

State of Idaho
Internal Control Report

Independent Auditor's Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements
Performed in accordance with *Government Auditing Standards*

Fiscal Year 2017



Legislative Services Office
Idaho State Legislature

Serving Idaho's Citizen Legislature

Eric Milstead
Director

February 6, 2018

Honorable C.L. "Butch" Otter, Governor
Honorable Representative Maxine Bell, JFAC Co-Chair
Honorable Senator Shawn Keough, JFAC Co-Chair
Honorable Brandon D Woolf, State Controller

We are pleased to submit the State of Idaho *Internal Control Report* as it relates to our audit of the statewide *Comprehensive Annual Financial Report* (CAFR) covering the fiscal year ended June 30, 2017. This *Internal Control Report* is an integral part of the CAFR audit process and is required by *Government Auditing Standards* issued by the Comptroller General of the United States.

These standards require that we consider the internal control over financial reporting and disclose weaknesses that could have a material effect on the financial statements. We are also required to perform and disclose the results of tests of compliance with certain laws, regulations, and other requirements that could have a direct and material effect on the financial statement amounts.

The results of our audit did not identify any material misstatements, material weaknesses in internal control or noncompliance required to be reported under *Governmental Auditing Standards*. However, we did identify two significant deficiencies in internal control, which are required to be reported under *Government Auditing Standards.* Although the risk of misstatements exists as a result of these issues, none of these weaknesses resulted in material misstatements. As such, we have issued an unmodified opinion on the financial statements.

This report is available on our website at www.legislature.idaho.gov, and the CAFR can be obtained from the Office of the Idaho State Controller's website at www.sco.idaho.gov.

Sincerely,

April Renfro

April Renfro, CPA, Manager
Legislative Audits Division

Mike Nugent, Manager
Research & Legislation

Paul Headlee, Manager
Budget & Policy Analysis

April Renfro, Manager
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Director

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

December 20, 2017

Honorable C.L. "Butch" Otter, Governor
Honorable Representative Maxine Bell, JFAC Co-Chair
Honorable Senator Shawn Keough, JFAC Co-Chair
Honorable Brandon D Woolf, State Controller

We have audited, 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, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Idaho as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the State of Idaho's basic financial statements, and have issued our report thereon dated December 20, 2017. Our report includes a reference to other auditors who audited the financial statements of Boise State University, Eastern Idaho Technical College, Idaho State University, Lewis-Clark State College, University of Idaho, and their respective component units, Idaho Fish and Wildlife Foundation, Idaho Potato Commission, Idaho Dairy Products Commission, Idaho State Bar, Idaho Wheat Commission, Endowment Fund Investment Board, State Lottery Commission, Public Employee Retirement System of Idaho, Public Employees' Deferred Compensation Plan, IDeal Idaho College Savings Program, Idaho Individual High Risk Reinsurance Pool, Idaho Small Employer Health Reinsurance Program, Idaho Health Insurance Exchange, State of Idaho Idle Pool, Local Government Investment Pool, Diversified Bond Fund, Idaho Building Authority, Bond Bank Authority, and the Idaho Housing and Finance Association (including The Housing Company, a discretely presented component unit of the Idaho Housing and Finance Association)as described in our report on the State of Idaho's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of Boise State University Foundation, Eastern Idaho Technical College Foundation, Idaho State University Foundation, Idaho Fish and Wildlife Foundation, Idaho Housing and Finance Association (including The Housing Company, a discretely presented component unit of the Idaho Housing and Finance Association), and the Public Employees' Deferred Compensation Plan were not audited in accordance with *Government Auditing Standards*.

Internal Control over Financial Reporting

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

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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. 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying Basic Financial Statement Findings that we consider to be significant deficiencies: 2017-101 and 2017-102.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Idaho's financial statements are free from 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*.

State of Idaho's Response to Findings

The State of Idaho's response to the findings identified in our audit are described in the accompanying Basic Financial Statement Findings and Management's Corrective Action Plan. The State of Idaho's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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

Sincerely,

April Renfro, Manager
Legislative Audits Division

STATE OF IDAHO
INTERNAL CONTROL REPORT
SCHEDULE OF BASIC FINANCIAL STATEMENTS FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

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IDAHO STATE LIQUOR DIVISION (Division)

FINDING 2017-101

Statutorily required distributions of excess funds are not supported by adequate documentation, and controls are not in place to ensure the accuracy of the amount distributed.

Type of Finding: Significant Deficiency

Criteria: The Division is required to distribute funds received into the Liquor Account (Fund 0418), in excess of an amount necessary to purchase liquor and pay administrative and operating costs, to the General Fund and to Idaho cities and counties based on the formula found in Idaho Code Section 23-404. All distributions shall be made periodically, but not less frequently than quarterly.

Should an estimate be involved in the calculation of distributions, management is responsible for establishing and documenting the process for preparing accounting estimates based on relevant, sufficient, and reliable data. This process should include a comparison of the prior accounting estimate with actual results to assess the reliability of the process and methodology used to develop the estimate.

The Internal Control Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) provides a basis for organizations to design internal control procedures to ensure reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations. Components of this framework include risk assessment and control activities. Risk assessment is the identification and analysis of various risks entities face because of changing economic, industry, regulatory, and operating conditions. It provides a basis to develop appropriate responses to manage those risks. Control activities are policies and procedures that help ensure that management directives are carried out and risks are mitigated. Verifications, approvals, reconciliations, authorizations, and segregation of duties are all control activities that support this objective.

Condition: In evaluating the calculation of the amount distributed, we noted that the amounts of cash on hand, accounts receivable, and accounts payable were obtained on inconsistent dates to arrive at the base amount to be distributed. Additionally, no supporting documentation for the amounts used in the calculation was retained or could be provided.

Several years ago, the Division began using an approach to increase the distribution above the required amount based on their determination that they had excess idle cash on hand. This approach resulted in the use of an estimated cash flow projection in order to maximize the distribution. While reviewing this process, we noted that assumptions used in formulating the estimate, as well as a subsequent review of the prior-year cash flows, were not documented.

Cause: The approach to maximize distributions in prior fiscal years led to a departure from using verifiable data and the use of an estimated amount to make excess distributions. No formal process is in place to document the assumptions used in establishing the estimate or to complete a

retrospective review of the Division's cash flows. Furthermore, no control over the accuracy of the calculation, such as a knowledgeable review by someone unaffiliated with the calculation, is performed.

Effect: Without the use of consistent and verifiable balances in the calculation for distributions, our ability to determine compliance with statutory requirements is limited. It would also be difficult, under this process, for the Division to implement a control to ensure the accuracy of the calculation.

Without relevant and sufficient documentation of the assumptions used in formulating the estimate and a review of the past estimate, too great of an excess distribution could be made, leading to a shortage of available cash, thus impairing the Division's ability to operate.

Recommendation: We recommend that the Division apply a consistent approach and use of verifiable amounts in the calculation of funds available for distribution, as well as implementing internal controls to ensure the accuracy of the calculation.

Management's View: *The Idaho State Liquor Division (ISLD) has reviewed the finding your office identified during the FY2017 audit of the statewide CAFR. We acknowledge the observation that a condition exists in the manner that the ISLD calculates and documents its true-up distribution to Idaho's cities, counties, and General Fund after the conclusion of a fiscal year.*

Our process for calculating this true-up has been in place since FY2011 and has passed the scrutiny of prior LSO Audits without mention. The practice for increasing this distribution by utilizing excess idle cash was previously endorsed by LSO, DFM, and JFAC. Your memo mentions that our revised approach "increased the distribution above the required amount." In our view, this assertion is incorrect and we feel strongly that our approach brings us in to better and more responsible compliance with Idaho Code. The suggestion that our process might lead to a cash shortage is highly implausible based on the nature of our business cycles, consumer behavior, and cash flow predictability.

Nonetheless, we do recognize that the manner in which we document and administer this process can be improved, and we will modify our procedure prior to the next true- up distribution in FY2019. Going forward, we will more thoroughly maintain documentation of all General Ledger balances and cash flow estimates used in the calculation of the true-up distribution. Additionally, we will ensure that an individual unaffiliated with the calculation will verify its accuracy and any assumptions utilized.

Auditor's Concluding Remarks: We thank the Division for its cooperation and assistance throughout the audit. We would like to emphasize that this finding is not implying a problem with the basic methodology that the Division utilized to increase the distribution of excess idle cash. The concern identified in the condition statement above is the lack of internal controls in place to ensure that this methodology is documented and executed as intended and reviewed for accuracy by knowledgeable staff to ensure errors do not occur and go undetected and uncorrected. The corrective action plan provided will not be complete until July 2018, so this finding will remain open until we complete a review as part of our audit work to support the fiscal year 2018 *Comprehensive Annual Financial Report.*

IDAHO TRANSPORTATION DEPARTMENT (Department)

FINDING 2017-102

The Grants Receivable and Accounts Payable closing packages contained errors resulting in the understatement of grants receivable, revenue, and accounts payable.

Type of Finding: Significant Deficiency

Criteria: Each year, State agencies are required to report financial information to the Office of the State Controller (SCO) in the form of closing packages, which provide the information necessary to prepare the statewide CAFR. The SCO provides instructions for reporting information in the closing packages in accordance with Generally Accepted Accounting Principles (GAAP).

Grants receivable should be reported when grant eligibility requirements have been met. This generally occurs when the Department has incurred allowable grant expenditures, but has not been reimbursed at June 30; therefore, grants receivable should also include any accounts payable related to federal expenditures. Additionally, receivables should be reported as revenue if the Department expects to receive the funds during the State's revenue recognition period, within 60 days of fiscal year-end. The amount expected to be collected after the 60 days should be reported as unavailable revenue.

Condition: The Grants Receivable closing package incorrectly reported $3.9 million received within the State's revenue recognition period as unavailable revenue. The Department's reimbursement request process occurs on a weekly basis, and the requested funds are received the following day. Based on this regular schedule, the Department should have been able to anticipate that the reimbursement would be received within the revenue recognition period.

Additional accounts payable totaling $4.6 million related to federal grant expenditures were not included on the Grants Receivable closing package or reported on the Accounts Payable closing package. A federal reimbursement for these expenditures was received on or before August 31 and should have also been reported as revenue.

Cause: The due date for the Grants Receivable and Accounts Payable closing package was August 14. The Department determined the revenue portion of the grants receivable balance based on the reimbursements that were received by the date the closing package was prepared; however, the amount expected to be received through the end of the 60-day revenue recognition period was not included.

The Department prepared the closing packages using a report of expenditures paid between July 1 and the date the closing packages were prepared. They did not perform procedures to determine if there were additional accounts payable that were paid after the date the closing packages were prepared that should be reported as accounts payable as well as grants receivable.

Effect: The error resulted in an understatement of accounts payable and accounts receivable of $4.6 million, an overstatement of unavailable revenue of $3.9 million and an understatement of revenue of $8.5 million.

Recommendation: We recommend that the Department improve procedures to identify and report all material accounts payable and grants receivable in the applicable closing packages. We further recommend that the Department improve procedures to properly report the portion of grants receivable as revenue in accordance with the State's revenue recognition policy.

Management's View: *ITD acknowledges that the information provided to the State Controller's Office in the appropriate closing packages did not contain the full 60 day values as directed by GAAP. The information provided was accurate as of the date of the closing package in order to meet the State Controller's Office due date. ITD notes that the incomplete information did not materially impact the financial statement in the Comprehensive Annual Financial Report (CAFR). Process changes are underway to improve and achieve accurate and reliable financial information in closing package reporting.*

Management's corrective action plan is to provide information based on the 60 days after year-end revenue recognition period as directed by GAAP. To improve efficiency and accuracy the Department will submit closing package information after month-end reconciliation. Information for the month of July will be used to meet closing package deadline prior to the State's revenue recognition period, within 60 days of fiscal year-end. Closing packages will be amended in the month of September to include reconciled information for the month of August. Re-evaluation of corrective action plan will not be possible until closing packages are completed for FY 2018.

The challenge State agencies have is the closing package due dates are prior to the 60 days after year-end revenue recognition period. This creates an inefficient reporting process by requiring the agency to amend the closing package. Essentially doing the work twice and creating an opportunity for discrepancies. The Department will work with the Office of the State Controller to improve closing package instructions and align deadlines with Generally Accepted Accounting Principles (GAAP).

The execution of these additional controls should identify and report all material accounts payable and grants receivable identified in the recent audit and prevent future failures of the same nature from occurring.

Auditor's Concluding Remarks: We thank the Department for its cooperation and assistance throughout the audit. The corrective action plan provided will not be complete until September 2018, so this finding will remain open until we complete a review as part of our audit work to support the fiscal year 2018 *Comprehensive Annual Financial Report.*

STATE OF IDAHO
INTERNAL CONTROL REPORT
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

MANAGEMENT'S CORRECTIVE ACTION PLAN

STATE OF IDAHO

OFFICE OF THE STATE CONTROLLER

BRANDON D WOOLF

January 31, 2018

April Renfro, CPA
Division Manager
Legislative Services Office, Audit Division
700 W Jefferson Street
P.O. Box 83720
Boise, Idaho 83720-0054

Dear Mrs. Renfro,

Enclosed with this letter is the State of Idaho's Corrective Action Plan and Summary Schedule of Prior Audit Findings for the fiscal year 2017 Internal Control Report related to the Comprehensive Annual Financial Report.

The State's Corrective Action Plan and Summary Schedule of Prior Audit Findings are a compilation of information provided to us by the applicable state agencies. They are prepared in conjunction with your fiscal year 2017 Comprehensive Annual Financial Report audit.

We appreciate the efforts of the Idaho Legislative Services Office in completing the Comprehensive Annual Financial Report audit for the State for fiscal year 2017. If you have any questions regarding this Corrective Action Plan, please do not hesitate to contact our office.

Sincerely,

Brandon D Woolf
State Controller

P.O. Box 83720, Boise, Idaho 83720-0011
Telephone: (208) 334-3100, e-mail: scoinfo@sco.idaho.gov, Fax: (208) 334-2671
Located at 700 W. State Street, 5th Floor

STATE OF IDAHO INTERNAL CONTROL REPORT
CORRECTIVE ACTION PLAN
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

State Agency: Idaho State Liquor Division

Finding Number 2017-101: Statutorily required distributions of excess funds are not supported by adequate documentation, and controls are not in place to ensure the accuracy of the amount distributed.

Related to Prior Finding: N/A

Corrective Action: The Idaho State Liquor Division (ISLD) has reviewed the finding your office identified during the FY 2017 audit of the statewide CAFR. We acknowledge the observation that a condition exists in the manner that the ISLD calculates and documents its true-up distribution to Idaho's cities, counties, and General Fund after the conclusion of a fiscal year.

Our process for calculating this true-up has been in place since FY 2011 and has passed the scrutiny of prior LSO Audits without mention. The practice for increasing this distribution by utilizing excess idle cash was previously endorsed by LSO, DFM, and JFAC. Your memo mentions that our revised approach "increased the distribution above the required amount." In our view, this assertion is incorrect and we feel strongly that our approach brings us in to better and more responsible compliance with Idaho Code. The suggestion that our process might lead to a cash shortage is highly implausible based on the nature of our business cycles, consumer behavior, and cash flow predictability.

Nonetheless, we do recognize that the manner in which we document and administer this process can be improved, and we will modify our procedure prior to the next true-up distribution in FY 2019. Going forward, we will more thoroughly maintain documentation of all General Ledger balances and cash flow estimates used in the calculation of the true-up distribution. Additionally, we will ensure that an individual unaffiliated with the calculation will verify its accuracy and any assumptions utilized.

Anticipated Corrective Action Date: Prior to the true-up distribution in fiscal year 2019.

Responsible for Corrective Action: Jeffery R. Anderson
Phone: 208-947-9403
jeff.anderson@liquor.idaho.gov
1349 E Beechcraft Ct
Boise, ID 83716

State Agency: Idaho Transportation Department

Finding Number 2017-102: The Grants Receivable and Accounts Payable closing packages contained errors resulting in the understatement of grants receivable, revenue, and accounts payable.

Related to Prior Finding: N/A

Corrective Action: The Department acknowledges that the information provided to the State Controller's Office in the appropriate closing packages did not contain the full 60 day values as directed by GAAP. The information provided was accurate as of the date of the closing package in order to meet the State Controller's Office due date. The Department notes that the incomplete information did not materially impact the financial statement in the Comprehensive Annual Financial Report (CAFR). Process changes are underway to improve and achieve and reliable financial information in closing package reporting.

Management's corrective action plan is to provide information based on the 60 days after year-end revenue recognition period as directed by GAAP. To improve efficiency and accuracy the Department will submit closing package information after month-end reconciliation. Information for the month of July will be used to meet closing package deadline prior to the State's revenue recognition period, within 60 days of fiscal year-end. Closing packages will be amended in the month of September to include reconciled information for the month of August. Re-evaluation of corrective action plan will not be possible until closing packages are completed for FY 2018.

The challenge State agencies have is the closing package due dates are prior to the 60 days after year-end revenue recognition period. This creates an inefficient reporting process by requiring the agency to amend the closing package. Essentially doing the work twice and creating an opportunity for discrepancies. The Department will work with the Office of the State Controller to improve closing package instructions and align deadlines with Generally Accepted Accounting Principles (GAAP).

Anticipated Corrective Action Date: During the fiscal year 2018 financial reporting period.

Responsible for Corrective Action: Dave Tolman
Phone: 208-334-8525
dave.tolman@itd.idaho.gov
3311 W State Street
Boise, ID 83703

STATE OF IDAHO INTERNAL CONTROL REPORT
SUMMARY OF PRIOR YEAR FINDINGS
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

No findings were identified in the 2016 Internal Control Report; therefore, no follow up action was necessary.

Compiled and Published
by
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