

The information reported for CFDA 20.205 Highway Planning and Construction program represents the activity of all open projects during FY 2011. These projects were funded from several apportionments. Apportionments refer to a federal, statutorily prescribed division or assignment of funds. The expenditures reflected on the schedule include expenditures for advance construction projects, which are not yet under agreements with the Federal Highway Administration.

Program Income - The Highway Planning and Construction Program earned program income of $12,642,530 in FY 2011. This income is comprised of program income (interest) attributable to the Garvee Bonds.

Refunds - Expenditures for the Highway Planning and Construction Program were shown net of any refunds, resulting from a reimbursement of prior or current year expenditures. Refunds totaled $1,537,708 for FY 2011.

Note 6 - Outdoor Recreation - Acquisition, Development and Planning (CFDA 15.916) and Recreational Trails Program (CFDA 20.219)

Administrative costs are shown as expended when received from the federal government. These costs are recovered through a negotiated, fixed indirect cost rate. Any over or under recovery will be recouped in the future.

Note 7 - Research and Development Expenditures

OMB Circular A-133 Section 105 states, "Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-federal entity."

The expenditures presented in the SEFA include R&D expenditures. The R&D portion of the expenditures for each program is listed below.

CFDA	Program Title	State Agency	Expenditures
10.025	Plant and Animal Disease, Pest Control, and Animal Care	F&W	$ 65,899
15.605	Sport Fish Restoration	F&W	395,422
15.615	Cooperative Endangered Species Conservation Fund	F&W	124,013
15.634	State Wildlife Grants	F&W	845,800
16.745	Criminal and Juvenile Justice and Mental Health Collaboration Program	AOC	35,219
93.243	Substance Abuse and Mental Health Services-Projects of Regional and National Significance	AOC	376,675
93.586	State Court Improvement Program	AOC	49,122
	Total Research and Development Expenditures		**$ 1,892,150**

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

Note 8 - <u>Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii (CFDA 14.228)</u>

The Commonwealth matches the federal portion of administration dollar for dollar. Cash expenditures include the federal portion of administration.

Note 9 - <u>Wildlife Restoration (CFDA 15.611)</u>

The Department of Fish and Wildlife Resources leases properties from the U.S. Army Corp of Engineers for Condition Three and Condition Five Projects. These projects stipulate that the properties leased be managed for wildlife purposes and may produce income. The leases for wildlife management rights on these properties are non-monetary. The Department of Fish and Wildlife Resources currently leases the following properties:

- Barren River
- Green River
- Dewey Lake
- Fishtrap Lake
- Barlow Bottoms-Olmstead

- Birdsville Island
- Lake Cumberland
- Paintsville Lake
- Sloughs-Grassy Pond

Any expenditure in excess of revenue from each property listed above will be eligible for reimbursement under the Wildlife Restoration (CFDA 15.611) grant from the U.S. Department of the Interior. The properties listed above are not reimbursed with federal funds if the grant has already been expended to manage other wildlife properties.

Note 10 - <u>Pass Through Programs</u>

OMB Circular A-133 Section 105 defines a recipient as "a non-Federal entity that expends Federal awards received directly from a Federal awarding agency to carry out a Federal program" and a pass-through entity as "a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program."

Federal program funds can be received directly from the federal government or passed through from another entity. Below is a list of all federal programs that are either (1) passed through, or (2) both direct and passed through.

Received From	Direct/Pass Through (Grantor)	State Agency	Amount
<u>Fund for the Improvement of Education (CFDA 84.215)</u>			
Powell County Board of Education	Pass Through (Various)	KHS	$ 152,114
	Total Fund for the Improvement of Education		$ 152,114

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

Note 11 - <u>Noncash Expenditure Programs</u>

The Commonwealth's noncash programs and a description of the method/basis of valuation follows:

CFDA	Program Title	Amount	Method/Basis of Valuation
10.551	Supplemental Nutrition Assistance Program	$ 1,246,973,544	EBT Issuance.
10.555	National School Lunch Program	22,080,669	Commodities issued for FY 2011 per ECOS report.
10.565	Commodity Supplemental Food Program	4,122,796	Quantity issued to recipients valued using April 2011 Commodity File.
10.569	Emergency Food Assistance Program (Food Commodities)	9,584,117	Quantity issued to recipients valued using FY 2011 ECOS Report.
10.664	Cooperative Forestry Assistance	125,072	Acquisition Cost as indicated by Government Services Administration (GSA).
12.700	Donations/Loans of Obsolete DOD Property	315,994	Depreciated value.
39.003	Donation of Federal Surplus Personal Property	489,229	23.68% of federal acquisition cost ($2,066,002).
66.034	Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act	141,854	EPA contracts with Research Triangle Institute for sample analysis.
93.069	Public Health Emergency Preparedness	244,801	Grant Award Document.

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

Note 11 - Noncash Expenditure Programs (Continued)

CFDA	Program Title	Amount	Method/Basis of Valuation
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	97,981	Grant Award Document.
93.268	Immunization Grants	42,429,993	CDC Report.
93.977	Preventive Health Services-Sexually Transmitted Diseases Control Grants	258,952	Grant Award Document.
	Total Noncash Expenditures	**$ 1,326,865,002**	

Note 12 - Activity Occurring in Programs with Inventoriable Items

The Department of Agriculture operates a statewide Commodity Supplemental Food Program (CFDA 10.565). The dollar value of the inventory, based on the June 2011 USDA Commodity File is as follows:

Commodity Supplemental Food Program CFDA 10.565

Beginning Inventory, July 1, 2010	$	1,473760
Price Adjustments		(64,503)
Adjusted Inventory, July 1, 2010		1,409,257
Received Commodities		4,128,401
Issued to Recipients		(4,122,796)
Net Value of Inventory Adjustments, June 30, 2011		(255,398)
Ending Inventory, June 30, 2011	$	**1,159,464**

Note 13 - Election Reform Payments (CFDA 39.011)

Interest earned must be used for additional program expenditures.

Note 14 - Pertaining to ARRA Designation

In order to identify ARRA funds on the Schedule of Expenditures of Federal Awards, the ARRA- prefix will precede the Program Title on the Grantor Schedule.

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011
(CONTINUED)

Note 15 - <u>Zero Expenditure Programs</u>

These programs had no expenditures related to the respective state agency during FY 11. The zero expenditure programs included programs with no activity during the year, such as old programs not officially closed out or new programs issued late in the fiscal year. They also included programs with activity other than expenditures. For CFDA numbers with multiple state agencies listed, the schedule is presented in descending expenditure amount order.

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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***

ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

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

Honorable Steven L. Beshear, Governor
Cabinet Secretaries and Agency Heads
Members of the Commonwealth of Kentucky Legislature

We have audited the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the Commonwealth of Kentucky as of and for the year ended June 30, 2011, and have issued our report thereon dated December 16, 2011. 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.

Internal Control Over Financial Reporting

Management of the Commonwealth is responsible for establishing and maintaining effective internal control over financial reporting**.** In planning and performing our audit, we considered the Commonwealth's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commonwealth's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commonwealth'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 financial statement findings we identified certain deficiencies in internal control over financial reporting that we consider to be material weakness and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of financial statement findings to be a material weaknesses, which are identified as findings 11-FAC-01, 11-PC-02, 11-PC-03, 11-PC-04, 11-PC-05, 11-PC-06, 11-PC-07, and 11-PC-08.

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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
(Continued)

A *significant deficiency* is a deficiency or a 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 financial statement findings to be significant deficiencies, which are identified as findings; 11-CHFS-09, 11-DMA-10, 11-DOC-11, 11-DOC-12, 11-DWI-13, 11-DWI-14, 11-DWI-15, 11-DWI-16, 11-DWI-17, 11-FAC-18, 11-FAC-19, 11-FAC-20, 11-FAC-21, 11-FAC-22, 11-KDE-23, 11-KDE-24, 11-KDE-25, 11-KDE-26, 11-KDE-27, 11-KDE-28, 11-KDE-29, 11-KDE-30,11-KEHP-31, 11-KEHP-32, 11-KEHP-33, 11-KEHP-34, 11-KEHP-35, 11-KHP-36, 11-KHP-37, 11-KHP-38, 11-KHP-39, 11-KSP-40, 11-KST-41, 11-KST-42, 11-KST-43, 11-KST-44, 11-KST-45, 11-KST-46, 11-KST-47, 11-PARKS-48, 11-PARKS-49, 11-PARKS-50, 11-PARKS-51, 11-PARKS-52, 11-PC-53, 11-PC-54, 11-PC-55, 11-PC-56, 11-PC-57, 11-PC-58, 11-REV-59, 11-TC-60, 11-TC-61 and 11-TC-62.

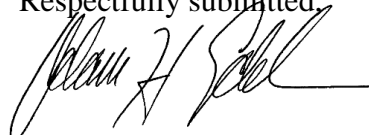Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commonwealth's financial statement for the year ended June 30, 2011, is 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.*

Management's response to the findings identified in our audit is described in the accompanying comments and recommendations. We did not audit management's response and, accordingly, we express no opinion on it.

We noted certain matters that we reported to management in separate letters.

This report is intended solely for the information and use of management, of the Commonwealth of Kentucky, others within the entity, and the General Assembly and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

Adam H. Edelen
Auditor of Public Accounts

December 16, 2011

FINANCIAL STATEMENT FINDINGS

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-FAC-01**</u>**: The Finance And Administration Cabinet Should Work With The KHRIS Production Team To Implement Reconciliation Procedures For The 13XX Fund Within eMARS**

Historically, when payroll was processed through the Unified Payroll/Personnel System (UPPS), FAC performed a reconciliation of payroll data from UPPS to the Payroll Clearing Account (13XX) within the enhanced Management Accounting and Reporting System (eMARS). While UPPS was functional, FAC would reconcile the clearing account within a few days of the payroll run. Effective April 1, 2011, the Kentucky Human Resource Information System (KHRIS) was implemented and replaced the UPPS. Review of the reconciliation process for FY11 revealed FAC did not reconcile the 13XX fund within eMARS for the three months of payroll data processed by KHRIS.

KHRIS supplies data in real-time; therefore, in order to perform a reconciliation, the system would have to be "locked" for use by all allowable users in order for a complete reconciliation to be completed. KHRIS is a "live" system and allows changes to personnel and payroll data at any time; these changes can affect current or historic data. Because it is a live system, KHRIS has a process where it self-corrects previous processing ("Retro calculations").

KHRIS has not been designed, implemented, and maintained in a manner which allows for the reconciliation of the 13XX fund within eMARS. As a result, the 13XX fund has not been reconciled since the implementation of KHRIS to ensure the integrity of the financial data contained in eMARS.

If the integrity of the data is compromised, the financial reporting that comes from the corresponding data is susceptible to error. This increases the risk that a misstatement in the Commonwealth's financial statements could be present and go undetected and uncorrected.

Good internal controls dictate the Payroll Clearing Account (13XX) be reconciled after each payroll run.

Recommendation

We recommend FAC management work closely with the KHRIS Production Team at the Personnel Cabinet to develop and implement the reconciliation procedures for the 13XX fund within eMARS to be completed after each payroll run. Variances identified as part of these reconciliation procedures should be investigated and any required adjustments resulting from this process should be thoroughly documented. Supporting documentation of the reconciliation procedures should be maintained for auditing purposes.

Further, once the reconciliation procedures are developed, FAC should perform reconciliations of the 13XX fund to determine whether variances occurred prior to the implementation of the reconciliation process. Any variance should be specifically reviewed and adjustments, as necessary, should be made. Documentation of these reconciliations should be maintained for auditor review.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-FAC-01</u>: **The Finance And Administration Cabinet Should Work With The KHRIS Production Team To Implement Reconciliation Procedures For The 13XX Fund Within eMARS (Continued)**

<u>Management's Response and Corrective Action Plan</u>

Prior to KHRIS implementation there was sufficient time between regular payrolls and supplemental payrolls for agencies to correct and finalize all rejected CA documents. This allowed the Controller's Office sufficient time to balance the 13XX fund to zero before the next payroll cycle began. Since KHRIS the number of regular payrolls and off-cycle payrolls has not allowed for sufficient time between each payroll to balance the 13XX fund.

There were discrepancies between the amounts on the CA documents and the amounts on the disbursements from April – July due to various issues within KHRIS. The KHRIS team corrected the majority of these issues and the Controller's Office is now in a position to begin the reconciliation process. The reconciliation process cannot be standardized for the months prior to January 2012. However, documentation of this reconciliation will be available upon completion.

The process for reconciliation going forward will involve a two tier balancing of the disbursement file to the CA files on the front end as opposed to on the back end as was the procedure prior to KHRIS and balancing the final CA documents back to the original CA documents for the 13XX after all documents are finalized by the agencies.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-02: The Personnel Cabinet Should Ensure Agencies Are Adequately Informed And Training Is Updated As Changes Are Made To The KHRIS System

As of April 1, 2011, state agencies and other entities with an administrative connection to the Commonwealth began processing payroll and benefits through the Kentucky Human Resource Information System (KHRIS) administered by the Personnel Cabinet. The primary objective of KHRIS was to replace the Commonwealth's legacy personnel, payroll and benefits administration systems. Some of these systems were approximately thirty (30) years old.

KHRIS has extensive on-line policies and procedures to help state agencies record and process transactions. However, individual state agency staff is ultimately responsible for understanding and complying with compensation plan terms and other pertinent legal provisions. As with any new system, there is a large learning curve associated with adapting to the new system. Although the Personnel Cabinet provided training to agencies, the initial Time and Payroll portion of the training provided to agency personnel prior to the implementation of KHRIS, has since been updated and will continue to be updated due to continuous revisions being made to KHRIS.

We noted the following concerns regarding the implementation of KHRIS:

- Training: The agencies that were interviewed indicated the training was at a high level, not agency specific, and did not address complex issues on an agency wide basis. The training was geared toward a single employee environment versus an agency wide environment. In addition, as noted above, since the initial training was held, numerous updates have been made to the system and agency personnel have not attended updated training.
- Data Entry Errors: Data entry errors in creating individual employee profiles have impacted pay and leave balances. For example, if an employee profile is not properly created to reflect that an employee is entitled to overtime pay, the employee will not be paid overtime but instead will be credited with compensatory time. In addition, if the employee has not been properly assigned to a Work Tax Area, if applicable, local taxes are not withheld from the employee's pay. Although these are errors made at the agency level, agency personnel did not feel prepared and did not fully understand the impact these types of data entry errors would have on payroll.
- Time Entry/Approval: KHRIS incorporates standardized time-keeping functionality. Timekeeping was previously conducted independently by agencies using many different software products. Under KHRIS, an agency establishes Time Administrators and/or Time Keepers who are responsible for entering time worked, including overtime and supplemental time, for all employees. If the time worked is not entered into the system and approved by the payroll cutoff date, an employee will not be paid correctly. Timeliness of time entry/approval has contributed to some extent to discrepancies in an employee's pay.
- Reporting: Payroll issues have been exacerbated by the reporting function in KHRIS. An integral component of KHRIS is not functioning in an effective and efficient manner. While the Division of Employment Management relies on various "reports" to assist agencies in their validation of the transactions processed in KHRIS, significant problems exist with the content, utilization, and the follow-up on these "reports". The complexity of running the reports in KHRIS generates a hardship for the agency personnel responsible for verifying the correctness

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-PC-02**</u>**: The Personnel Cabinet Should Ensure Agencies Are Adequately Informed And Training Is Updated As Changes Are Made To The KHRIS System (Continued)**

and completeness of the time and pay entered into KHRIS. We determined that agencies did not always have a working knowledge on how to run agency-wide reports in KHRIS.

- Prior to the implementation of KHRIS, the Division of Employee Management was responsible for the preparation and maintenance of all employee personnel and payroll records. With the implementation of KHRIS, the responsibility for these functions was assigned to the agency level. The Division of Employee Management's criteria for delegating personnel duties were not well defined and communicated to the agencies. Therefore, although agencies have been required to implement new internal controls related to KHRIS, there appears to be a general lack of understanding of the full extent of the responsibilities now required of agencies. Also, in some cases, agencies were not prepared to take on additional verification and reconciliation responsibilities due to the lack of standardized procedures and due to reporting inadequacies in KHRIS.

It appears that KHRIS training focused heavily on system functionality, but did not fully assist agencies in transitioning to new roles and responsibilities as a result of the system change. Furthermore, although the Personnel Cabinet provided newsletter updates of KHRIS procedural changes that type of communication was not effective when there were numerous changes being implemented. Without mandatory updated training, the risk increases for Time Keepers, Time Administrators, Time Management HRG, etc., to incorrectly enter data into KHRIS and not be aware that the data entered is incorrect due to inability to run reports in KHRIS.

As a result, payroll and personnel is more susceptible to erroneous and fraudulent transactions processed through KHRIS. Several instances of errors and improper payments were noted during the transition period. Although the Personnel Cabinet and others have worked diligently to correct issues as they are known, agencies continued to struggle well after the end of the fiscal year with error correction and efficient, effective methodologies for detecting them.

Good internal controls dictates Division of Employee Management should ensure that agencies have the knowledge and skills to ensure data used in payroll calculations are accurate.

<u>**Recommendation**</u>

We recommend the following:

- The Division of Employee Management ensures that Time Keepers, Time Administrators, Time Management HRG, etc., have the requisite knowledge, skills, and abilities to accurately perform their assigned duties. Since KHRIS is being continuously updated, these individuals should be required to attend updated training on a continual basis so that they are aware of the changes being made to the system and how these changes affect their job duties.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-PC-02</u>: **The Personnel Cabinet Should Ensure Agencies Are Adequately Informed And Training Is Updated As Changes Are Made To The KHRIS System (Continued)**

<u>Recommendation (Continued)</u>

- System controls should be implemented to ensure that correct version of payroll data files are used (e.g. correct pay rates, tax deductions tables, etc.).
- The Division of Employee Management provide agencies with a more agency-specific training tailored to developing agency level internal controls and processes to improve the detection and correction of errors. A key point to remember is the KHRIS system is complex. Each agency has unique business needs and resolution requires effort from everyone involved.

<u>Management's Response and Corrective Action Plan</u>

The Personnel Cabinet is appreciative of the efforts by the State Auditor of Public Accounts to assist with improvements in agency level training and reporting resources to ensure data used in payroll calculations are accurate. As additional training needs are addressed, the KHRIS team will update training materials and make available to agency staff so they are aware of the changes being made to the system and how these changes affect their job duties.

There is an ongoing effort to identify training needs as well as enhance available resources for agency specific training. This effort will continue as standardized job functionality is incorporated. Further, the Personnel Cabinet has an electronic report manual available to all agencies online. The link to this electronic manual is available to all agencies online at http://personnel.ky.gov/persadmin/hradministrators/khrisreports.htm. This manual list all reports available in KHRIS, by function module, report description and instructions to run each report.

Additionally, Business Process Procedures (BPP) are documented instructions for end users, to supplement in-class training, and are an on-line resource to all users of KHRIS. A significant feature of KHRIS is to better consolidate job functions and agency reporting to be more efficient and flexible for external reporting by agency. These resources will assist in the development of agency level internal controls and processes to improve the detection and correction of errors.

Agency business owners can request additional reporting features to facilitate their business procedures for human resource management and administrative accounting by submitting a KHRIS Change Request (KCR). The Division of Technology Services of the Personnel Cabinet will review KCRs from business owners and follow the system change request process.

The Personnel Cabinet will continue researching any training gaps and update documentation of the KHRIS to provide adequate solutions to assist agencies as needed. Thank you for your continued efforts to ensure critical business owner training needs and current processes are documented within KHRIS to benefit agency level staff.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-PC-03</u>: **The Personnel Cabinet Should Ensure Edits Are In Place And Operating Effectively**

During the FY 2011 audit of Personnel Cabinet's Kentucky Human Resource Information System (KHRIS), it was brought to the auditor's attention that an individual was incorrectly posted to the State Active Duty Default Labor Accounting Template (RLKYNG), resulting in payment for work that he did not perform. As a result of this error, this individual incorrectly received payments (net of tax and other deductions) totaling $10,284.42.

According to information provided to the auditor, the Department of Corrections (DOC) performs dual entry for personnel actions in both KHRIS and KRONOS, their third party timekeeping system. When the employee at DOC was imputing the data into KRONOS, they made a typo and used the employee ID assigned to an individual located in another agency. When the files in KRONOS were uploaded into KHRIS, the incorrect data was not rejected.

The KHRIS system did not have system edits in place to prevent an agency from uploading incorrect data on an individual located in another agency for which they did not have approval over.

Without system edits in place, there is an increased risk that inappropriate transactions could be processed in KHRIS. This could result in employees being paid for work not performed.

Adequate payroll controls should be in place and functioning effectively within KHRIS. Further, the Personnel Cabinet should ensure that all transactions entered into the KHRIS system are appropriate and reported accurately.

> **Recommendation**
>
> We recommend edits be enhanced to ensure all agency transaction data is entered completely and accurately. At a minimum, this should include an edit within KHRIS to ensure that the data being uploaded is associated with an individual for which the agency has approval over.
>
> **Management's Response and Corrective Action Plan**
>
> *The KHRIS team of the Personnel Cabinet endeavors to ensure that all transaction data is entered accurately and appreciates the State Auditor of Public Accounts assistance in that effort. Management agrees that an agency should only have access to employee's data in which the agency has approval.*
>
> *The cause of this issue resulted from an Employee ID, the primary key used in place of SSN or PERNR, was not properly validated within the processing of payroll time files at go-live. This should not have been necessary as (1) Division of Technology Services (DTS) provided Department of Corrections (DOC) all their employees' Employee IDs and (2) KHRIS provides an update file every period containing DOC's employee master data which included Employee ID at the end of each subsequent period.*

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-PC-03:** The Personnel Cabinet Should Ensure Edits Are In Place And Operating Effectively (Continued)</u>

<u>**Management's Response and Corrective Action Plan (Continued)**</u>

Instead of utilizing this update file to programmatically update DOC's Kronos®, DOC chose to manually key the Employee ID for the employee in question. This manual key action allowed for the transposition of the correct Employee ID to another, yet valid Employee ID belonging to a State Active Duty employee. The charges to accounting template RLKYNG were correct for that State Active Duty employee but were not correct for the DOC employee for which DOC intended to pay.   Once this issue was identified, DTS notified DOC to correct the Employee ID in their Kronos® which did not occur. Over the course of the next three pay periods this employee was intercepted and manually corrected during interface processing audit prior to payroll run. If DTS had not flagged the employee as part of the time file audit, the State Active Duty employee would have been paid three additional periods. After each of these pay periods, DOC was notified by the Time Management team to correct the employee's Employee ID. This correction was finally performed on the fourth pay period out from the period the issue was initially identified.

Once this issue was noted, DTS worked over the course of several months to develop a solution as documented in part of System Change Request (SCR) 0144-TM_Interface_Roles. This change consisted of creating batch users with structural authorization for each of the time interfacing agencies to prevent them from making this type of error in the future. These changes were transported to production on November 15th, 2011 and used to successfully process the 11/01-11/15 time files.

Again, thank you for your continued efforts to ensure payroll time is reported properly and any errors are identified timely.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-PC-04</u>: **The Personnel Cabinet Should Develop Policies And Procedures To Ensure A Reconciliation Of KHRIS To eMARS Is Performed And Reports Are Maintained**

Prior to April 1, 2011, the majority of personnel and payroll actions were processed through the Unified Payroll/Personnel System (UPPS). When the UPPS payroll was processed, various reports were created for central level and agency level use. Included in these reports were the following: payroll voucher, cost distribution, employee deductions listings, payroll registers, etc. The payroll voucher and cost distributions were sent to Finance & Administration Cabinet (FAC) and served as the basis for the payroll check warrant and accounting entries. Generally, all mathematical computations were performed by UPPS. UPPS generated the check tape and EFT tape that were forwarded to the Department of Treasury. Before payroll was certified, the Payroll Branch performed an audit to verify the payroll balanced to the reports generated; however, the Personnel Cabinet did not perform a reconciliation of UPPS to eMARS. Even though the Payroll Branch did not perform a reconciliation, static reports were available that enabled a reconciliation to be easily performed by outside parties.

Effective April 1, 2011, payroll and personnel actions are processed through the Kentucky Human Resource System (KHRIS). During our FY11 audit, it was brought to our attention the reporting functionality that was available in UPPS was not readily available in KHRIS. Since KHRIS supplies a standard of data in real-time, static reports are no longer maintained, thus hindering any reconciliation of KHRIS to eMARS.

Also, under the UPPS system, the Personnel Cabinet generated an Employee Status Summary Report at the end of each fiscal year detailing the number of employees per agency and department along with their classifications, i.e., merit, non-merit, full-time, part-time, interim, etc. This report was generated to substantiate the Personnel Cabinet was in compliance with KRS 18A.010, which imposes restrictions on the number of personnel that may be employed during the fiscal year. This report was not developed until November 2011 for distribution.

KHRIS was not designed, implemented, and maintained in a manner which allows for reconciliations to eMARS and for the creation of reports to ensure that management is in compliance laws and regulations.

Due to the reporting limitations, the Auditor was unable to perform a reconciliation of KHRIS to eMARS and verify the balancing within KHRIS.

Without adequate reports, payroll related costs cannot be verified as having been properly paid and reported; and the Personnel Cabinet cannot ensure compliance with KRS 18A.010.

Good internal controls dictate the KHRIS system should have the capability of producing static reports that are useful and valid for management decision-making purposes and to ensure compliance with applicable laws and regulations.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-PC-04**</u>**: The Personnel Cabinet Should Develop Policies And Procedures To Ensure A Reconciliation Of KHRIS To eMARS Is Performed And Reports Are Maintained (Continued)**

<u>**Recommendation**</u>

We recommend the Personnel Cabinet take the following actions in relation to the reporting functionality within KHRIS:

- Policies and procedures be created and implemented to ensure that a reconciliation of KHRIS to eMARS is performed and the reports generated, at the time of reconciliation, be maintained for audit purposes. In order to accomplish this task, it is recommended that Personnel Cabinet, FAC, and the KHRIS team collaborate on this process.

- Ensure the Employee Status Summary is generated timely to assure compliance with KRS 18A.010.

<u>**Management's Response and Corrective Action Plan**</u>

The Personnel Cabinet agrees with the APA recommendation to add necessary KHRIS reporting functions to ensure timely reconciliations with eMARS. KHRIS team members will collaborate with FAC and/or other state agencies to complete this functionality.

When new KHRIS reports are developed, efforts are being made to better educate the user community on how to run and interpret reports at the agency level. There is an ongoing effort to document existing reports as well as enhance training for how to use reports. The reporting functionality and reconciliation procedures are different with KHRIS as compared to the legacy systems. Previously, static reports were generated and saved as a point of record.

Unlike the legacy systems, KHRIS is an ERP solution with retroactive capabilities. When information is sent from KHRIS to eMARS and Info advantage, it is then synchronized. However, due to the retroactivity in KHRIS and due to the fact that changes are being made every day (in real time), the information will not always match. This is not an indication the information is incorrect, just that KHRIS totals are an accurate reflection of the business data at that point in time.

The Personnel Cabinet is using KHRIS to better consolidate reporting to be more efficient and flexible for external reporting by agency. Some aspects of previously used reports can be found in the enhanced information sent to info-Advantage for reporting, which is a more central repository and eliminates redundant data feeds. The KHRIS team agrees that the Employee Status Summary Report was not available at the end of the fiscal year. However, after thorough testing of this report in development, this information has been provided to agencies as of November of 2011.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-04: The Personnel Cabinet Should Develop Policies And Procedures To Ensure A Reconciliation Of KHRIS To eMARS Is Performed And Reports Are Maintained (Continued)

Management's Response and Corrective Action Plan (Continued)

Agency business owners can request additional reporting features to facilitate their business procedures for reconciling accounts by submitting a KHRIS Change Request (KCR). The Division of Technology Services will review KCRs from business owners and follow the system change request process. KHRIS concurs with the APA observation that reporting was not adequate between the KHRIS "go-live" date and the conclusion of the 2011 fiscal year. Thank you for your continued efforts to ensure that accounting totals are accurate and made available for the Commonwealth.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-05: The Personnel Cabinet Should Ensure Appropriate Reporting Is Available, Complete, And Accurate Within The Kentucky Human Resources Information System (KHRIS)

During our fiscal year (FY) 2011 audit of the Personnel Cabinet's Kentucky Human Resources Information System (KHRIS), we determined Personnel did not have the ability to report critical information at implementation. Further, at the end of field work, in August 2011, there were still concerns related to the functionality, availability, and completeness of reporting within KHRIS.

KHRIS went into production on April 1, 2011. At that time, Personnel had not developed numerous reports within KHRIS that were comparable to what was previously available within the legacy system. Legacy reports used to reconcile time and payroll data not available in KHRIS when first implemented include reports 151 – Carrier and Deductions, 152 and 152A – Payroll Registers, and 153 – Payroll Distributions.

Three months of processing was captured by KHRIS for FY 2011. Payroll for the Commonwealth of Kentucky is processed bi-monthly; therefore, the data processed within KHRIS for FY 2011 consists of the March 16, 2011 through June 30, 2011 payrolls and represents annual Pay Periods 7-13. During this time, there were no reports similar to the legacy reports noted above available for agencies to use to reconcile information coming from KHRIS to that appearing in the enhanced Management Accounting and Reporting Systems (eMARS). The Payroll Distribution Reports (PDRs) within KHRIS was developed by Personnel to replace the legacy 153 report. The Office of State Budget Director (OSBD) released the first seven payroll PDRs to all agencies on July 18, 2011. Therefore, no reports concerning reconciliation of payroll were available to agencies until after the fiscal year end. Further, state agencies were informed that the PDR reports reflect what "should have" posted to the eMARS from KHRIS, not what actually posted. Agency staff were to review the data and make any necessary corrections within eMARS.

The OSBD provided additional PDRs for Pay Period 13-15 to agency staff via CD in August 2011. In comparing the original PDR for Pay Period 13 provided to the Auditor of Public Accounts (APA) in July 2011 to this new report, we discovered four additional staff members on the new PDR. Furthermore, the amount originally reported for two staff members had changed in the new PDR. Subsequent to issuing the first set of PDRs, Personnel identified a defect within the PDR report and indicated that the second PDR for Pay Period 13 was correct.

Discussions with OSBD staff revealed they were assisting the Personnel Cabinet with the distribution of the PDRs to ensure all budget contacts at each agency receive them. Further discussions with Personnel Cabinet staff revealed the PDRs are provided to state agencies on CD due to file size. However, HRGs have been granted access to and have the ability to generate these reports within KHRIS. The system is configured so that reports can be downloaded in Excel format.

The PDR contains the following fields: Check Date; Cost Center; Organizational Unit and Name; Employee Name; Accounting Template; Work Breakdown Structure (WBS) Unit, Location and Activity; Work Order, Object, Hours Worked, Earnings by Object Code, and Total Employer Costs. This information was not sufficiently detailed for some agencies to ensure costs were appropriately allocated to track federal funding.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-05: The Personnel Cabinet Should Ensure Appropriate Reporting Is Available, Complete, And Accurate Within The Kentucky Human Resources Information System (KHRIS) (Continued)

Only system interfaces required to perform payroll processing were available at implementation, or April 1, 2011. Additional critical interfaces were to be added post-implementation. As of the end of field work, the Transportation Enterprise Database (TED) interface and the eMARS infoAdvantage interface were not created. The TED interface provides Kentucky Transportation Cabinet (KYTC) staff with detailed labor data relating to each pay period. This detail is necessary for federal reporting purposes. Without access to TED data, KYTC is unable to provide detailed personnel cost data required for Federal Emergency Management Agency (FEMA) and American Recovery and Reinvestment Act (ARRA) reports. The eMARS infoAdvantage interface provides payroll and personnel data to the infoAdvantage PER universe. The TED interface is not expected to be available until the statewide data feeds to infoAdvantage is completed; however, there is no anticipated date as to when this interface will be complete.

Further, the KASES interface, which processes child support information and payments, wasn't complete at KHRIS go-live. However, follow up with the KHRIS Team revealed this interface was functional as of August 2011.

Furthermore, a report of the tax breakout associated with Off-Cycle payrolls is not automatically created by KHRIS and provided to the Kentucky State Treasury (Treasury). While a report is provided, Personnel Cabinet staff has to query the system in order to manually generate this report each pay period and then provide it to Treasury.

After the first payroll was processed through KHRIS, it was discovered that the Flexible Spending Account (FSA) year-to-date (YTD) amount was not reported correctly on employee pay stubs. According to Personnel staff, the FSA YTD amount is reported correctly on the remuneration statement which is able to be viewed by HRGs. Personnel sent this concern to the Department of Employee Insurance (DEI) on April 18, 2011 for resolution. However, as of the end of the fiscal year, the employee pay stub still reflected an incorrect YTD amount.

Further, in the April 1 through 15, 2011 pay period, the compensatory leave amount being populated in the "earned" field on the employee's paystub did not accurately reflect the hours attributed to the individual's balance for the period. In addition to the hours actually earned for the period, KHRIS was also including the straight overtime hours for the last week of the prior pay period, which was a split week. These hours had already been reported and attributed to the balance in the prior pay period. This was determined to be a defect in the design of the paystub and was corrected for the April 15-31, 2011 pay period.

Finally, there is insufficient information available for users to run all reports available within the KHRIS production environment. During our testing, we found a report whose name had changed from the original listing of custom reports; however, this had not been updated.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-PC-05**</u>**: The Personnel Cabinet Should Ensure Appropriate Reporting Is Available, Complete, And Accurate Within The Kentucky Human Resources Information System (KHRIS) (Continued)**

A report purporting to provide All Actions Approved for the Month was found to be extracting data incorrectly. Additionally, there is no specific training manuals explaining the reports available within KHRIS and what information is required for the reports to generate properly.

Without adequate reporting, the risk increases for a user to develop reports based on incorrect data elements. Further, state agencies may be unable to properly reconcile payroll costs processed through the system. Federal funding may also be compromised without complete and timely reporting. KYTC has specifically asked for patience and time from their federal partners and they have expressed understanding in relation to the reporting restrictions associated with KHRIS.

Good internal controls dictate procedures be in place to ensure all reports used for financial reporting are complete and accurate. For reports to be useful and valid for management decision-making purposes, the reporting solution used should be appropriately designed to allow users to view data and develop reports that are complete and accurate. A reporting solution must, therefore, be understandable by the end user in structure, content, and context. Further, the underlying structure of the data must be appropriate for the overall accounting regulations of the organization; otherwise, the solution may provide information that is not expected by the end user.

Recommendation

We recommend the Personnel Cabinet take the following actions in relation to the reporting functionality within the new KHRIS application:

- Continue its efforts to generate comparable reports in KHRIS to the legacy 151, 152, and 152A. These reports may be different in structure; however, they should contain similar content as reported by the legacy system.
- Development, testing, and implementation should be completed for necessary system interfaces including TEDS and infoAdvantage to ensure federal and state reporting requirements are met.
- Create a report that will be automatically generated within KHRIS to reflect taxes associated with off-cycle payrolls and this report should be provided to Treasury in a timely fashion.
- Work with agencies using cost allocation methods to develop reports that will assist in reconciliation and reporting of this information to all necessary federal agencies.
- Validate all base line and Kentucky specific reports within KHRIS to ensure they produce the expected results when run.
- Develop a reporting manual inclusive of all reports within KHRIS. This manual should explicitly document each report identifying the purpose of the report and what information is required for the report to function properly.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-PC-05</u>: **The Personnel Cabinet Should Ensure Appropriate Reporting Is Available, Complete, And Accurate Within The Kentucky Human Resources Information System (KHRIS) (Continued)**

<u>**Recommendation (Continued)**</u>

- Ensure the reporting of the FSA YTD amount on the pay stud reflects the accurate amount.
- Continue to monitor the employee pay stub information to ensure the information being presented is accurate and complete.

<u>**Management's Response and Corrective Action Plan**</u>

The Personnel Cabinet continues to strive to make improvements to reporting from KHRIS. Along with developing new reports as time and budget allow, efforts are being made to better educate the user community on how to run and interpret reports.

Specific to the bulleted items above, below are the responses in the same order as recommended:

- *Reports similar to the legacy reports noted are in development. The Personnel Cabinet is using KHRIS to better consolidate reporting to be more efficient and flexible. Some aspects of the legacy reports noted can be found in the new Payroll Distribution Report, and the enhanced information sent to infoAdvantage.*
- *The Personnel Cabinet continues to work with OSBD/Finance to refine the interface into infoAdvantage. This work is designed to be a more central feed to meet the needs of all agencies and eliminate redundant data feeds that were produced from legacy systems.*
- *Tax reporting has been addressed for all payroll runs including off-cycle. The Personnel Cabinet continues to work with Treasury and Finance to insure reconciliation and understanding of all tax reporting, and taxed amounts.*
- *As stated above, the Personnel Cabinet continues to work with OSBD/Finance and agencies to provide the necessary data for all external reporting by those agencies. This will primarily be accomplished using the enhanced Payroll Distribution report and the enhanced interface to infoAdvantage. This information includes the necessary level of allocation detail.*
- *The Personnel Cabinet has continued to improve how agencies are trained to run reports, as well as eliminating defects as they are noted. Additionally, significant effort has been made to make sure results across reports are consistent and correct.*
- *The Personnel Cabinet continues to improve documentation of processes, including reports. This includes an ongoing effort to document existing reports as well as enhanced training for how to use and run reports. The Personnel Cabinet has developed an initial draft of an electronic report manual, which will be available to all agencies online October 26. This manual will list all reports available in KHRIS, by function module; identify the purpose of each report, and instructions to run each report. As new reports are added, they will be included in the manual.*

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-05: The Personnel Cabinet Should Ensure Appropriate Reporting Is Available, Complete, And Accurate Within The Kentucky Human Resources Information System (KHRIS) (Continued)

Management's Response and Corrective Action Plan (Continued)

- *The FSA amount that is reported on the pay stub is the cumulative amount from the time of go-live. It does not include the FSA contributions prior to KHRIS go live. Since FSA is a calendar year amount, the stub will be correct beginning in January 2012.*
- *The Personnel Cabinet is constantly monitoring any error or defects associated with information on the check stub or ESS.*

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-06: **The Personnel Cabinet Should Formally Document And Perform Reconciliation Procedures Of Payroll Data Processed By The Kentucky Human Resources Information System To The Enhanced Management Accounting And Reporting System**

During our fiscal year (FY) 2011 audit of the Personnel Cabinet, we determined the Personnel Cabinet (Personnel) did not document formal reconciliation procedures related to regular and off-cycle payrolls. Further, they did not reconcile the three months of payroll data processed by the Kentucky Human Resources Information System (KHRIS) to the data reported within the enhanced Management Accounting and Reporting System (eMARS).

KHRIS was implemented by Personnel on April 1, 2011. While employee's pay and benefits are compiled and administered at the state agency level, the final payment is processed through KHRIS. Therefore, state agencies are responsible for ensuring the completeness of their own payroll data within KHRIS and the Personnel Cabinet is responsible for reconciling payroll expenditures for the state as a whole to eMARS. After the implementation of the KHRIS system, there were several processing issues identified that resulted in required adjustments at the end of the fiscal year within eMARS. Specifically, on May 23, 2011, the Finance and Administration Cabinet (Finance) informed agency fiscal and budget officers that "setup issues within the KHRIS system" affected the initial postings associated with Federal Insurance Contributions Act (FICA), Retirement, Life Insurance, Personal Service Contract (PSC) payments, and Health Insurance, which occurred in April and May 2011. Within this same memo, state employees were informed that "accounting periods 10 and 11 will display incorrect values per period but the combined values of the two periods will reflect the total payroll for accounting periods 10 and 11". These issues are commented on in a separate processing comment (see 11-PC-7).

Further, on June 30, 2011, Finance notified applicable agency eMARS staff that due to delays in getting accurate KHRIS data to eMARS the soft and hard close for Accounting Period 13 was extended to allow agencies time to make corrections before close out of FY 2011. The KHRIS Team was using this time to create a "retrocalculation" to correct previous errors identified in the KHRIS processing. On July 13, 2011, Finance informed applicable agency eMARS staff that only part of the KHRIS correcting documents posted to Budget Fiscal Year (BFY) 2011. An eMARS job was used to process those documents in "Ready" or "Held" status. However, agency staff had to search eMARS for "rejected" Cost Accounting (CA) documents and manually process them.

At implementation of the KHRIS system and throughout FY 2011, agency staff did not have access to payroll distribution reports developed from KHRIS data. State agencies were not provided with the Payroll Distribution Report (PDR) for Pay Periods 7-13 until July 18, 2011. As a result, agencies were unable to reconcile their payroll data that processed through KHRIS for the March 16, 2011 through June 30, 2011 Pay Periods until after the fiscal year closed. Further, Finance staff informed state agencies that the PDR reports reflect what "should have" posted, not what actually posted in eMARS. According to this communication, the first KHRIS payroll posted a number of agency expenditures to the default accounting template for Pay Period 7 instead of the accounting template represented on the employee's timesheet. Agencies were instructed to review these reports and determine what corrections were necessary. At Personnel, there are no reports available reflecting changes made by agency personnel to reconcile the differences noted in amounts processed through KHRIS and eMARS for Pay Periods 7 through 13.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-06: The Personnel Cabinet Should Formally Document And Perform Reconciliation Procedures Of Payroll Data Processed By The Kentucky Human Resources Information System To The Enhanced Management Accounting And Reporting System (Continued)

The Auditor of Public Accounts (APA) was provided two different PDRs for our agency for Pay Period 13. In comparing these two reports, auditors determined that the original file provided was incomplete in that four staff members were missing from the file. Also, the costs associated with two employees were reported as a negative amount in the original file. However, the subsequent PDR file reflected the absolute value of the original amount. Subsequent to issuing the first set PDRs, Personnel identified a defect within the PDR report and confirmed that the second PDR for Pay Period 13 was correct.

Larger agencies such as the Jefferson County Sheriff's Office, the Cabinet For Health and Family Services (CHFS), and the Kentucky Transportation Cabinet (KYTC) have also experienced reconciliation problems. These agencies are not only unable to reconcile their payroll for Pay Periods 7 through 13, but they are also unable to determine what costs should be allocated for federal funding based on the data reported within the PDR and Payroll Journal. Specific to KYTC, although requested during development, Personnel has not created and implemented the Transportation Enterprise Database (TED) interface, which is to be used by KYTC to determine hours worked by employee and costs associated with each as is required for federal reporting. Furthermore, Personnel continues to work with the Jefferson County Sheriff's Office to properly report base wages and fringe benefits on overtime. Personnel has created new Wage Types and Payroll Journal variants to try and report the correct data; however, as of the end of fieldwork, Jefferson County staff indicated continued variances with the reported data. Each of these agencies requires detailed reporting to ensure compliance with federal government regulations. Reporting issues are addressed in a separate comment (see 11-PC-5).

Without formal reconciliation procedures in place, the Personnel Cabinet cannot ensure proper reconciliation of the state's payroll data processed through KHRIS. Also, without adequate reconciliation-related reports, state agencies cannot verify that earnings, special payments, employee benefits, employee taxes and voluntary/involuntary deductions are properly calculated.

Adequate payroll controls should be in place and functioning effectively within KHRIS. Processes and procedures should be in place within KHRIS to ensure each payroll is complied, sent, and processed completely and accurately within eMARS. This process should be performed after each payroll run. Any variances or errors noted should be addressed in a timely fashion. Documentation of the reconciliation process, including any remedial actions necessary, should be maintained for audit purposes.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-06: The Personnel Cabinet Should Formally Document And Perform Reconciliation Procedures Of Payroll Data Processed By The Kentucky Human Resources Information System To The Enhanced Management Accounting And Reporting System (Continued)

Recommendation

We recommend the Personnel Cabinet develop and document formal reconciliation procedures to ensure payroll data processed through KHRIS is compiled accurately, sent to eMARS, and reconciled completely to what posted in eMARS. All documentation developed related to the reconciliation of payroll, including any remedial actions necessary for errors or variances should be maintained for audit purposes.

We also recommend the Personnel Cabinet continue to work with agencies needing specialized reporting to ensure federal reporting is complete, accurate and timely.

Additional recommendations have been made in regards to reporting in comment 11-PC-5.

Management's Response and Corrective Action Plan

The Personnel Cabinet agrees with the IT Audit Branch recommendation to update documentation with formal reconciliation procedures and ensure KHRIS data is accurate for reconciling to eMARS. Subsequent the fiscal year end, the Personnel Cabinet is balancing each payroll period before the information is sent to eMARS, and the information is reconciled to what is sent to eMARS. Each of the reconciliations is documented in an email as a step in the payroll process, which has been thoroughly documented. The Personnel Cabinet continues to work with OSBD/Finance to reconcile and adjust any balances that may have been initially incorrect.

As stated in response to RCW 11-PC-5, the Personnel Cabinet is working with OSBD/Finance on enhanced versions of the Payroll Distribution Report and InfoAdvantage to provide the level of detail necessary for federal reporting. The intent of KHRIS is to try to standardize reporting across agencies to try to eliminate specialized reporting by agency.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-PC-07**</u>: **The Personnel Cabinet Should Ensure Processing Associated With The Kentucky Human Resources Information System Functions As Intended**

During our fiscal year (FY) 2011 audit of the Personnel Cabinet (Personnel), we determined certain processing functions associated with the Kentucky Human Resource Information System (KHRIS) was not functioning at implementation as originally designed.

KHRIS was implemented by Personnel on April 1, 2011. The KHRIS Team worked with numerous vendors as well as the Commonwealth Office of Technology (COT) to improve design and functionality associated with KHRIS; however, state agencies have experienced problems with KHRIS processing since implementation.

We found employee pay rates are not calculated consistently within KHRIS. According to the Human Resource Generalist (HRG) Training Manual, the following information is required based on Time Management (TM) Status and Time Card Rule:

1. When TM Status 1 (Actual Times) and Time Card Rule 1 (Time Card Required), time must always be keyed or an individual will not get paid.
2. When TM Status 9 (Planned Times) and Time Card Rule 2 (Time Card Not Required), an individual is paid regardless of time keyed. Exception time (leave claimed) only is to be entered.
3. When TM Status 9 (Planned Times) and Time Card Rule 1 (Time Card Required), an individual must enter exception time or certification that all planned hours were worked.

The Auditor of Public Accounts (APA) staff has been designed as positive time [TM Status 1 (Actual Times) and Time Card Rule 1 (Time Card Required)]. During the May 16, 2011 through May 31, 2011 pay period, an individual within our agency was found to have omitted normal work hours off her timesheet. After processing, we determined this individual was paid her full anticipated salary instead of being paid for only those hours keyed on her timesheet. Discussions with Personnel found that for individuals who are salaried and are established as positive time, the pay rate is calculated on the total number of regular work and leave hours provided to KHRIS, not on the schedule hours for the individual. Therefore, if time is not sent up for a day, the individual will still receive their full salary pay, but the pay rate per hour will not be accurate. Therefore, the HRG training manual is incorrect. As this process effects pay rates, it could potentially affect cost allocation for regular time and distribution of costs for leave. Discussions with agency personnel revealed the pay period rate for Salaried/Positive Time employees is a work in progress with the KHRIS Time and Payroll Team.

Also, when KHRIS went live on April 1, 2011, there was a feature within the Employee Self Service (ESS) portal to allow employees to submit a leave request to their supervisor. When a manager approved the leave request, the system automatically reduced the employee's existing leave balance. On May 11, 2011, employees were informed that in the case of compensatory leave, this process was causing a negative impact on the earning and payment of Block 50s for eligible employees. Therefore, employees were asked to manually request the use of compensatory leave until the issue could be resolved. On May 17, 2011, the same issues affecting compensatory leave were also found to be affecting sick and annual leave. Therefore, at that time, the leave request/approval functionality within KHRIS ESS was removed.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-07: The Personnel Cabinet Should Ensure Processing Associated With The Kentucky Human Resources Information System Functions As Intended (Continued)

Discussions with agency personnel revealed gaps in development, causing issues with planned leave and the intermittent transfer of approved leave, resulted in incorrect payments. There are three defects within the modification process currently related to Leave Requests. These defects are being addressed by the KHRIS Team; however, they have been given low priority since the Leave Request functionality is optional within KHRIS and many agencies have chosen not to utilize it.

On May 23, 2011, the Finance and Administration Cabinet (Finance) Office of the Controller issued a formal memo informing agency fiscal and budgetary staff that issues within KHRIS affected the initial postings in the enhanced Management Administrative and Reporting System (eMARS) associated with Federal Insurance Contributions Act (FICA), Retirement, Health Insurance, Life Insurance, and Personal Service Contract (PSC) payments. The following specific issues were noted in the memo and occurred in April and May 2011.

- "E121 Employers FICA - for individuals whose time was charged to multiple accounting templates, the total Employers FICA was charged to the employee's default accounting template
- E122 Employers Retirement - this issue varies in the 3 pay periods that have posted. Some cases the amounts are correct and in others the amounts are incorrect.
- El23 Employers Health Insurance - One change that occurred with the implementation of KHRIS is to split the employer's health insurance premium expenditures between the two payrolls in a month. The first payroll in April (Pay Period 7) posted correctly. The second payroll in April (PP8) and the first payroll in May (PP9) were not correct.
- E124 Employers Life Insurance - some agencies may notice life insurance amounts for the first pay period in May (PP9) that were incorrect."

According to Finance, "these setup issues have been corrected within the KHRIS system and the second payroll posting in May (PP10) should display the correct results."

Additionally, Finance explained the PSC payments made through KHRIS have not posted in eMARS since KHRIS went live in April 2011. The Commodity Based Payment Requisition (PRC) documents have been generated from KHRIS, but the amounts on the PRC document were incorrect. The KHRIS Team has identified that this issue stems from time entry charging time to multiple accounting templates for contract employees. The contracts in eMARS already have accounting templates assigned to them. The PSC documents must not have override accounting elements entered in KHRIS when performing time entry. When these alternate accounting elements are coded, it interferes with the KHRIS to eMARS interface, causing the interface to reflect incorrect amounts for payment against the contract.

Until such time as a system modification can be developed to specifically address this issue, the KHRIS Team has asked agency staff to not include override accounting elements for PSCs on the timesheet. It was anticipated that corrected PCR documents would be completed by the end of May 2011.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-07: The Personnel Cabinet Should Ensure Processing Associated With The Kentucky Human Resources Information System Functions As Intended (Continued)

Initially, some agencies reported using IT0015 Additional Deductions/Payments to pay employees money due for events that occurred prior to March 16, 2011 in KHRIS. The Personnel Cabinet informed agencies that they do not endorse this practice due to the fact there is no auditing process when using this KHRIS InfoType (IT). Personnel asked that SAS-27 documents be completed and processed for pay due prior to March 16, 2011.

Discussions with Jefferson County Sheriff's Office staff revealed the Payroll Journal and Payroll Distribution Reports (PDRs) do not reflect fringe benefits on overtime. As a result, the Sheriff's Office does not have sufficient information to support reimbursement requested associated with their Federal Task Forces. Also, when KHRIS went into production on April 1, 2011, the Jefferson County Sheriff's Office had to manually enter into KHRIS the vendor's name and amount associated with health insurance payments. Discussion with Personnel revealed an issue existed at implementation in which some counties had benefit deductions incorrectly mapped to the wrong vendors. To ensure accuracy of vendor payments and amounts, the Department of Employee Management (DEM) contacted the counties directly for vendor, address, and payment information. Health insurance payments are processed once a month for counties.

In our conversion testing related to the Auditor's Office, we found instances where Deferred Compensation deduction amounts were not correctly established in KHRIS. We are aware the Deferred Compensation deduction amounts were not converted from the legacy payroll system; instead this information was provided as an interface file from the Deferred Compensation vendor. According to Personnel, the information provided from the vendor contains inaccurate data for some employees. Since Personnel is relying on the vendor for this information, they have asked agencies to inform them if any staff have issues with this process.

Finally, subsequent to the first payroll processed in KHRIS, agency staff was notified that the Deferred Compensation contribution was not calculated correctly for those employees electing to have a percentage of their net pay deducted as a contribution. According to Personnel, if these employees wanted to make an adjustment to correct this deduction, they would need to coordinate with their agency HRG, who would code a single time deduction for the following pay period. During a KHRIS update meeting held on April 12, 2011, we learned fixed amount withholdings for individuals were working correctly; however, percentage-based calculations associated with overtime was still not being reported correctly within KHRIS. Specifically, if overtime is carried into the next period for payment due to split weeks, then the percentage of Deferred Compensation is not paid on the overtime amount. As of the end of fieldwork, September 2011, this had not been corrected.

If system processes and/or functionality is not well designed or implemented, the accuracy of processed information, operational efficiency and effectiveness, and compliance with relevant regulations, policies and procedures is compromised.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-07: **The Personnel Cabinet Should Ensure Processing Associated With The Kentucky Human Resources Information System Functions As Intended (Continued)**

As noted in the discussion above, the KHRIS system was found during the first three months of processing to incorrectly calculate and report deductions, to inconsistently calculate pay rates for certain staff, and to erroneously or incompletely state information on pay stubs and payroll reports. State agencies are negatively impacted by the inadequate design of the system since they are burdened with performing extra tasks to determine if their data processed completely and accurately through KHRIS. Further, data processing problems may result in non-compliance with federal requirements.

Compliance requirements and significant operational processes and practices employed in administering the payroll and personnel functions for the State of Kentucky as they are established within the KHRIS system should be thoroughly documented or communicated to all appropriate agency personnel. Further, the Personnel Cabinet should ensure that all transactions entered into the KHRIS system are appropriate, are processed as expected, and are reported accurately.

Recommendation

We recommend the Personnel Cabinet document significant operational processes and procedures to ensure compliance with state and federal regulations related to personnel and payroll data. In addition, we recommend the Personnel Cabinet take these steps to ensure complete and accurate data processing:

- Calculate employee pay rates consistently and uniformly within KHRIS to ensure that rates are reflective of the actual hours scheduled for the position.
- If the ESS is configure to allow leave requests to be submitted and approved, ensure that this does not negatively impact employee's earnings and payment of Block 50s.
- Establish a formal listing of accounting templates within KHRIS that is accessible to agencies for verification purposes to ensure the appropriate template was used during processing.
- Perform a review of all additional payments made to employees for events occurring prior to March 16, 2011 in KHRIS to ensure a SAS-27 document was properly recorded for each entry. Documentation and validation should be maintained for all payments not supported by a SAS-27 document.
- Continue to monitor information being provided by the Deferred Compensation vendor and the calculation of Deferred Compensation percentage-based contributions to ensure the deductions are being correctly reported.
- Continue to work with the Jefferson County Sheriff's Office and other state agencies to ensure reporting available within KHRIS provides complete and accurate data that is useful for their daily processing.

Finally, we recommend Personnel continue to work toward a system modification that will eliminate the processing errors caused by time data being entered for employees on PSCs with override accounting elements.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-PC-07</u>: **The Personnel Cabinet Should Ensure Processing Associated With The Kentucky Human Resources Information System Functions As Intended (Continued)**

<u>Management's Response and Corrective Action Plan</u>

The Personnel Cabinet strives to ensure compliance with regulations while ensuring data is complete and accurate for processing in KHRIS. Personnel staff has documented processes and procedures in place, both operationally and in KHRIS to comply with state and federal regulations.

Specific to the bulleted items above, below are the responses in the same order as recommended:

- *Rates and rules are configured and applied uniformly within KHRIS based on state and federal rules and regulations. During the first few payrolls processed in KHRIS, rules regarding pay for positive time reporting time card required were set to warning instead of error in anticipation of inadvertent missed time entry. This has since been reverted back to the standard rules. Agencies had access to see when time had not been entered for individuals during these pay periods.*
- *The leave request through ESS initially did include a defect not found during testing. The ESS leave request has been removed and the defect correction is considered a low priority. Reinstatement of the ESS leave request is TBD.*
- *Accounting templates used in KHRIS are interfaced from eMARS on a daily basis. Only accounting templates that can be used for payroll entry are available for use in KHRIS. These are validated at time entry.*
- *All SAS-27s not in the Legacy system will be accounted for in KHRIS. Documentation and approval are maintained for any pay action in KHRIS. Most "manual" payments, which were exclusively through a SAS-27 in legacy, are handled through the various off-cycle payrolls run in KHRIS. These require the proper documentation and approval before being entered.*
- *The Deferred Compensation error that occurred in the initial payroll of KHRIS has been corrected. All subsequent payrolls have been correct.*
- *The Personnel cabinet has worked diligently to improve reporting for all entities and agencies. This includes the payroll distribution report that is available, along with improved communication to agencies on how to properly run reports for their needs.*
- *The error caused by PSCs has been eliminated.*

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-08: The Personnel Cabinet Should Enable Security Auditing And Formally Document System Edits And Auditing Functions For The Kentucky Human Resource Information System

During our fiscal year (FY) 2011 audit of the Personnel Cabinet's Kentucky Human Resource Information System (KHRIS), we determined a comprehensive listing of edits established within the system and auditing functionality related to system processing had not been developed prior to the implementation of the system at the beginning of April 2011. The Personnel Cabinet did not provide an anticipated completion date. They explained that work on the documentation would not be started until staff became available sometime after implementation. As of the end of fieldwork in August 2011, this type of documentation was not completed.

During the first payroll processed through KHRIS, seven employees had no address indentified in KHRIS and one employee whose bank accounting information was set up incorrectly, which would have caused these individuals to not have been paid. These errors were caused by changes being made to the master data for employees within KHRIS by agency Human Resource Generalists (HRG) using incorrect effective dates. These issues were fixed during the final payroll process.

Availability of master data is based on the effective start and end dates. Throughout the HRG training provided by the Personnel Cabinet, the fact HRGs have the ability to overwrite master data within KHRIS was addressed. During these sessions, the HRGs were instructed to use the copy feature instead of the change feature and include the proper effective start date of a new action. This process will create a new version of the master data and delimit the previous version as of the effective date for the new version and thereby leaving an audit trail of changes made to master data. In contrast, if the change feature is used, the system will allow the user to overwrite the effective start date and, if this date is after the original start date for this employee in the system, will cause the master data to be unavailable for use for related processing, such as payroll processing, prior to the new effective date. There is currently no pre-processing edits or post-processing audits in place to review the validity of changes made to master data by Personnel Cabinet.

If system edits are not properly designed or are circumvented, there is an increased risk that data validity as well as the overall reporting processes could be materially affected. Failure to keep formal system documentation related to system edits could lead to tasks not being performed or a misunderstanding of assigned responsibilities. Failure to document and adequately monitor security events and transaction logs creates the possibility for unauthorized changes to be made within the production tables, thereby compromising the data therein.

Formal documentation should be maintained that describes system functionality, error handling, and monitoring.   This documentation should accurately reflect edits that are established within the system to ensure data is being entered, processed, and reported as expected. Payroll calculation will only be accurate if using complete and accurate master data. The risk of inappropriate transactions being processed by the system increases without effective monitoring of event and security logs. A logging and monitoring function within an application and consistent review of the results enables early detection of unusual or abnormal activities.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-08: **The Personnel Cabinet Should Enable Security Auditing And Formally Document System Edits And Auditing Functions For The Kentucky Human Resource Information System (Continued)**

Recommendation

We recommend the Personnel Cabinet formally document all edits and audit functions established within KHRIS. This documentation should adequately describe, at a minimum:

- the purpose of each edit and audit function,
- the criteria for meeting the edit or audit,
- the resulting actions taken by the system when the edit or audit is met,
- the actions required by either Personnel or agency staff to mitigate the edit or audit, and
- at what point in processing the edit or audit is run.

Also, we recommend the Personnel Cabinet ensure security auditing is enabled on critical data within the KHRIS system. An appropriate level of management should review the event and history logs on a regular basis. Documentation of these reviews and any necessary remediation should be maintained for audit purposes.

Management's Response and Corrective Action Plan

The Personnel Cabinet endeavors to provide accessible, reliable and reportable data that is maintained, managed and hosted in the Kentucky Human Resource Information System (KHRIS). KHRIS is the repository of human resource information and transactions for all state employees. This state wide system is the Commonwealth's reporting source in complying with federal, state and local government laws and regulations. KHRIS maintains all audit functions and edits documented within the system.

The various edits and audits are inherent to and/or built into the configuration of the system, and into any custom development for the system. All configuration and custom development is documented on-line in configuration documents, functional specifications, and technical specifications. In keeping with the green initiatives of the Commonwealth of Kentucky, these documents are not maintained completely in a written form, but are available for perusal in the system.

Furthermore, there are system reviews available at various levels within the Personnel Cabinet. These are regularly used for troubleshooting errors when found within the system, and reviewed for reasonableness.

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-08: The Personnel Cabinet Should Enable Security Auditing And Formally Document System Edits And Auditing Functions For The Kentucky Human Resource Information System (Continued)

Auditor's Reply

The auditor requested a listing of all system edits available within KHRIS prior to and after the system went into production. We were repeatedly told that this documentation did not exist, but would be documented once processing stabilized. Furthermore, we have documented the original functional and technical specifications developed by the Personnel Cabinet, which was included with the Request For Proposal (RFP). However, the Personnel Cabinet has made and continues to make major modifications to functionality and processing in order to resolve defects with the system. Therefore, the original specifications are out-of-date.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-CHFS-09**</u>**: The Cabinet For Health And Family Services Should Continue To Improve Oversight At Hazelwood**

During our FY 11 audit of the Cabinet for Health and Family Services (CHFS), we tested forty expenditures at Hazelwood Intermediate Care Facility for supporting documentation, proper authorization, and timeliness of payment. While accounting practices have improved at Hazelwood, the following exceptions were noted for FY 11:

- Ten procurement card transactions lacked supporting documentation such as invoices or receipts;
- One payment was processed nineteen months after the invoice date; and,
- Three payments lacked supporting documentation such as invoices or receipts.

The auditors also noted that Procurement Cards were being used to pay late bills for services such as food delivery to the Hazelwood facility. While these transactions were for legitimate bills, they should not have been paid with the procurement card. They should have been paid through the normal process in eMARS and approved through CHFS central office.

During procedures to follow up on prior year findings, we requested the sign in sheet for Ethics Training that was scheduled to occur in December of 2010. Hazelwood personnel were unable to provide attendance records for that training.

A lack of oversight from CHFS and poor accounting practices at Hazelwood led to the exceptions noted during the audit. Though accounting practices have improved under new management, these exceptions occurred in the period under audit but before the change in personnel.

If no supporting documentation is provided for a transaction the reasonableness or necessity of the expense cannot be confirmed by management. If invoices are not paid in a timely manner, late fees could be assessed and vendors could cease to provide necessary goods and services to the facility. If invoices are lost and balances must be paid based on statements from the vendor there is a greater risk for duplicate or incorrect payments.

If current business office staff and procurement card users have not attended Ethics training, past issues at Hazelwood could recur.

KRS 45.453 states, "All bills shall be paid within thirty (30) working days of receipt of goods and services or a vendor's invoice except when the purchasing agent has transmitted a rejection notice to the vendor."

FAP 111-58-00 states in section 10d, "Each cardholder shall reconcile transaction information provided by the financial institution to all cashier receipts and invoices to ensure the accuracy of that information."

In response to a prior year finding, CHFS indicated that Hazelwood employees would attend Ethics training and that it would be held annually.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-CHFS-09:**</u> **The Cabinet For Health And Family Services Should Continue To Improve Oversight At Hazelwood (Continued)**

Recommendation

We recommend:

- All Procurement Card users should attend training to familiarize themselves with the policies established in FAP 111-58-00.
- The business office should continue to improve record retention and ensure documentation exists to justify all purchases and to reconcile payments to invoices and/or receipts in a timely manner.
- All Hazelwood employees with fiscal management responsibilities should attend Ethics training annually and CHFS should ensure this occurs. Documentation of these trainings should be maintained, including who attended.
- CHFS should closely monitor this facility to ensure bills are paid timely, payments are documented with invoices etc, procurement card purchases are supported and reasonable. This would likely include site visits to the facility.
- Written policies and procedures should be completed and all appropriate personnel at Hazelwood should have access to them.

Management's Response and Corrective Action Plan

The Department for Behavioral Health and Developmental and Intellectual Disabilities (DBHDID) has been working diligently over the past year to improve business office functions at Hazelwood. This includes major changes in management and recruitment of staff. With the assistance of DBHDID central office, recruitment efforts have focused on hiring new personnel with significant experience in health care financial operations. As noted by the auditors above, progress has been made at Hazelwood in the business office functions, and we believe that significant improvements have resulted from the changes already implemented. Several key staff from DBHDID central office assisted in the implementing improvements at Hazelwood along with the Cabinet's Division of Procurement Services.

While significant progress has been made over the past year, this audit period did include some findings early in the audit year prior to all changes having been implemented. The Department continues to be vigilant in monitoring Hazelwood to continue improvements and ensure that the business office is appropriately addressing business practices, including record retention and documentation. Since the new business manager at Hazelwood assumed his duties, the Department's Director of the Division of Administration and Financial Management holds weekly calls (or more frequent, when needed) with the new business office manager. As the new manager becomes more familiar with the operations of Hazelwood, the need for weekly calls is expected to decrease. Plans are in place to improve communication with all facilities by instituting periodic meetings with the fiscal leads for all DBHDID state facilities. The first meeting is expected to be held in January. This will increase lines of communication and allow facilities to discuss related issues and quickly address common problems.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-CHFS-09: The Cabinet For Health And Family Services Should Continue To Improve Oversight At Hazelwood (Continued)

Management's Response and Corrective Action Plan (Continued)

The cited Pro-Card transactions date back to a prior Fiscal Manager and Pro-Card Administrator before the above referenced changes had been made. On January 19th, 2011, the facility received procurement and Pro-Card training from the Cabinet's procurement team. This training included Pro-Card users and department managers at the facility. During the spring of 2011, the Cabinet's procurement team provided several weeks of on-site, one-on-one training with Hazelwood staff. The current Pro-Card Administrator received training in Pro-Card procedures (regarding FAP 111-58-00) from the CHFS Office of Administrative and Technology Services (OATS), Division of Procurement Services on November 1, 2011. There have been a number of personnel changes at the facility's business office. Accordingly, on January 10, 2012 all Pro-Card holders at Hazelwood will receive Pro-Card training from CHFS OATS.

Ethics training is currently required on an annual basis. All Executive Staff, Supervisors, Compliance Department staff, HR staff and Business Office staff are required to complete the GSC Executive Branch online ethics course by December 31, 2011. If applicable, new hires will take the online course immediately following orientation. Documentation of the classes and attendees will be retained in the Human Resources Office at Hazelwood. It should be noted that with the use of on-line training, course completion can be verified through the CHFS TRAIN system.

Hazelwood has a Business Office Procedures Manual which is currently being reviewed and updated. Check lists/desk guides are being developed for all job functions and the manual will be provided to all business office staff. The check lists/desk guides for each function will include information on required supporting documentation. The revised manual is expected to be completed and distributed to business office staff not later than June 30, 2012.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DMA-10: The Department Of Military Affairs Should Ensure All Payments Are Made In A Timely Manner

During the FY 2011 Department of Military Affairs (DMA) audit it was noted that DMA had encountered issues with paying invoices timely. As a result, DMA incurred $20,760 of late payments during FY 2011. Of this total, one transaction accounted for the 84% of the total late fees. It was noted, that those responsible for paying bills sometimes have difficulty getting them paid timely, due to bills not being submitted for payment timely from others out in the field.

When the DMA fails to make payments in timely manner, it results in the unnecessary loss of financial resources, primarily through late fees associated with unpaid bills. The vendor customer relationship can be strained when bills are not paid in a timely manner. Furthermore, failure to input expenditures into the Commonwealth's accounting system timely could result lead to erroneous financial reporting for DMA expenditures.

Strong internal controls at a minimum require invoices/bills are accounted for and paid in a timely manner to ensure accurate financial reporting. Failure to make payments timely constitutes a non compliance with KRS 45.453 which states, "All bills shall be paid within (30) working days of receipt of goods and services or a vendor's invoice except when the purchasing agency has transmitted a rejection notice to the vendor."

Further, KRS 45.454 states, "An interest penalty of one percent (1%) of any amount approved and unpaid shall be added to the amount approved for each month or fraction thereof after the thirty (30) working days which followed receipt of the goods or services or vendor's invoice by a purchasing agency."

Recommendation

We recommend the Department of Military Affairs develop and implement controls to ensure all invoices are paid timely as required by KRS 45.453. These procedures should include reiterating to all DMA departments the importance of getting invoices to the business office as soon as possible for payment.

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for allowable costs and cost principles is to provide reasonable assurance that funds are expended only for allowable activities and that the costs of goods and services charged are allowable and in accordance with the applicable cost principles. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of the identified deficiency.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-DMA-10**</u>**: The Department Of Military Affairs Should Ensure All Payments Are Made In A Timely Manner (Continued)**

<u>**Management's Response and Corrective Action Plan (Continued)**</u>

Based on the auditor's finding, DMA management has conducted an analysis of the overall risk environment currently facing the department and concurs with the auditor's finding.

DMA-OMA has revised and published a departmental procedure for funding and coding payment documents containing late payment penalties as well as developed specialized eMARS reports for identifying late payment penalty payments to upper management. However, the Division of Emergency Management (KyDEM) and the Facilities Management Division (FAC) are still currently working on developing specific Corrective Action Plans that address this year's audit finding. These will be forwarded when available. However, the largest late payment penalty in the current SFY2011 audit finding is a repeat of a like finding in the SFY2010 statewide single audit.

In last year's SFY2010 audit response by KyDEM they identified that the $21,658 late payment penalty found by the SFY2010 audit came from the Other Needs Assistance (ONA) federal grant state matching payment payable to FEMA. The invoice for payment was mailed by FEMA to the KyDEM ONA Program Coordinator who, at that time, had been working away from his office at another location for the Disaster Field Office (DFO) to help process claims. The invoiced bills for payment had then accumulated on his desk at his regular office without anyone's knowledge. In last year's corrective action plan, KyDEM stated that they had contacted FEMA to change the procedure to where FEMA would email the bills directly to the KyDEM fiscal management office thereby eliminating any further potential delay. However, the current year SFY2011 audit finding is another Other Needs Assistance (ONA) federal grant state matching payment that was invoiced by FEMA for state payment but not paid in a timely manner thereby costing the division $17,385 in late payment penalties.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DOC-11: **The Department Of Corrections Should Strengthen And More Closely Adhere To The Kentucky Offender Management System (KOMS) Defect Management Process**

As noted in the prior three audits, the fiscal year (FY) 2011 review of program modification controls for the Department of Corrections (DOC) Kentucky Offender Management System (KOMS) identified multiple instances where the existing program change control procedures were either outdated or were not being consistently followed.

The KOMS Defect Management Process describes the procedures for requesting and completing modifications to KOMS. DOC Information Technology (IT) staff and KOMS trainers may request changes to KOMS using tickets within the in-house issue tracking application. Issues are prioritized, and either DOC or the KOMS vendors develop a solution. The vendors view the KOMS requests and address any software defects; defects are resolved by the creation of new KOMS releases or patches. All defects are logged and tracked in the vendor-maintained KOMS Defect Tracking Tool. If the issue does not require a programming solution, it is deemed to be a technical assistance request and is assigned to DOC IT staff for completion.

Releases or patches developed by the vendors are sent to DOC for approval and testing, and then the testing documentation is sent back to the vendors to review. The KOMS Defect Management Process developed by DOC states DOC Executive Staff is to provide written approval to the vendors for releases or patches; however, DOC management indicated they do not adhere to this approval procedure. Once the release, patch, or DOC-developed change is tested and approved by the appropriate parties, DOC IT staff makes an email request to the Commonwealth Office of Technology (COT) Service Desk for movement of the change into production. Once the change has been implemented and the associated ticket has been closed by COT, a notification email is sent to DOC IT staff.

Our review of eighty-four unique logged KOMS software issues and associated release notes since the prior year fieldwork revealed:

- Thirty-seven issues (approximately 44 percent) had a priority level of '0'. This is not a valid priority level based on the KOMS Defect Management Process and discussions with agency staff.
- Twenty-one issues (25 percent) lacked a priority level.
- Six issues (approximately 7.1 percent) did not have the tester, testing date, and/or results recorded.
- Seven issues (approximately 8.3 percent) omitted the Issue Identification (ID).
- Four issues (approximately 4.8 percent) did not specifically state "pass" or "fail" in the testing results.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-DOC-11</u>: **The Department Of Corrections Should Strengthen And More Closely Adhere To The Kentucky Offender Management System (KOMS) Defect Management Process (Continued)**

To further test the controls surrounding KOMS program modifications, a sample of seven completed KOMS issues was reviewed to ensure all supporting documentation for testing and approvals were developed and maintained within the DOC tracking system. This examination revealed the following exceptions:

- Four issues (approximately 57.1 percent) for which the release notes and tracking system ticket reflected differing priority levels.
- Two issues (approximately 28.6 percent) for which documentation could not be provided to show the approval was sent to COT prior to being placed into production.

Also noted during audit fieldwork, the KOMS Defect Management Process document was not updated since April 28, 2008. Though the APA was provided with updated addendum documents during the audit fieldwork, there are processes that have changed and are not accurately reflected in the KOMS Defect Management Process document. Specifically, DOC migrated to a new issue tracking application during FY 2011, which alters the KOMS change request procedures. Further, the updated addendum documents do not provide enough information to replace the KOMS Defect Management Process document. DOC management was in the process of updating the KOMS Defect Management Process and addendums at the time of fieldwork with an anticipated completion by the end of FY 2011.

Finally, KOMS Priority Team meeting minutes were not available during the audit field work. DOC management stated that retaining minutes will be a priority in the future and they will be made accessible in the issue tracking system for review.

Failure to properly apply and monitor change control procedures increases the risk that incorrect or unauthorized changes could be made to critical applications and, potentially, be moved into the live production environment. Further, this failure in process increases the risk that changes will not be prioritized appropriately, which could untimely affect the progress of changes to implementation. Retaining meeting minutes provides a historical record to committee members and management, to avoid confusion and track group decisions.

Program modification control procedures should be consistently applied and formally documented in order to ensure that only appropriately authorized changes to critical applications are made and implemented within the production environment in a timely fashion. Consistent monitoring of the change control process helps ensure adequate documentation exists for all changes and that the changes made are acceptable to the user business areas prior to implementation. Meeting minutes documenting discussions between agency and vendor staff should be retained and made accessible to all relevant parties.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DOC-11: The Department Of Corrections Should Strengthen And More Closely Adhere To The Kentucky Offender Management System (KOMS) Defect Management Process (Continued)

Recommendation

We recommend DOC take the following actions to strengthen the controls of the KOMS program modification process:

- Review the current KOMS Defect Management Process document to ensure the established procedures are appropriate and acceptable to all parties. Revisions should be made where necessary to reflect current procedures and software used in the change control process.
- Review the KOMS Defect Management Process addendums to ensure they also provide accurate and current information and update where necessary.
- Consistently apply all established procedures within the KOMS Defect Management Process document and addendums.
- Ensure all KOMS software issues are logged within the current tracking system and assigned an accurate priority level and issue ID.
- Ensure the KOMS release notes are thoroughly completed to reflect all issue details and testing documentation. It should be clear from reading the notes whether an issue has passed or failed. The priority level and issue ID should correlate back to the tracking system ticket.
- Ensure all COT requests for production migration are retained.
- Take and retain change committee meeting minutes.

Management's Response and Corrective Action Plan

Corrections has completed the revisions to the Defect Management Process and provided a copy of the document to the auditor. Corrections will incorporate the promotion requests to COT into the tracking system, and retain minutes to post onto the tracking system as well. Corrections will conduct a monthly review of past promotions to ensure proper documentation and adherence to the Defect Management Process.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-DOC-12**</u>**: The Kentucky Department Of Corrections Should Ensure Sufficient Authentication Is Required to Access Potentially Sensitive Information**

During our fiscal year (FY) 2011 security vulnerability assessment on Kentucky Department of Corrections (DOC) machines, instances were discovered where no authentication was required to allow an outside user to gain access either to information about the machine or to the service running on a designated port. We determined 12 out of the 73 scanned machines, or approximately 16.4 percent of the population, did not have sufficient authentication. Three of these machines were reported to the agency in the previous two audits.

For security purposes, detailed information that would identify the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

If a machine is allowed to provide excessive information associated with the machine to an anonymous user, then an intruder could potentially use this information to attempt to gain access to the machine or network.

Only necessary and required users should have access to services, particularly those services containing potentially sensitive information. Even if sensitive information is not present on the noted machines, gaining access to one machine on a network could allow additional network machines containing sensitive information to be compromised.

Recommendation

We recommend DOC ensure all services on network machines are restricted to only those users with a specific, business related need. All public or anonymous users should not be allowed access. As any new devices are placed on the network, they should be reviewed for open ports and services which may provide default access to public or anonymous users. If a service is not necessary, required, and properly configured, it should be disabled. For business-related services, authentication should be configured and only users who have a specific business need for services should be granted access.

Management's Response and Corrective Action Plan

Corrections has disabled FTP on the 12 machines listed and has provided a document listing the port scan results to the auditor. All 12 machines were network attached printers using the default settings. Corrections will integrate FTP access and uses in the network security/configuration policy.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DWI-13: An Independent Review Of The Reconciliation Of Unemployment Insurance Financial Records Should Be Performed

Each year the Office of Unemployment Insurance handles over $1 billion in funds flowing through funds 6210 and 6200. The key reconciliation of the bank and accounting records conducted for UI is handled by the UI Trust Fund Officer. The UI Trust Fund Officer reconciles (4) key data sources once each month to ensure they properly reconcile. The data sources are the Tax Cashbook, reconciled to a 6210 ABATP report each day which is generated from eMARS; the Benefits Cashbook, reconciled to a 6200 ABATP report each day which is generated from eMARS; State report 2550; and eMARS. ABATP Reports are reconciled to Funds 6200 and 6210. However, there are no controls in place for an independent review and approval of this key reconciliation process.

The monthly reconciliation of the UI bank and accounting records is performed by the Trust Fund Officer, who is one of the few people with an understanding of the various records and how they fit together. The Trust Fund Officer is directly responsible for maintaining two of the four data sources used for conducting the key reconciliation. The Trust Fund Officer is not independent of the records being reconciled. Therefore, it is important for a process to be in place for an independent review of the reconciliation of an account that handles such a significant amount of funds.

The review of the key reconciliation is not being conducted by someone independent of the underlying bank and accounting records. An independent person is not reviewing the key reconciliation.

Reconciliations of accounting information are performed to ensure accurate and comprehensive financial reporting. Monthly reconciliations are crucial to identify errors and inconsistencies requiring correction. Independent internal verification should be done by someone who is independent of the employee responsible for the information. When duties cannot be separated, management should increase the review and oversight function.

Recommendation

We recommend management assign someone to review at least quarterly the key reconciliation being conducted by the Trust Fund Officer. The reviewer assigned should be someone independent of the underlying bank and accounting records.

Management's Response and Corrective Action Plan

All financial data reports created and maintained by the Trust Fund Officer(TFO) are tied directly to the source documents of the Tax (6210 Fund/VA) and Benefits (6200 Fund/UA) Chase bank account statements, EMARS ABATP report, and Trust Fund account (Automated Standard Application for Payment/Bureau of Public Debt), which are reviewed and balanced by Finance and Treasury. All UI financial data is reportable monthly and quarterly on the Federal Employment and Training Administration (ETA) reports (8401, 8405, 8413, 8414, and 2112). Each ETA report is checked for timeliness and accuracy and must balance with the source documents, cashbooks, and other state reports. Each transaction and EMARS document

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-DWI-13:** An Independent Review Of The Reconciliation Of Unemployment Insurance Financial Records Should Be Performed (Continued)</u>

<u>Management's Response and Corrective Action Plan (Continued)</u>

if outside Dept 531 will require additional approval and validation by Finance and then Treasury to ensure accountability and reconciliation before money is transferred/disbursed through the General account. The Tax cashbook and Benefits cashbook are always reconciled to the bank statement through the ABATP report and EMARS 2550 showing the individual daily detail transactions from the state wide accounting system (Automated Bank Account Cash Transfer Detail Report/EMARS daily transactions are compiled on the monthly tax and benefits cash book all reconciled to the tax account, trust fund, and benefits bank account used to report ETA federal reports).

A majority of the Tax transactions (Cash Receipts etc.) are created by the Department of Revenue and Finance then validated/disbursed by Treasury through the state wide accounting system (EMARS) to each account seen on the daily ABATP Report. They are then compiled by the TFO on the Tax cashbook to match the beginning and ending ledger balances daily from the Chase Tax bank account to reconcile and account for tax transactions. These transactions represent tax dollars or reimbursement coming from the employer population and transferred to the UI Trust Fund to then pay for state unemployment benefits. All money moving from tax in form of EMARS documents must be created, verified, and then approved by Finance and Treasury before money is moved. Once the tax revenue has been balanced from each source to match the bank daily, the TFO will determine how much in funds can be transferred from the Chase Tax account to the Trust fund and still maintain a positive balance in the Tax account. These documents must again be created, signed and approved in-house, and then validated by an outside agency (Finance and Treasury) to move the funds from the Tax Account to the Trust Fund via wire transfer. The only transactions that can be moved without other agency oversight and approval is when there is transfer of funds within our agency.

The trust fund transactions see only one incoming deposit from the tax account (Manual Disbursement Warrant Deposit through FedWire) validated and confirmed by Finance and Treasury. This document when being prepared is created by the TFO and approved by the UI Director.   Once this has been completed it is emailed to Finance and Treasury for final validation and approval before funds are transferred based on available funds in the account as well as the EMARS Balance Sheet (if there are not enough funds on the books Finance must issue an override per request by TFO). The Trust fund Automated Standard Application for Payment (ASAP) will show the corresponding deposit to match the Tax Chase account withdrawal. Finance will reconcile with the Bureau of Public Debt monthly to verify accuracy and accountability of the UI Trust Fund. The Trust Fund also will disburse state UI and Federal money through the Drawdown accounted for in EMARS and created by Benefits Payment Control (BPC). This document must also be signed and approved by the UI Director before the document can be created and funds disbursed based on the check register (also approved and signed by UI Director). Benefits transactions are substantiated through BPC and the Check register (prepared by BPC supervisor/staff and signed by UI Director). All transactions affecting

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DWI-13: An Independent Review Of The Reconciliation Of Unemployment Insurance Financial Records Should Be Performed (Continued)

Management's Response and Corrective Action Plan (Continued)

the Benefits account are maintained in EMARS and most are controlled and disbursed through the Treasury General Account shown on the ABATP (transactions displayed on the ABATP report require final approval from Finance and Treasury) and 2550 reports. As all daily detail transactions are reconciled by the ABATP report to the Benefits account and posted to the cash book, the Drawdown (signed by UI Director) is calculated and funds are disbursed from the Trust Fund (Bureau of Public Debt) to the Benefits account to cover UI Claim checks presented. This is created and recorded as a CR by BPC and the Trust Fund disbursements and EMARS 6200 fund transactions are reconciled monthly by Finance to ensure accountability.

- *Documents are being created, reconciled, balanced, validated and approved in EMARS through a multi agency (UI, Finance, Revenue, and Treasury) approach with active communication by email and signed documentation providing checks and balances.*
- *Daily and Monthly state wide reports such as the ABATP and 2550 are being created and maintained by outside agencies (Treasury) to supply transaction activity transpired through EMARS to balance and match the Chase Tax and Benefits account activity.*
- *Wire Out requests are signed and approved by upper management before being created and sent to Finance and Treasury for multi agency approval and transfer of funds.*
- *Daily Check Registers are compiled outside of the Trust Fund Office and signed off by UI Director*
- *Drawdown is signed and approved by upper management and document is created in EMARS outside of the Trust Fund Office.*
- *Chase Tax and Benefits account activity are monitored and maintained in the Chart of Accounts by Finance and Treasury. Bank statement and analysis reports are furnished to UI by Treasury to complete required Banking Activity ETA Reports (8413 and 8414).*
- *ETA reports are submitted monthly to the regional office and the 2112 is signed by the UI Director.*
- *Monthly and quarterly ETA reports are verified for timely submission and audited for accuracy through internal data validation review and key source document reconciliation.*

The Trust Fund Office has increased its staff by a position to assist and learn the fundamental basics of the operations and has an additional back up person in place to carry out basic requirements such as the wire out and drawdown if needed. The cash books, once balanced, supply the needed information required to report monthly on the ETA reports (8401, 8405, 8413, 8414, and 2112) required by the U.S. Department of Labor (USDOL). These ETA reports are public record and are maintained in the state menu and agency wide data base. The bank accounts are affected by the multi agency requests, validations, and approvals of the inter agency and EMARS accounting system reflected on the ABATP and 2550 Report. The ABATP and 2550 Report are controlled by Finance and Treasury and are used to create and maintain

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-DWI-13:** An Independent Review Of The Reconciliation Of Unemployment Insurance Financial Records Should Be Performed (Continued)</u>

<u>Management's Response and Corrective Action Plan (Continued)</u>

the Cashbooks which must balance with the bank statements in order to complete the monthly financial reports. The Federal ETA reports are created by using the cashbook information that includes the transactions on the daily ABATP report and state monthly 2550 report. The bank statement displays the daily summary totals while the ABATP report and 2550 will display transaction detail to formulate the cash books and ETA reports.

We believe there is sufficient independent oversight in place to verify daily and monthly reconciliation of the Chase accounts (Finance and UI), to the Cashbooks (TFO), from the ABATP and 2550 Reports (Revenue, Finance, Treasury, and UI), to the ETA Reports and the Trust Fund/Bureau of Public Debt (Finance). Additionally, the ETA reports are being verified for timeliness and validated for accuracy (postings on bank account statements, cash books, other ETA reports and Bureau of Public Debt) then reviewed and signed by the UI Director. Multiple units (UI Tax Accounting and BPC, Revenue, and Finance) makeup the individual transactions required for the TFO to maintain the Tax, Trust Fund, and Benefit accounts and are reviewed and validated (Finance and Treasury). Each transfer of funds must be properly recorded and reconciled by each appropriate unit (BPC/Tax) before an EMARS document can be submitted, validated and approved in many instances by multiple agencies (Finance/Treasury) before the transfer of funds can take place. This is done by line of authority approval and signatory review of the Register, Wire Out, Drawdown and ETA 2112. Various units within the UI Division make up the individual transactions and each process is overseen by EMARS validation and approval along with Director signatory review as well as outside agency required approval.

We have confirmed with the Finance Cabinet that both the 6200 and 6210 funds are reconciled by them each month as well as the Trust Fund with the Bureau of Public Debt. In the event a question arises, Finance Cabinet staff will contact the TFO regarding any necessary adjustments to UI funds for the annual state audit. Again we believe sufficient outside and independent review measures exist.

<u>Auditor's Reply</u>

We appreciate the thoughtfulness and depth of the agency's response. The processes handled by the Trust Fund Officer (TFO) are rather complex. It takes considerable knowledge and understanding to perform those processes.

However, the TFO has significant control over the data pieces that make up the processes which feed into the key reconciliation. While the TFO is very capable of ensuring everything balances and works correctly, proper segregation of job duties should be implemented to ensure someone with such access over source records is not reconciling the data. Although the UI Director approves some components of the reconciliation, there is no evidence of an approval on all of the supporting accounting records.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DWI-13: An Independent Review Of The Reconciliation Of Unemployment Insurance Financial Records Should Be Performed (Continued)

Auditor's Reply (Continued)

Finance, Treasury, and the Department of Revenue perform many tasks related to accounting processing within state government. However, there are some tasks those three agencies do not perform, such as:

- approving the internal key reconciliations within each agency,
- reviewing internally created and maintained records, and
- correcting the processing errors within each agency.

We continue to recommend that management assign someone to review, at least quarterly, the key reconciliation conducted by the TFO. As noted, the reviewer assigned should be someone independent of the underlying bank and accounting records.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DWI-14: The Department Of Workforce Investment Should Strengthen Its Disaster Recovery Plan

Our assessment of the Department of Workforce Investment (DWI) business continuity planning revealed that, although planning documents were created, some information was either not sufficiently detailed or required clarification. Concerns related to the business continuity planning have been addressed to the agency during the last seven audits.

The DWI has created and formalized the following documents regarding disaster recovery:

- The Kentucky Unemployment Insurance (UI) Disaster Recovery Plan (DRP);
- EDU-06 Backup Procedures Policy;
- Division of Technology Services (DTS) Business Contingency Plan (BCP); and,
- DWI DTS DRP.

The agency stated no changes were made to these formal documents from the prior year's audit field work, with the exception of the EDU-06 Backup Procedures Policy, which was updated to reflect DTS as the responsible party for all DWI back-ups.

We are aware that DWI has contracted with an outside vendor to evaluate the current business needs in relation to business recovery. At the end of this project, DWI will receive a full DRP. Additionally, the vendor will be working with DWI to procure all necessary hardware, software, and network resources to support the DRP and will be performing an initial disaster recovery test. At the time of review, the project was beginning the third of five phases of work.

A review of the current UI DRP revealed a lack of information for the back-up schedule and off-site storage location, details about the pyramid notification system used by supervisors in case of an emergency, details surrounding cooperative efforts with the Department of Revenue to back up quarterly reports and payments, information regarding employee awareness and training related to the DRP, and documentation concerning how alternate work sites would be determined in the case of an emergency.

A review of the DTS DRP revealed there was no specific information presented for recovery procedures related to the Unemployment Insurance Accounts (UIA) and the Unemployment Insurance Benefits (UIB) system. Further, no documentation exists within the DTS DRP related to employee awareness and training or disaster recovery testing procedures, results, or future testing plans.

The Commonwealth Office of Technology (COT) performs annual Disaster Recovery tests for select systems. Discussions with DWI personnel revealed that UIA, UIB, and Wage Records Systems (WRX) were last tested successfully in 2004. The UIA and UIB systems were included in a 2009 test; however, due to problems with two critical databases, system recovery was unable to be completed. According to agency management, budgetary constraints were the reason for the length of time between tests.

Failure to maintain a complete and current disaster recovery plan increases the possibility of loss due to excessive recovery time, costs, and disruption of processing capabilities in the case of a disaster or extended system outage.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DWI-14: The Department Of Workforce Investment Should Strengthen Its Disaster Recovery Plan (Continued)

Good management practices minimize risks through planning. The goal of a DRP and a BCP is to improve preparedness at minimal cost using available resources. Accordingly, proper documentation, knowledge, and periodic training for the DRP assures that DWI's IT systems can be recovered in cases of emergency, and that critical processes are not hindered by lengthy system down time. An effective DRP should document the most current critical personnel and contact information, critical systems and related data files with specific backup and recovery procedures, training and testing requirements, and update procedures intended for the DRP. In addition, assurance of adequate asset management and insurance coverage should be considered as part of the DRP.

Recommendation

We recommend DWI continue to work closely with their outside vendor to ensure the development of a full DRP. We would recommend the following issues be considered in this development project:

Specific to the UI DRP, details should be included regarding:

- the back-up schedule and where the off-site storage is located,
- the pyramid notification system,
- the back-up of quarterly reports and payments at the Department of Revenue,
- how employees are educated or trained concerning the procedures in case of an emergency,
- documentation of how alternate work sites are determined in case of an emergency, and;
- an incorporation, by reference, of the EDU-06 Backup Procedures Policy.

Subsequent to the development of the full DRP, we further recommend a review schedule be developed to ensure any necessary updates are made in the procedures or key personnel references on a periodic basis. Updated copies of these documents should be distributed to key personnel and a copy be maintained centrally and within an appropriate off-site storage area.

Finally, DWI should continue discussions with COT to allow for scheduling of Disaster Recovery testing for the UIA/UIB and WRX systems as soon as funding is available.

Management's Response and Corrective Action Plan

The Division of Technology Services has worked with an independent vendor to develop a disaster recovery plan for UI which is compliant with standards set by the National Institute of Standards and Technology (NIST). Phase I of the project, which consisted of a Business Impact Analysis has been completed. Also complete is Phase II of the project, which documented the Concept of Operation and Activation and Notification sections of the plan. Phase III of the project, which documents the detailed recovery procedures is currently in progress. While developing this plan, DTS continues to evaluate and update its policies, including but not limited to those regulating back-up schedules, off-site storage, and notification systems.

The Division of Technology Services has also completed EDU-21 to define and standardize procedures for contingency planning.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DWI-15: **The Office Of Employment And Training Should Develop Formal System Documentation To Support Processing Performed By The Workforce Investment Act Online Reporting Of Kentucky System**

As noted during the prior year audit, our fiscal year (FY) 2011 audit of the Office of Employment and Training's (OET) Workforce Investment Act (WIA) Online Reporting of Kentucky (WORK) system revealed OET did not maintain basic documentation of the overall functionality or specific processing of the WORK system.

The WORK system was based on a vendor-developed application customized for the Commonwealth of Kentucky. It was designed to manage the process of initiating, reviewing, and awarding grant monies offered by the State Pass-Through Entity for WIA, the Department of Workforce Investment (DWI), to the Local Workforce Investment Area (LWIA) offices. WORK also manages the processes of reimbursement, financial reporting, and progress reporting. The original contract with the application vendor required a user manual to be created for use at the LWIAs and training be provided for the central level staff. The vendor did not provide specific user or technical manuals to OET for use by the central level staff. Further, no user or technical documentation was developed and finalized internally at OET for central level staff. OET recently drafted a manual for central level staff; however, the draft manual is limited in scope and does not cover administrative or other grant or reporting functions for central level staff.

We are aware OET has continued its contract with the vendor and anticipates implementing an upgrade to the WORK system by April 30, 2011.

Lack of documentation increases the likelihood of erroneous or incomplete processing. It further increases the likelihood of unauthorized data modification, destruction of assets, and interruption of services.

Proper documentation should be maintained for each critical system in production to, at a minimum, identify the purpose of the system, what procedures can be performed within the system, how the system will interact with other systems, and what output of data or reports are anticipated.

> **Recommendation**
>
> As the upgrade to the WORK system in anticipated by April 30, 2011, we recommend OET work with the application vendor to develop a manual of the specific functionality available within the WORK system upgrade. This document should specifically cover the overall functionality of the system, the administration of the system, and the processing of transactions at the central and LWIA levels.
>
> **Management's Response and Corrective Action Plan**
>
> *Regarding the WORK documentation finding: DTS Security will work with OET and the software vendor to implement policies and procedures regarding the WORK system. This process was delayed due to awaiting approval from the Finance Cabinet for the upgrade of this program and maintaining the current vendor. Approval date was May 6th, 2011.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DWI-16: **The Office Of Employment And Training Should Strengthen And Consistently Apply Administrative Logical Security Procedures Over The Workforce Investment Act Online Reporting Of Kentucky System**

As noted during the prior year audit, our fiscal year (FY) 2011 audit of the Office of Employment and Training's (OET) Workforce Investment Act (WIA) Online Reporting of Kentucky (WORK) system revealed the informal administrative logical security controls over the WORK system were lax. This lack of formal documentation of controls for the system allowed a situation where staff were provided excessive rights based on current job duties and a lack of understanding on the requirements for administering the system.

Six levels of access were allowed to the WORK system. Three of these levels were explicitly defined within the vendor-created Grantee Help Manual and are being used by staff at the Local Workforce Investment Area (LWIA) offices. The remaining three levels of access are being used by central level Department of Workforce Investment (DWI) staff; however, there is no documentation of the exact functionality established for each of these central access levels. The auditor was able to determine from discussion with staff and inference of functional characteristics within the Grantee Help Manual, that these three central access levels allow administration of user accounts, development of allocation for grants, and approval of applications from LWIAs for grant funding. The only specific difference identified by OET management between these access levels is one access level has the ability to create a new grant within WORK. Therefore, all central level staff, no matter the individual job duties within the system, was provided both administrative and operational functionality, which creates a segregation of duties situation.

Currently, there is no access level established within the system that would allow "read" only access to data and reports. If someone needs information from WORK and does not have access, an authorized WORK user will publish reports for the individual.

The Grantee Help Manual, which is provided to LWIA staff for processing at the LWIA level within the WORK system, specifies the process to be followed by LWIA staff to request, delete, or change access for users. According to Section 1.1.6 of the Grantee Help Manual, DWI requires that the Chief Executive Officer of a LWIA write a letter to the DWI Budget and Support Branch Manager requesting access for each member of the LWIA who will be accessing WORK. This process was followed when WORK was first implemented; however, has since been changed. Currently, requests for new access, deletion, or changes in status require a written request from either the LWIA Fiscal Officer or Authorized Signatory. A written request, usually in the form of an email, is the only requirement for Level 2 (LWIA Staff Member) or Level 4 (Fiscal Officer) access. A Level 5 (Authorized Signature) access request requires both a written request and a signed OET Authorized Signature Form.

It was determined in the previous two audits that users had been established with both Fiscal Officer and Authorized Signatory rights at the LWIAs. Due to staffing resources at some LWIAs, OET management decided to allow this dual function for users if the LWIA Director provided approval through a formal request for the access. Since the prior year audit, OET management confirmed with each LWIA Director that all current users with the dual access required it to perform their job duties.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-DWI-16</u>: **The Office Of Employment And Training Should Strengthen And Consistently Apply Administrative Logical Security Procedures Over The Workforce Investment Act Online Reporting Of Kentucky System (Continued)**

We are aware OET has continued its contract with the vendor and anticipates implementing an upgrade to the WORK system by April 30, 2011.

Failure to develop and implement administrative logical security controls could lead to a lack of understanding by management and users of specific roles and responsibilities, which could result in a failure to comply with security policies, a failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. If the developed controls are not sufficiently strong, this situation increases the risk of unauthorized data modification, destruction of assets, interruption of services, and inappropriate or illegal use of system resources.

The foundation of logical security is access control, which refers to how system access is determined and granted to users. Formal policies provide a security framework to educate management and users of their security responsibilities. Consistent application of formalized security policies and procedures provides continuity for implementation and sets the tone of management concern for strong system controls. Further, the level of system access granted to users should be restricted to only areas necessary for an employee to perform assigned job duties.

> <u>Recommendation</u>
>
> As the upgrade to the WORK system in anticipated by April 30, 2011, we recommend OET work with the vendor to create, formalize, and implement a WORK security manual specific to the upgraded system. This manual should, at a minimum, specifically cover all access levels available in the system; the process for requesting access to the system; the process for establishing, altering, revoking, and deleting access to the system for users; and appropriate use guidelines for all users. Further, all available access levels should be identified and associated access rights for each level should be explicitly described.
>
> We also recommend the Grantee Help Manual be updated to reflect the current access request process for LWIA staff. Further, for those LWIA staff provided both Level 4 (Fiscal Officer) and Level 5 (Authorized Signatory) access, OET should document the required authorization process to receive both types of access. OET should define an alternative procedure for approval for those instances where the staff requiring the Fiscal Officer and Authorized Signatory access is the LWIA Director.
>
> Once the WORK security manual is developed and the Grantee Help Manual is updated, these documents should be provided to all appropriate staff. The documented processes in these manuals should be consistently applied to all new users or additional levels of access, and any applicable access request forms should be completed and maintained for all users.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DWI-16: The Office Of Employment And Training Should Strengthen And Consistently Apply Administrative Logical Security Procedures Over The Workforce Investment Act Online Reporting Of Kentucky System (Continued)

Recommendation (Continued)

We recommend OET work with the application vendor to determine whether a security access level will be available within the upgrade which would allow only read access to the system. If this type of access is not available, OET should consider working with the vendor to establish this level of access.

In anticipation of the upgraded system,

- OET should create a listing of all currently active users in the individual LWIAs to be reviewed and validated for appropriateness.
- OET should review the currently active central level staff to ensure access is still necessary.
- Any user accounts identified as no longer necessary should be changed to inactive status.
- OET should specifically identify the functionality needed within the system for each central level staff. Using this information, functional groups should be identified, such as administration, grant review, and allocation. These functional groups should be provided as defined access levels to the vendor for inclusion in the new system.

Management's Response and Corrective Action Plan

Regarding the WORK system administration finding: DTS Security currently has access to create accounts for new users. DTS will work with OET and the software vendor to implement procedures for granting access to this application. This will include written documentation on the procedures for granting access, new request forms and password structure procedures. This process was delayed due to awaiting approval from the Finance Cabinet for the upgrade of this program and maintaining the current vendor. Approval date was May 6th, 2011.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DWI-17: **The Office Of Employment And Training Should Ensure Programmatic Logical Security Controls Are Properly Designed And Configured**

As noted during the prior year audit, our fiscal year (FY) 2011 audit of the Office of Employment and Training's (OET) Workforce Investment Act (WIA) Online Reporting of Kentucky (WORK) system revealed programmatic logical security controls were not designed or properly configured to ensure only authorized users interact with the system.

User accounts can be established by users granted one of three central access levels. When a new user account is created, the user will be provided a user name and initial password. The password must be changed by the user upon first login. The criteria established for the syntax of a valid password are very minimal:

- Password must be at 7-12 characters in length.
- Password must not be "password."
- The same password may not be used twice in a row.

However, there is not a password lockout threshold and passwords do not expire.

Additionally, OET staff is unaware of a function within the WORK system that would allow a password for a current user account to be reset. According to OET, if a user is unable to remember his or her password, then an authorized member of OET may either create a new account for the user or look up the current account's password. It was determined the password is shown in clear text within the source code of the user information screen in the WORK system.

Finally, it was noted that user accounts within the WORK system are numeric and issued sequentially. There were two active user accounts identified during review of user accounts within the system that did not follow this anticipated syntax.

We are aware OET has continued its contract with the vendor and anticipates implementing an upgrade to the WORK system by April 30, 2011.

The existence of non-expiring passwords, the lack of a lockout threshold, and the sequentially numbered user names increase the risk that an unauthorized user could attempt to access the system and would not be identified. A password cracking tool could be run against a known user account without causing a disruption in service to the user, since the account would never be locked out, even if a large number of incorrect passwords were attempted. Since the tendency of most users with non-expiring passwords is to keep the same password indefinitely, a potential intruder has the advantage of an unlimited amount of time to work with an account to determine the correct password.

Further, the fact passwords are viewable in clear text increases the risk a current user of the system with access to this information might impersonate another valid user. Because a legitimate user account name and password would be used, there would be no direct indication of inappropriate use.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DWI-17: The Office Of Employment And Training Should Ensure Programmatic Logical Security Controls Are Properly Designed And Configured (Continued)

The Commonwealth Office of Technology (COT) has issued an Enterprise Policy related to logical security controls over user accounts and passwords, CIO-072, UserID and Password Policy. This policy was originally established in 2002 and most recently updated in May 2007. Within this policy, COT establishes specific expectations for user IDs and password controls.

...
Passwords must be:
- *Kept confidential;*
- *Changed at least every 31 days unless otherwise approved (non-expiring passwords must be approved on an exception basis);*
- *Changed whenever there is a chance that the password or the system could be compromised;*
- *Encrypted when held in storage or when transmitted across the network when the path is connected to an external network.*

...
Passwords must:
- *Be eight (8) or more characters;*
- *Contain uppercase letter(s);*
- *Contain lowercase letter(s);*
- *Contain a number;*
- *Contain a special character.*

...
Password History
Individuals must not reuse previously used passwords. To prevent this, a password history of 12 or more previous passwords must be kept.

Password Change
Passwords must be changed by the user at least every 31 days. If inadvertent disclosure is known or suspected, the passwords must be changed immediately. NOTE: In the event misuse is suspected, do NOT change the password; IMMEDIATELY notify the System/Network Administrator and/or the agency's security office. A security incident must be documented. Subsequent password change shall be made by the System/Network Administrator's and/or agency's security office direction only.

Minimum Password Age
Where supported, the minimum password age must be set to one day. This will help prevent users from "cycling" through passwords, thus bypassing the password history list. However, if inadvertent disclosure is known or suspected, the password must be changed immediately. In such instances, notify the systems administrator immediately.

...
Password and UserID Lockout

To prevent individuals from attempting to log-in with UserIDs by guessing passwords, accounts will be locked after three (3) consecutive invalid log-in attempts. Password resets must follow the policy stated herein for password length/composition.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-DWI-17: The Office Of Employment And Training Should Ensure Programmatic Logical Security Controls Are Properly Designed And Configured (Continued)

Further, it is good business practice to develop a system that would allow a password to be reset, if there is an occasion where a user has forgotten his or her password. This control should be maintained at an appropriately high level of management and requests for password resets should be documented and maintained for review.

Recommendation

As the upgrade to the WORK system is anticipated by April 30, 2011, we recommend OET work with the application vendor to alter any necessary password control configurations within the upgraded system to comply with the CIO-072, UserID and Password Policy. These control configurations should include, at a minimum,

- Passwords should be at least 8 characters.
- Passwords should contain at least one upper case letter, lower case letter, number, and special character.
- Passwords should be changed every 31 days.
- Passwords should have a minimum age value of 1 day.
- A password history of the last 12 passwords should be maintained.
- Accounts should be locked out of the application after three consecutive invalid log-in attempts.

OET should request the application vendor to restrict access to the underlying source code of the user information page in the upgraded system, if possible. If that is not possible, the password information should be removed from the source code and stored only in an encrypted format to be used within the password validation process.

Further, OET should work with the application vendor to determine if a password reset function will be available within the upgraded system. If so, this process should be formally documented, distributed to all appropriate staff, and immediately implemented. If this functionality is not available, OET should work with the vendor to determine the feasibility of adding this function to the upgraded system.

Finally, OET should consider implementing a new username syntax that is more complex than currently in place. Once established, the syntax should be consistently applied to all new users established within the system.

Management's Response and Corrective Action Plan

DTS will work with the software vendor to determine if a password reset function & a password lockout threshold is available. DTS will also work with the vendor to remove the password information from the source code. This process was delayed due to awaiting approval from the Finance Cabinet for the upgrade of this program and maintaining the current vendor. Approval date was May 6th, 2011.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-FAC-18**</u>: **The Commonwealth Office Of Technology Should Ensure Asset Locations Are Properly Coded In eMARS**

During the course of the auditor's physical inventory observation at the Kentucky Emergency Warning System (KEWS) building, the inventory taker noted several items on the equipment inventory list believed to be in a different location. eMARS identified the items as being assigned to two separate locations simultaneously, and therefore it appeared the KEWS building location was inaccurate. Also, one additional item, an ATV, could not be observed during the physical inventory count because it was being stored at an employee's residence.

Errors made in entering location information into eMARS for two equipment items led to conflicting information. Also, one asset was not being stored on state property. As a result, the inventory taker was unable to observe the existence and condition of the assets during his physical observation procedures. Without physical verification of assets, the assets are subject to misuse or misappropriation, and the value of capital assets on the financial statements could be misstated if the equipment is lost, stolen, or impaired.

Good internal controls dictate that the existence of all asserted physical assets should be verifiable through periodic physical inventory procedures. Also, equipment should be stored in a secure location on state property, with the exception of authorized items with legitimate and justifiable uses, such as take home vehicles, equipment approved for home office purposes, etc.

Recommendation

We recommend:

- COT ensure eMARS properly reflects the location and assignment of assets.
- Assets not assigned to employees should be stored on state property to ensure security and proper use of the equipment.

Management's Response and Corrective Action Plan

COT ensure eMARS properly reflects the location and assignment of asset.

The 3 assets referenced in this item are assets that are <u>physically located on the repair trucks of KEWS technicians</u>. These techs work out of their trucks & do not report to any particular location. They travel throughout the day making repairs at KEWS microwave sites and other network infrastructure locations.

There are no EMARS locations for these trucks. I have asked in the past if we could create an EMARS location for the trucks, but it was determined that it was not feasible to do so. EMARS could not designate a truck as a location as I recall.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-FAC-18</u>: **The Commonwealth Office Of Technology Should Ensure Asset Locations Are Properly Coded In eMARS (Continued)**

<u>Management's Response and Corrective Action Plan (Continued)</u>

We have always shown them as a part of the main KEWS location & designated the trucks by showing the District, Technician's Name, & Stock under the Room Number. If you check the room number on the EMARS report for all 3 items, it will show that the items are on a truck to be used as stock.

During the annual physical inventory, the technicians <u>do physically verify</u> all assets on their trucks…the same as we do at any other location. They report their findings to the main KEWS location.

As a result of this audit, I can certainly understand the confusion for the auditors with respect to our practice in handling the truck situation. The auditors can hardly observe a Bowling Green district truck inventory in Frankfort.

The action I have taken is to change the location for these 3 items in EMARS to reflect the nearest physical location for the trucks. I have also kept the Room Number information to designate that it is located on a technician's truck. When we perform the annual physical inventory, these trucks will then be a part of that District's location and can travel in if the District site is chosen for observation.

Assets not assigned to employees should be stored on state property to ensure security and proper use of the equipment

The ATV in question on this item is one that is used across the state at the KEWS tower sites. Similar to the trucks, we have shown it at the main KEWS location. The KEWS Manager was taking the ATV in for service repairs at the time of the audit & that is why it was off state property. It normally is stored on state property in a secure location.

<u>Auditor's Reply</u>

The auditor agrees that revising the asset information within eMARS to more precisely reflect its physical location will facilitate observation of the asset's location and condition. If the asset is predominately used in another area of the State it should be assigned to the appropriate district and physically observed by an inventory observer at that location. In relation to the ATV stored at an employee's residence, the eMARS location listed the ATV at the employee's residence, so the location assignment did not appear to be temporary in nature. This location assignment was confirmed during the count by agency personnel, and the auditor was not able to observe the asset during the physical inventory observation.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-FAC-19: The Finance And Administration Cabinet Should Ensure Anonymous Access Is Limited Through Network Neighborhood

Based on an issue originally identified during the fiscal year (FY) 2009 audit of the Office of Financial Management (OFM) related to the ability to access a machine housing the Complete Asset Management, Reporting, and Accounting (CAMRA) application, it was determined that the Finance and Administration Cabinet (Finance) did not properly restrict access to machines on one of its domains. During the FY 2011 audit, review of this Finance domain through Network Neighborhood revealed 193 out of 256 machines within the oversight responsibility of the Commonwealth Office of Kentucky (COT) allowed access without authentication of the requesting user. Of the 193 machines, 128 machines had files or folders that were accessible. Also, the auditor was able to access sub-folders within 53 machines. Of the 53 machines housing sub-folders, 49 machines contained files or documents in which the auditor could view. The information found on the accessible machines included databases, reports, resource drivers, messaging logs, image files, and various executable files.

The auditor also specifically reviewed a machine that houses the CAMRA application. As noted during the prior year audit, our initial review performed on February 18, 2011 revealed an anonymous user had the ability to access files within a production data directory and download them to an external location. Subsequent testing performed on August 30, 2011 determined that the directory housing the CAMRA application was subsequently properly secured.

Further, we reviewed a machine that houses data for the Department of Corrections (DOC). Based on this review, we determined that an anonymous user could view an approved visitor listings per correctional facility either by inmate or visitor name. These listings contained the visitor's name, age, date of birth, relationship, address, and any special conditions.

For security purposes, detailed information concerning the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Sensitive information that is placed in a shared file can be obtained by unauthorized users if not properly secured. Further, if a machine is not configured to prohibit anonymous access, then an intruder could potentially use this available resource to attempt to gain access to the network.

Security policies should be in place to address adequately securing files on local workstations. Access to an agency's domain machines should be restricted to only users requiring access related to a valid business purpose. All anonymous access should be prohibited.

Recommendation

We recommend Finance work with COT to review all machines within the domain discussed above to ensure resources are adequately secured and that policies are implemented to address this issue. Security on all network machines should be configured to prohibit anonymous access, unless a valid business purpose is determined and specifically documented. Periodic reviews of domain machines should be performed to ensure anonymous access is not allowed.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-FAC-19: **The Finance And Administration Cabinet Should Ensure Anonymous Access Is Limited Through Network Neighborhood (Continued)**

Management's Response and Corrective Action Plan

COT is in agreement that access to files and folders must be restricted and that adequate security is in place to protect the data and resources housed on servers. COT is in the process of reviewing the detail information provided by the APA. COT will work with the appropriate business owners for the servers identified within the findings to ensure that the permissions are in line with their business needs and are adequately restricted. Any unnecessary access will be removed at the request of the business owner through existing change management procedures. Access with a required business need will be documented. This review is expected to be completed by the end of the calendar year 2011.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-FAC-20**</u>: **The Finance And Administration Cabinet Should Ensure All Reporting From infoAdvantage Is Accurate And Complete**

As noted in the past four audits, our fiscal year (FY) 2011 audit of the Finance and Administration Cabinet (Finance) revealed that infoAdvantage, the reporting solution used in conjunction with the Enhanced Management Administrative and Reporting System (eMARS) Advantage Financial application, could not be fully relied upon to provide the user with complete and accurate data. During the audit we found instances where reporting was not functioning properly.

We identified four instances where a data field related to a document was not available within the associated universe, but were either explicitly required or prohibited by the Document Control (DCTRL) table and available for use on the online version of the document.

- We noted that the "Commodity Line Description" field is required for the Solicitation Response (SR) document, based on the DCTRL table; however there is not a "Commodity Line Description" field within the Solicitation Response class or linked to the document codes within the Procurement Awards Universe. This field is available to be populated when the document is developed. When a user develops a report of SR documents from the infoAdvantage Procurement Awards universe including these fields, the values for the "Commodity Line Description" are coming from the Award Accounting Line. However, there is not a direct relationship between the Solicitation Response and the Award Accounting Line tables in the Procurement Awards universe. Therefore, the data values returned cannot be relied upon.
- We noted that the "Customer" field is prohibited for the SR and Solicitation Response Wizard (SRW) documents, based on the DCTRL table; however, there is not a "Vendor/Customer Code" within the Solicitation Response class or linked to the document codes within the Procurement Awards Universe. This field is available to be populated when the document is developed, due to the fact that a "Vendor" code is allowable. When a user develops a report of SR or SRW documents from the infoAdvantage Procurement Awards universe including this field, the values for the "Vendor/Customer Code" are coming from the Award Accounting Line. However, there is not a direct relationship between the Solicitation Response and the Award Accounting Line tables in the Procurement Awards universe. Therefore, the data values returned cannot be relied upon.
- We found that the "Cited Authority" field is required for the Contract (CT), Contract 2-Way Match (CT2), Contract KYTC (CTT1), Contract 2-Way Match KYTC (CTT2), Delivery Order (DO), Delivery Order 2-Way Match (DO2), General Accounting Expense/Expenditure (GAX), Purchase Order (PO), Purchase Order 2-Way Match (PO2), Proof of Necessity Agreement (PON2), Commodity Based Payment Requisition (PRC), and Commodity Based Internal Payment Requisition (PRCI) documents based on the DCTRL table; however, the "Cited Authority" field is not available in the Accounting Journal class or linked to the document codes within the General Accounting Universe. Although, the field is available for use when these documents are developed.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-FAC-20</u>: **The Finance And Administration Cabinet Should Ensure All Reporting From infoAdvantage Is Accurate And Complete (Continued)**

- We noted there is no "Event Type" field available within the Accounts Payable - KY Universe; therefore, the auditor was not able to verify edits for required or prohibited fields based on the Event Requirement (ERQ) tables were operating appropriately. Specifically, this issue affected the Check Writer Check Cancellation (CWC) document.

Additionally, we identified three instances where a data field related to a document is available within the anticipated universe, but the linking is not established to allow for reporting that will include the data field.

- We identified instances where the "Event Type" field is available, but not linked, to the Document Header within the Accounts Payable Universe. Without this linking to the "Event Type," it is not possible for reporting to be developed to determine the appropriateness of coding for required and prohibited fields from the ERQ table on the Management Budget (OB1) or CWC, and General Accounting Intercept Payment (GAIP) documents.
- We determined it was not possible to create a report within infoAdvantage from the Procurement Awards Universe that would show all procurement awards associated with a specific federal program, identified by a Catalog of Federal Domestic Assistance (CFDA) number. Currently, a link does not exist between the Award Line information and Cost Accounting Chart of Accounts fields identifying the CFDA number, which would allow this type of reporting.
- We determined the Vendor/Customer information was not linked to the Document Header within the Accounts Payable Universe. Without this linking, it is not possible to ensure edits related to Vendor/Customer fields were operating effectively. Specifically, the GAIP document was affected by this issue.

We are aware Finance has created the KY-Contract Expenditure Summary Universe. Based on our review of this Universe, we determined the universe captures summary expenditure information related to contracts. It does not identify individual disbursement documents. Further, there is no link from the summary data to Cost Accounting Chart of Accounts fields identifying the CFDA number. Discussions with agency staff revealed Finance is in the process of establishing a detailed explanation of what type of payments and adjustments are present in the Universe; however, as the end of fieldwork, this documentation had not been completed.

The lack of a data dictionary in conjunction with the inability of a normal end-user to see the underlying database links related to data elements increases the risk that a user will develop reports based on incorrect data elements, or inadvertently exclude data due to links that the user is unaware of when developing the report. Such reporting issues could cause the results to be inaccurate or incomplete.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-FAC-20**</u>**: The Finance And Administration Cabinet Should Ensure All Reporting From infoAdvantage Is Accurate And Complete (Continued)**

For reports to be useful and valid for management decision-making purposes, the reporting solution used should be appropriately designed to allow users to view data and develop reports that are complete and accurate. A reporting solution must, therefore, be understandable by the end user in structure, content, and context. Further, the underlying structure of the data must be appropriate for the overall accounting regulations of the organization; otherwise, the solution may provide information that is not expected by the end user.

<u>**Recommendation**</u>

We recommend Finance continue work on the infoAdvantage reporting solution, in conjunction with the vendor, to ensure that all known reporting problems are corrected or properly addressed. Further, a review of the established links within the universes should be performed to ensure they are functioning as intended for the Commonwealth of Kentucky.

To further assist end user reporting capabilities, Finance should develop a data dictionary that is available to all users. This data dictionary should include information concerning:

- The originating table location of the data element;
- A description of the data element;
- A description of all pertinent joins involving the data element; and,
- A listing of other data elements that the data element is dependent upon for reporting purposes.

Finally, we recommend Finance ensure a detailed explanation of what fields are available within the KY-Contract Summary Expenditure Summary Universe is completed. In addition, Finance should consider expanding the available information within the universe for further insight into disbursement document level.

<u>**Management's Response and Corrective Action Plan**</u>

Finance is continuing to work with the vendor to ensure that know reporting problems are addressed. We are currently undergoing a conversion from the 3.6 version of infoAdvantage to 3.9. The implementation is scheduled for April 2012. The new version of infoAdvantage contains many Universe changes in many functional areas. It is possible that new data elements will be available in 3.9 that are not currently available today in 3.6.

While we understand and appreciate what a data dictionary would provide to our end users it is not feasible at this time to develop one. There are numerous changes in the 3.9 version of infoAdvantage and both Commonwealth and vendor resources are working diligently to ensure the Universes, reports and ETLs are configured correctly for the April 2012 implementation.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-FAC-21: **The Finance And Administration Cabinet Should Develop And Implement A Formal Policy To Govern Security Of The eMARS Checkwriter Interface Process**

As noted during the previous four audits, the Finance and Administration Cabinet (Finance) has yet to develop or implement a formal policy identifying specific responsibilities of those individuals involved with the Enhanced Management Administrative and Reporting System (eMARS) Checkwriter (CW) interface process. The Finance Statewide Accounting Services (SAS) is ultimately responsible for the processing of CW files. Further, SAS is responsible for ensuring access to CW files is reasonable. SAS should ensure a proper segregation of duties exists between the creator of the CW file and the person certifying the file for processing and check generation through eMARS. These duties are established through the use of eMARS security roles and a manual review process performed by SAS during the central level certification.

Our examination of the CW certification process revealed one CW file where the individual who loaded and certified at the department level was the same user. No documentation was on file with SAS authorizing this individual to perform both actions. In addition, we determined one SAS employee loaded and certified two CW files associated with the Personnel Cabinet's Kentucky Human Resources Information System (KHRIS). Discussions with agency personnel revealed that due to timing, it was critical for these CWs to be loaded and certified quickly. However, since there is no established policy for CW processing, formal authorization was not provided by Personnel and the Controller's Office did not provide approval for this employee to load and certify both CWs. For proper segregation of duties, management should have provided formal approval prior to these actions being taken. A Personnel Cabinet employee did apply agency certification once the CWs were loaded.

Allowing users the ability to both create CW files and certify those files for processing and check generation increases the likelihood of unauthorized payments and may compromise the integrity of data processed through the system. A lack of formalized policy and procedures concerning the CW file access and processes can lead to inconsistent understandings between the agency, management, and users.

Formally implemented policy and procedures concerning CW access and established processes is necessary to allow both management and users to have a clear understanding of respective responsibilities. These controls are imperative to ensure the reasonableness of individual access as it relates to CW files and proper segregation of duties when processing CW files.

Recommendation

We recommend Finance establish formal policy and procedures to govern the security surrounding CW interface access and the submission and certification processes. This effort should include standardized procedures to ensure proper segregation of duties at the agency and central levels between the individuals creating and uploading the CW file and those individuals placing the certification on the CW file. This policy should explain the responsibilities associated with each of the CW interface security roles and discuss the need to assign these roles to different individuals, where possible, to ensure proper segregation of duties.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-FAC-21**</u>: **The Finance And Administration Cabinet Should Develop And Implement A Formal Policy To Govern Security Of The eMARS Checkwriter Interface Process (Continued)**

<u>Recommendation (Continued)</u>

In the event that the same user is required to load and department certify a CW file, the formalized CW interface security policy should require the department head or designee to request prior approval from SAS. Further, if the central level certifier determines that a CW file has already been loaded and certified by the same user, SAS should elicit justification for these actions from the department. SAS should document the request and associated approval or refusal.

We further recommend that if a member of SAS is required to load and certify a CW file, formal authorization is provided by the agency and proper approval is granted by the Controller's Office prior to performing these tasks.

<u>Management's Response and Corrective Action Plan</u>

We have not formalized the procedures surrounding the processing of Checkwriter interface files in eMARS. Since eMARS was implemented in July 2006 we have used the "agency" and "central" checkwriter training manuals in place of a formal policy.

Finance agrees that these procedures should be formalized to account for some of the items in this RCW, such as how to handle checkwriter processing when a single user has both loaded and departmentally-certified the same file. The policy should explain the responsibilities/duties associated with each of the CW security roles.

Finance would like to use the impending 3.9 release of the software as the time to implement the "formalized" policies. We would like to have the policies/procedures completed by the first quarter of calendar year 2012 in time to have them implemented before the April 2012 release of the 3.9 application.

The issue with the SAS employee loading two Personnel CW files and applying the central certification on each was an anomaly and should not be an issue in the future. In both instances SAS was working hand-in-hand with Personnel to ensure the processing of employee paychecks was not delayed. The unusual circumstances surrounding the loading/certifying of the same file had to do with the implementation of the new HR system at Personnel. Never before had we done anything in eMARS like this and we haven't done it since. Had we not processed the checkwriter files this way there would certainly have been employees who would not have received their paychecks in a timely manner.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-FAC-22: **The Finance And Administration Cabinet Should Formalize And Consistently Apply A Policy To Govern The Security Of The eMARS Production Databases**

Our fiscal year (FY) 2011 audit of the Finance and Administration Cabinet (Finance) revealed that informal logical security procedures existed for granting access to the Enhanced Management Administrative and Reporting System (eMARS) production databases and for establishing non-expiring passwords for specific types of accounts. However, these procedures were neither formally documented nor consistently applied. This situation was also noted during the previous three audits.

In order to request access to the eMARS production databases, a COT-F181 form must be completed, authorized electronically, and emailed to the Commonwealth Service Desk for processing within the FrontRange Information Technology Service Management (ITSM) application. Of the 12 new individual users with access to the eMARS production databases, the following was noted:

- One user had a supporting COT-F181 form and ITSM ticket on file for a database to which the user was granted access; however, the ITSM ticket was withdrawn.
- One user had a supporting COT-F181 form and ITSM ticket on file; however, the ITSM ticket was not approved.
- Two users were associated with a Commonwealth Office of Technology (COT) Database Administrator (DBA). Finance does not complete COT-F181 forms for DBAs, since they maintain the databases. One of these accounts is no longer necessary.

Additionally, five instances were identified where accounts were active on one or more databases for employees who were either no longer employed by the state or associated agencies, or who transferred to positions that no longer required access to the production databases. As a result of the inquiry into these accounts, Finance requested the removal of database access for the above accounts. Supporting COT-F181 forms were completed for the revocations. During our fieldwork, Finance implemented an addendum to the Security Policy which requires a review of database accounts twice per year. However, Finance did not complete this review for FY 2011.

There are three user profiles utilized for the eMARS production databases. Two of these profiles are for system accounts or by outside agency automated jobs to extract information from the data warehouse. The accounts within these profiles require non-expiring passwords. The final user profile is used for the remaining individual users who are required to change passwords. The current process related to establishing accounts with non-expiring passwords requires the submission of the COT-F085 Security Exemption Request Form to the COT Security Administration Branch. The agency director and executive director must sign the request, and COT must indicate approval.

There were a total of seven accounts established since the previous audit that was granted one of the profiles allowing non-expiring passwords. For two of the seven accounts, or 28.6 percent, a COT-F085 form was not on file to support this access. It was determined both accounts were incorrectly placed in one of the profiles allowing non-expiring passwords. Both of these accounts were in the incorrect profile for at least 6 months. As a result of the inquiry into these accounts, Finance requested these accounts to be moved to the user profile that requires changing of passwords.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-FAC-22: The Finance And Administration Cabinet Should Formalize And Consistently Apply A Policy To Govern The Security Of The eMARS Production Databases (Continued)

Further, two profiles on one or more databases had a profile setting regarding failed login attempts that did not comply with the CIO-072 COT Userid and Password Policy.

Failure to consistently apply logical security controls could lead to a lack of understanding by management and users that could result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. This situation increases the risk of unauthorized data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources. In addition, whenever electronic signatures are accepted forms of authorization, there should be another form of documentation on file, such as emails, to substantiate those signatures. The existence of unnecessary accounts is inviting to intruders and can lead to those accounts being utilized by unauthorized users.

Established security policies and procedures should be formally documented and consistently applied to provide continuity for policy implementation and set the tone of management concern for a strong system to secure assets and resources. Access should only be granted to approved users, and access should be removed promptly upon termination of employment or when said access is no longer required.

Further, the Userid and Password Policy (CIO-072) states "To prevent individuals from attempting to log-in with UserIDs by guessing passwords, accounts will be locked after three (3) consecutive invalid log-in attempts."

Recommendation

We recommend Finance formalize and consistently apply logical security procedures to ensure only authorized access is granted to the ePayment Gateway, Finance and Administration, Vendor Self Service, and infoAdvantage production databases. These procedures should require the COT-F181 form for establishing or changing access for accounts and the COT-F085 forms for authorizing a non-expiring password to be consistently used. Furthermore, emails authorizing these forms should be retained for audit purposes. All documentation establishing a user's access should be retained in a central repository for audit purposes.

In accordance with the updated policy, we also recommend Finance perform semi-annual reviews of the access granted to the production databases to ensure only authorized users have access. Items identified during this review and actions taken to resolve any issues should be maintained for audit purposes.

Further, the profile settings should be set to comply with the COT password policy.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-FAC-22:**</u> **The Finance And Administration Cabinet Should Formalize And Consistently Apply A Policy To Govern The Security Of The eMARS Production Databases (Continued)**

<u>**Management's Response and Corrective Action Plan**</u>

COT has existing procedures for granting and removing access to production databases. These procedures require the appropriate documentation and authorization prior to completing the change to grant or revoke database access. All documentation regarding these changes is processed in accordance with COT change management processes and stored within the service ticket system used by COT. This ticket system serves as the central repository for all information regarding these changes. Finance and COT will work together to ensure that these procedures are consistently applied.

Finance has developed and implemented formalized procedures for the review of production database access to be completed on a semi-annual basis.

COT has reviewed the profiles mentioned in the details findings as provided by the APA. COT is in agreement that one profile is not in compliance with the CIO-072 and is taking the required actions to bring the profile in to compliance. The second profile that was identified in the detail findings does not house user accounts and is reserved for system level accounts. Implementing the recommendations on this profile could have negative implications on business. COT is in the process of completing and submitting a F085 to document this exemption from policy.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-23: KDE Should Refrain From Charging Salaries And Benefits To Federal Grants Unless Documentation Exists To Support Assigning Employee Time And Effort To The Grants

The Kentucky Department of Education (KDE) moved salary and benefit expenditures for two employees from the general fund to a federal program without documentation to support the move. Further, the transaction's processing reflected improper segregation of duties because one of the employees whose salary was moved prepared the transaction.

We tested 61 expenditure transfers involving federal funds. We found one transaction, JV2E 1100003402, in which the preparer moved part of her own salary and benefits and that of another employee from the general fund to the Special Education Grants to States - Preschool program (established in the Individuals with Disabilities Education Act and referred to as the IDEA B Preschool program). The amount of salary and benefit expenses moved totaled $37,763.73. There were no timesheets or other documentation linking the personnel involved to the IDEA B Preschool program or showing how the amount of salary and benefits charged to IDEA B was determined.

KDE management stated they estimate those employees spend approximately half their time on IDEA B Preschool, so management concluded that charging the program for one quarter's salary and benefits would be acceptable. No record exists in timesheets or elsewhere to document that employee time was spent on federal programs.

Allowing an employee to initiate transactions involving her own salary indicates employees and supervisors lack knowledge about segregation of duties.

KDE did not document the extent to which these employees' activities relate to the IDEA B Preschool program. Salary and benefits in the amount of $37,763.73 were charged to this federal program without adequate documentation.

A lack of segregation of duties allowed an employee to move her own salary from one fund to another.

Good internal controls dictate that appropriate documentation should be maintained to support transactions and that there is proper segregation of duties relating to employee salaries.

Mitigating controls which require that JV2E's be approved by the Branch Manager of Financial Management are in place. But these mitigating controls are not a substitute for segregation of duties and fail to prevent management override of controls.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-23: KDE Should Refrain From Charging Salaries And Benefits To Federal Grants Unless Documentation Exists To Support Assigning Employee Time And Effort To The Grants (Continued)

Recommendation

We recommend KDE document current job descriptions for all employee positions, including the approximate proportion of time spent on each federal grant whenever that is expected to be consistent for each pay period. We also recommend that employees whose work can be readily assigned to multiple federal programs and/or non-federal programs, while the proportion varies from pay period to pay period, should document in their timesheets the time spent on each chargeable and non-chargeable program. KDE should document any movement of an employee's personnel costs to different programs and funds with either the employee's job description or timesheet.

We also recommend KDE maintain appropriate segregation of duties. Employee training should regularly address how this is implemented and why it is important.

Management's Response and Corrective Action Plan

The salaries questioned in JV2E 11*3402 are for staff who works directly with the IDEA B Preschool grant. The portion of the salary that was moved was time staff worked directly on grant related activities. In the future, staff will properly document time spent working on multiple projects (federal and state); the time will be recorded accordingly on the employee's timesheet.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-24: **KDE Should Ensure Consistent Approval And Verification Of All Expenditure Transactions**

The Kentucky Department of Education (KDE) has not consistently followed its procedures to document approval of expenditures and to verify payments were processed as intended. Standard payment documentation procedures consist of attaching a coversheet to the payment document; the coversheet records the date the transaction was entered into the accounting system, and the date the transaction was verified as having successfully gone through the accounting system. The coversheet is also stamped with a dated approval stamp indicating that someone other than the person who entered it into the Enhanced Management and Reporting System (eMARS) approved the transaction. We tested a sample of 64 federal expenditure transaction lines at KDE. We noted 19 transaction lines involving 8 GAX documents that lacked a dated approval stamp. Of these, 5 transaction lines from 4 GAX documents also lacked the date verified.

The apparent cause was KDE's failure to follow consistently its payment documentation procedures.

KDE's internal controls concerning payment documentation are designed to ensure accurate and complete transaction processing. Paper supporting documentation related to a payment transaction initiates payment. The eMARS document should reflect supporting documentation, but failure to approve the paper documentation provides no assurance that this is the case. The approval stamp and date signals the payment transaction's originator to verify that payment has been executed. The lack of an approval stamp could delay verification of the transaction.

The failure to verify the transaction means that KDE will not know if the transaction was successfully paid to the requesting district or vendor until they see the Finance and Administration Cabinet's exception report. This results in a delayed payment to the vendor or district.

Internal controls are effective only when performed thoroughly and consistently.

Recommendation

The auditor recommends KDE require that employees consistently follow payment documentation procedures.

Management's Response and Corrective Action Plan

As of September 2011, KDE staff certify cover sheets are attached, date verifications are made, and stamps are applied prior to completion. Document processors have been notified to take additional care in adhering to this process in the future.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-25: **The Kentucky Department Of Education Should Ensure All Agency Machines Are Properly Configured To Include Only Necessary Services**

Our fiscal year (FY) 2011 security vulnerability assessment on machines owned by the Kentucky Department of Education (KDE) revealed 37 of 307 scanned central level machines, or approximately 12 percent, could potentially be mis-configured. A mis-configured machine could waste resource, entice an attack using ports that are unnecessarily open, have default services running, or allow excessive hypertext transfer protocol (HTTP) methods. The ports open on each of these machines should be reviewed to ensure they have a specific business purpose and that the services are properly authorized. Nine of these machines contained open ports addressed with the agency during the previous audit. An additional machine had an open port that was reported during the previous two audits. Of the 37 potentially mis-configured machines, 14 machines reported the potential use of a remote shell suite of programs.

For security purposes, detailed information that would identify the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

System misconfigurations that allow unnecessary services can negate other security configurations established on the machine, increase potential security vulnerabilities, and provide enticements for intruders to enter the system. Specific to web servers, excessive HTTP methods provide additional avenues for system intrusion. The use of unsecured transmission programs also increases the risk of compromised data transmissions.

To assist in securing a network adequately, it is necessary to ensure all machines and web services are configured to only allow necessary services to operate. Only necessary business-related ports should be open. Default services should be disabled. Only the necessary HTTP methods (such as POST, HEAD, and GET) should be supported on agency web servers.

Recommendation

We recommend KDE take the necessary actions to ensure the noted services on each machine have a specific business purpose and are properly authorized. If the service is necessary, it should be reviewed to ensure it is properly authorized, licensed, and configured as well as adequately secured. Default services should be disabled or removed from all servers. Any unnecessary services should be disabled or the associated ports should be closed. HTTP methods not required for the operation and maintenance of a web server should be disabled. If the remote shell suite of programs is being utilized, it should be replaced by a more secured shell suite.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KDE-25**</u>: **The Kentucky Department Of Education Should Ensure All Agency Machines Are Properly Configured To Include Only Necessary Services (Continued)**

<u>**Management's Response and Corrective Action Plan**</u>

KDE will review all KDE managed servers noted and take action to address. We will remove unnecessary and default services where possible. The UNIX hardware is limited and dated, which limits the ability to update the support tools, RTools. These are used on the UNIX environment supporting the MUNIS application.

There is a current KDE project to migrate the MUNIS application to another operating system and hardware platform. The districts are migrating over the next 18 months. RTools, which were specific to the UNIX platform, will no longer be needed.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-26: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Should Expand And Consistently Apply Logical Security Policies For The KETS Network And MUNIS

Our fiscal year (FY) 2011 audit of the Kentucky Department of Education (KDE) system controls revealed weaknesses related to the Office of Knowledge, Information And Data Services (KIDS) security surrounding the Kentucky Education Technology System (KETS) network and MUNIS. However, some improvements have been made since the prior year audit. Although KDE has developed an overarching Security Program, Acceptable Use Policy, and Access Control Policy to address appropriate use of resources within KDE, these policies do not specifically address IT responsibilities associated with the KETS network and MUNIS. At this time, there are no plans for a policy specific to KETS and MUNIS. Further, none of these address security controls specific to KIDS servers. Similar issues have been addressed to the agency during the past four audits.

KIDS management is responsible for central workstations and servers, as well as KIDS-related employee and contractor network access. Further, audit logging was enabled by KIDS for all UNIX and Windows-based servers; but, no security policy was formalized at the central level concerning procedures to periodically review the audit logs for users with high-level privileges.

All KDE users were granted Local Administrator rights on their workstations. This is considered unnecessary access for most KDE employees. Technical and support staff should be the only personnel with this level of access to prevent the accidental or intentional introduction of viruses or the loss of programs or data and to ensure workstations utilize only approved software.

In addition, an access request form was not developed for requesting and granting access to agency resources and applications. Currently, the KIDS Data Center Services team grants server access. The level of access is determined by the Division of District Support (DDS). Employees are required to sign Confidentiality Agreements upon hire. However, this form did not specifically identify the agency resources or applications to which the user requires access, did not list the level of access to be granted to the user, and was not required to be updated for changes in access. KDE intends to require access requests be processed through the KETS Service Desk in the future, although this is not currently a formal procedure.

The school districts primarily use the MUNIS financial system to manage their finances. In addition, certain financial and staffing reports exist that KDE uses from the districts for state and federal purposes. When districts are ready to forward files to KDE, a transfer utility program transfers the file to a Gateway server maintained by KIDS, and then the files are transported daily to a File Transfer Protocol (FTP) server and temporarily stored for pickup by the DDS staff. As MUNIS is a purchased system, specialized for Kentucky, select vendor staff also has access to the districts' MUNIS servers in the event that support is needed. For FY 2011, four new vendor support staff were identified with update access to district servers. A Confidentiality Agreement was not on file for one of the four users, or 25 percent. Further, KETS Service Desk tickets were not completed for these four MUNIS users.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-26: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Should Expand And Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)

During FY 2011, one new user account was established on the Gateway server and added to two security groups on the Gateway server. Appropriate documentation was provided supporting the account setup and addition to the security groups. However, we identified five disabled accounts on the Gateway server that remained members of one or more security groups on the server.

Although no new Jefferson County school district employees were granted access to the servers since FY 2009, we determined KDE still does not request Confidentiality Agreements or other supporting documentation for Jefferson County employees. During the FY 2010 audit, KIDS planned to establish an agreement with Jefferson County to ensure all Jefferson County employees with MUNIS access agree to an appropriate level of confidentiality. However, follow up performed during FY 2011 revealed this had not been done.

Although KIDS had not implemented a formal security policy related to specifically accessing MUNIS servers or software in the districts, an informal process was in place for KDE or KIDS staff to first obtain authorization from the school district before accessing the district's MUNIS server or software. A log was maintained at KIDS to track access to district servers by the root account. However, review of this log revealed that the activity being captured does not include the district server being accessed.

Without strong, formalized, logical security controls, the opportunity increases for unauthorized modification to financial and staffing reports as well as the likelihood of errors or losses occurring from incorrect use of data and other resources. Granting users local administrator rights to their workstations allows those users the ability to download and install unauthorized software as well as possibly pirated data.

Formalized security policies set the tone of management concern for strong system security and provide a security framework used to educate management and users of their responsibilities. System security should be administered in such a way as to ensure proper segregation of duties. System access should be limited to the level necessary for performing assigned duties, and system accounts should not be shared to ensure individual user activity could be tracked. Granting users system administration access to their computers increases the likelihood that unauthorized and unlicensed software could be installed and increases the chance of system attacks by viruses or other malware.

Further, access to servers that house critical financial and staffing data should be restricted to only necessary employees. Intruders often use inactive accounts to break into a network. If an account is not used within a reasonable period of time, the account should be disabled until it is needed. This minimizes the possibility that an unauthorized user will access the account. Accounts that are not anticipated as being used in the future should be periodically purged. Finally, system user accounts and audit trails should be reviewed periodically in order to ensure identification and tracking of user activity.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-26: **The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Should Expand And Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)**

Recommendation

We recommend KIDS standardize security responsibilities for all KIDS employees and ensure critical programs and data related to the KETS network and MUNIS, as well as the servers housing such data, are properly secured. The agency should, at a minimum:

- Develop formal procedures related to the management of locked and disabled accounts related specifically to the KETS network and MUNIS. These procedures should address the process of disabling or removing terminated employee accounts, as well as unnecessary generic accounts. Accordingly, a methodology should be developed so that a distinction can be made between accounts that can be safely removed versus accounts that must be retained on the server for performance reasons or audit trail history. These procedures should include the requirement for a periodic review of disabled and locked accounts to determine their necessity. If an account is deemed unnecessary, it should be permanently removed from the KIDS servers unless there is a pragmatic reason for maintaining the account, in which case it should be, at a minimum, disabled. All disabled accounts should be removed from current group membership on the KIDS servers.
- Evaluate all security group assignments on the KIDS servers to ensure that all assigned users require membership in the assigned groups. Implement procedures to periodically review security audit logs with special attention being given to users with high-level privileges so that inappropriate use of resources can be further investigated, if the need arises.
- Restrict Local Administrator rights to technical and support staff.
- Finalize and implement plans to establish an agreement with Jefferson County to require a confidentiality agreement for all Jefferson County employees with access to KIDS servers.
- Develop and implement a user access request form to explicitly identify access being requested to resources or data and all necessary approvals required. All users, both internal and external to KDE, requesting access to KDE resources or applications should be required to complete this form. The completed forms should be approved by appropriate management and should be maintained in the user's file as supporting documentation for their access. Until an access request form is established, KIDS should continue to use KETS Service Desk tickets to establish or alter access. These tickets should be maintained for audit purposes.
- Ensure sufficient information is captured with the log used to track access to the district servers to allow the reviewer to determine the server on which the activity took place.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-26: **The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Should Expand And Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)**

Management's Response and Corrective Action Plan

KDE will institute a unified process to ensure that MUNIS user accounts belonging to terminated employees will be deleted or disabled, except where the disabling of such accounts will interrupt normal operation. Due to the large number of services dependant on Active Directory for user access, including MUNIS, KDE has started a formal process to review and remove accounts.

KDE plans to develop a process to review the security group assignments of sensitive servers. KDE does not have adequate resources, staff or tools to regularly review security logs in an effective and efficient manner. Logs are retained short-term for review once an incident/issue is identified.

KDE continues to investigate current methods available to reduce the number of KDE workstations with Local Administrator rights.

The KDE is currently working on a solution to remove the need for district employees to have access to a KIDS server. In the meantime, KDE will establish a process with Jefferson County for the management of confidentiality agreements for all Jefferson County employees who have access to the referenced KIDS server. We will document the permissions granted and the approval and make them available.

KDE will continue to expand, enhance and standardize the electronic access control processes for permissions to network and critical applications.

We will continue to investigate new methods to capture the MUNIS district server identification within the district server access log. There is a current KDE project to migrate the MUNIS application to another operating system and hardware platform. Once complete, KDE staff will no longer be responsible for maintaining the district MUNIS servers.

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-27: **The Division Of School And Community Nutrition Should Ensure Proper Segregation Of Duties**

Our fiscal year (FY) 2011 audit of the Kentucky Department of Education's (KDE) Division of School and Community Nutrition's (DSCN) School and Community Nutrition Payment (SCNP) Application revealed DSCN did not employ proper segregation of duties between the system administration and processing functions. This issue has been addressed with DSCN for three consecutive years.

Currently, security levels available within the SCNP application will not allow sufficient segregation of duties. DSCN has reviewed staff duties and developed a proposed list of changes to access security levels to promote greater segregation of duties within the SCNP application. However, the Commonwealth Office of Technology (COT), which developed and currently maintains the application, has not completed the necessary configuration changes to update the security levels in order to implement the newly designed roles.

Testing revealed a Child Nutrition Program Consultant was provided full administrative control over the security as well as the ability to process data through the system. For proper segregation of duties, Child Nutrition Program Consultants should not be allowed to submit and approve claims processed through the system. Testing performed revealed this individual approved one For-Profit and ten Not-For-Profit claims submitted by various Sponsors during August 2010. As a result of our testing, this individual's access was changed to the appropriate level during fieldwork. Given the fact that the system does not retain historical data and no formal review process is in place, elevated or inappropriate levels of access could potentially allow controls to be circumvented.

We are aware that DSCN intends to implement a formal review process to ensure corrected claims submitted by central-level staff are appropriate and authorized by March 2011.

Further, DSCN has issued an RFP to facilitate a full upgrade/replacement of the legacy SCNP application. Once the new SCNP application is in production, the highest security level, which allows full administrative control, will be limited strictly to a testing environment.

Employing strong segregation of duty controls decreases the opportunity for unauthorized modification to files, data, and programs, and decreases the likelihood of errors or losses occurring because of incorrect or unauthorized use of data, programs, and other resources.

Employees that process payments should not be allowed to input or approve a claim on the system. Smaller organizations that cannot easily segregate duties should implement compensatory controls to supervise and monitor system activities to ensure erroneous claims are not processed.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-27: The Division Of School And Community Nutrition Should Ensure Proper Segregation Of Duties (Continued)

Recommendation

We recommend DSCN continue to work with COT to ensure the proposed security levels and associated roles promote adequate separation of duties and are appropriately implemented within the current SCNP application. Once implemented, DSCN should perform a review of access rights granted to all central level staff to ensure access rights are appropriate and reasonable given their individual job functions. These new security levels and roles should also be taken into consideration when designing the security of the new SCNP application currently under development.

Further, we recommend DSCN finalize and implement a formalized review process to ensure all claims submitted and approved within the current application are appropriate. Adequate documentation supporting this monthly review should be maintained for audit purposes.

Management's Response and Corrective Action Plan

An explanation is necessary on how claims were seemingly approved for one for-profit and ten not-for-profit claims by a program consultant. This situation occurred when a program consultant and administrator were both assigned the same user id. This inadvertently assigned an inappropriate security level to the program consultant. We corrected this situation as soon as it was identified. To prevent this from recurring, we will maintain a current user ID list for the application and verify its accuracy.

COT has been in the process of developing the new security levels, which were placed in the test environment on 5/13/11. We plan to begin testing the security levels immediately to verify the security levels function in accordance with our design document. When the user acceptance testing has been successfully completed these new security levels will be moved to production. We will then share the new security levels and changes in job responsibilities with the claims staff, who will be primarily affected.

The last person who modifies the claim is logged. We will request COT provide us with a list of any claim modified by SCN staff to ensure all paid claims have a valid reason, which would be late/corrected/audited/reviewed claims. This review will be conducted on a monthly basis to ensure all paid claims processed through the system are appropriate.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-28: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Should Expand And Consistently Apply Program Modification Procedures

Our fiscal year (FY) 2011 audit of the Kentucky Department of Education (KDE) system controls revealed the program modification process developed by the Office of Knowledge, Information and Data Services (KIDS) is not sufficient to ensure only authorized changes to the Information Technology (IT) environment, which includes the Municipal Information System (MUNIS), are made. Similar issues have been noted for the past five audits; however, some improvements have been made since the prior year audit.

KIDS developed and implemented a formalized Change Management Policy and Procedures Manual. This manual stipulates changes made to the IT environment must be documented on a properly completed and approved Request for Change (RFC) form. However, the manual does not specify the individuals responsible for performing testing of a proposed change or migration of a change to production. The current informal process has members of the MUNIS Support Team and one MUNIS vendor employee responsible for testing MUNIS-related changes. On the approval of the Project Manager, MUNIS-related changes are moved into production by a member of the MUNIS Support Team. This informal process could lead to a segregation of duties issue between the request for change, development of the change, testing of the change, and promotion to production. It could also lead to a failure to complete any one of these tasks.

Over the past five years, we have recommended the implementation of digital signatures on the RFC forms. However, due to budgetary constraints, KIDS does not anticipate moving to this technology. Since the RFC forms are submitted and approved electronically through a simple process of typing an individual's name in the approver's field, there is not sufficient information maintained within the documentation to substantiate who provided an approval for a change. Also, KIDS had not developed a listing of authorized Requesters/Owners who can request a change to the IT environment.

Additionally, our review of five KDE utilities revealed 231 lines of code changed within one utility program affecting processing. An associated RFC form was provided; however, it did not reflect approval from the second line supervisor or the date in which testing was performed. Further, the description of the change was vague and did not adequately describe all the changes made.

Finally, an examination of eight RFC forms related to changes to the MUNIS system since our prior year review revealed five forms were missing at least one of three required approvals. Also, the testing section of two of these forms was incomplete. The other three forms were properly completed; however, the testing was designated as being completed by the MUNIS Support Team. Since this team is made up of three individuals, there is no way of knowing who actually performed the testing and moved it to production.

Failure to properly apply and monitor change control procedures increases the risk that incorrect or unauthorized changes could be made to critical applications and, potentially, be moved into the live production environment.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-28: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Should Expand And Consistently Apply Program Modification Procedures (Continued)

Program modification control procedures should be consistently applied in order to ensure that only appropriately authorized changes to critical applications are made and implemented within the production environment. All program modifications are to be requested on a Request for Change form. They should be monitored and thoroughly documented, with procedures established to log all program change requests, review and approval processes to be followed, and supporting documentation to be maintained for the process. Changes to KIDS utilities should also be included in the change management process.

Recommendation

We recommend an expansion of the KIDS Change Management Policy and Procedure manual to identify specific individuals or groups responsible for performing changes, testing changes, authorizing promotion of changes, and moving changes into production. All change management controls should be consistently applied to critical system software and utility programs.

All changes should be requested and approved using the RFC form. Since KIDS does not plan to implement electronic signatures, individuals responsible for approving the RFC form either should be required to print, sign, and date the RFC form or provide email correspondence indicating approval which can be linked to the RFC form in order to validate approvals and avoid segregation of duties issues.

Finally, the requirement for support related to changes to the utility programs should be expanded. In the event a major change is made to a utility program, KIDS should perform a comparison of the old and new versions of the utility code to determine which lines specifically were changed and provide an explanation of the necessary changes. In instances where a minor change to a utility program is required, KIDS should provide a summary of the changes made. This can be done for each module or section of code changed. Each time a change is made to a utility program, a brief overview of the change should be documented in the 'Revision' section of the source code.

RFC forms as well as other supporting code compare or change descriptions should be maintained for audit purposes.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-28: The Kentucky Department Of Education's Office Of Knowledge, Information And Data Services Should Expand And Consistently Apply Program Modification Procedures (Continued)

Management's Response and Corrective Action Plan

There is a current KDE project to migrate the MUNIS application to another operating system and hardware platform. Once complete, onsite vendor staff will no longer be responsible for maintaining utility codes. KDE will review the KDE/KIDS Change Management documentation and add the following improvements:

- *Identify groups responsible for performing, testing, and approving changes for critical system software and utility programs.*
- *KDE will more explicitly document the RFC approvals.*
- *Identify and track major changes to utility code for critical systems in the Revision section of the code.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-29: The Division Of School And Community Nutrition Should Develop Formal System Documentation To Support Processing Performed By The School And Community Nutrition Payment Application

Our fiscal year (FY) 2011 audit of application level logical security revealed the Kentucky Department of Education's (KDE) Division of School and Community Nutrition (DSCN) did not maintain current, technical documentation describing the processing performed by the School and Community Nutrition (SCNP) Application. This issue has been addressed with DSCN for three consecutive years.

The SCNP application, which was developed by and is currently maintained by the Commonwealth Office of Technology (COT), went into production in 1982. Updates and expansions of services were made to the application over the last 29 years, most recently in October 2010. Discussion with COT personnel during the FY 2009 audit revealed no technical manuals existed documenting the design or functionality of the system. They did indicate a series of binders had been maintained containing notes documenting how to perform different tasks within the application; however, many of the notes were identified as being outdated or obsolete. For FY 2011, documentation had been developed by COT in relation to the last system upgrade. This included numerous use cases, which provides a basic understanding of current business processes.

DSCN includes on their website the Online Reporting System User Guide and Application and Agreement User Guides for the various programs supported by DSCN. These are updated annually and provided to Sponsors during mandatory annual training. These documents provide a general overview of business processes and procedures associated with submitting claims and applications/agreements, but they do not provide a technical overview of system processing. During FY 2010, DNHS staff also provided to the auditors a Nutrition and Health Services (NHS) Technology Manual; however, it was determined at that time to be several years out of date. Further, this manual was not updated during the FY 2011 audit.

For FY 2011, DSCN hired a business analyst who will be responsible for formulating clear, comprehensive, and well-organized business rules of the existing system. This project was expected to begin in January 2011. At the time in which fieldwork was completed, technical documentation still needed to be compiled and organized as a reference manual.

We are aware DSCN has issued an RFP to facilitate a full upgrade/replacement of the legacy SCNP application. Within the requirements for the system, the vendor must provide several documents at initial implementation including functional and technical specifications as well as user guides.

Lack of documentation increases the likelihood of erroneous or incomplete processing. It further increases the likelihood of unauthorized data modification, destruction of assets, and interruption of services.

Proper documentation should be maintained for each critical program in production in order to, at a minimum, identify the purpose of the programs, the origin of data, the specific calculations or other procedures performed, and the output of data or reports.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-29: The Division Of School And Community Nutrition Should Develop Formal System Documentation To Support Processing Performed By The School And Community Nutrition Payment Application (Continued)

Recommendation

We recommend DSCN continue working with COT to develop documentation that provides an understanding of critical programs or jobs currently running in production. The documentation could include a network diagram; user and operational manuals; and flowcharts, diagrams, or descriptive narratives of functional areas. Information normally collected in design documents includes a technical description of the program, sources and location of files used by the program, and the processing steps for main functions. This documentation should be used during the planning of the new SCNP application for cross-walking procedures from the old to the new system.

Management's Response and Corrective Action Plan

Discussions have been held with COT on the state of the current system documentation. COT has researched what documentation is available; including any documentation generated through past development efforts. COT's findings revealed that some documentation is available on the mainframe. When a job is updated this information must be updated and moved to production with the job. This documentation includes the job description, job frequency, description of the most recent change, input and output data sets, and reports generated from the job. Based on this inventory plans will be made to ensure sufficient documentation is available on critical programs in production.

The former Technology Manual incorporated many different areas that are irrelevant to SCN's current operations, including phone setup, use of the copier, etc. Portions of the Technology Manual pertinent to the current online application system were extracted and transformed into a mainframe user manual. The manual includes the most comprehensive step-by-step instructions and accompanying code definitions to date. The user manual will be beneficial to current staff as well as assist with the transition to the new system.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-KDE-30</u>: **The Division Of School And Community Nutrition Should Enable System Auditing That Will Provide Documentation To Allow For Appropriate Monitoring Of Security Violations On Its School And Community Nutrition Payment System**

Our fiscal year (FY) 2011 audit of application security over the Kentucky Department of Education's (KDE) Division of School and Community Nutrition's (DSCN) School and Community Nutrition Payment (SCNP) Application revealed historical transactions, including those related to security, are not logged or tracked within the system. The United States Department of Agriculture (USDA) Southeast Regional Office (SERO) of Food and Nutrition Service (FNS) had a finding related to this issue since FY 2007. This is the third consecutive year that this issue has been addressed to DSCN.

The SCNP application, which was originally developed and is currently maintained by the Commonwealth Office of Technology (COT), retains the date of the last update to claims and approvals, as well as the user Id of the person that made the update. However, it does not identify what information was changed. Further, the system does not retain a historic version of transactions.

Additionally, users with an access level of '1' are given full control over claims, sponsor and organization screens, applications, agreements, approvals, system access, and bank balances within the application. Since the system does not maintain a history of changes to security levels, it is not possible for the system administrator or management to review changes to a user's security level within the system. DSCN has reviewed staff duties and developed a proposed list of changes to access security levels to promote greater segregation of duties within the SCNP application. However, during FY 2011 fieldwork, COT had not completed the necessary configuration changes to accommodate these improvements.

We are aware DSCN has issued an RFP to facilitate a full upgrade/replacement of the legacy SCNP application. With this planned system change, DNHS does not believe it is feasible to enable security auditing on the current SCNP application. However, they hope to implement a formal review process over corrected claims submitted by central-level staff by March 2011.

Failure to adequately monitor security events and transaction logs could result in failure to identify suspicious activities that may be occurring on the system.

Without effective monitoring of event and security logs, the risk of inappropriate transactions being processed by the system increases. A logging and monitoring function within an application and consistent review of the results enables early detection of unusual or abnormal activities.

> <u>Recommendation</u>
>
> As DSCN is in the process of developing a new SCNP application, we recommend DSCN work in conjunction with COT to ensure the proposed security level changes within the currently SCNP application are incorporated to improve segregation of duties and, thereby, system security. Until a new system is in place, DSCN should implement a formal review process to ensure all corrected or revised claims and approval changes are appropriate and being made by authorized central level staff.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KDE-30: The Division Of School And Community Nutrition Should Enable System Auditing That Will Provide Documentation To Allow For Appropriate Monitoring Of Security Violations On Its School And Community Nutrition Payment System (Continued)

Recommendation (Continued)

An appropriate level of management should perform regular reviews of changes being made by central level staff within the SCNP application. This review should be documented and retained for audit purposes.

Further, we recommend DSCN ensure audit logging is a requirement for the new system. Once the new system is implemented, DSCN management should review the event and history logs on a regular basis. Identified security violations should be thoroughly documented to ensure they are resolved in a timely manner. This review should be documented and retained for audit purposes.

Management's Response and Corrective Action Plan

A formal review process to ensure corrected/revised claims are appropriate and being made by SCN staff has been implemented by SCN. COT provides a spreadsheet of claims modified by SCN staff in the prior month. The monthly audit review worksheets are being reviewed by an SCN administrator.

Business requirements for the new system include maintaining of an audit log of past versions and the user ID associated with the change. In addition, the vendor notes the proposed system tracks statistics that may be related to suspicious access activities such as repeated failed login attempts and attempting to access functions the user is not authorized to perform.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KEHP-31**</u>: **The Personnel Cabinet Should Submit Program Modifications To The KHRIS Vendor To Develop Required Static Reports**

We audited the Kentucky Employees' Health Plan (KEHP) and determined the computer systems used to generate the health insurance premium billings and track the premium collections, the Legacy system and the Kentucky Human Resources Information System (KHRIS), failed to produce static reports needed to perform required month-end closing procedures. As a result, the Department for Employee Insurance (DEI) was unable to perform reconciliations of the health insurance premium billings for state-wide plan member enrollments to the health insurance premium collections, processed by the Legacy system and KHRIS. In addition, DEI was unable to formally reconcile the health insurance billings and collections from the Legacy system and KHRIS to the eMARS statewide accounting and reporting system.

The Legacy system was in use during the first nine months of FY11. Based on data queries of the Legacy system, DEI reported a net un-reconciled difference of $4,341,737 for health insurance premium and Health Reimbursement Account (HRA) collections over actual Legacy billings as of March 31, 2011. An additional un-reconciled difference resulted from the Legacy system's reported $710,060 of health insurance premium and HRA collections over the actual revenues reported by eMARS as of March 31, 2011.

Effective April 1, 2011, KHRIS replaced the Legacy system. Based on data queries of KHRIS, DEI reported a net un-reconciled difference of $2,142,217 for health insurance premiums and HRA billings over actual KHRIS collections for the fourth fiscal quarter ending June 30, 2011. However, eMARS reported a net $832,631 of health insurance premiums and HRA revenues over the collections per KHRIS for the fourth fiscal quarter ending June 30, 2011.

The computer systems that generate the health insurance premium billings and track the premium collections, Legacy and KHRIS, are not designed or programmed for a formal month-end closing, or to produce monthly static reports necessary for DEI to perform its required monthly reconciliations.

Without formal system (KHRIS) month-end closings, and system-generated bi-monthly and/or monthly static reports of payroll, health insurance, and other benefits information, DEI cannot accurately perform the required monthly reconciliations of the billings for state-wide plan member enrollments to the health insurance premium collections. Likewise, without reliable static system reporting DEI cannot be assured of the accuracy of the health insurance billing and collections information processed by KHRIS and reported in eMARS.

Good internal controls dictate that system-generated (i.e., KHRIS) reports be designed to provide accurate, useful, and timely financial data and other supporting detail. Such reports should provide adequate detailed information useful for the timely reconciliation of KEHP billings and collections of the various plan members, as well as the reconciliation of the KHRIS financial data to the eMARS state-wide accounting and reporting system.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KEHP-31**</u>: **The Personnel Cabinet Should Submit Program Modifications To The KHRIS Vendor To Develop Required Static Reports (Continued)**

<u>**Recommendation**</u>

We recommend the Personnel Cabinet submit the necessary program modification request(s) to its vendor that addresses the KHRIS reporting functionality deficiencies. KHRIS program modifications to the reporting feature should provide a formal monthly closing that generates static reporting of all payrolls, health insurance, and other benefits information; however, internal controls over access and usage must also be defined and implemented. In addition, the Personnel Cabinet should collectively coordinate with key directors, management, and staffing within the various divisions and departments of Personnel, and with the KHRIS vendor to discuss additional concerns and needs about KHRIS with respect to internal controls.

<u>**Management's Response and Corrective Action Plan**</u>

The Department for Employee Insurance appreciates the efforts of the State Auditor of Public Accounts to assist with improvements to reporting functionality for system balancing. The Personnel Cabinet strives to ensure that reporting totals are accurate and made available to users for monthly closing procedures. Detailed information is essential for reconciliation of KEHP billings and collections of plan members and balancing financial data to the state-wide accounting and reporting system.

DEI completely agrees with APA that additional reporting is essential to successfully close each month on a regular basis, and we further agree that closing each month routinely is best practice. The KHRIS team is working to develop reports to resolve the reconciliation issues causing delays in the subsidiary ledger reconciliation to eMARS. With the new KHRIS system implementation, DEI did not have sufficient reporting capabilities and staff is working rapidly with the technical support team to obtain and use the reports provided (e.g., receivables, month end closing, etc.). DEI reviews accounts, gathers data to reconcile on a monthly basis and ensures the results are reviewed by management. Because the newly built reports provide summarized instead of bulk activity, we expect that this will help expedite the monthly reconciliation process.

DEI will continue to use manual processes to verify and check data as an additional control even when the technical issues are resolved. DEI also plans to use internal resources as necessary to work together to ensure the reconciliation process is completed timely and make changes to the process as needed. Then going forward, the subsidiary ledger and eMARS financial reconciliation will be completed within the timeline as updated in our procedures.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KEHP-31**</u>**: The Personnel Cabinet Should Submit Program Modifications To The KHRIS Vendor To Develop Required Static Reports (Continued)**

<u>**Management's Response and Corrective Action Plan**</u>

A cabinet meeting has been conducted with DEI business owners, KHRIS Quality Assurance, programming staff and audit team members to address reporting requirements necessary to complete reconciliation processes. The KHRIS team has performed a business analysis for identifying business needs to balance Commonwealth employee payroll benefit deductions. DEI has requested the necessary reports through the KHRIS change process but knows that funding is limited and that the KHRIS Team has to contend with competing priorities. We fully concur with the APA recommendation.

The Division of Technology Services (DTS) as a Division in the Personnel Cabinet and charged with Information Technology support for KHRIS understands the business needs for additional and/or enhanced reporting relative to this comment. Thank you for APA's continuing efforts to ensure the accuracy of the human resource data for the Commonwealth.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KEHP-32**: **The Personnel Cabinet Should Have Appropriate Reports Available To Reconcile KHRIS Information To eMARS**</u>

Effective April 1, 2011, payroll and personnel actions are processed through the Kentucky Human Resources Information System (KHRIS). Through accounting templates set up in KHRIS, cost allocation (CA) documents are generated to eMARS for each payroll run (twice monthly) for all state-wide agency health insurance benefits/payments, HRA premiums, FSA withholdings, and administrative fees. The Department for Employee Insurance (DEI) reviews the eMARS CA document amounts to determine the reasonableness of the state-wide agency payments for health insurance, HRA, FSA withholdings, and administrative fees. DEI cannot, however, determine whether all state agencies have paid the total amount owed, or whether any qualifying events, terminations, and/or other adjustments have occurred.

As part of our testing, we determined the Kentucky Employees' Trust Fund (2500) was underpaid by approximately $10 million during April 2011 for state-wide agency Health Insurance Premiums, Health Reimbursement Account Premiums (HRA), and Administrative Fees. In addition, in May 2011 the Fiduciary Fund (7241) was reduced by $189,629 for state-wide agency employees' Flexible Spending Account (FSA) Withholdings. A correcting payroll document occurred during May 2011 for the April shortage to the Trust Fund; however, the Trust fund remains underfunded by approximately $227,395. In August 2011, an IET correction was posted to the Fiduciary Fund for the May 2011 FSA error; however, the Fiduciary fund remains understated by approximately $215,652.

DEI does not receive any additional KHRIS-generated static reports that provide agency, departmental, cost center, and/or individual employee level health insurance payments and benefits information. In addition, because KHRIS is a live system there are no formal monthly closing procedures in the KHRIS system. Therefore, the employee/employer payroll portions, health insurance and benefit-related data for any time period could be modified, intentionally or unintentionally. As such, DEI is unable to perform the necessary reconciliations of KHRIS to eMARS.

The computerized systems for generating the health insurance premium billings and tracking the premium collections, Legacy and KHRIS, are not designed or programmed for a formal month-end closing, or to produce monthly static reports necessary for DEI to perform the necessary monthly reconciliations.

The KHRIS system's inability to provide a formal month-end closing, or generate monthly static reporting of all payroll, health insurance, and other benefits information prohibits the various KHRIS users within the Personnel Cabinet (e.g., DEI, Department of Human Resources) to perform required monthly reconciliations of the financial data to the eMARS statewide accounting and reporting system. In addition, without formal reconciliation procedures in place, DEI cannot ensure proper reconciliation of the state's benefit data processed through KHRIS. Also, without adequate reporting, state agencies cannot verify that employee benefit deductions for Health Insurance Premiums, Health Reimbursement Accounts (HRA), and Flexible Spending Accounts (FSA) are properly calculated and remitted.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KEHP-32:** The Personnel Cabinet Should Have Appropriate Reports Available To Reconcile KHRIS Information To eMARS (Continued)</u>

Good internal controls require system-generated (i.e., KHRIS) reports be designed to provide useful and timely financial data and other supporting detail. Such reports should provide adequate detailed information that allows for the timely reconciliation of KEHP billings and collections of the various plan members, as well as the reconciliation of the KHRIS financial data to the eMARS statewide accounting and reporting system.

<u>Recommendation</u>

We recommend the KHRIS users within the Personnel Cabinet (e.g., Department of Employee Insurance, Department of Human Resources Management), as well as at the state-wide agency level, have access to static reporting that provides agency, departmental, cost center, and/or individual employee level data needed to perform all required reconciliations by pay period and/or month to eMARS.

<u>Management's Response and Corrective Action Plan</u>

The Department for Employee Insurance agrees with the APA recommendation to add necessary KHRIS reporting functions. Limitations in KHRIS reporting hinder health plan accounting and management.

When new KHRIS reports are developed, efforts are being made to better educate the user community on how to run and interpret reports at the agency level. There is an ongoing effort to document existing reports as well as enhance training for how to use reports. The Personnel Cabinet is using KHRIS to better consolidate reporting to be more efficient and flexible for external reporting by agency. Some aspects of previously used reports can be found in the enhanced information sent to info-Advantage for reporting, which is a more central repository and eliminates redundant data feeds.

Agency business owners can request additional reporting features to facilitate their business procedures for reconciling accounts by submitting a KHRIS Change Request (KCR). The Division of Technology Services will review KCRs from business owners and follow the system change request process.

In the interim, DEI has developed compensating controls for monitoring activities and establishing check points to identify errors and/or irregularities. These control areas include the appropriate authority and approval to accomplish job responsibilities and checks for reasonableness, accuracy, and classification to ensure compliance with departmental guidelines and polices. Further, additional staffing has been requested to support extra requirements that came about upon KHRIS implementation.

DEI and the KHRIS team continue to make improvements to reporting features and data access for all agencies. DEI concurs with the APA observation that reporting was not adequate between the KHRIS "go-live" date and the conclusion of the 2011 fiscal year on June 30 and has filed a change request for additional reports for the consideration of the KHRIS Team. Thank you for your continued efforts to ensure that accounting records are accurate and made available for the Commonwealth.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-33: The Personnel Cabinet Should Update Financial Policies And Procedures For ERRP Requirements

During our FY 2011 audit of the Kentucky Employees' Health Plan, we determined the Department of Employee Insurance (DEI) had not developed and implemented written policies and procedures for participation in the U.S. Department of Health & Human Service's (HHS) Early Retiree Reinsurance Program (ERRP). We received conflicting statements from DEI management concerning formal written policies and procedures. With our initial request for copies of any policies, we were told that no formal policies or procedures were in place for FY 2011. However, during the course of the audit, DEI management produced a document containing Early Retiree Reinsurance Program Policies and Procedures. Based upon closer review of this document and tests performed by the auditors, we confirmed that such policies and procedures were not utilized during the audit period. Furthermore, the internal control section that addresses Authorization of Transactions and Activities, does not include or reference the restrictions for use of the ERRP reimbursements in accordance with the Code of Federal Regulations (45 CFR § 149.200).

Without the development and implementation of policies and procedures that incorporate ERRP requirements, DEI may inadvertently overlook key federal program requirements. In addition, the conflicting information concerning the written policies and procedures for ERRP, raises concerns regarding the inconsistency of information provided by DEI. Consequently, weaknesses in policies and procedures increase the risk that a material financial misstatement or program noncompliance could exist and not be detected in routine operations.

Effective internal controls require that management develop and implement formal policies and procedures for guidance with financial and operational practices. The policies and procedures should incorporate the relevant accounting standards and compliance requirements applicable to DEI's business activities, including participation in the ERRP federal program. In addition, the policies and procedures should be clearly communicated to the appropriate staff and made available for further reference.

Recommendation

We recommend DEI update financial policies and procedures to include the applicable compliance requirements set forth in the Code of Federal Regulations (45 CFR 149) for the Early Retiree Reinsurance Program, and also incorporate the necessary accounting standards. The policies and procedures should be clearly communicated to the appropriate staff and made available for further reference.

Management's Response and Corrective Action Plan

The Department for Employee Insurance (DEI) of the Personnel Cabinet appreciates the efforts of the State Auditor of Public Accounts to assist in ERRP compliance. We agree that we had a control weakness in this area and may not have dealt with it adequately without

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KEHP-33:**</u> **The Personnel Cabinet Should Update Financial Policies And Procedures For ERRP Requirements (Continued)**

<u>**Management's Response and Corrective Action Plan (Continued)**</u>

APA's independent review and recommendations. DEI has developed internal written formal policies and procedures in response to the APA recommendation.

This comment contains several components, all of which revolve around the lack of formal written policies and procedures for DEI's participation in the ERRP. Associated with the lack of formal written policies and procedures were inconsistencies in responses to this issue from different individuals in DEI and the Personnel Cabinet.

Concerning APA's review and comment about DEI's ERRP Policies and Procedures, DEI submits as follows. The formal written policies and procedures implemented by DEI contain information that references the restrictions of the ERRP reimbursements. Specifically, on page 9, "Design and Methodology Guidelines" makes specific reference to the Catalog of Federal Domestic Assistance (CFDA) #93.546 and incorporated it as Attachment A to the DEI policies and procedures (pages 18-21). The CFDA provides a full listing of all Federal programs available to State and local governments (including the District of Columbia) and is incorporated as Attachment A with a section entitled "Uses and Use Restrictions" that clearly states the legally permitted and prohibited uses for ERRP funds.

Before a sponsor may request reimbursement for early retiree claims, the sponsor must apply to participate in the program, and both the sponsor and the plan under which the claims were incurred must be certified by the Secretary of HHS. See 45 CFR § 149.35(b)(4). The Commonwealth of Kentucky, Personnel Cabinet, Department of Employees Insurance responded to questions certified by the signature of the Plan Sponsor's authorized official to abide by the program's legal requirements concerning the use of ERRP reimbursements. The Plan Sponsor Agreement requires the confirmation of compliance with: "all terms and conditions of Section 1102 of the Patient Protection Act (P.L.111-148) and 45 C.F.R. 149 and in other guidance issued by the Secretary of the U.S. Department of Health & Human Services (the Secretary), including, but not limited to, the conditions for submission of data for obtaining reimbursement and the record retentions process." This specifically would include the use of reimbursed funds.

DEI's response to the questions in the application were as follows: "[A]ny funds received through reimbursement under the Early Retiree Reinsurance Program will be used (1) to offset increases in health benefit costs under KEHP for the Commonwealth of Kentucky, (2) to reduce premium contributions, copayments, deductibles, coinsurance, or other out-of-pocket costs for some or all participants in KEHP, or (3) both to offset increases in the Commonwealth's costs and to reduce participants' costs under KEHP. In no event will funds received under the Early Retiree Reinsurance Program be used as general revenue for the Commonwealth of Kentucky…… The Commonwealth expects that most or all of the funds it receives in 2010 or 2011 will be used to reduce future health care inflation trend costs for KEHP in 2012."

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-33: The Personnel Cabinet Should Update Financial Policies And Procedures For ERRP Requirements (Continued)

Management's Response and Corrective Action Plan (Continued)

However, DEI agrees with APA that a control weakness existed and now has written policies and procedures to clarify the use of ERRP funds, and DEI management is well informed on the permitted and prohibited uses of the ERRP funds as set forth in federal law and regulations. A finalized and implemented ERRP policy and procedures manual is also in place for all appropriate DEI staff and management. Again, DEI appreciates the assistance of APA in bringing these matters forward to assure compliance with federal requirements.

DEI did not have adequate formal, written internal policies at COB June 30 and did not intend to imply otherwise. With the assistance of APA we now have them in place and would welcome any additional APA input that would help us improve administrative and financial procedures. We appreciate the hard work and assistance that APA provided in this matter.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-34: **The Personnel Cabinet Should Implement Procedures To Ensure Compliance With Governmental Accounting Standards And ERRP Provisions**

Based on our audit of the Kentucky Employees' Health Plan (KEHP), the Department of Employee Insurance (DEI) placed full reliance on its third party claims administrator for the data management services in preparation and submission of claim submissions under the Early Retiree Reinsurance Program (ERRP). As such, DEI could not readily provide supporting claim files, or evidence that management had reviewed supporting claims detail during FY 2011 prior to the submission of $63,420,420 of ERRP claims reimbursements by its third party claims administrator. In addition, DEI had no evidence to support that $63.4 million of ERRP claim reimbursements received by KEHP during the FY 2011 were in compliance with U.S. Department of Health & Human Service (HHS) ERRP guidelines. Likewise, there was no evidence available during our testing that indicated DEI had properly monitored program claim submissions and reimbursements.

In addition, DEI management questioned the consideration of any ERRP receivable as of June 30, 2011, upon request by the auditors to provide claims detail supporting the submitted, but unreimbursed FY 2011 ERRP claims. DEI stated that no ERRP receivable existed at the fiscal year end. Conversely, DEI management indicated that unreimbursed qualifying FY 2011 ERRP claims had been submitted to ERRP for reimbursement, but could not identify the amount without the assistance of its third party claims administrator. Consequently, in order to determine the ERRP receivable balance as of June 30, 2011, and perform the necessary audit procedures, the auditors requested that DEI obtain the database of all unreimbursed claims for FY 2011 from its third party claims administrator. Upon receiving the database, DEI analyzed the database and compared the results to DEI's preliminary receivable computation in order to determine the reasonableness of the June 30, 2011 ERRP receivable. DEI acknowledged a problem with the third party administrator's claims data that created a potential error in the receivable calculation of $745,287. The database contained claims adjustments from September 2011; however, did not have sufficient detail to identify the specific claims associated with the adjustment. DEI was, therefore, unable to determine whether the adjustments were related to claims paid prior to June 30, 2011, or for claims paid subsequently. In addition, DEI identified a $50,763 discrepancy between the claims detail database and DEI's independent calculation. As such, DEI was unable to explain the resulting $796,050 for the combined errors.

In conclusion, we determined that DEI management had very limited involvement in the substantiation of claims details prior to submission to HHS by its third party claims administrator. DEI had significantly delegated its management responsibilities for the oversight, review, and approval of all ERRP claim submissions to its third party claims administrator.

The Department of Employee Insurance did not develop and implement policies and procedures that incorporate the necessary ERRP requirements. In addition, management responsibilities for the oversight and verification of program ERRP compliance, as well as on-going monitoring of program participation, were delegated to its third party administrator.

Without the development and implementation of policies and procedures that incorporate ERRP requirements, DEI may not fully understand the federal program requirements, including maintenance of records. In addition, the delegation to its third party claims administrator of the responsibilities for determination and submission of ERRP claims, without sufficient oversight and approval by DEI, could

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-34: The Personnel Cabinet Should Implement Procedures To Ensure Compliance With Governmental Accounting Standards And ERRP Provisions (Continued)

result in the submission of unallowable claims and denial of reimbursement by HHS. Likewise, HHS may determine that claims detail submitted for previously reimbursed ERRP claims actually included disallowed program claims and may require KEHP to repay the disallowed claims.

Good internal controls require the development and implementation of formal policies and procedures that incorporate the relevant accounting standards for all of entity's business activities, including participation in a federal-related program. In accordance with the Governmental Accounting Standards Board's Statement No. 33, concerning the timing for recognition of revenues resulting from non-exchange transactions, revenue should be recognized when all applicable eligibility requirements are met. Therefore, all eligible ERRP claims submissions that were unreimbursed as of the fiscal year end, and pertain to the applicable fiscal year, should be reported as a revenue and receivable (accrual accounting). In addition, effective internal controls require that management be knowledgeable of applicable accounting standards, and provide oversight and approval of all business activities, and financial reporting. Lastly, the Code of Federal Regulations (45 CFR §149.350) require ERRP participants to maintain and have available upon request all supporting documentation, data, and other information for all ERRP claim submissions.

Recommendation

We recommend DEI implement the following steps to ensure compliance with ERRP provisions:

- The financial policies and procedures should be updated to include the applicable compliance requirements for the Early Retiree Reinsurance Program and also incorporate the necessary accounting standards.
- The policies and procedures should be made available for use by the appropriate personnel. In addition, personnel involved in the administration of ERRP should be knowledgeable of the program requirements, perform preliminary analyses of ERRP claim details and/or other reasonableness testing prior to submission for reimbursement by its third party claims administrator, perform monitoring of the claims data supporting ERRP reimbursements, and verify the financial reporting accuracy.
- Lastly, supporting data files, documentation, and other correspondence and information related to ERRP claim submissions should be readily available for audit. All records must be maintained for a minimum of 6 years after the expiration of the plan year in which the costs were incurred.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-34: The Personnel Cabinet Should Implement Procedures To Ensure Compliance With Governmental Accounting Standards And ERRP Provisions (Continued)

Management's Response and Corrective Action Plan

The Department for Employee Insurance (DEI) of the Personnel Cabinet appreciates the efforts of the State Auditor of Public Accounts to assist in ERRP compliance. The intent of APA and DEI is to reach full compliance and administrative best practices, and we believe it important that both agencies continue to work together toward that end.

DEI believes it important to provide background information, explain the processes of ERRP claim reimbursement, and the respective roles of Thomson Reuters and DEI. DEI agrees with APA that it should have greater involvement in the ERRP claim submission process and that it should maintain and/or have access to the supporting claims submissions files to strengthen DEI's compliance with ERRP regulations. To that end, DEI has implemented several enhancements both during the course of the audit and moving forward as a result of the APA's recommendations and comments.

Initially when reviewing the program requirements, it was clear that DEI did not possess the required data, perhaps the most fundamental requirement for the ERRP. It is important to understand that plan sponsors commonly don't maintain detailed claims data. In reviewing the Preamble to the ERRP Internal Final Regulation it is very clearly contemplated that many plan sponsors would not and traditionally do not have access to the necessary claims data to complete an ERRP submission. DEI maintains enrollment data and demographic protected health information (PHI) only and does NOT have any access to detailed claims data originated from Humana and ESI and ultimately sent to Thomson Reuters in their data aggregator role. Given the aforementioned requirements and limited time window to submit, DEI did not have the ability to access all data and dedicate staff to the project and still receive reimbursement from the program. As a result, DEI determined the prudent approach would be to utilize the ERRP services of Thomson Reuters, the current data aggregator.

DEI collaborated with Thomson Reuters to create an ERRP project plan designed to assure compliance with the application, claims submission and other requirements of the ERRP. DEI approved the project plan on May 25, 2010. Thereafter, Thomson Reuters and DEI worked hand-in-hand to implement (and, if needed, to revise) the plan. Teleconferences and other types of meetings were held between the two parties on a regular basis (typically weekly). To date Thomson Reuters has provided these services to more than 60 large Plan Sponsors, submitted in excess of 200 ERRP reimbursement files to U. S. HHS and is responsible for securing almost $2 billion in ERRP funds through their services. In addition, Thomson Reuters established a dedicated ERRP team that meets regularly to review policy and program changes and perform the services necessary to ensure Plan Sponsors are fully compliant with ERRP regulations.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-34: The Personnel Cabinet Should Implement Procedures To Ensure Compliance With Governmental Accounting Standards And ERRP Provisions (Continued)

Management's Response and Corrective Action Plan (Continued)

Thomson Reuters and DEI established procedures and controls that followed a structured review and acceptance process. Thomson Reuters and DEI apply this process for every submission. DEI receives distribution reports for approval that identify the early retiree population by application and plan year. DEI assesses the reinsurance estimate for reasonableness by comparing it with a cost summary extracted by DEI from a separate database known as MEDSTATS. The reasonableness check is a control for monitoring the effectiveness of Thomson Reuters' efforts in creating the Early Retiree List. If the reinsurance estimate appears reasonable, DEI authorizes Thomson Reuters to submit the Early Retiree List to HHS. After DEI approves the selection criteria and counts, Thomson Reuters executes the ERQ process and provides periodic reporting for DEI to review. The ERQ report provides costs, thresholds, limits and calculated reinsurance amounts for retirees to be included on the retiree list to be transmitted to the secure federal ERRP website.

However, to more directly address the control weakness concerning reliance on Thomson Reuters and lack of supporting evidence and in response to APA, DEI has made several changes to enhance oversight and direct involvement with Thomson Reuters in the ERRP claims submission process. First, in accordance with a request of the APA, DEI requested and obtained the ERRP claims database from Thomson Reuters for all prior ERRP claims submissions. DEI now maintains and has access to all ERRP claims supporting detail and performs the necessary testing and oversight on that claims data. Thereafter, DEI's Health Data Administrator conducted an "after-the-fact" analysis of the KEHP ERRP. The claims databases that were produced on our behalf by Thomson-Reuters were converted to Access databases and given to the auditors as soon as we could process them. DEI provided the auditors with a complete set of analytics to compare Thomson-Reuters claims detail records to the summary data provided to HHS as part of the ERRP submission. These analytics contained all SQL code necessary to perform this analysis for both the 2010 and 2011 claims submissions. At a later time, we also shared queries to assist the auditors in performing their functions. The 2010 claims file balanced to within $13.33 cents on more than $194 million in claims and the 2011 file balanced to the penny.

Second, DEI's healthcare data administrator performed 100% eligibility testing on the ERRP claims database. Over the two plan years of the ERRP program, only one person was erroneously placed on the claims file out of more than 6,700 participants in the program. DEI's healthcare data administrator has since taken action to ensure that the person's claims are removed from following submissions, which will reduce the next submission by the amount erroneously credited to the Commonwealth. Finally, DEI implemented formal written policies and procedures to further ensure compliance with all ERRP regulations.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-34: The Personnel Cabinet Should Implement Procedures To Ensure Compliance With Governmental Accounting Standards And ERRP Provisions (Continued)

Management's Response and Corrective Action Plan (Continued)

To address the comments concerning the availability of evidence and maintenance of records, ERRP regulations contain the following requirements:

> *The sponsor of the certified plan (**or a subcontractor, as applicable**) must maintain and furnish to the Secretary, or its designee, upon request the records as specified in §149.350(b). The records must be maintained for 6 years after the expiration of the plan year in which the costs were incurred, or longer where otherwise required by law. Similarly, as required by §149.350(b), the sponsor must require its health insurance issuer or employment-based plan, as applicable, to maintain and produce upon request records to satisfy subparagraph (c) of this regulation. See Federal Register / Vol. 75, No. 86 / Wednesday, May 5, 2010 / Rules and Regulations.*

DEI and Thomson Reuters are in compliance with the regulations. With the contract in place with Thomson Reuters, DEI and Thomson Reuters stand fully willing and able to comply with the six year records retention requirement as well as meet any requests for information from the Secretary of HHS concerning ERRP. DEI agrees with APA that it should have provided data from Thomson-Reuters to APA on a timely basis to help APA meet its statutory deadlines associated with the CAFR. DEI made the data and information available but not quickly enough and has addressed that problem.

As to our discussions with the auditor related to the ERRP receivable as of June 30, 2011, it is correct that a receivable had not yet been recorded at the beginning of audit fieldwork. The reason a receivable had not been recorded is due to a difference in opinion on the application of GASB Statement No. 33 to the ERRP revenue. At COB June 30, the KEHP and Thomson Reuters had submitted 4 requests for Reimbursement – 3 of which had been accepted and 1 of which was later rejected (on 09/14/11). Reimbursement was not a certainty—when U.S. HHS runs out of funding, the program is over—and DEI knew by experience that not all requests for reimbursement are successful.

During our discussions with the auditor we understood APA's preference to recognize the ERRP receivable in accordance with paragraph 15 of GASB Statement No. 33 and then to estimate and record an allowance for any portion of the ERRP receivable determined to be uncollectible in accordance with footnote 41 to GASB Statement No. 34. Following a lengthy discussion, we agreed to implement the auditor's suggested approach.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-34: The Personnel Cabinet Should Implement Procedures To Ensure Compliance With Governmental Accounting Standards And ERRP Provisions (Continued)

Management's Response and Corrective Action Plan (Continued)

DEI acknowledges a problem with the 3rd party administrator's claims data that created a potential error of $745, 287 in the calculation of receivables. The problem amounted to when to post data—in FY 2011 or FY 2012—not the dollar amount.

To assist APA in the course of the audit, DEI conducted a reconciliation of the data submitted to U. S. HHS with DEI's independent calculations. DEI did this quickly to satisfy APA's need for a timely response and offered to further refine its work to reduce or eliminate a $50,763 discrepancy. APA indicated that the $50,763 was not material. The $745,287 in receivables cited above was an issue related to financial reporting. DEI agreed with APA and added the $745,287 to its financial statements as a receivable. For additional detail please see the management response to 11–KEHP–35.

In summary: 1. DEI has complied with the APA recommendation on the treatment of receivables and has strengthened financial controls and procedures related to the filing of reimbursement requests with U. S. HHS; 2. DEI now has backup data on-site for ERRP submissions and conducts more detailed analysis of submissions for compliance with ERRP guidelines; and, 3. ERRP files, documentation, and correspondence related to ERRP claim submissions are now readily available for audit.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-35: **The Personnel Cabinet Should Implement Procedures To Reduce Difficulties Encountered During The Audit Of ERRP Claims Reimbursements And Receivables**

During our audit of the Kentucky Employees' Health Plan (KEHP), we encountered audit difficulties related to the audit of $63,420,420 of claim reimbursements received from the U.S. Department of Health & Human Services (HHS) under the Early Retiree Reinsurance Program (ERRP). Auditors experienced problems in obtaining the supporting claims data and other information, from both the Department of Employee Insurance (DEI) and its third party claims administrator, necessary for testing reimbursements. It took more than six weeks to obtain this data, which should have been available as part of the agency's programmatic administration and monitoring functions. Upon obtaining the claims database to support the reimbursements, auditors invested significant time in reconciling the detail to the reimbursement request since DEI did not have this reconciliation process in place at the time claims were submitted for reimbursement. In performing these procedures, auditors noted that sufficient information was not provided to make the reconciliation possible. Subsequent discussions and written communication with DEI management ultimately led to these difficulties being rectified, but impaired the audit from being finalized in a more timely manner.

Additionally, DEI management questioned the inclusion of any ERRP receivable as of June 30, 2011, and notified auditors that no ERRP receivable existed at the fiscal year end. Conversely, DEI management indicated that unreimbursed qualifying FY 2011 ERRP claims had been submitted to the program for reimbursement, but could not identify the amount without the assistance of its third party claims administrator. Consequently, the auditors made multiple requests of DEI to obtain from its third party claims administrator the database containing the ERRP claim reimbursements and the database of ERRP claims receivables as of June 30, 2011.

The difficulties encountered may be attributed to the agency's inexperience with the financial accounting, reporting, and compliance requirements for the new ERRP grant, limited oversight and approval by DEI of claims detail prior to submission by its third party administrator, and limited monitoring of ERRP claim reimbursements.

The circumstances encountered during the FY 2011 audit impeded the auditor's ability to perform the necessary testing within the timeframe required by Kentucky Revised Statute (KRS) 18A.2254(3)(e). DEI's inability to provide all supporting ERRP claims documentation could have led to a scope limitation, which would have impacted the expression of the auditor's opinion. In addition, the Affordable Care Act includes record maintenance requirements, indicating these records should be maintained in a manner in which they are available upon request. The audit fieldwork timeframe was extended in order to give the agency additional time to obtain the data to avoid a scope limitation in its audit, but the extension did not alleviate the weakness related to the agency's failure to obtain the data for appropriate oversight and monitoring during the fiscal year.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-35: The Personnel Cabinet Should Implement Procedures To Reduce Difficulties Encountered During The Audit Of ERRP Claims Reimbursements And Receivables (Continued)

KRS 18A.2254 (3)(e) The Auditor of Public Accounts shall be responsible for a financial audit of the books and records of the trust fund. The audit shall be conducted in accordance with generally accepted accounting principles and shall be completed within ninety (90) days of the close of the fiscal year. All audit reports shall be filed with the Governor, the President of the Senate, the Speaker of the House of Representatives, and the secretary of the Personnel Cabinet.

The AICPA auditing standards (AICPA Codification AU Section 326.01) require the auditor to obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit. In accordance with AICPA Codification guidelines for the auditor's Reports on Audited Financial Statements – Departures from Unqualified Opinions, AU Section 508.22 states: The auditor can determine that he or she is able to express an unqualified opinion only if the audit has been conducted in accordance with generally accepted auditing standards and if he or she has therefore been able to apply all the procedures he considers necessary in the circumstances. Restrictions on the scope of the audit, whether imposed by the client or by circumstances, such as the timing of his or her work, the inability to obtain sufficient appropriate audit evidence, or an inadequacy in the accounting records, may require the auditor to qualify his or her opinion or to disclaim an opinion.

The Code of Federal Regulations (45 CFR §149.350) require ERRP participants to maintain and have available upon request all supporting documentation, data, and other information for all ERRP claim submissions.

Recommendation

We recommend DEI implement the following steps to ensure compliance with ERRP program provisions:

- The financial policies and procedures should be updated to include the applicable compliance requirements for the Early Retiree Reinsurance Program and also incorporate the applicable accounting standards.
- The policies and procedures should be made available for use by the appropriate personnel. In addition, personnel involved in the administration of ERRP should be knowledgeable of the program requirements, perform preliminary analyses of ERRP claim details and/or other reasonableness testing prior to submission for reimbursement by its third party claims administrator, perform monitoring of the claims data supporting ERRP reimbursements, and verify the financial reporting accuracy.
- The supporting data files, documentation, and other information related to ERRP claim submissions should be readily available for audit. All records supporting ERRP reimbursements should be maintained in accordance with 45 CFR 149.350.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-35: **The Personnel Cabinet Should Implement Procedures To Reduce Difficulties Encountered During The Audit Of ERRP Claims Reimbursements And Receivables (Continued)**

Management's Response and Corrective Action Plan

The Department for Employee Insurance (DEI) of the Personnel Cabinet endeavors to comply with all federal requirements under the Early Retiree Reinsurance Program (ERRP) and appreciates the effort of the State Auditor of Public Accounts to assist in that effort. APA committed significant resources to help DEI manage the ERRP program and had to contend with time constraints and data availability issues that increased the difficulties associated with the audit.

The Commonwealth's data aggregator, Thomson-Reuters, is the leading data management firm among state health plans and large private sector plans in the United States and is the national leader in submitting claims for reimbursement under the ERRP. Thomson Reuters is under contract to collect data from Humana, Inc. and Express Scripts Inc., the Commonwealth's third party administrators, format it, and provide it for actuarial and programmatic analysis. As the data manager for KEHP, Thomson Reuters was in an ideal position to collect and sort the data required for ERRP reimbursement claims from U. S. HHS. The Commonwealth used its contractual relationship with Thomson Reuters for its ERRP grant submission, and Thomson is the leader nationally in receiving ERRP reimbursements for its clients.

Under the ERRP and as contracted, Thomson Reuters has the responsibility for submitting requests for reimbursement that comply with federal regulations. The regulations under the program change frequently and even retrospectively, and Thomson Reuters has thirty employees fully dedicated to keeping up with legal requirements, managing ERRP data, and making submissions. Two private sector audit firms have audited Thomson Reuters regarding the ERRP and their processes are currently subject to review by the Office of the HHS Inspector General. The audit reports have noted no irregularities or problems. Thomson Reuters is the keeper of the Commonwealth's data submissions to U.S. HHS and is responsible for their content. U.S. HHS has reviewed and approved Kentucky's submissions for claims reimbursement and has made payments to KEHP. DEI, in response to APA, has strengthened its role in managing Thomson-Reuters.

The APA requested the data used for the ERRP reimbursement submissions to reconcile the detail to the reimbursement requests. DEI obtained the data as quickly as possible, and DEI staff worked extra hours to re-create it into a more readily understandable format and conducted the analysis. APA did not find anything materially wrong after reconciling the submission with the detail.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-35: The Personnel Cabinet Should Implement Procedures To Reduce Difficulties Encountered During The Audit Of ERRP Claims Reimbursements And Receivables (Continued)

Management's Response and Corrective Action Plan (Continued)

As to our discussions with the auditor related to the ERRP receivable as of June 30, 2011, it is correct that a receivable had not yet been recorded at the beginning of audit fieldwork. The reason a receivable had not been recorded is due to a difference in opinion on the application of GASB Statement No. 33 to the ERRP revenue. At COB June 30, the KEHP and Thomson Reuters had submitted 4 requests for Reimbursement – 3 of which had been accepted and 1 of which was later rejected (on 09/14/11). Reimbursement was not a certainty—when U.S. HHS runs out of funding, the program is over—and DEI knew by experience that not all requests for reimbursement are successful. The rejected submission covered ERRP claims incurred and paid through June 30, 2011 and, therefore, included claims that would constitute a receivable at June 30, 2011.

Once this approval from HHS was obtained subsequent to year-end a receivable would have been recorded as of June 30, 2011 as had been done in the interim financial statements prepared as of December 31, 2010. DEI did not submit the applicable request for reimbursement until mid-September and HHS approval was received on October 13, 2011. During our discussions with the auditor we understood the preference to recognize the ERRP receivable in accordance with paragraph 15 of GASB Statement No. 33 and to then to estimate and record an allowance for any portion of the ERRP receivable determined to be uncollectible in accordance with footnote 41 to GASB Statement No. 34. Following a lengthy discussion, we agreed to implement the auditor's suggested approach.

The claims data backing up the submissions to U.S. HHS for reimbursement were delayed because DEI had a choice of slowing down the next submission for approximately $32 million or obtaining backup data for APA. The distribution of funds from U.S. HHS is on the basis of the date of receipt of reimbursement requests, and, again, U.S. HHS has limited, one-time funding for the program. Slowing Thomson Reuters down on the reimbursement submission to produce backup data would have resulted in a high level of risk in our opinion. However, DEI fully concurs with APA that it did not supply back up data from its ERRP request in a timely manner to APA and hindered APA's ability to meet statutory deadlines.

We are pleased to enhance our existing compliance efforts. To the best of our knowledge, virtually all submissions from large health plans for ERRP reimbursements have been through data aggregators with more than half of the submissions to U. S. HHS coming from Thomson Reuters. Supporting documentation is available through Thomson Reuters, and other states are also relying on Thomson Reuters to meet record maintenance and back up requirements. The contractual relationship with Thomson

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-35: The Personnel Cabinet Should Implement Procedures To Reduce Difficulties Encountered During The Audit Of ERRP Claims Reimbursements And Receivables (Continued)

Management's Response and Corrective Action Plan (Continued)

Reuters also meets the requirements of the Code of Federal Regulations pertaining to the ERRP documentation and data requirements.

Before a sponsor may request reimbursement for early retiree claims, the sponsor must apply to participate in the program and both the sponsor and the plan under which the claims were incurred must be certified by the Secretary of HHS. See 45 CFR § 149.35(b)(4) and (g). In addition to certification, several other requirements must be met. The sponsor must among other things make certain information, data, documents, and records available to HHS upon request. See 45 CFR § 149.35(b)(1).

The language in the law indicates that a plan sponsor, like DEI, must require its administrators and data aggregator to maintain records to satisfy any records requests made by the Secretary of HHS. It is equally clear that the plan sponsor is "responsible for ensuring records are maintained and provided" upon request. The regulation clearly contemplates that there is no single entity that must maintain the ERRP records. It could be the sponsor or another contracted vendor or aggregator that maintains the records on behalf of the sponsor. This is perfectly acceptable under the regulation. There are no requirements that the plan sponsor, like DEI, maintain all the necessary records because in most cases doing so is not practical or efficient. The plan sponsor is required to "ensure" records and documents are available and able to be produced to satisfy the maintenance of records requirements.

The above background information helps explain our response to APA's recommendations below:

1. *We concur with the APA recommendation that prospective requests for reimbursement with data from a prior fiscal year be considered receivables and have made the necessary adjustment to our year-end financial statements. We further concur that our financial policies and procedures should be updated to include applicable compliance requirements. We have been careful to assure that our data aggregator, Thomson Reuters, complies with ERRP requirements in applying for reimbursement, and Thomson Reuters has done excellent work even when new federal regulations had to be applied retrospectively. A DEI weakness, which APA has considered, was in the management of the requests for reimbursement under the ERRP. DEI, in response, has increased its oversight of Thomson Reuters to assure compliance with ERRP requirements.*

2. *We further agree that appropriate personnel should be familiar with the ERRP's policies and procedures. As stated above we also agree with APA on accounting for receivables and have made that adjustment*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KEHP-35: The Personnel Cabinet Should Implement Procedures To Reduce Difficulties Encountered During The Audit Of ERRP Claims Reimbursements And Receivables (Continued)

Management's Response and Corrective Action Plan (Continued)

> *APA's recommendations have led DEI to tighten procedures around submissions to U. S. HHS, and we have found no irregularities. In addition, we now have written policies and procedures to enhance the knowledge of DEI staff of ERRP administrative requirements.*
>
> 3. *We agree with APA that supporting data files, documentation, and other information related to ERRP claim submission should be readily available for audit and that all supporting ERRP reimbursements should be maintained in accordance with federal regulations. Thomson Reuters per regulation and under contract will maintain back-up ERRP data for six years. When APA requested back-up data on August 26, we did our best to comply with the APA request, but obtaining it was not as timely as it would have been coming from our own servers. However, without ThomsonReuters we would not have been successful in applying for funding under the ERRP Program. We have collected $95 million to date under the program. We concur that it would have been desirable to obtain the back-up data on a timely basis and we now have the back-up data based on APA recommendations. We have tightened up our review of Thomson-Reuters submissions and have obtained and reviewed back-up data.*

> *We appreciate APA's efforts to improve DEI's administrative procedures and financial management, especially given the challenges of new electronic systems and programs.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KHP-36: **The Kentucky Horse Park Should Ensure All Invoices Are Paid In A Timely Manner**

During the FY11 Kentucky Horse Park (KHP) audit, we tested a sample of 54 invoices to verify that controls were in place and ensure accuracy and completeness of KHP expenditures. Based on the evidence provided for the sample items tested, we noted 15 invoices that were not paid in a timely manner. KHP incurred $3,503 in late payments for bills associated with these vendors. Late payments are a recurring problem for KHP since the FY07 audit.

The business office does not receive invoices from the various departments within the park timely and there are a large number of bills to be processed. When the business office receives the bills, they cannot be processed quickly and efficiently due to limited staffing resources.

When KHP does not pay bills in a timely manner, there is a monetary loss to the park through late fees and the vendor customer relationship is strained. Furthermore, failure to record expenditures in the eMARS statewide accounting system in a timely manner could result in misstated expenditures in the financial statements.

Good internal controls require bills to be accounted for and paid in a timely manner to ensure accurate financial reporting. Failure to pay bills timely constitutes a noncompliance with KRS 45.453 which states, "All bills shall be paid within (30) working days of receipt of goods and services or a vendor's invoice except when the purchasing agency has transmitted a rejection notice to the vendor."

KRS 45.454 states, "An interest penalty of one percent (1%) of any amount approved and unpaid shall be added to the amount approved for each month or fraction thereof after the thirty (30) working days which followed receipt of the goods or services or vendor's invoice by a purchasing agency."

Recommendation

We recommend KHP develop and implement controls to ensure all invoices are paid timely as required by KRS 45.453. The procedures should include reiterating to all KHP departments the importance of submitting invoices to the business office when received. KHP should also implement a plan for improving processes in the business office.

Management's Response and Corrective Action Plan:

The Kentucky Horse Park management agrees with the auditor's recommendation. It is true that occasionally departments do not submit invoices to the Business Office in a timely manner. Although this has been an ongoing issue, the Business Office believes the instances of late submittal are becoming less frequent. This is because of the regular reminders the Business Office provides. Another reason why some invoices were paid late is a continuing restricted cash flow situation that began in the last quarter of fiscal year 2008. Due to this, some invoices had to be held longer than appropriate. This has been and continues to be an unavoidable problem. The Kentucky Horse Park understands the urgency of paying invoice in a timely manner and is constantly striving to improve this matter.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KHP-37: **The Kentucky Horse Parks Should Improve Controls For The Bank Reconciliation Process And Ensure A Timely Completion**

We reviewed the internal controls over bank reconciliations, during the FY 2011 Kentucky Horse Park audit. We randomly selected three months of bank statements and reconciliations for the receipt account and the charge card account (Pro-Card). Both of these bank accounts are reconciled monthly to account for deposits in transit and outstanding checks. For the months selected, we reviewed all activity in these accounts to ensure the bank reconciliations were performed, reviewed, approved, and unusual reconciling items were explained.

We noted the following findings for the receipt account:

- The receipts account reconciliations for the months of January and May were completed, but not signed or dated by a reviewer.
- The review of the January reconciliation was performed in March.

We noted the following findings for the Pro-Card account:

- The charge account reconciliations for September, January, and May were completed, but all three were missing the reviewer's signature and date.
- The review of the September reconciliation was performed in December and January was performed in April.

If errors or omissions occurred, they would remain undetected when bank reconciliations are not reviewed timely. If the reconciliations do not contain signatures and dates, we cannot verify that reconciliations were performed timely.

Good internal controls require bank accounts to be reconciled in a timely manner. Bank reconciliations should be performed monthly to account for all activity of the organization and should contain the signatures and dates of both the preparer and reviewer.

Recommendation

We recommend the KHP implement procedures to ensure bank reconciliations are performed in a timely manner and contain both the preparer's and reviewer's signature and date to evidence their work.

Management's Response and Corrective Action Plan

The Kentucky Horse Park management agrees with the auditor's recommendation. The timeliness of reviewing bank reconciliations is important and the Business Office Director will make every effort to improve on this. The issue arises when the substantial workload in the business office compels labor hours to be prioritized and regrettably, recent circumstances have increased the Director's work load making timely review difficult. Currently, based on the schedule of future business and accounting, the Business Office Director will be able correct this situation and review reconciliations timely.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KHP-38**</u>**: The Kentucky Horse Park Should Improve Segregation Of Duties And Improve Procedures For Its Preparation For The Annual Audit**

During the FY 2011 audit of the Kentucky Horse Park (KHP), we noted a lack of appropriate segregation of duties concern and problems with the business office's ability to finalize its trial balance and prepare for audit in a timely manner.

- The Deputy Executive Director has the ability to create, review, authorize, and approve documents in eMARS without any other employees being involved in the process, as well as the responsibility to review the reconciliations of bank statements. This raises a concern that there is not sufficient segregation of duties within the business office, which is further weakened during periods when other business office employees are absent from work. With the absence of any business office employee, the Deputy Executive Director often must fill in for the employee in order for the office to function. The Deputy Executive Director is also responsible for preparing the financial statements, supervising business office employees, and reporting to the KHP Board of Directors. This oversight function is weakened due to the lack of proper segregation of duties and also when he acts as backup to other employees.
- For the FY 2011 audit, the business office was significantly delayed in its completion of its year-end closing package and trial balance, which impeded the auditor's ability to perform the audit in a timely manner. This is a concern discussed with the KHP management over the past few years, and continues to be a concern. During FY 2011, the year-end closing package was not complete as late as November 30, 2011.

The lack of segregation of duties in the business office creates the opportunity for misuse of state resources and puts both KHP and the employee at risk. It also increases the risk of errors, theft, and weakens the agency's monitoring and oversight controls.

KHP appears to be delayed in its preparation of critical year-end financial data due to inadequate staffing and an inability to prioritize these functions due to other important competing objectives placed on the business office during the same time frame. The failure to finalize year-end financial information in a timely manner not only delays the audit, but increases the risk of material misstatement in financial statements that could go undetected. Furthermore, KHP is a major enterprise fund of the Commonwealth, and delays also impact the audit of the CAFR. Furthermore, these delays result in higher audit costs to KHP due to additional time spent in coordinating the work.

Good internal controls require certain job duties to remain separate when dealing with the creation, processing, recording, review, authorization and approval of transactions. In addition to protecting the organization, internal controls are intended to protect employees in the course of performing their assigned duties. A good internal control system mitigates the risk for errors, theft, and promotes processing of transactions in a timely and efficient manner.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KHP-38: The Kentucky Horse Park Should Improve Segregation Of Duties And Improve Procedures For Its Preparation For The Annual Audit (Continued)

Recommendation

We recommend KHP:

- Evaluate processes in the business office to determine a course of action to resolve the lack of proper segregation of duties.
- Management should implement procedures to ensure year-end financial reporting is completed in a timely manner, and submitted to FAC within the scheduled deadlines. This may require KHP management to develop new procedures, hire additional staff, request assistance from another agency, or rearrange functions of current employees in a way that assists in meeting this objective.

Management's Response and Corrective Action Plan

The Kentucky Horse Park's management agrees with the auditor's recommendation. The Director of Support Services position has been vacant since July 1, 2011. This vacancy, along with other circumstances, has caused the Deputy Executive Director to assume more responsibility, creating this recent unavoidable segregation of duties concern. Management has begun the process of hiring a new Director of Support Services. When this position has been filled, management is confident that the Deputy Executive Director and the Director of Support Services can work together to help resolve the segregation of duties issue as well as provide timely completion of the Park's financial statements.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KHP-39**</u>**: The Kentucky Horse Park Should Ensure Loan Balances Are Reported In The Proper Fiscal Year**

During the FY 2011 Audit of the Kentucky Horse Park (KHP), we noted the Energy Savings Obligation Note or Note 6 of the FY2010 KHP financial statements was misstated. In FY 2010, KHP entered into a financing agreement with Bank of America (BOA) for energy savings measures. However, for the FY 2010 financial statements, KHP failed to report the loan balance on the Energy Savings Loan in Note 6 of the financial statements. The failure to report this amount in FY 2010 caused the FY 2011 beginning loan balance to be misstated. Furthermore, additions in the loan balance for FY 2011 were incorrectly reported.

Good internal controls dictate that management disclosures in the notes to the financial statements are accurate, complete, and adequately supported by appropriate documentation. Good internal controls also dictate that a reporting entity such as KHP have controls in place for ensuring the propriety of management's disclosures in the financial statements.

> <u>**Recommendation**</u>
>
> We recommend KHP develop procedures to ensure the accuracy and completeness of the information that is reported in the financial statements and notes.
>
> <u>**Management's Response and Corrective Action Plan**</u>
>
> *The Kentucky Horse Park's management agrees with the auditor's recommendation. The error in not reporting the ending Energy Savings Obligation balance in FY 2010 was an oversight. Careful attention will be given to the loan balances and transactions in the future to prevent this from occurring again. Furthermore, the additions in the loan balance for FY 2011 that were initially incorrectly reported were discovered by the KHP and reported to the auditors. Based on the auditor's recommendation, this addition error was corrected by the KHP before the final financial statements were issued and thus does not show up in the final audit report.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KSP-40: The Kentucky State Police Should Ensure All Employees Follow Procedures For The Reporting Of Annual, Sick, And Compensatory Time In Accordance With The Fair Labor Standards Act

During our testing of Kentucky State Police (KSP) payroll records, we noted unusual circumstances involving supervisors within the Financial and Grants Management Branch. Supporting documentation indicated certain supervisors were scheduled to be off for compensatory leave, but their timesheet did not reflect any compensatory time being taken. We inquired of KSP management regarding the timekeeping practices utilized by the Financial and Grants Management Branch.

Based on records examined and the results of the inquiry with management, supervisors with a compensatory leave balance of approximately 200 hours were maintaining a separate record of compensatory time earned and used that was not reflected in the official payroll records. The auditor was notified that the Director and Assistant Director of the Administrative Division instructed employees to stop maintaining a separate record of compensatory time earned and used once they became aware of this practice. However, the auditor did not determine whether the agency took additional steps to determine the amount of any unused compensatory leave, or sought guidance regarding the appropriate disposition of those balances.

Supervisors did not include all compensatory time worked and/or compensatory time taken on their state issued timesheet. The supervisors bypassed the agency's time and attendance record keeping policies.

Each time an employee submits a timesheet, he or she certifies that the time reported is accurate and complete. In bypassing the agency's established policies, the employee falsified the official payroll records, and by passed the supervisory approval controls established by the agency. These documents are used as the basis for certification of payroll under KRS 18A.125 by the Commissioner of Personnel.

The Fair Labor Standards Act (FLSA) requires an employer to maintain accurate records with respect to overtime worked. All hours worked, including compensatory time (hours between normal work hours and 40 hours), and overtime must be recorded on the official time sheet. Employers are specifically prohibited from allowing, and employees are specifically prohibited from keeping, a separate set of books for overtime.

Recommendation

We recommend Kentucky State Police:

- Disseminate written time and attendance recordkeeping procedures to all employees to ensure the correct reporting of annual time, sick time, and compensatory time.
- Provide additional training to supervisors to ensure that they understand Fair Labor Standards Act requirements regarding the reporting of annual, sick and compensatory time.
- Work through its legal counsel and the Personnel Cabinet to determine whether any obligation exists to correct the official payroll records for any remaining unused leave balances.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KSP-40: **The Kentucky State Police Should Ensure All Employees Follow Procedures For The Reporting Of Annual, Sick, And Compensatory Time In Accordance With The Fair Labor Standards Act (Continued)**

Management's Response and Corrective Action Plan

KSP conducts a Civilian Orientation Program several times each year. This program includes timekeeping and time and attendance review, distribution of copies of the Personnel Cabinet regulations pertaining to time and attendance, as well as distribution of a copy of the Commonwealth of Kentucky Employee Handbook. Thus KSP does distribute time and attendance procedures to its employees. However, in reviewing agency policy the Commissioner determined it would be beneficial to develop a section on civilian employees. KSP will create a new section of the policy addressing civilian timekeeping and discipline to supplement its current policy and address the audit findings.

Similarly, KSP has Civilian Leadership training for all civilian supervisors that is conducted bi-annually. Timekeeping and civilian discipline are addressed. To address the audit findings, special care will now be taken to develop a timekeeping block to address Fair Labor Standards Act requirements and other timekeeping issues for civilian employees.

Finally, KSP is aware of corrected time sheets submitted through the KHRIS system regarding the Financial Grants Management personnel. To date, KSP is not aware of any verifiable unused leave balances for which it owes an obligation to compensate current or past employees pursuant to the Fail' Labor Standards Act or other state or federal law.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-41: **The Kentucky State Treasury Should Ensure Bank Account Reconciliations Are Completed Timely Each Month**

The Kentucky State Treasury has historically performed a reconciliation of the Commonwealth's bank accounts to the accounting system on a monthly and daily basis. Following the implementation of a new accounting system, eMARS, Treasury was unable to complete these reconciliations in a timely manner for FY 07, FY 08, FY 09, and FY 10. These problems persisted through much of FY 11, with reconciliations being untimely for 7 of the 12 months of the fiscal year. However, through the development of improved procedures Treasury was able to catch-up the reconciliation process, and complete and balance reconciliations of all accounts for the months of February 2011 through June 2011.

Until February 2011, a workable reconciliation process had not been developed that would efficiently gather information to allow for the timely completion of the reconciliations. Difficulties through the first half of the fiscal year continued until an improved process was developed and streamlined that allowed for the completion of the reconciliations for the remainder of the fiscal year.

When the state's bank accounts are not promptly reconciled oversights, errors, and miscalculations may occur and remain undetected. Ultimately these mistakes could misstate the account balances for financial reporting purposes. Given the volume and size of the receipts and disbursements processed by Treasury, these reconciling items could potentially materially misstate account balances reported in the CAFR.

For instance we noted that June 2011 escheats were not processed correctly due to an error. This would have been identified and resolved by Treasury if the reconciliation process was functioning properly. Examples of other errors that are likely to occur include:

- Deposits received at the bank not posted to an agency's eMARS account either due to missing approvals or an error that caused the transaction to be rejected.
- Deposits recorded to eMARS that were not received at the bank.
- Errors in transaction amounts or accounts either in eMARS or the bank.

Good internal controls dictate that bank accounts be reconciled in a timely manner. Daily reconciliations should be performed within a few days of the actual occurrence and monthly account reconciliations should be performed within a few weeks of the closeout period at the end of each month. In addition, management's consideration of controls should be updated frequently to account for changes in operating activities, as in the change in banking functions or changes in the accounting system.

Recommendation

Treasury should continue to take appropriate steps to ensure monthly bank reconciliations are performed timely. Going forward, as future accounting system changes occur, we recommend FAC and Treasury address the impact of those changes on Treasury processes as early in the implementation as possible to avoid significant and prolonged gaps in internal controls.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KST-41:** The Kentucky State Treasury Should Ensure Bank Account Reconciliations Are Completed Timely Each Month (Continued)</u>

<u>Management's Response and Corrective Action Plan</u>

Catching up the bank account reconciliations is one of the proudest accomplishments of the State Treasurer's Office in recent years. As has been noted on many occasions, the eMARS statewide accounting system implemented in July 2006 did not include a workable bank reconciliation system which could be employed by the State Treasurer's Office. It was many months before a reconciliation system could be developed by the Treasury Staff, and even longer before the eMARS data became reliable enough to use in reconciliation. A workable system was in place by March 2009, and the Treasury staff members were able to reconcile every month and to bring the process current by February 2011. It has been a monumental task to which the Treasury Department has devoted every available resource.

The Auditor's comment "Until February 2011, a workable reconciliation process had not been developed that would efficiently gather information to allow for the timely completion of the reconciliations" is not accurate. As indicated above, the system was developed long before that time, and the monthly reconciliations were underway. In February 2011 the monthly reconciliations became current.

Additionally, the issue noted by the Auditor concerning the June 2011 escheats is actually a Fiscal Year 2012 issue, outside the scope of this audit. The accounting transactions for escheat checks occur in the month after the checks become one year old, and are no longer negotiable. The referenced error, which was made by the Finance Cabinet in the escheat process, was caught by the Treasury Department and corrected.

No one understands the importance of current, monthly bank account reconciliations better than the staff of the State Treasurer's Office. Not to be current on account reconciliation creates a nightmare for the Treasury Department which greatly complicates the daily operations of the office. We certainly applaud the Auditor's recommendation that as future central accounting system changes occur, the impact of those changes on Treasury processes be addressed as early as possible in the implementation process. This has not been the case in the past.

<u>Auditor's Reply</u>

The June 2011 escheats referred to in the finding represents checks that were no longer valid at fiscal year end. For practical purposes, the write-offs occur the following month. However, these checks are invalid at year-end and auditors are required to verify that procedure even though the procedure actually occurs in the subsequent fiscal year. We include this incident in this finding as an example of the importance of performing timely reconciliations.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-KST-42</u>: **The Kentucky State Treasury Should Strengthen System Security Settings**

As noted during the prior three audits, review of application security over the Kentucky State Treasury (Treasury) data processing system revealed Treasury did not establish sufficiently strong system values to properly secure the data processing system. Further, critical system values on the Treasury data processing system did not adhere to industry best practice recommendations. System values are flags that configure and control various aspects of the data processing system.

Treasury developed a System Values Change Requests policy; however, this policy is a very high level discussion of the request process. According to the System Values Change Requests policy, requests for system value changes should be submitted to the Division Director for justification, and the approved request should be submitted through email to the Information Technology (IT) Division Manager. Subsequent to review, IT staff performs changes and maintain the request email for documentation. Although a policy was developed, it did not include appropriate benchmark settings for system values as determined by Treasury, it omitted the storage location for request emails, and it did not reference the overarching Treasury program modifications policy. In addition, an Employee Service Request Form was developed in response to our prior year recommendation; however, the request form did not specifically address system value changes. In addition, the System Values Change Requests policy does not mention the use of the new form.

Further, we reviewed industry best practice recommendations from the data processing system's vendor and another vendor partner for 42 system settings or values to ensure security was adequate to protect the system from known vulnerabilities. During FY 2011, we found Treasury altered seven system values identified as exceptions in the prior year review to bring them into compliance with the recommendations. However, of the 42 system values examined, we discovered eight system values, or approximately 19.0 percent, were more lax than the recommended industry best practices.

For security purposes, detailed information concerning the specific system values that contributed to these findings was intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

By not adequately documenting and communicating application-based security policies, including system settings or values, could lead to a lack of understanding by management and users. Without adequate security settings, the system may be subject to vulnerabilities that otherwise could have been prevented. By allowing excessive system value settings, Treasury exposes their processing system to a more heightened risk of unauthorized access and manipulation.

System settings and values are an integral part of the security environment within a system. It is important to note the default values, which are set when the system is shipped and installed, do not represent industry best practices or the most secure values.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-42: The Kentucky State Treasury Should Strengthen System Security Settings (Continued)

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Recommendation

We recommend Treasury expand the System Values Change Requests policy to identify all security-related system settings deemed as being critical, a description of the function of the system setting, the suggested value established for the setting, and the justification for the selected value. Reputable resources should be used to ensure settings comply with industry best practices, and any required deviations should be explained and documented. In addition, the System Values Change Requests policy should be updated to stipulate the location where request emails will be retained and should reference the overarching Treasury program modifications policy for additional guidance on the process for requesting and completing changes. If Treasury wishes to use the Employee Service Request Form for requesting changes to system values, the request form should be updated accordingly and referenced from within the System Values Change Requests policy.

Once the policy has been expanded, management should review the current settings on the data processing system to ensure compliance and make changes where necessary. The revised System Values Change Requests policy should be made available to staff who require this information to perform their job duties. Management should ensure strict adherence to the policy, and the policy should be updated as needed.

Management's Response and Corrective Action Plan

We have difficulty in understanding how this rises to the level of being a "significant issue." The only system value changes that have been made to the Treasury system in the past 10 years have been those done at the suggestion of the Auditor, and those necessitated by the twice yearly adjustments for Daylight Savings Time. There have been no other system values changes or requests for changes. The proper Systems Values Change Request Policy, therefore, is hardly a burning issue or a huge risk.

The Treasury Department will review the system values about which the Auditor is concerned to see if the "best practices" values are compatible with the Treasury Department processes. In the past, this has not always been the case.

Should the Data Processing Division receive a System Values Change Request in the future, they will retain the request and any related documentation in the email folder.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KST-42**</u>**: The Kentucky State Treasury Should Strengthen System Security Settings (Continued)**

<u>**Auditor's Reply**</u>

System value configurations are an integral part of Treasury's data processing system. We used the best practice standards created by the data processing system vendor and security business partner to facilitate our review of Treasury's system value settings. While we recognize Treasury has traditionally executed few changes to the system values, as noted in the comment's Condition, eight system value settings are not in compliance with industry best practice standards. Of those eight settings, four were deemed high priority in the best practice documentation.

In addition, Treasury has not created a baseline of the existing system value settings. It should be noted we offered to provide the best practice baseline values to Treasury. A documented baseline listing of system value configurations developed for the Treasury system, inclusive of reasoning for any deviation from industry best practice standards, is imperative to ensure the system is established as authorized by management. If any unintentional changes to system values are executed, the listing can be used to restore the values to their authorized state. In the case of intentional system value changes requested through the system values policy, an associated change should be made to the listing along with the justification for the change.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KST-43**</u>: **The Kentucky State Treasury Should Improve Segregation Of Duty Controls**

As noted during the prior three audits, our fiscal year (FY) 2011 review of the Kentucky State Treasury (Treasury) system controls revealed Treasury did not employ sufficient segregation of duties between the system security administration, operation, programming, and librarian functions in relation to their data processing system. Our testing revealed all critical functions had been granted to a single individual. This individual has unlimited access to every aspect of Treasury's data processing system including management of the use, configuration, functionality, and security of the system. Because of the lack of management oversight related to these functions, there are numerous security controls that could potentially be circumvented without detection.

Of major concern is the fact that this individual had unlimited access to the following production libraries through either a system profile or individual user profile:

- The vendor-supplied library housing all production and test libraries used to perform daily and monthly processing;
- The library housing 'new' objects used to pull enhanced Management Administrative and Reporting System (eMARS) data to assist with the monthly reconciliation; and,
- The library housing all source code objects used to process the reconciliation programs and generate the monthly reconciliation reports.

This individual had the ability to make any change deemed necessary, without management approval, to system values, user profiles, and critical objects and resource authorities.

Although not functioning as the operator of the main monthly reconciliation program, this individual still acted as the librarian for the library containing the reconciliation programs and was responsible for monitoring a history log for suspicious activity on the data processing system, yet had the ability to alter the data within this log.

Also, this individual, along with two computer operators, had read and write access to a directory on the processing system housing the Automated Clearing House (ACH) file provided by the Finance and Administration Cabinet (FAC), which contains several eMARS electronic fund documents. This file is generated from eMARS production tables, downloaded by the Treasury computer operators from a file transfer protocol (FTP) server and stored on the data processing system, and then submitted to the bank using software provided by the bank. The two computer operators are both responsible for the retrieval of the ACH file from FAC and submission of the file to the bank; the individual noted above with multiple incompatible duties serves as the backup for the computer operators. Although this is not considered direct access to eMARS production data, it still represents a segregation of duties issue since unauthorized changes could be made to this file prior to submission to the bank. We recognize that new ACH procedures will be in effect in FY 2012 due to a bank transition.

It is possible that these segregation of duties issues have existed since the implementation of the data processing system, which dates back to FY 2000.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-43: The Kentucky State Treasury Should Improve Segregation Of Duty Controls (Continued)

For security purposes, detailed information concerning the specific account profiles and libraries contributing to this finding are being intentionally omitted from this comment. However, these issues are thoroughly documented and have been sent hardcopy to the appropriate agency personnel.

Employing strong segregation of duty controls decreases the opportunity for unauthorized modification to files and programs, and decreases the likelihood of errors or losses occurring because of incorrect use of data, programs, and other resources.

Computer programmers should not have direct access to the production version of program source code or be able to directly affect the production environment. The reason for this control is to ensure that the programmer does not intentionally or unintentionally introduce unauthorized or malicious source code into the production environment. Smaller organizations that cannot easily segregate programmer duties from librarian duties should implement compensatory controls to supervise programmer activities to ensure only properly tested and authorized programs are migrated into production.

Programmer duties should not include the migration of programs into production libraries or performing operator procedures such as executing production programs. Programmers should be restricted from the production environment and their activities should be conducted solely on "test" data. This control is designed to ensure an independent and objective testing environment without jeopardizing the integrity of production data.

The same individual should not retrieve the text file with eMARS funding data and also submit that same file to the bank, unless there are compensating controls in place to ensure no changes have been made to the data from the time it was received from FAC to the time it was submitted to the bank.

Recommendation

We recommend Treasury review the current job duties of the individual performing the security administrator, programmer, librarian, and operator function within the data processing system, and determine how these job functions can be redistributed among staff to ensure a proper segregation of duties. Specifically, Treasury should ensure:

- Someone other than the system administrator, who has unlimited access to the system, be the primary programmer who creates changes within the production programs.
- Someone other than the programmer or operator be required to move changes into the production environment as the librarian.

In addition, Treasury should ensure the individual performing the programming function is restricted to a "Read Only" level of access within the production environment (including libraries, files, programs, etc.). The individual responsible for monitoring the history log of suspicious activity should have "Read Only" access to that file.

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Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-43: **The Kentucky State Treasury Should Improve Segregation Of Duty Controls (Continued)**

Recommendation (Continued)

Based on our understanding of the Treasury staffing limitations and budget constraints, we acknowledge the difficulty in hiring additional staff to accomplish complete segregation of duties. Therefore, our recommendation is focused on the redistribution of certain job duties currently completed by the security administrator among existing staff. We recommend the security administrator select staff members to mentor in security administration and librarian functions with the eventual goal of these individuals taking over these responsibilities. Since the current system administrator has the most data processing system expertise, we recommend he continue to make programming changes. As the security administration and librarian functions are transitioned to other staff, we recommend Treasury work toward establishing segregation of functions as discussed above. With the disbursement of duties among multiple existing staff members, we do not foresee these efforts requiring significant time, thereby allowing staff to also perform their existing routine job duties.

Further, if the new bank contract requires Treasury to manually retrieve the ACH file from FAC and submit it to the bank, we recommend one computer operator be primarily responsible for the retrieval of the ACH file from FAC and the other be primarily responsible for the submission of the ACH file to the bank. In addition, we recommend the operator sending the file to the bank review it against the original file downloaded from FAC to identify any changes prior to submission. A log with the date, time, and name of the reviewer should be maintained to document this review. In the event one of the computer operators cannot fulfill his duties, a backup should be appointed to perform his part of the above process.

Management's Response and Corrective Action Plan

The Treasury Department certainly understands that the job responsibilities of the staff of the Data Processing Division do not meet the textbook criteria of proper segregation of duties. There simply are not enough people with the necessary skills to accomplish the type of separation that the Auditor envisions. As a result of the repeated comments and concerns of the Auditor over the past years, the State Treasury Department has attempted to obtain funding for additional data processing positions which would allow the segregation of duties which the Auditor feels is so important. The efforts of the Treasury Department to secure this funding are well documented. The Treasury Department has even attached copies of the audit comments from past years to the budget requests. In spite of these requests, and the Auditor's continuing concerns, the funding requests have been denied. There is no funding or authorization for additional positions which would enable the Treasury Department to segregate the duties currently being performed by the Data Processing Supervisor.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KST-43**</u>: **The Kentucky State Treasury Should Improve Segregation Of Duty Controls (Continued)**

<u>Management's Response and Corrective Action Plan (Continued)</u>

The recommendation that the security administrator select staff members to "mentor" in other responsibilities in order to re-distribute job duties is only partially feasible. It may be possible for another staff member to perform the librarian functions to move changes into the production environment. The Treasury Department will explore this possibility. There is no one else on staff other than the System Administrator/ Programmer that has the I-Series knowledge necessary to assume the responsibilities of security administration, however. This is not a casual responsibility, and it does require in-depth I-Series data processing system understanding and experience.

Under the new banking contract with JPMorganChase, the ACH retrieval has been automated. When the Treasury Department operator retrieves an ACH file from FAC, the file goes directly to the bank. The file does pass through the Treasury system, but it is not held on that system. There is no opportunity to access or change the information. This should eliminate many of segregation of duties concerns in ACH processing expressed in the comment.

The segregation of data processing duties envisioned by the State Auditor, unfortunately, cannot be accomplished with the current staffing and funding levels. We are open to any suggestions, and will pursue any feasible options, but at the present time we do not see what those options could be short of adding additional staff.

<u>Auditor's Reply</u>

We acknowledge Treasury's past attempts to gain funding for an additional position and also appreciate the willingness to consider appointing a librarian to move changes into the production environment. Considering the relatively small amount of security changes traditionally executed on the data processing system, we feel it would be attainable to mentor a current staff member in rudimental security administration responsibilities, especially with the help and guidance of the current security administrator. These responsibilities could originally include user access. More complex functions could then be added as the individual becomes more familiar with the system including managing security over system values, critical libraries, system commands and utilities, and files and programs. We understand these types of change in process will not occur quickly; however, we continue to encourage Treasury to explore options of establishing independent librarian, system administrator, and programmer function using current staffing.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-44: **The Kentucky State Treasury Should Update Formal System Documentation To Reflect Processing Performed**

As noted during the prior three audits, our fiscal year (FY) 2011 audit of the Kentucky State Treasury (Treasury) system controls related to their main data processing system revealed that Treasury did not maintain clear and accurate descriptions of critical system programs and associated files used in the bank reconciliation process. Based on testing and discussions held with agency personnel, it appears this lack of documentation has existed since the implementation of the data processing system in 2000.

The Treasury Bank Reconciliation Manual provides a high-level general overview of the reconciliation process, the reconciliation data extract process, each of the critical programs that are run to generate the monthly reconciliation reports, and timing difference and analysis reports. Treasury also implemented an Operators Guide for performing critical tasks on the data processing system.

During the examination of the contents of three critical computer libraries used by Treasury, we determined documentation was insufficient to allow a user to verify if the individual objects (files, programs, etc.) maintained within the libraries were used in production. The following specific issues were identified during testing:

- Of the 303 objects residing within the library housing the 'new' check processing/accounting objects, 186 objects, or approximately 61.4 percent, did not have a description. Also, 30 objects, or approximately 9.9 percent, had descriptions that were only the name of the object or another one word name insufficient to determine the functionality of the object. Of the remaining 87 objects containing descriptions, 4 objects, or approximately 1.3 percent, contained the word 'test' within the description, indicating the object may not be used in production.
- Of the 1,972 objects residing within Treasury's main production library used to run the reconciliation programs, 1,246 objects, or approximately 63.2 percent, did not have a description. Also, 94 objects, or approximately 4.8 percent, did not appear to be run in production based on the description. Words found within the descriptions included 'onetime,' 'under development,' 'Y2K,' 'test,' 'MARS,' 'temporary,' and 'temp.' Additionally, 42 objects, or approximately 2.1 percent, had descriptions only reflecting the name of the object or another one word name insufficient to determine the functionality of the object.
- Of the 17 objects residing within the library used by the Treasury employee responsible for making program changes, 13 objects, or approximately 76.5 percent, did not have a description.

During the FY 2008 audit, Treasury indicated the intention to re-name the library objects to provide a better understanding of the individual program functionality. However, this project has not yet been started.

For security purposes, detailed information concerning the specific objects that contributed to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Lack of documentation increases the likelihood of erroneous or incomplete processing. This increases the likelihood of unauthorized data modification, destruction of assets, and interruption of services. Failure to appropriately update system documentation increases the risk that users will be unaware of

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Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-44: The Kentucky State Treasury Should Update Formal System Documentation To Reflect Processing Performed (Continued)

changes that could potentially alter their business processes. The inability to determine the function of library objects could lead to agency staff being unable to differentiate between production, development, and test objects.

Proper descriptive documentation should be maintained for each critical library object in order to, at a minimum, identify the purpose of the objects, the origin of data, the specific calculations or other procedures performed, and the output of data or reports. Object descriptions should provide a clear distinction between active production and test objects.

Recommendation

We recommend Treasury thoroughly review the objects within each library and ensure all objects are needed. All unnecessary objects should be removed. If any objects are housed in an incorrect library, such as testing objects in a production library, the objects should be moved to the appropriate library. For all necessary objects, adequate descriptions should be provided identifying the intended function of each object. This information is critical given the complexity of the programs currently used by Treasury to perform monthly processing.

We further recommend Treasury follow through with the renaming of library objects to better reflect their functionality.

Management's Response and Corrective Action Plan

As indicated in last year's comment response, this is an on-going project which, with the current staffing level in the Treasury Department, will take many years to complete.

There are currently some 30,000 or more objects on the Treasury system. Since the Auditor's comments in the past years, the Treasury Department has examined and removed a great number of these objects which were deemed unneeded, and has added descriptions to others. It is an extremely slow process, however. Many of the objects on the system have been added over several decades by multiple programmers and data processing managers. To go back and analyze decades of work done by numerous people is daunting. Objects cannot be eliminated until it is clear the role they play in every Treasury operation. If a name on an object is changed, it must then be changed in every single program that utilizes that object. This is a huge task!

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-44: The Kentucky State Treasury Should Update Formal System Documentation To Reflect Processing Performed (Continued)

Management's Response and Corrective Action Plan (Continued)

This project was relegated to a lower priority level this year because of new issues which had an immediate day-to-day impact on the operation of state government. The Treasury bank reconciliation project, the state's new payroll and personnel system (KHRIS), the Revenue Department Collection System, and, most recently, the new Commonwealth central banking contract have been all-consuming for Treasury Data-Processing staff. The demands of these new systems will not ease in the near future, either. As time allows, the Treasury staff will return to this on-going project to give better identification to the objects, but this will not happen quickly.

We fully expect to be writing this same response to the audit comments for FY 12.

Auditor's Reply

We acknowledge the time involved in the data processing system object review. To this end, we recommend Treasury prioritize all agency libraries with the initial focus being on the critical agency libraries designated in the Condition section above.

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Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KST-45**</u>**: The Kentucky State Treasury Should Strengthen Logical Security Controls To Ensure Only Authorized Users Can Access The Data Processing System**

As noted during the prior three audits, during our fiscal year (FY) 2011 audit of the application security of the Kentucky State Treasury (Treasury) data processing system, we determined Treasury did not implement adequate logical security controls governing user access to the system. During our review, 73 user profiles were shown as having access to the data processing system. Based on a review of the profile naming conventions, there appear to be three types of profiles – individual user, IBM-supplied, and group.

Fifty-three profiles with access to the data processing system were IBM-supplied. One of these profiles, or approximately 1.9 percent, functioned as a group account. The group account was shared by two system operators. Treasury established an individual profile for one of the two operators; however, the user still accessed the group profile. An individual profile was not created for the remaining operator.

Detailed profile setting documentation was obtained for one of the individual user profiles and one of the vendor-supplied profiles to determine if adequate security settings were established for the profile. All settings appeared appropriate, with the exception of one. The 'Limit Device Sessions' setting on each profile was set according to the system value setting, which allowed users to have more than one active device session at a time.

Treasury has implemented the Information Technology (IT) Security Access Request Policy governing access requests to the data processing system. According to the policy, requests are to be discussed with the Division Director and, when determined appropriate, submitted to the Information Technology Division Manager through email. The policy does not include the requirement to maintain supporting documentation, the location where the documentation is to be stored, guidelines for determining appropriate access for users, or approval and completion notifications.

During testing related to the security surrounding critical utilities and commands, we found out of a sample of five key commands, the vendor-supplied profile functioning as a group account had access to one of the five key commands sampled, or 20 percent. In addition, the public user authority was granted excessive access to one of these resources, or 20 percent. While the public user authority is not an individual, vendor-supplied, or group account, when active it does allow anyone with access to the data processing system the ability to access an object. The public user authority does not grant access to any anonymous internal or external user; rather, an individual must be an authorized, approved user of the Treasury data processing system before the public user authority can be used. As a follow-up performed regarding one command reported during the prior year that the group vendor-supplied profile was granted access to, we noted this profile still had access to one command in FY 2011.

In addition, the vendor-supplied profile functioning as a group account had access to the reconciliation report file, to the critical library that houses the 'new' check processing/accounting objects, to the audit history log file, and to the Automated Clearing House (ACH) file containing electronic payment information to be submitted to the bank.

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Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-KST-45**</u>**: The Kentucky State Treasury Should Strengthen Logical Security Controls To Ensure Only Authorized Users Can Access The Data Processing System (Continued)**

For security purposes, detailed information concerning the specific profiles that contributed to these findings was intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Incomplete logical security procedures increase the risk that users are provided inappropriate or unauthorized access to the system. Allowing users the ability to access information without proper authorization may subject the processing of data to errors and/or omissions and may compromise the integrity of data processed through the system. Granting access to the public user authority could provide users the ability to access resources beyond the scope of their required job duties. The use of group profiles increases the risk that account passwords could be compromised and limits the ability to maintain an accurate audit trail. Permitting concurrent device sessions increases the risk that an account could be exploited through another machine. The existence of unused accounts also increases the risk of unauthorized use.

Management should ensure that the agency's logical security procedures are sufficiently thorough to reflect the entire logical security process. Unnecessary accounts should be disabled, as well as concurrent device sessions. Security surrounding system objects and commands should be controlled at the individual profile level and the public user authority should be removed or set to *EXCLUDE. Group profiles should be avoided in favor of individual user profiles.

Recommendation

We recommend Treasury strengthen its IT Security Access Request Policy related to data processing system access. Specifically, the policy should be expanded to include:

- A requirement to maintain all supporting documentation regarding additions, changes, or deletions to access, as well as the location of retained files;
- A requirement for dual signatures on the access request form, from the IT Division manager and the requesting division director;
- A requirement for an approval or denial section on the access request form from the IT Division Manager to the requesting division director, as well as retention of this form in the designated repository; and,
- Guidelines for determining appropriate access for users based on job duties.

Additional recommendations to expand the IT Security Access Request Policy related to local area network (LAN) access were made in the Security Policy comment 11-KST-46.

We recommend Treasury perform a periodic review of all user and vendor-supplied user profiles to ensure access is appropriate. All unnecessary accounts should be disabled. The number of concurrent device sessions should be set to one in accordance with industry best practices.

In addition, the vendor-supplied profile functioning as a group profile should be disabled, and an individual user profile should be created for each computer operator. Treasury should either

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Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-45: The Kentucky State Treasury Should Strengthen Logical Security Controls To Ensure Only Authorized Users Can Access The Data Processing System (Continued)

Recommendation (Continued)

remove the public user authority from all command, utility, file, and program resources or change its Object Authority to *EXCLUDE, which would restrict access to the object to only the owner, security officer, and users with specific authority. If individuals who previously used the public user authority to gain access to libraries or object still require this access, their individual profiles should be granted access to only those resources required for the completion of their job duties.

Additional recommendations regarding segregation of duties were made at 11-KST-43.

Management's Response and Corrective Action Plan

The group account to which the Auditor refers is still in use for a specific reason. Individual accounts cannot be established for the employees involved until after the review of the objects discussed in 11-KST-44 is completed. Each individual account has to be given access to every object needed to do the required job. To do this, the impact and interrelation of each object must be documented and understood fully. If an essential object is missed, a disruption in a critical process could occur. When the review of the objects is completed, individual accounts for the operators will be created and the group account will be disabled. Until that is possible, the group account will continue to be used to access this functionality. We know it works.

With regard to the public user authority, the default system value has been changed to "EXCLUDE". The changeover for object access is on-going. Every object and every job process must be examined before the public user authority can definitively be set to "EXCLUDE", however.

We continue to feel that the elaborate IT Security Access Request Policy recommended by the Auditor is "over-kill" for an agency this size. It is designed for a large agency that does not have the daily one-on-one contact seen in the Treasury Department. However, the Treasury Department will (and currently does) maintain all relevant supporting documentation as suggested. The Data Processing Division normally receives very limited types of requests, and in many cases there is very little documentation involved. In addition, we will amend the access request form to require dual signatures, and will add an approval or denial section to the form.

The appropriate access for each job is very well known to the Treasury Department's Data Processing Staff. They know what each person does, and they understand the authority that is required for each job. They will not allow an over-reach of authority. It is a small office.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-45: The Kentucky State Treasury Should Strengthen Logical Security Controls To Ensure Only Authorized Users Can Access The Data Processing System (Continued)

Auditor's Reply

We acknowledge additional research will be required before the noted group account can be disabled to ensure no interruptions to business operations occur. We recommend Treasury work toward the goal of disabling the group account and assigning individual accounts to the operators once all associated research has been completed.

Despite the size of the office, this does not eliminate the need for formalized policies and procedures governing access to the Treasury data processing system due to the critical nature of the processing performed. These procedures need not be overly involved or complex, but should accurately describe all key steps and roles in the access request process. Since the operations are not as complex as larger agencies, it should be more manageable for Treasury to document their current procedures.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-46: **The Kentucky State Treasury Should Develop And Implement An Application Security Policy Related To The Data Processing System**

As noted during our three prior year audits, the FY 2011 audit of application-level security over the Kentucky State Treasury (Treasury) data processing system revealed Treasury did not have formal security control policies or procedures in place concerning critical functionality on the data processing system. Of greatest concern is the lack of management-defined security controls related to critical utility programs, commands, libraries, and objects such as programs and files residing on the data processing system.

Treasury created an Information Technology (IT) Security Access Request Policy; however, this policy only discusses the process to request access to the network and data processing system. Additionally, Treasury employs an operator's guide for the data processing system, has developed individual procedures related to physical security and contingency planning, and adheres to the Commonwealth Office of Technology (COT) Anti-Virus Policy CIO-073. However, none of these policies specifically discuss security controls for the critical aspects of the data processing system.

By not adequately documenting, implementing, or communicating acceptable application security policies and procedures management and users may lack an understanding of security related issues. This lack of understanding could potentially result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system functionality or resources. Additionally, it increases the likelihood of unauthorized or inaccurate data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources.

Formal policies should be established specifically addressing security controls over critical utilities, commands, libraries, and objects to help ensure only authorized access is granted to these resources and appropriate actions can be taken against Treasury's data processing system. Consistent application of formal security policies and procedures provides continuity for implementation and sets the tone of management concern for strong system controls.

> **Recommendation**
>
> We recommend Treasury develop formal policies and procedures to administer the security of their data processing system. The system security policy should include:
>
> - functional and technical requirements;
> - management's objectives and expectations for information security in clear, unambiguous terms, along with the implications of noncompliance;
> - key risks and mechanisms for dealing with those risks;
> - roles and responsibilities of management and users;
> - a process for regular monitoring and feedback to ensure the polices are enacted and enforced;
> - flow charts of the system and interfaces;
> - end user accountability and acceptable use;
> - policy for enabling auditing and frequency of review;

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-46: The Kentucky State Treasury Should Develop And Implement An Application Security Policy Related To The Data Processing System (Continued)

Recommendation (Continued)

- listing of critical libraries, commands, utilities, and objects and authority that should be established over them;
- references to the operator's guide; and,
- references to the physical security, contingency planning, and anti-virus procedures.

These policies and procedures, once developed, should be properly distributed and all necessary system users made aware of their responsibilities. Further, management should ensure the consistent application of these procedures.

Management's Response and Corrective Action Plan

The Treasury Department will continue to work toward the development of a formal policies and procedures manual to be used to administer the security of its data processing system. The system security policy envisioned by the Auditor is comprehensive and detailed, and will involve a major time commitment. With the very limited staff available, and with the current on-going projects, including bank reconciliation, the conversion to the new bank and the implementation of the new statewide payroll system, which are critical to the daily operations of the office, this comprehensive security policy cannot receive very high priority at the current time. It will remain an important long-term goal of the Treasury Department's Data Processing Division. This detailed policy will also be dependent upon the completion of the examination of the libraries and the objects associated with the Treasury computer system, which are discussed in other audit comments. With the magnitude of this total project, it is not something that will happen quickly.

Auditor's Reply

We acknowledge the time involved in the creation of a formal security policy for the data processing system. Among other avenues available to accomplish this goal, we suggest Treasury might work with the Commonwealth Office of Technology (COT) to determine if any of their existing enterprise policies could be customized to fit the needs of the Treasury data processing system.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-47: The Kentucky State Treasury Should Expand And Strengthen Formal Program Change Control Procedures

As noted during the prior three audits, our fiscal year (FY) 2011 audit of system controls revealed weaknesses with regard to the program change control procedures of the Kentucky State Treasury (Treasury). During FY 2010, Treasury implemented a Programming Requests Policy governing controls for program development and modifications of critical data processing systems. However, the policy did not adequately address all phases of the program change control process.

The Programming Requests Policy dictates that all programming requests for new development or modification to existing systems be discussed with the appropriate Division Director. Once there is justification for the change request, the Division Director makes a formal request by email to the Information Technology (IT) Division Manager. The requests are then reviewed for feasibility by the IT Division Manager and either approved, returned for more information, or rejected with explanation. Although not specified in the policy, the IT Division Manager stores all requests in a Microsoft Outlook folder.

The Programming Requests Policy is stated at a very high level and does not contain specific requirements related to the following areas:

- Supporting content of the initial request email;
- Testing of program changes prior to submitting to production;
- Approval to move to production;
- Final acceptance notification;
- Retention of all documentation supporting change, including request emails, testing documentation, approval documentation; and,
- For new program development, the creation and retention of program specifications and other related technical documentation.

Further, testing of supporting documentation for twelve secondary program changes made since the prior year review revealed adequate documentation was not on file for the implementation of these changes. Two emails regarding the request for the changes were not maintained in the specified folder. Subsequent to our review, these emails were moved to the designated folder. No emails were maintained to show the approval of the change, approval to move the change from testing to production, or final approval of the change. Further, there was no documentation on file showing the changes were tested prior to being moved to production.

Without specific and detailed program change control procedures, management increases the risk of developing and implementing ineffective or inaccurate systems and the risk of unauthorized changes being placed into the production environment that have an adverse affect on system processing results.

Policies and procedures ensure that an organization's program change control methodology applies to the development of new systems and programs, major changes to existing systems and programs, and user participation. Program change control procedures require adequate program specifications be provided to a programmer prior to program development to mitigate processing errors and the need for numerous program modifications. Sufficient procedures dictate that complete and accurate system

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-47: The Kentucky State Treasury Should Expand And Strengthen Formal Program Change Control Procedures (Continued)

documentation be developed and maintained for all critical systems, as this information is vital to ensuring longevity of the system. Program change control procedures must be consistently applied and include adequate procedures to segregate the live production environment from development and testing environments. They should also be distributed to all key personnel to ensure consistent implementation of new systems.

Recommendation

We recommend Treasury expand their current Programming Requests Policy to ensure all steps of a complete program change control process are adequately defined. With regards to the formal request by email, the policy should state the requirement of the emails to include as much information as possible concerning the problem identified and the proposed correction or update. The programmer should then document, at a minimum, the following:

- the necessity for the change;
- the affected system(s); and,
- the program and/or report the change will affect.

We also recommend the following expansion of the procedures in order to strengthen the Programming Requests Policy:

- add requirement to retain all documentation supporting the change, including request emails, testing documentation, and approval documentation within the specific retention location;
- add requirement to test program changes prior to submitting to production;
- add requirement for approving changes to be implemented in production;
- add requirement for a final acceptance notification from requestor accepting changes after moved to production; and,
- add requirement for new program development related to the main accounting/reconciliation system to create and retain detailed program specifications and technical documentation.

Once these changes have been made to the Programming Requests Policy, Treasury should provide this information to all appropriate staff and ensure strict adherence to the policy going forward.

Management's Response And Corrective Action Plan

The Data Processing Manager will retain (and currently does retain) any supporting documentation regarding the change request. There is usually very little additional documentation involved.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-KST-47: The Kentucky State Treasury Should Expand And Strengthen Formal Program Change Control Procedures (Continued)

Management's Response And Corrective Action Plan (Continued)

The Treasury Department Data Processing Division will attempt to comply as closely as possible with the outlined recommendations for the expansion of the procedures for the Programming Requests Policy. Obviously program changes are tested before submitting to production. The documentation that is generated in the change process will be retained. With only one programmer/ data processing system professional with I-Series expertise on staff, however, it is difficult to visualize from whom the various approvals for testing, moving into production, and acceptance will come.

Auditor's Reply

We feel an approval process for testing, moving to production, and acceptance is attainable. We recommend the user requesting the change be responsible for either testing the change directly or reviewing testing documentation to ensure the requested changes were achieved. Sign off by the requesting user would be required before approval to move to production is sought. A member of management could review the change documentation and the testing and user sign off documentation, and then provide authorization to move to production. After production implementation, the requesting user could again review the change to ensure it is functioning appropriately and sign off to verify the completed change is in accordance with the original request. Each of these approvals could be completed by individuals not having an extensive knowledge of the data processing system as long as the programmer ensures sufficient documentation is in place to allow each approver to validate the change.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PARKS-48: The Department Of Parks Should Ensure Expenditures Are Coded To The Appropriate Accounting Codes

During tests of Parks FY11 expenditures, the auditor noted three (3) transactions that were not charged to the appropriate object code. Two (2) expenditures were for the purchase of packaging items that were charged to the food category when they should have been charged to kitchen supplies which require additional approvals.

The third miscoded expenditure was for the purchase of three boat motors costing $5,995 each, which were incorrectly charged to vehicle maintenance and not the proper equipment category.

The prior approval of expenditures ensures that adequate funds exist for purchases and that management concurs with the necessity of purchases. Certain items such as food do not require these prior approvals and coding other items to a food category allows the purchase to avoid these requirements.

Budgetary restraints have forced many state agencies including the Department of Parks to reduce expenditures. When expenditures are not properly classified, budgets are based on inaccurate information and do not accurately reflect the actual historic expenditures of the department.

Good internal controls dictate that expenditures be coded to the appropriate categories. This allows for proper tracking of expenditures by type, provides expenditure date that can be reliable compared by time periods or locations, and allows for adequate tracking of all expenditure types.

> **Recommendation**
>
> We recommend the Department of Parks review the expenditure coding policies with purchasing staff at parks facilities. Supporting documentation should be reviewed to ensure that purchases are recorded to the correct accounting codes and approved at the required levels. Exceptions should be documented brought to the attention of the appropriate individuals. Those not following this policy should be disciplined as outlined in Parks Business Procedures Manual.
>
> **Management's Response and Corrective Action Plan**
>
> *The Department of Parks is working on a plan to educate all staff on appropriate uses of object codes. Several of the codes are subject to the reviewers discretion which makes it difficult to ensure the accuracy for all.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PARKS-49: The Department Of Parks Should Implement Controls To Ensure Expenditures Are Paid Timely

During the FY 2011 audit of the Department of Parks (Parks), the auditor discovered five (5) instances where invoices to a particular vendor were not paid in a timely manner:

- Four instances where the vendor was paid more than 30 working days after the date of the invoice.
- One instances where the vendor was paid more than one year after the date of the invoice.

Although we continue to note instances where invoices are still being late, the number of late invoices noted has decreased over prior audit periods.

Agencies are responsible for a 1% penalty on each payment not made within 30 working days. Failure to pay vendors in a timely manner also erodes relationships with those vendors who may decide to stop doing business with Parks. Thus, failure to pay invoices on time costs the agency money, can affect the running of the state parks, and can negatively impact the services provided to guests.

KRS 45.451 through KRS 45.458 and Finance and Administration policy BO 120-05-00 address prompt payment to vendors. The policy can be summarized, as "all bills shall be paid within 30 working days of receipt of goods and/or services, except when the purchasing agency has transmitted a rejection notice to the vendor."

In addition, the purchasing agency is responsible for a 1% penalty when payment is not made within 30 days.

Recommendation

We continue to recommend payments be made in a timely manner. Controls should be developed and implemented to ensure payments are made in a reasonable time frame in compliance with legal statutes. The agency should review the statutes and policy noted above to ensure full compliance. The agency should take steps to ensure that the people involved in processing and approving payments read and understand the relevant laws and policies.

Parks should improve procedures related to recurring monthly charges to ensure that each month's payment are made timely and no invoices are missed.

We recommend that Parks review this procedure with purchasing staff at parks facilities and ensure that purchase approvals are documented with the supporting documentation of all purchases including the documentation of the date purchased items are received.. Those not following this policy should be disciplined as outlined in Parks Business Procedures Manual.

Additionally, we recommend that Parks work with central office staff reviewing and approving expenditures to ensure that all transactions are reviewed for proper approvals and those exceptions are documented and dealt with in accordance with Parks policies.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PARKS-49: The Department Of Parks Should Implement Controls To Ensure Expenditures Are Paid Timely (Continued)

Management's Response and Corrective Action Plan

The Department of Parks is in agreement with the findings and has addressed the issue with the parks involved directly. We will continue to monitor timeframe of payments made and address those falling outside the guidelines. In most instances, with the specific documents listed, it is difficult to tell if the invoice was truly paid late or if the items in question arrived after the date of the invoice thus delaying the payment. Due to the economic times directly affected our budget we continue to have funding issues during the fiscal year end which makes it necessary for some invoices to carry over outside the 30 day turn around for payment.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PARKS-50: The Department Of Parks Should Ensure Receipts Are Deposited And Recorded Timely In Accordance With Their Written Policies

During the fiscal year 2011 audit of the Department of Parks (Parks) the auditor tested 60 receipt transactions and found eight exceptions to the timely deposit and recording of receipts:

- Four instances in which the transfer of funds (ePAY) from a state park's local bank account to the main Parks account took place more than five days after deposit to the local bank account. On average these four transactions were processed in nine days rather than five per parks' policy.
- One instance in which the deposit of checks and cash into the local bank account took 14 days. Per parks' policy the receipts from weekend business should have been made the following Monday, three days after receipt.
- Five instances in which the preparation of the JV2P document to record revenue in eMARS took more than 9 days. Two transactions were not recorded to the state's accounting system until 2 weeks after the date of receipt.
- One instance where the DBR was posted to an incorrect accounting period.

Delays in depositing cash and checks and recording these transactions increase the possibility of theft. Delays in making ePAY transfers to the general fund and preparing documents to record the deposits to eMARS increase the likelihood of mistakes due to human error.

Given current economic constraints, Parks depends on funds collected from guests at the state park level. All delays to the deposit and recording of these transactions prevent Parks from having an accurate record of available funds and may impact their ability to promptly pay vendors.

Recording of receipts in the incorrect time period results in inaccurate reports and limits the potential of Parks management to accurately budget for expected revenues.

Per the Department of Parks Business Procedures Manual:

Deposits for each day will be kept separate and each day's receipts must be deposited intact. Deposits should be taken to the local bank no less than on Mondays & Fridays".   (Section 4-"Change Fund—Cash Receipts—Accepting Personal Checks")

Good internal controls dictate that the state's accounting system (eMARS) be updated timely and accurately to reflect the funds available to Parks and allow for accurate reporting.

Recommendation

We recommend the Department of Parks follow its' written policies regarding the timeliness of cash deposits and the recording of these transactions to the state's accounting system and reemphasize the importance of timely deposits.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PARKS-50: The Department Of Parks Should Ensure Receipts Are Deposited And Recorded Timely In Accordance With Their Written Policies (Continued)

Management's Response and Corrective Action Plan

We agree with the assessment and in most of the instances the delays in making deposits to local bank and processing of ePays was a result of the weekends or staff shortage due to reduction of hours and furlough days. We have and will continue to e-mail park's management of the importance of following the Business Procedures Guide with regards to the timeframes required for procession DBRs, Deposits and ePays.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-PARKS-51**</u>: **The Department Of Parks Should Enforce Procedures Requiring Tagging And Tracking Of Capital Assets**

During testing of expenditures, the auditor noted that Parks had not recorded in eMARS all equipment received valued at greater than $300 as required by departmental policy. In total, the auditor found that four (4) items valued at $18,371.96 were not properly included in the capital asset inventory listing in eMARS.

The parks that purchased these items was responsible for assigning a number and providing the number and other required information to the property officer for entry to eMARS. The four (4) items noted were not assigned a number or not entered to eMARS during the 2011 fiscal year. Because these items were either not tagged or entered to eMARS, they are not being tracked and therefore become more susceptible to theft.

Three of these items should have been included in the capital assets inventory for items exceeding $5,000 per FAC policy.

FAP 120-20-01 states in part:

> Pursuant to KRS 45.313, each budget unit shall maintain a current fixed asset record of equipment having an original cost of five hundred dollars ($500) or more and a useful life of greater than one year. . . . Agencies shall enter records into the fixed asset system for non-expendable property that promotes financial reporting, safeguarding of assets, and adequate insurance. . . . a. A state agency shall maintain current records of physical properties and equipment and make appropriate additions and deletions to fixed asset records as property is acquired or disposed.

Parks policy requires items costing more than $300 to be tagged and entered to eMARS to ensure that the items are tracked to reduce the threat of theft of misappropriation of assets.

> <u>**Recommendation**</u>
>
> We recommend the Department of Parks enforce current procedures and policies for tagging and tracking equipment. Further we recommend that Parks consider changing procedures to require items be tagged when received and that information transmitted with the request for payment submitted to Parks. This would allow for greater oversight at Central Office over the process.
>
> In addition, Parks should ensure that employees reviewing expenditures at Central Office have sufficient understanding and knowledge of the capital asset requirements to identify those items that should be tagged as capital assets per FAC and Parks policies.
>
> <u>**Management's Response and Corrective Action Plan**</u>
>
> *The Department of Parks agrees with the audit findings. On three of the items (outboard boat motors), park personnel were under the impression that the motors were tagged with the boat as one unit. However this was not the case as the motors had separate asset tags. To help identify such items in the future, we have instructed payable staff to alert the property officer of any assets purchased over $300.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PARKS-52: The Department Of Parks Should Ensure Leave And Overtime Request Approvals Are Documented

During testing of payroll expenditures for the 2011 fiscal year, the auditor noted the following exceptions:

- Two timecards or timesheets that were not signed by either the employee, their supervisor or both.
- Fifteen instances where there was no documented approval of overtime worked or leave time taken for the time period. Three of these instances occurred during a furlough week.
- Two instances where the time recorded worked on a holiday per the KHRIS timesheet is not supported by the timesheet.

Expenditures including payroll should be supported by documentation that agrees to the amount paid for that expenditure. Due to the errors and omission described above these payroll expenditures were not adequately substantiated by the documentation including timesheets, properly approved leave requests, and overtime forms.

While overtime was not prohibited to be worked during weeks an employee took a required furlough day, approval of overtime should have been properly approved.

Good internal control over payroll dictates that payroll charges should be supported by adequate documentation including signed timesheets or timecards, leave and overtime forms that detail and substantiate hours and times worked by each employee.

Recommendation

We recommend the Department of Parks review established standards for recordkeeping including requirements for the use of leave and overtime approvals and ensure that procedures are uniform across all Parks facilities. In addition, Parks should consider establishing a periodic review of payroll at each park that includes agreeing timecards and other supporting documents to ensure that they support payroll and are completed per the established guidelines.

Management's Response and Corrective Action Plan

During testing of payroll expenditures for the 2011 fiscal year, the auditor noted the following exceptions:

- *Two timecards or timesheets that were not signed by either the employee, their supervisor or both.*
- *Fifteen instances where there were no documented approval of overtime worked or leave time taken for the time period. Three of these instances occurred during a furlough week.*
- *Two instances where the time recorded worked on a holiday, per the KHRIS timesheet is not supported by the timesheet.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-PARKS-52:** The Department Of Parks Should Ensure Leave And Overtime Request Approvals Are Documented (Continued)</u>

<u>**Management's Response and Corrective Action Plan (Continued)**</u>

HR Administrator, HR Specialist III, and Director of Human Resources reviewed the exceptions and agree with the findings. The Director of Human Resources is in the process of contacting each park manager that had exceptions and reviewing with them the exceptions as well as reiterating the importance of checking payroll information for proper signatures and supporting documentation, and maintaining this documentation properly. Park Managers will be instructed to review the payroll procedures and recordkeeping requirements with their payroll officers to ensure compliance. The Parks audited that had exceptions were General Butler SRP, Lake Barkley SRP, Taylorsville SP, Natural Bridge SRP, EP "Tom" Sawyer SP, and Central Office. Natural Bridge SRP had two exceptions where time recorded on a holiday per the KHRIS was not supported by the timesheet, these errors required corrections. These corrections have been made in KHRIS.

Department of Parks currently has a park policy that requires employees and supervisors to sign all timecards as well as initial any times written in or any changes made to the time card. Park Policy also requires employees to utilize the leave slip for all leave time and compensatory time earned and used. On December 16, 2011 the Director of Human Resources sent a memo, via email, to all park managers, business managers, and payroll officers reiterating established standards for recordkeeping including requirements for the use of leave and overtime approvals and ensure that procedures are uniform across all Parks facilities. Park Policy 01-01 was reiterated, instructing park managers/payroll officers to review with supervisors and employees the payroll policies as well as the types of errors that were found to ensure that all employees are fully aware of the payroll policies and to ensure that payroll officers are reviewing employee payroll more carefully. The Director of Human Resources does believe that our payroll officers and managers have a good understanding of the payroll process. However they do need to review the payroll more closely and catch these type errors.

The exceptions where there was not proper documentation to support that leave was approved in advance, was due to the Department of Parks Central Office staff discontinuing the using of leave slips/and or attaching emails to document approved leave, when we transitioned into KHRIS. Employees were instructed to insert comments directly into the electronic timesheet. Now that it has been brought to the director's attention that this is not appropriate, the Department of Parks will go back to the previous process of attaching emails directly to the timesheet, or dating on the timesheet each for each occurrence, exactly when the leave was prior approved.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PARKS-52: The Department Of Parks Should Ensure Leave And Overtime Request Approvals Are Documented (Continued)

Management's Response and Corrective Action Plan (Continued)

There were three occasions where there was no documentation to support that the overtime worked during a furlough week was approved. Supervisors/Managers were instructed to document all approved overtime for a furlough week, and to provide justification for the hours worked. I will reiterate the importance of this documentation to all Supervisors and Park Managers, to ensure we're in compliance in the future. The Director will also remind the Central Office Payroll Division to verify that we receive the supporting documentation for all overtime worked during Furlough weeks.

The Human Resources Director also discussed the exceptions with our internal auditor. The auditor will be scheduling an internal payroll audit in a few months as a follow up. This review will include agreeing timecards and other supporting documents to ensure that they support payroll and are completed per the established guidelines.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-53: The Personnel Cabinet Should Ensure The Correct Reporting And Remittance Of Employee And Employer Deductions To The Appropriate Entities And Maintain Supporting Documentation

During our FY 11 audit of payroll deductions within the KHRIS system, we noted discrepancies in the employer/employee amounts due to what was remitted to the appropriate entities and were unable to reconcile the employee and employer deductions to payments made to the appropriate entities. Payroll deductions are made on a pay-period-by-pay-period basis for each employee and are reflected on their pay stub. Along with the employees' deductions, the employers' share of FICA, retirement, health insurance and life insurance are also reflected on the employee's pay stub.

If system functionality is not well designed, the accuracy of processed information is compromised.

We cannot verify the deductions were properly calculated and the correct remittances were made to the appropriate entity.

Good internal controls dictate that deductions are properly calculated and the correct payment is being forwarded to the appropriate entity.

Recommendation

We recommend the Personnel Cabinet develop and implement procedures to ensure the correct reporting and remittance of the employee/employer deductions to the appropriate entities. Reconciliations should be performed after each payroll run and "static" reports maintained to document the reconciliation. Any variances identified as part of the reconciliation, should be investigated and any required adjustments resulting from this process should be thoroughly documented. Supporting documentation of the reconciliation procedures should be maintained for auditing purposes.

Management's Response and Corrective Action Plan

The Personnel Cabinet appreciates the recommendation to ensure accurate reporting of employer/employee deductions and continues to strive to make enhancements to reporting from KHRIS. Along with developing new reports as time and budget allow, efforts are being made to better educate the user community on how to interpret reports.

The reports in KHRIS are designed to be more flexible to reduce the number of custom reports. The Personnel Cabinet has continued to improve available reporting for reconciliation efforts, including reports being generated from the same source. The reports in KHRIS are designed to be more flexible to reduce the number of custom reports. The Cabinet has improved the consistency of running reports with the proper criteria to reduce the confusion of data irregularities due to changing report criteria.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-53: The Personnel Cabinet Should Ensure The Correct Reporting And Remittance Of Employee And Employer Deductions To The Appropriate Entities And Maintain Supporting Documentation (Continued)

> **Management's Response and Corrective Action Plan (Continued)**
>
> *Each payroll deduction total is reconciled to the corresponding deposit or payment. Report defects have been identified and reconciled as of this date. Reconciliation procedures have been documented along with normal payroll and off-cycle payroll procedures. Furthermore, KHRIS reporting is designed to eliminate the need for "static" reports by being able to run reports on demand to a point in time. The Cabinet continues to improve procedures to run reports, and correct defects in reports in a timely manner.*
>
> *The KHRIS team is constantly monitoring any error or defects associated with employee payroll deduction information. Again, your efforts to ensure the accuracy of Commonwealth payroll deduction data are greatly appreciated.*

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-54: The Personnel Cabinet Should Ensure Leave Accruals Are Properly Calculated And Processed By The Kentucky Human Resources Information System

During our fiscal year (FY) 2011 audit of the Personnel Cabinet's (Personnel) Kentucky Human Resources Information System (KHRIS), we determined Personnel did not develop formal system documentation explaining how time data and accruals of leave time are calculated and processed by the system.

The Auditor of Public Accounts (APA) IT Audit staff requested read only, statewide access to KHRIS data in April 2010; however, it was not granted until July 29, 2011. In addition, Personnel was unable to provide a report showing year-to-date (YTD) accruals similar to that produced within the legacy system from the new KHRIS system for all Commonwealth of Kentucky employees. As a result, we were unable to perform in-depth testing for FY 2011 to ensure employees received the correct amount of sick and annual time based on their years of service and performance evaluations and employees were appropriately paid for a block 50 based on compensatory hours accumulated.

Testing was performed to ensure leave balances within the legacy system as of March 31, 2011 converted correctly to KHRIS for employees within a sample of three state agencies: the Auditor's Office, the Attorney General's Office, and the Board of Hair Dressers & Cosmetologists. During this review, we determined sick leave for Constitutional Officers was not maintained within KHRIS. According to Personnel staff, KHRIS cannot maintain leave balances for individuals without also having that individual's accrued leave. Therefore, sick leave earned by Constitutional Officers must be maintained manually outside of KHRIS.

Starting with the May 16-31, 2011 pay period, compensatory leave within KHRIS is calculated based on a split week. Additional hours worked in a split week are not added to the employee's compensatory leave quota until after the end of the week, which falls in the next pay period. Any hours worked in the first part of the split week are essentially held in a "bucket" within KHRIS until the next pay period when the end of the split week is processed. Even though these hours are maintained, administratively compensatory leave hours earned during the split week are available to employees for use during the period in which they were earned. As a result, KHRIS will allow a certain threshold of negative compensatory leave hours and will not give a hard stop error. While employees cannot see the held hours in a "bucket", a Human Resource Generalist (HRG) can see these hours using certain transactions and variants within KHRIS. Personnel holds it is agency staff is responsible for monitoring these instances and for not approving compensatory leave to be used when it has not earned by the employee. However, since the negative balance is not tied to the split week additional hour "bucket", the Personnel Cabinet runs the risk of paying individuals for hours not previously available or earned within the period.

Without formal documentation regarding the processing of leave accruals, the agency can inadvertently calculate an employee's leave earned or used incorrectly. By allowing employees to have a negative compensatory leave quota, the Personnel Cabinet can essentially pay an employee for hours or leave to which they are not entitled.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-PC-54**</u>**: The Personnel Cabinet Should Ensure Leave Accruals Are Properly Calculated And Processed By The Kentucky Human Resources Information System (Continued)**

The capture of employee time allocations and leave is essential to the accurate processing of payroll and related financial reporting. Payroll processing will only be accurate if employee time and leave requests have been captured correctly by the system. Annual, sick, and compensatory leave accumulation rates and limits are governed by 101 KAR 3:015. Employees should not be paid for hours not earned.

<u>**Recommendation**</u>

We recommend the Personnel Cabinet document formal system documentation describing how leave accruals for Commonwealth of Kentucky employees is calculated and processed within KHRIS. The system documentation should explain how annual, sick and compensatory leave accruals, usage, and conversions are processed within KHRIS to comply with 101 KAR 3:015.

We also recommend the Personnel Cabinet configure KHRIS to raise a 'warning flag' at the point of time entry if requested compensatory leave will result in negative quota balances. This process will ensure appropriate actions are taken by agency personnel to reject the employee leave requests that are not supported by hours either banked or earned within a split week for the pay period.

Further, we recommend the Personnel Cabinet develop a report within KHRIS similar to legacy which will show leave quota balances, accruals, and usage over a requested time period. This report should be able to be queried for a range of dates by an individual employee, a group of employees, or organization unit.

Finally, we recommend the Personnel Cabinet continue to pursue a system change that would allow the capturing of sick leave quota information for Constitutional Officers.

<u>**Management's Response and Corrective Action Plan**</u>

The Personnel Cabinet appreciates APA's recommendation for detailed documentation describing how leave accruals for Commonwealth of Kentucky employees are calculated and processed within KHRIS and will create said documentation.

A 'warning flag' is not feasible on the point of entry since compensatory time is calculated on a work week and timesheet edits are on a pay period. Current Time Evaluation messaging rules output instances of negative comp at the end of the pay period and this is reportable via PT_BAL00.

Leave quota balances, accruals, and usage over a requested time period is currently reportable within transaction code PT_BAL00.

The Personnel Cabinet will continue researching the possibility of capturing of sick leave quota information for Constitutional Officers in KHRIS. Thank you for your continued efforts to ensure the accuracy of the accrued leave balances and supporting information data for the Commonwealth.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-55: The Personnel Cabinet Should Develop Formal System Documentation To Support Processing Performed By The Kentucky Human Resource Information System

Our Fiscal Year (FY) 2011 audit of the Personnel Cabinet's (Personnel) Kentucky Human Resource Information System (KHRIS) revealed that Personnel did not develop or maintain basic documentation that describes critical processing performed by the system.

KHRIS is the software system used to manage human resource data for the Commonwealth of Kentucky. The KHRIS system was implemented on April 1, 2011. Various modules and components are used to process payroll, personnel administration, life and health benefits, and time administration within KHRIS. During fieldwork, the auditors requested manuals or other documented procedures that reflect how the Personnel Cabinet and other agencies enter payroll data, both on-line and through interface files, edits or audits within the system that could cause errors at the point of payroll entry, error corrections procedures, and Personnel Action Number (PAN) transactions procedures. In addition, we asked Personnel to identify tables and/or programs used to perform financial calculations. Furthermore, we requested formal payroll balancing/reconciliation procedures for regular and off-cycle payrolls. None of this documentation was provided by the end of audit fieldwork. The need for documentation associated with edits and audits is addressed in a separate comment see 11-PERS-8. The need for reconciliation procedures is also addressed in a separate comment see 11-PC-6.

While Personnel has documented numerous Business Process Procedures (BPPs) and eLearning Courses on the KHRIS Knowledge Center website that state agency personnel can view, discussions with Personnel management revealed technical and functional manuals that describe critical components and functionality will not be documented until processing stabilizes. They are currently working to create a manual that captures processes and procedures performed by the Commonwealth Office of Technology (COT), which houses and maintains the KHRIS system. However, this was not completed by the end of audit fieldwork.

Lack of documentation increases the likelihood of erroneous or incomplete processing. It further increases the likelihood of unauthorized or unintentional data modification, destruction of assets, and interruption of services.

Proper documentation should be maintained for each critical program in production in order to, at a minimum, identify the purpose of the programs, the origin of data, the specific calculations or other procedures performed, and the output of data or reports.

Recommendation

We recommend Personnel develop documentation that provides an understanding of critical programs or jobs currently running in production. Information normally collected in design documents includes a technical description of the programs, sources and location of files used by the programs, and the processing steps for main functions. The documentation could include a network diagram; user and operational manuals; and flowcharts, diagrams, or descriptive narratives of functional areas. Once developed, Personnel should provide this documentation to technical staff for reference and ensure the documentation is updated as changes are made to the system.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-55: **The Personnel Cabinet Should Develop Formal System Documentation To Support Processing Performed By The Kentucky Human Resource Information System (Continued)**

Management's Response and Corrective Action Plan

The Personnel Cabinet continues to strive in making improvements for more detailed documentation encompassing both the technical solution as well as instructions to end users.

All configuration and custom development is documented and maintained on-line in configuration documents, functional specifications, and technical specifications. In keeping with the green initiatives of the Commonwealth of Kentucky, these documents are not maintained completely in a written form, but are available for perusal in the system.

Additionally, as noted, Business Process Procedures (BPP) document instructions to end users, supplement in-class training, and are an on-line resource to end users.

The Personnel Cabinet will continue researching any gaps in documentation of the KHRIS solution and create as needed. Thank you for your continued efforts to ensure critical business procedures and system processes within KHRIS are documented.

Auditor's Reply

We made several requests for KHRIS system documentation throughout our audit process and were not provided with the information discussed in the agency response.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-PC-56</u>: **The Personnel Cabinet Should Develop Formalized Disaster Recovery Procedures For The Kentucky Human Resource Information System**

During our Fiscal Year (FY) 2011 audit of the system controls for the Personnel Cabinet (Personnel), we found a disaster recovery plan (DRP) and system backup processes was not formalized for the Kentucky Human Resource Information System (KHRIS) prior to its implementation in April 2011. Further, by the end of FY 2011, neither a DRP nor formal system backup procedures had been developed. In addition, KHRIS was not tested from a disaster recovery standpoint.

We are aware disaster recovery for the KHRIS production environment should also be covered through the Commonwealth Office of Technology (COT) disaster recovery contract which is held with an outside vendor.

Failure to develop and implement a formalized disaster recovery plan increases the possibility of both data and monetary loss due to excessive recovery time, costs, and disruption of processing capabilities in the case of a disaster or extended system outage.

The goal of a disaster recovery plan is to improve preparedness for extended system outages at minimal cost using available resources. Disaster Recovery or Business Recovery Plans should be documented, approved, properly distributed, tested on a consistent basis, and updated as needed.

> <u>Recommendation</u>
>
> We recommend Personnel formalize and implement a DRP that appropriately addresses the new KHRIS and associated resources. The plan, once created, should be reviewed and updated annually as necessary to reflect emergency contacts, potential alternative processing sites, system descriptions and process requirements, backup procedures, and planned testing procedures. The DRP should be properly distributed to key personnel and training should be provided to those personnel as needed.
>
> We also recommend this system be included within the COT disaster recovery test as soon as possible. Personnel should work with COT to ensure all KHRIS hardware is included in the vendor's contract to allow it to be tested during the annual COT disaster recovery test.
>
> <u>Management's Response and Corrective Action Plan</u>
>
> *The Personnel Cabinet agrees with the IT Audit recommendation to update the Business Contingency Plan from prior years and continue working with COT to include the KHRIS environment in the annual disaster recovery testing efforts. During the audit period, staff in the Department of Human Resources Administration (DHRA) has updated the 2011 DHRA Emergency Call Tree, Blackberry Users Listing 050611 and current Personnel SSL VPN listing.*
>
> *The Personnel Cabinet will ensure that the Business Continuity Plan is updated to include the recently implemented KHRIS environment. The contact person responsible for corrective action will be designated and the plan will include information regarding disaster recovery procedures for critical systems, backup and recovery procedures, emergency contacts, and alternative sites. This plan is expected to be updated and complete within the next six months.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-57: **The Personnel Cabinet Should Ensure All Variances Identified During Parallel Cycle 1 And 2 Testing Associated With The Kentucky Human Resource Information System Are Resolved**

During our Fiscal Year (FY) 2011 audit of the Personnel Cabinet's Kentucky Human Resources Information System (KHRIS), we determined the parallel cycle testing performed prior to KHRIS implementation between the payroll data processed by KHRIS and by the legacy Uniform Personnel and Payroll System (UPPS) was not completed to determine the cause of all variances identified. Further, documentation of actions taken to remedy noted variances within the testing was not maintained.

Based on a review of the parallel cycle 1 test results, the auditor determined there were 5,431 payroll records with a variance that was categorized as either 'Gross' or 'Net'. 'Gross' pay refers to pay before deductions are taken and 'Net' pay is what is left after deductions are taken. There were 2,250 records with a Gross negative variance totaling $186,859.04 and there were 3,181 records with a Net positive variance totaling $136,274.42. Of the total records with variances, 4,789 records had a reason code associated with it. Although requested by the auditor, documentation was not provided by the end of fieldwork, September 2011, to explain the correlation between the noted reason codes and the actions taken by the KHRIS team to resolve the variances. The remaining 642 records, or approximately 11.8 percent, did not have a reason code identified for the difference between the KHRIS and UPPS amounts. The Personnel Cabinet stated that these records were not researched due to time constraints with the parallel cycle testing and because no new reasons were identified for the variances from the records already reviewed.

In review of the parallel cycle 2 test results, the auditor determined there were 8,664 payroll records with a variance that was categorized as either 'Gross' or 'Net'. There were 5,215 records with a Gross negative variance totaling $1,172,791.93 and 3,449 records with a Net positive variance totaling $113,867.70. Each variance had a reason code associated with it; however, by the end of fieldwork, no documentation was provided explaining what actions were taken to resolve the noted variances.

Discussions with agency personnel revealed parallel cycle 1 and 2 variances were resolved during testing without documenting steps taken. Therefore, no documentation exists explaining how each variance was resolved prior to the implementation of KHRIS.

Without adequate documentation to explain variances identified during parallel cycle testing, there is no assurance all discrepancies were resolved appropriately prior to system implementation.

The purpose of parallel testing is to ensure the implementation of a new system will meet user requirements. Any discrepancy identified between the processing within the proposed and the legacy systems, no matter how small, must be explained and remedial actions, if necessary, should be documented and addressed by processing and operations staff. Furthermore, the explanation must be acceptable in terms of risk posed to the accuracy of the payroll.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-57: **The Personnel Cabinet Should Ensure All Variances Identified During Parallel Cycle 1 And 2 Testing Associated With The Kentucky Human Resource Information System Are Resolved (Continued)**

Recommendation

We recommend Personnel document actions taken by the KHRIS Team to resolve all variances identified during parallel cycle 1 and 2 testing. This documentation should address each reason code assigned to each variance. For those variance records in the parallel cycle 1 testing without a reason code, these records should be reviewed and the reason codes should be populated. If there are processing issues identified in these results that were not specifically addressed within the KHRIS system, these issues should be documented for the KHRIS Team and any necessary processing changes should be initiated. The documentation should be maintained for audit purposes.

Management's Response and Corrective Action Plan

The Personnel Cabinet appreciates APA's recommendation for detailed documentation for KHRIS's pre-go-live Payroll Parallel testing. In most all cases the issues (aka reason codes) identified causing payroll variations, if technical in nature, were resolved at the time of discovery. The payroll parallel strategy was an iterative process re-running payroll for the selected periods introducing corrections as needed with documentation of those system changes for the corrections.

KHRIS went live in April 2011, now constituting 13 pay periods (2011 PP07 through PP20) as of October 25th. All errors in pay either by user error or system issues are identified and corrected during payroll off-cycles which occur one to three times a week. The Division of Employee Management process is fully documented. Thank you for your assistance to protect the mission critical information systems data for the Commonwealth.

Auditor's Reply

Although management's response indicated that in most all cases issues were addressed at the time of discovery, there was no documentation of this process maintained and, therefore, it is not possible to verify that all variances or exceptions noted during the parallel testing were considered for modification within the production system. Therefore, we are reemphasizing the need for Personnel staff to review and consider all the variances or exceptions found during the parallel testing to ensure they were dealt with appropriately in production.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-PC-58**</u>**: The Personnel Cabinet Should Ensure System Changes Are Not Tested Within Production**

During our Fiscal Year (FY) 2011 audit of the Personnel Cabinet's (Personnel) Group Health Insurance (GHI) system, we noted an instance where system changes were tested within the production environment, causing production data to be altered.

Our office was contacted by a state employee and informed of problems she had experienced with the Kentucky Employees Health Plan (KEHP). Based on the employee's discussions with the Department of Employee Insurance (DEI), it was her understanding that a member of DEI had made changes to her plan within production while testing system changes.

According to GHI management, due to system limitations in GHI as well as an urgent cutover requirement for pre-tax qualifying events, testing data was inserted into both the testing and production environments. Although Personnel indicated that a plan was in place to remove the test data subsequent to the testing, a DEI employee failed to back out the test data after testing was completed. DEI did not maintain sufficient documentation of this plan to remove the test data or of specific test data used within production.

With the implementation of the Kentucky Human Resource Information System (KHRIS), the process of updating the system has changed. DEI now follows a more complex testing/cutover process which prohibits testing within the production environment. KHRIS also offers a quality assurance testing box which allows a business owner to test all changes before migrating changes into production.

Failure to properly apply and monitor change control procedures caused there to be changes made to production data within the GHI system.

Program modification control procedures should be consistently applied to ensure only appropriately authorized changes to critical applications are made and implemented within the production environment. Further, testing of changes should be limited to a separate testing environment. Consistent monitoring of the change control process ensures adequate documentation exists for all changes and that the changes made are acceptable to the user business areas prior to implementation.

> <u>**Recommendation**</u>
>
> We recommend Personnel ensure testing of changes be performed only in a test environment before movement into production. Going forward, changes made within KHRIS, as they relate to health insurance, should be properly requested, tested and authorized prior to being moved to production. Proper documentation should be maintained for audit purposes.
>
> We also recommend Personnel perform testing to ensure no other unexpected changes occurred as a result of this issue.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-PC-58: **The Personnel Cabinet Should Ensure System Changes Are Not Tested Within Production (Continued)**

Management's Response and Corrective Action Plan

The Personnel Cabinet strives to adhere with those developed procedures for migrating planned changes to the production environment. An issue was created in DEI during system testing in July of 2010, prior to Open Enrollment for the 2011 Plan Year. The testing effort within the production environment was not an optimal situation for the Personnel Cabinet's Division of Technology Services. DEI followed a post-cutover testing plan which was designed to clean up the testing scenarios. However, this inadvertent error was noticed approximately two weeks subsequent the testing effort and was corrected by removing the false dependent data.

In April 2011, the GHI system was replaced by a new system - the Kentucky Human Resource Information System (KHRIS). With the implementation of KHRIS, the process of updating the system has changed. DEI now follows a more complex testing/cutover process which prohibits testing within the production environment. KHRIS offers a quality assurance testing box which allows a business owner to test all changes <u>before</u> migrating changes into production, removing the requirement for follow-up testing.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-REV-59: The Department Of Revenue Should Strengthen Logical Security Controls Over The On-Line System For The Collection Of Accounts Receivable

As noted during the previous four audits, our fiscal year (FY) 2011 audit of the Department of Revenue (DOR) logical security controls revealed the Systems Administration Branch within the Division of Collections did not consistently follow the existing procedures for granting access to Kentucky's On-Line System for the Collection of Accounts Receivable (KY OSCAR).

Access to the KY OSCAR application and mainframe groups through Resource Access Control Facility (RACF) must both be granted in order for a user to access the KY OSCAR application. A supervisor or manager must complete the Authorization to Access Department of Revenue Confidential Computer Information and the KY OSCAR User ID Request forms to request system access. Both forms are then submitted to the DOR Security Office. The DOR Security Office reviews the Authorization to Access Department of Revenue Confidential Computer Information form to ensure it is approved and properly indicates access to KY OSCAR and ensures the user has also submitted a KY OSCAR User ID Request form. The DOR Security Office then grants access to the KY OSCAR RACF group and initials both forms. Once completed by the DOR Security Office, the Authorization to Access Department of Revenue Confidential Computer Information form is filed for documentation purposes, and the KY OSCAR User ID Request form is forwarded to the Systems Administration Branch within the Division of Collections for processing. The Systems Administration Branch next establishes the KY OSCAR User ID, and they sign and retain the KY OSCAR User ID Request form.

Review of the Authorization to Access Department of Revenue Confidential Computer Information and KY OSCAR User ID Request forms specific to a sample of eight new KY OSCAR users revealed DOR did not adhere to the established procedures as follows:

- Two Authorization to Access Department of Revenue Confidential Computer Information forms, or 25 percent of the tested user population, were not on file. DOR Security Office staff indicated RACF access was never requested in conjunction with KY OSCAR; therefore, it was not granted.
- One KY OSCAR User ID Request form, or 12.5 percent of the tested user population, did not specify a user capability level.
- Three KY OSCAR User ID Request forms, or 37.5 percent of the tested user population, indicated a different capability level than was granted.
- One KY OSCAR user, or 12.5 percent of the tested user population, lacked KY OSCAR User ID Request forms to support the revocation of access to an old user ID and the addition of access to a new user ID.

Allowing users the ability to access information without proper authorization may subject the processing of data to errors, omissions, or unauthorized transactions and may compromise the integrity of data processed through the KY OSCAR.

According to Finance and Administration Cabinet (FAC) standard procedure 6.5.2, the DOR requires supervisors or managers to complete the Authorization to Access Department of Revenue Confidential Computer Information and the KY OSCAR User ID Request forms to request system access.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>**FINDING 11-REV-59**</u>**: The Department Of Revenue Should Strengthen Logical Security Controls Over The On-Line System For The Collection Of Accounts Receivable (Continued)**

<u>**Recommendation**</u>

We recommend the DOR consistently adhere to the established procedures for requesting and granting access to KY OSCAR. Specifically, the DOR should ensure all forms are completed and properly authorized and the Security Office and Systems Administration Branch signs off on the applicable forms identifying approval for processing the access request. Further, the capability level should be specified on the KY OSCAR User Id Request form and only the requested capability level should be granted to the application. When a user is re-assigned to a new user Id, a delete form should be created and placed on file to substantiate the revocation of the old account, and a new account form should be created and placed on file for the new account.

Related to the two individuals with no supporting Authorization to Access Department of Revenue Confidential Computer Information forms on file, if the individuals still require KY OSCAR access, RACF forms should be completed and authorized. If access is not required, a KY OSCAR delete form should be completed, and the KY OSCAR account should be deactivated.

<u>**Management's Response and Corrective Action Plan**</u>

The Division of Collection's Systems Administration Branch met on September 22, 2011 to address the issues outlined in this document.

The following items/procedures will be put in place to assure adherence to established policies/procedures:

1. *The Systems Administration Branch will ensure all security forms are completed timely, accurately and have the proper authorization before submitting them to the DOR Security Office.*
2. *Supervisory staff with the Division of Collections will be sent an email outlining procedures regarding changes to a user's capability level. (Completed)*
3. *Security forms submitted by Collections supervisors that have errors will no longer be corrected by Systems Administration staff. Forms will be returned to the submitting supervisor for corrections. Repeated errors will be reported to the assistant director.*
4. *Copies of security forms will be timely filed in the Systems Administration area.*
5. *KY-OSCAR User-ID Form was revised to remove capability level 00 and 10 as options as it was determined that these should not be used for DOR employees. This form will be sent to FAC Management for review/approval. A revision date will be added.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-REV-59: The Department Of Revenue Should Strengthen Logical Security Controls Over The On-Line System For The Collection Of Accounts Receivable (Continued)

Management's Response and Corrective Action Plan (Continued)

6. *Systems Administration Branch will work with supervisors to review security access for all users.*

RACF forms related to the two individuals with no supporting Authorization to Access Department of Revenue Confidential Records have been completed.

Systems Administration Branch will continue to work closely with DOR Security to ensure all policies/procedures regarding security paperwork are adhered to.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-TC-60: The Transportation Cabinet Should Ensure All Bridge Inspections Are Reviewed

During the FY 2011 KYTC audit, we tested bridge inspection reports in the PONTIS computer system to determine if the inspection had been reviewed by KYTC district personnel. Of the 40 inspections tested, the following eight (8) had not received a review by a KYTC District Reviewer.

Bridge Inspection	Inspection Date
097C00022N	03-24-10
095B00009N	03-15-10
103C00105N	05-10-10
033B00015N	05-11-10
099B00035N	11-15-10
088C00035N	11-29-10
070B00051N	02-03-11
116B00018N	05-09-11

One of the inspections above (103C00105N) was performed by a contractor. Bridge inspections performed by contractors should be reviewed and approved by a KYTC employee.

There have been problems with a lack of qualified review personnel available in the district as well as a lack of time by qualified personnel to perform the reviews. There is no set time for a bridge inspection to be reviewed by a district reviewer other than a reasonable length time. Several of the instances noted above were over a year.

Without a review of the bridge inspections, errors could go undetected and the quality control system is not functioning as designed. In addition, the agency is not complying with the procedures established in the Kentucky Bridge Inspection Procedure Manual and Code of Federal Regulation requirements.

When the District Reviewer has not signed off on the bridge inspection in PONTIS, the Central Office cannot select the bridge for spot check or determine a spot check will not be performed on the bridge.

23 Code of Federal Regulations 650.313 (g) states:

> Quality control and quality assurance. Assure systematic quality control (QC) and quality assurance (QA) procedures are used to maintain a high degree of accuracy and consistency in the inspection program. Include periodic field review of inspection teams, periodic bridge inspection refresher training for program managers and team leaders, and independent review of inspection reports and computations.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-TC-60: The Transportation Cabinet Should Ensure All Bridge Inspections Are Reviewed (Continued)

Section III Quality Control of the Kentucky Bridge Inspection Procedure Manual under the District Review heading states:

- All inspection procedures shall be overseen by at least one qualified team leader. Notes from inspection will be reviewed by and entered into the report by the team leader, reviewed for accuracy and submitted to the District Bridge Engineer.
- The District Bridge Engineer will review the inspection report and discuss needs or concerns (in the case of the DBE being the Team Leader for inspection the report will be submitted to a senior Team Leader or program manager for review).

Recommendation

We recommend:

- A timeframe for bridge inspection reviews be specified in writing by management.
- KYTC ensure bridge inspections are reviewed by qualified personnel. KYTC should consider sharing resources among different districts. For instance, a qualified reviewer from one district could review inspections if there is a lack of time or qualified personnel to perform reviews of bridge inspections in another district.

Management's Response and Corrective Action Plan

Auditor Recommendation: A timeframe for bridge inspection reviews be specified in writing by management.

KYTC is committed to abiding by the National Bridge Inspection Standards (NBIS) as detailed in 23 CFR 650C which states bridge inspection reviews should be completed within a reasonable length of time. KYTC is committed to the success of the bridge program, including public safety and the inspection process. We continuously strive to improve our program with the resources available. The majority of the bridges listed in this finding as still needing an inspection review are in District 10, which currently has only one 'Qualified Team Leader' in its structures section. This 'Qualified Team Leader' performs the bridge inspections. However, a 'Qualified Team Leader' cannot review his own bridge inspections. District 10 has been trying for over a year to hire a Qualified Team Leader for bridge inspections and inspection reviews, but as of this date has not been successful. We discussed bridge inspection reviews in our Bridge Engineers meeting on November 16, 2011. After much discussion, several districts agreed to help District 10 with their bridge inspection reviews. A report will be generated each month indicating which reviews are approaching 90 days and which reviews, if any, have exceeded 90 days. Over the past two years, a similar monthly report has succeeded in keeping all of our bridge inspections completed on time.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

<u>FINDING 11-TC-60</u>: **The Transportation Cabinet Should Ensure All Bridge Inspections Are Reviewed (Continued)**

Management's Response and Corrective Action Plan (Continued)

Auditor Recommendation: KYTC ensure bridge inspections are reviewed by qualified personnel. KYTC should consider sharing resources among different districts. For instance, a qualified reviewer from one district could review inspections if there is a lack of time or qualified personnel to perform reviews of bridge inspections in another district.

KYTC ensures bridge inspections are reviewed by qualified personnel. As stated above, KYTC has asked other districts to help with District 10 bridge inspections reviews. Reviews conducted by other district personnel may not be as effective since the other district personnel may not be as familiar with the particular bridge. Districts also experience extra busy periods where they are consumed with not only routine bridge inspections, but fracture critical bridge inspections, in-depth bridge inspections, special bridge inspections, and substandard bridge inspections. As stated above, KYTC has a reporting system that will alert district personnel which bridges have not been reviewed within 90 days of its inspection date. If needed, available inspectors from other districts will be asked to help with reviews where needed.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-TC-61: The Transportation Cabinet Should Ensure Proper Segregation Of Duties Related To Closing Package Preparation

During the audit of the Kentucky Transportation Cabinet's accounts payable, we noted the closing package submitted to the Finance and Administration Cabinet is mainly prepared and supporting documentation maintained by one KYTC employee. The employee was absent for a period of time during the audit and the remaining department staff were unable to answer some questions and provide requested supporting documentation. Once the employee returned, all questions were promptly answered and the requested documentation was provided.

Having only one employee preparing the close package made it difficult to obtain information about the closing package during the absence of the responsible employee. Without additional employees involved in the closing package preparation process, KYTC could have problems if the responsible employee resigns or makes an error which could have been prevented by segregating the closing package preparation duties.

Good internal controls dictate more than one employee should have the knowledge necessary to prepare the closing package for KYTC.

Recommendation

We understand the efficiencies gained by having an experienced and qualified employee prepare the closing package; however, we recommend KYTC establish segregation of duties by training additional staff to prepare the closing package.

Management's Response and Corrective Action Plan

We agree that we should have trained backup staff for all procedures and we maintain that the Division of Accounts does have adequate backup in the area of preparing the closing package. When we received the request for information on the closing package data, we knew the Assistant Director would be returning to work soon and it would be a better use of resources to wait and allow the Assistant Director respond to the questions since he had compiled the data. Most of the questions presented to the Assistant Director involved the development of reporting data by the Auditor's office that was not consistent with the reporting requirement from the Finance Cabinet. Once these inconsistencies were explained, the reports balanced. The General Accounting Branch within the Division of Accounts works and develops closing package data. We will ensure that future closing package preparations have more involvement from our General Accounting Branch and alternate assignments to make sure all areas maintain skills needed to extract the required closing data.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 11-TC-62: **The Kentucky Transportation Cabinet In Coordination With The Commonwealth Office Of Technology Should Ensure Sufficient Authentication Is Required To Access Potentially Sensitive Information**

While performing the fiscal year (FY) 2011 security vulnerability assessment for the Kentucky Transportation Cabinet (KYTC) machines, we discovered instances where no authentication is required to allow an outside user to gain access either to information about the machine or to the service running on a designated port. We determined 39 out of the 212 machines scanned, or approximately 18.4 percent of the population, did not have sufficient authentication enabled on one or more ports. All 39 machines allowed file uploading through an anonymous access. Further, 16 machines reported the administrative password was not set.

For security purposes, detailed information that would identify the specific machines contributing to these findings are being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

If a machine is allowed to provide excessive information associated with the machine to an anonymous user, then an intruder could potentially use this information to attempt to gain access to the machine or network.

Only necessary and required users should have access to services, particularly those services containing potentially sensitive information.

Recommendation

We recommend the KYTC restrict the level of information provided by their network machines to public or anonymous users. If a service is not necessary, required, and properly configured, it should be disabled. For appropriate services, authentication should be configured, and only users who have a need for services should be given user IDs and passwords for access.

Management's Response and Corrective Action Plan

The Commonwealth Office of Technology (COT) is in the process of reviewing the detail findings associated with the 39 hosts that have been identified as network print devices and will take appropriate actions. This review is expected to be completed by June 3, 2011.

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APPENDIX

COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2011

This report is available on our website, www.auditor.ky.gov in PDF format. For other requests, please contact Gregory Giesler, APA's Open Records Administrator, at (502) 564-5841 or gregory.giesler@auditor.ky.gov. If copies of the CAFR for FY 11 are required, please contact Lori H. Flanery, Finance and Administration Cabinet Secretary, at (502) 564-4240 or lori.flanery@ky.gov.

The list includes agencies receiving financial statement audits by Certified Public Accounting firms (CPA) used for preparing the Commonwealth's CAFR. CPA reports are available upon request to the respective agency.

Bluegrass State Skills Corporation
Capital Plaza Tower
500 Mero Street
Frankfort, Kentucky 40601

Turnpike Authority of Kentucky
Room 78, Capitol Annex Building
Frankfort, Kentucky 40601

Kentucky Transportation Cabinet
Kentucky Transportation Cabinet Worker's Compensation
200 Mero Street
Frankfort, Kentucky 40622

Kentucky Center for the Arts
5 Riverfront Plaza
Louisville, Kentucky 40202-2989

Kentucky Economic Development Finance Authority
Capital Plaza Tower
500 Mero Street
Frankfort, Kentucky 40601

Kentucky Housing Corporation
1231 Louisville Road
Frankfort, Kentucky 40601

Kentucky Retirement Systems
Perimeter Park West
1260 Louisville Road
Frankfort, Kentucky 40601

Kentucky Teachers' Retirement System
479 Versailles Road
Frankfort, Kentucky 40601

COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2011
(Continued)

University of Louisville
2301 South 3rd Street
108 Grawemeyer Hall
Louisville, Kentucky 40292

Western Kentucky University
Vice President for Finance and Administration
1 Big Red Way
Bowling Green, Kentucky 42101-3576

Murray State University
322 Sparks Hall
Murray, Kentucky 42071

Kentucky State University
Office of Administrative Affairs
400 East Main Street
Frankfort, Kentucky 40601

Kentucky Lottery Corporation
1011 West Main Street
Louisville, Kentucky 40202-2623

Kentucky State Fair Board
Kentucky Fair and Exposition Center
P.O. Box 37130
Louisville, Kentucky 40233-7130

Kentucky Educational Television Authority
600 Cooper Drive
Lexington, Kentucky 40502

Kentucky Higher Education Assistance Authority
1050 U.S. 127 South, Suite 102
Frankfort, Kentucky 40601

Kentucky Higher Education Student Loan Corporation
Financial Services Department
10180 Linn Station Road, Suite C200
Louisville, KY 40223

Kentucky Infrastructure Authority
1024 Capital Center Dr., Suite 340
Frankfort, Kentucky 40601

COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2011
(Continued)

Kentucky Local Correctional Facilities Construction Authority
Suite 261 Capitol Annex
Frankfort, Kentucky 40601

Kentucky Judicial Form Retirement System
P.O. Box 791
Frankfort, Kentucky 40602

University of Kentucky
301 Peterson Service Building
Lexington, Kentucky 40506-0005

Eastern Kentucky University
Vice President for Business Affairs
521 Lancaster Avenue
Richmond, Kentucky 40475-3101

Morehead State University
Office of Accounting and Budgetary Control
207 Howell-McDowell Administration Building
Morehead, Kentucky 40351-1689

Northern Kentucky University
Office of Business Affairs
Lucas Administration Center
726 Nunn Drive
Highland Heights, Kentucky 41099-8101

Kentucky Community and Technical College System
300 North Main Street
Versailles, KY 40383

Kentucky Council on Postsecondary Education
1024 Capital Center Drive, Suite 320
Frankfort, Kentucky 40601

Office of the Petroleum Storage Tank
Environmental Assurance Fund
81 C. Michael Davenport Boulevard
Frankfort, KY 40601

Kentucky Public Employees' Deferred Compensation Authority
101 Sea Hero Road, Suite 110
Frankfort, KY 40601-5404

COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2011
(Continued)

Workers' Compensation Program
State Office Building, 3rd Floor
501 High Street
Frankfort, KY 40601

Kentucky Department of Labor - Special Fund
1047 US Highway 127 S, Suite 4
Frankfort, KY 40601

Kentucky Horse Park Foundation
4089 Iron Works Parkway
Lexington, Kentucky 40511