

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit



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December 14, 2010

Ms. Karen Rehfeld, Director
Office of Management and Budget
P.O. Box 110020
Juneau, Alaska 99811-0020

The Honorable John Cramer
Acting Commissioner
Department of Administration
P.O. Box 110200
Juneau, Alaska 99811-0200

Ms. Kim Garner, Director
Division of Finance
P.O. Box 110204
Juneau, AK 99811-0204

Dear Ms. Rehfeld, Mr. Cramer, and Ms. Garner:

This communication is provided pursuant to the parameters of United States Office of Management and Budget's (OMB) Single Audit Internal Control Project for American Reinvestment and Recovery Act (ARRA) of 2009 – Phase 2. Such a project requires the auditors of entities that volunteer for the project to issue, in writing, an early communication of significant deficiencies and material weaknesses in internal control over compliance for certain federal programs having ARRA funded expenditures at an interim date prior to the completion of the compliance audit. Accordingly, this communication is based on our audit procedures performed through November 30, 2010, an interim period. Because we have not completed our compliance audit, additional significant deficiencies and material weaknesses may be identified and communicated in our final report on compliance and internal control over compliance issued to meet the reporting requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

In planning and performing our audit through November 30, 2010, for the programs listed in Exhibit 1, we are considering State of Alaska's compliance with the material compliance requirements listed in Exhibit 2 as described in the *OMB Circular A-133 Compliance Supplement* for the year ended June 30, 2010:

We are also considering the State of Alaska's internal control over compliance with the requirements previously described that could have a direct and material effect on CFDA 10.557/10.578 WIC, CFDA 17.225, UI and CFDA 84.397, SFSF-GS, in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over compliance.

Our consideration of internal control over compliance is for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined in the following paragraphs. However, as discussed subsequently, based on the audit procedures performed through November 30, 2010, we identified certain deficiencies in internal control over compliance.

A *control deficiency* in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. We consider Recommendation No. 3 to be a control deficiency.

A *significant deficiency* is a control deficiency or combination of control deficiencies that adversely affect the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in Recommendations Nos. 1 and 2 to be significant deficiencies.

Exhibit 1

- CFDA 10.557/10.578, Special Supplemental Food Program For Women, Infants, and Children (WIC) administered by the Department of Health and Social Services (DHSS);
- CFDA 17.225, Unemployment Insurance program (UI) administered by the Department of Labor and Workplace Development (DLWD); and
- CFDA 84.397, State Fiscal Stabilization Fund – Government Services (SFSF-GS), administered by the Department of Commerce, Community, and Economic Development (DCCED).

Exhibit 2

- Activities allowed or unallowed.
- Allowable costs and cost principles.
- Cash management.
- Eligibility.
- Matching. (UI only)
- Period of availability.
- Program income. (UI only)
- Reporting.
- Subrecipient Monitoring (WIC and SFSF-GS)
- Special tests and provisions.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. None of the recommendations below are considered to be material weaknesses.

Recommendation No. 1

The Division of Public Assistance's director should ensure vendors participating in the Women, Infant, and Children (WIC) program are adequately monitored according to federal requirements.

Monitoring of WIC vendors was not performed in accordance with federal requirements in FY 10. These federal requirements include compliance investigations of high-risk vendors¹ and a review of vendors that potentially derive more than 50 percent of their annual food sales revenue from WIC food instruments.² Consequently, the WIC program was not in compliance with the special test and provision requirements.

Only two of nine required compliance investigations of high risk vendors were completed by September 30, 2009, in accordance with 7 CFR 246.12 (j)(4)(i). Additionally, WIC program staff did not review the FFY 09 federal report "*Authorized Vendors Potentially Meeting the Above-50-Percent Criterion*," which identified 10 potential above-50-percent vendors and, therefore, did not maintain compliance with 7 CFR 246.12 (g)(4)(i)(F). At least one of the vendors exceeded the 50 percent threshold (at 53 percent) and should have been suspended from the program.

Insufficient vendor monitoring is due to inadequate oversight by program managers. There is a significant deficiency in controls to ensure staff are performing monitoring activities as federally required. Vendor monitoring primarily ensures costs of food items are contained, and only eligible participants receive benefits. By not performing vendor monitoring sufficiently and routinely, food costs could unreasonably increase and ineligible participants could receive benefits, both of which result in reducing benefits available for eligible participants.

Accordingly, we recommend the Division of Public Assistance's director ensure WIC vendors are sufficiently and routinely monitored by program staff as required by federal compliance requirements.

¹High risk vendors are vendors identified as having a high probability of committing a vendor violation of Federal program requirements.

²These potential vendors are referred to as above-50-percent vendors.

CFDA: 10.557/10.578
Questioned Costs: None
Repeat Recommendation? No

Federal Agency: USDA
Significant Deficiency, Noncompliance
Special Tests and Provisions

Agency's Response

The department concurs with this recommendation. The division has several activities underway to address the vendor monitoring finding. These activities are the result of concerns identified in the FY2009 audit and I believe shared with you during the FY2010 audit process. The corrective compliance activities underway to ensure vendors participating in the Women, Infants and Children (WIC) program are adequately monitored include:

- *A comprehensive assessment of WIC Vendor Management responsibilities. Following the FY 2009 audit, the division sought and secured federal WIC Operational Adjustment (OA) in SFY 10 to complete the evaluation and seek recommended solutions. A professional service contract was procured with Resource Data Inc. (RDI) to review all aspects of Vendor Management including compliance policies, procedures and practices, vendor support and technical assistance needs, data needs, organizational structure and staffing and work flow, and automation improvements. This assessment was completed on September 30, 2010 and the division is in the process of reviewing the findings and recommendations and developing an action plan for implementing solutions. These improvements include operational changes to the staff and management infrastructure to support vendor management responsibilities and automating manual processes. These actions are expected to lead to significant improvements and correct the deficiencies noted in the SFY09 and SFY10 audits.*
- *Examining options to deal with the challenges in meeting the requirements of 7 CFR 24.12 (j)(4) (i) in Alaska. The October 13, 2010 Management Letter No. 1 cites insufficient vendor monitoring efforts and lack of managerial controls that resulted in program deficiencies.*

While on-site compliance buys may be the preferred method of monitoring vendors, the federal regulations allow states some alternatives. 7CFR 246.12 (j) (4) (i) states: "A compliance investigation of a high risk vendor may be considered complete when the State agency determines that a sufficient number of compliance buys have been conducted to provide evidence of program noncompliance, when two compliance buys have been conducted in which no program violations are found, or if an inventory audit has been completed."

Alaska's remoteness and geography present a multitude of extenuating circumstances that make it difficult for (expense, weather, and other geographic challenges) monitoring vendors

through on-site compliance. WIC staff must rely on inventory audits to offset the time and expense of traveling to many remote areas of Alaska where WIC vendors are located.

In FFY2009 (overlapping with SFY2010), program staff attempted to complete thirteen (13) on-site visits (four more than the 5% required to meet federal standards). Of the 13 buys, two (2) met the criteria of being “completed”; one (1) vendor voluntarily withdrew from enrollment as a result of deficiencies identified.; and the ten (10) remaining vendors needed follow-up visits that staff were not able to perform because of workload and extenuating travel circumstances. In SFY2010, WIC vendor staff began conducting inventory audits as a means of monitoring high-risk vendors and to supplement on-site compliance buys.

The Division of Public Assistance expects that the activities outlined above will correct the program management deficiencies noted in Management Letter No.1 and bring Alaska’s WIC vendor monitoring responsibilities into compliance with federal requirements in SFY2011.

*Contact Person: Alison Elgee, Assistant Commissioner
Department of Health and Social Services
Finance and Management Services
Telephone: (907) 465-1630*

Recommendation No. 2

The Department of Labor and Workforce Development’s (DLWD) information technology (IT) manager should address weaknesses over the Unemployment Compensation (UC) Information System.

DLWD’s UC Information System contains various weaknesses in the logical access³ controls. Together these control deficiencies represent a significant deficiency and make the UC system vulnerable to access by unauthorized people.

DLWD does not have sufficient policies and procedures to address all logical control issues. Additionally, the implementation and follow-up on controls used by DLWD are sometimes delayed because of competing priorities.

The National Institute of Standards and Technology (NIST)⁴ publishes best practices for information systems controls. If implemented, these best practices should provide adequate

³Logical access controls are tools used for identification, authentication, authorization, and accountability. They are components that enforce access control measures for systems, programs, processes, and information. The logical access controls can be embedded within operating systems, applications, add-on security packages, or database and telecommunication management systems.

⁴The NIST is the federal technology agency that works with industry to develop and apply technology, measurements, and standards.

controls over logical access thus substantially reducing the risk of unauthorized access to DLWD's UC information system.

We recommend that DLWD's IT manager establish written policies and procedures based on NIST best practices for logical access information system controls.

CFDA: 17.225
Questioned Costs: None
Repeat Recommendation? No

Federal Agency: USDOL
Significant Deficiency
Allowable Costs

Agency's Response

DLWD acknowledges the identified weaknesses in logical access information system controls, policies, and procedures for the UC Information System. DLWD has taken action to proactively remediate all identified UC system vulnerabilities.

Implementation of logical access controls and development of policies and procedures have been made high priority work items. All remediation and policy development efforts are being conducted in accordance with National Institute of Standards and Technology (NIST) best practice guidance.

DLWD understands the need for adequate access controls to reduce the risk of unauthorized access to the UC information system. DLWD is dedicated to adhering to core security principles including the Principle of Least Privilege, which states that any individual should be granted only enough privilege to accomplish assigned tasks.

*Contact Person: Guy Bell, Assistant Commissioner
Department of Labor and Workforce Development
Office of the Commissioner
Telephone: (907) 465-2700*

Recommendation No. 3

DCCED's commissioner should ensure that American Recovery and Reinvestment Act (ARRA) Section 1511 certificates are prepared and published on the State of Alaska ARRA website.

During FY 10, DCCED staff did not prepare, maintain, or publish Section 1511 certificates as required by ARRA. Section 1511 certificates certify that infrastructure⁵ investments were an appropriate use of taxpayer funds. We identified six State Fiscal Stabilization Fund

⁵The USDOE defines infrastructure as:

projects that meet the United States Department of Education (USDOE) definition of infrastructure; one of the six had expenditures in FY 10. However, no certificates have been placed on the State of Alaska website.

ARRA designates the governor as the person responsible for Section 1511 certificates. The governor delegated authority to execute ARRA Section 1511 certificates to the commissioner of DCCED. DCCED staff do not have a process to ensure that Section 1511 certificates are prepared nor are there adequate review procedures to determine when certificates are required.

We recommend that DCCED's commissioner ensure that ARRA Section 1511 certificates are prepared and published as required and that procedures be implemented to ensure full compliance with ARRA Section 1511.

CFDA 84.397
Questioned Costs: None
Repeat Recommendation? No

Federal Agency: USDOE
Control Deficiency/Noncompliance
Reporting

Agency's Response

We concur that the department needs to ensure that ARRA Section 1511 certificates are prepared and published and that procedures be implemented to ensure full compliance with ARRA section 1511. The six identified ARRA Section 1511 certificates have been prepared and are published on the Alaska.gov/recovery website. All future State Fiscal Stabilization Fund projects meeting the U.S. Department of Education definition of infrastructure will be identified at the time the department receives a proposed written scope of work. Section 1511 Certificates will be prepared and posted at the time a grant agreement is fully executed and before expenditures take place.

The Division of Community and Regional Affairs website is being updated to include a description of all ARRA funded programs administered by the division and will also include a link to copies of each Section 1511 Certificate and to Recovery.gov. These procedures ensure full compliance with ARRA section 1511.

*Contact Person: JoEllen Hanrahan, Director
Department of Commerce, Community and Economic Development
Administrative Services
Telephone: (907) 465-2506*

An infrastructure investment is financial support for a physical asset or structure needed for the operation of a larger enterprise. Therefore, infrastructure investments include support for tangible assets or structures such as roads, public buildings (including schools), mass transit systems, water and sewage systems, communication and utility systems and other assets or structures that provide a reliable flow of products and services essential to the defense and economic security of the United States, the smooth functioning of government at all levels, and society as a whole. However, an infrastructure investment does not include "minor remodeling" as defined in 34 C.F.R. § 77.1(c).

Ms. Rehfeld
Acting Commissioner Cramer
Ms. Garnero

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December 14, 2010

DHSS, DLWD and DCCED's responses to our findings are described in the preceding paragraphs under Agency's Response. We did not audit the agencies' responses, and accordingly, we express no opinion on them.

This interim communication is intended solely for the information and use of DHSS, DLWD and DCCED management, Office of the Governor, Department of Administration, and federal awarding agencies. It is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

A handwritten signature in black ink that reads "Pat Davidson". The signature is written in a cursive style with a long horizontal flourish at the end.

Pat Davidson, CPA
Legislative Auditor

cc: Acting Commissioner William Streur
Department of Health and Social Services
Commissioner Click Bishop
Department of Labor and Workforce Development
Commissioner Susan Bell
Department of Commerce, Community, and Economic Development