STATE OF NEVADA
LEGISLATIVE COUNSEL BUREAU
LEGISLATIVE BUILDING
401 S. CARSON STREET
CARSON CITY, NEVADA 89701-4747
Fax No.: (775) 684-6600

LORNE J. MALKIEWICH, *Director*
(775) 684-6800

LEGISLATIVE COMMISSION (775) 684-6800
RANDOLPH J. TOWNSEND, *Senator, Chairman*
Lorne J. Malkiewich, *Director, Secretary*

INTERIM FINANCE COMMITTEE (775) 684-6821
MORSE ARBERRY, JR., *Assemblyman, Chairman*
Mark W. Stevens, *Fiscal Analyst*
Gary L. Ghiggeri, *Fiscal Analyst*

PAUL V. TOWNSEND, *Legislative Auditor* (775) 684-6815
DONALD O. WILLIAMS, *Research Director* (775) 684-6825
BRENDA J. ERDOES, *Legislative Counsel* (775) 684-6830

Legislative Commission
Legislative Building
Carson City, Nevada

We have completed an audit of controls associated with the Integrated Financial System (IFS) to determine if they provide reasonable assurance that financial and payroll transactions are processed as intended. This audit is part of the ongoing program of the Legislative Auditor as authorized by the Legislative Commission. The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions. The results of our audit, including findings, conclusions, recommendations, and the Department of Administration's response, are presented in this report.

We wish to express our appreciation to the management and staff of the Department of Administration and those state agencies that assisted us during this audit.

Respectfully presented,

Paul V. Townsend, CPA
Legislative Auditor

January 23, 2004
Carson City, Nevada

STATE OF NEVADA
INTEGRATED FINANCIAL SYSTEM CONTROLS

AUDIT REPORT

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INTEGRATED FINANCIAL SYSTEM CONTROLS

AUDIT REPORT

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EXECUTIVE SUMMARY

INTEGRATED FINANCIAL SYSTEM CONTROLS

Background

On April 18, 1997, the State of Nevada issued a request for proposal for the development of an Integrated Financial System (IFS). The purpose of this system was to replace the State's financial and human resources systems. According to design documentation, the new system was to improve data integrity, and reduce costs through the elimination of redundant systems, processes, and data. On October 2, 1997, the State awarded a contract to American Management Systems, Inc. for the development and implementation of this system. Since inception, the Legislature has appropriated $56,207,054 for the project. As of July 9, 2003, over $52 million had been expended or obligated.

The IFS developed for the State consists of system modules covering statewide financial reporting, human resources management, materials procurement, and administrative reporting requirements unique to the Nevada Department of Transportation. The IFS provides agency-specific and statewide financial information to users, and is the source of financial information available to the public through the State's data warehouse Internet website. The implementation of IFS has resulted in significant changes to the State's financial control environment. As a result, new initiation and approval practices apply to almost all financial transactions processed by state agencies.

Purpose

The audit included the controls over processing transactions at the fiscal center level in the financial and human resources modules of the IFS. The audit included system and agency controls over processing receipts, expenditures, purchasing, payroll, and fixed assets transactions. The audit reviewed the online IFS transactions processed in calendar year 2002. The audit did not include a detailed assessment of the computer system's technical environment and system controls for all applications being used by the IFS. The objective of our audit was to determine if internal controls have been established to provide reasonable assurance that financial and payroll transactions were processed as intended.

Results in Brief

Internal controls associated with the Integrated Financial System (IFS) provided reasonable assurance that financial and payroll transactions were processed as intended. However, certain aspects of the control environment at the State's fiscal centers could be strengthened. For example, key control practices were not always performed and written policies and procedures could be improved. In addition, requirements for maintaining property and equipment records were not always complied with and security over system access could be strengthened. Finally, retention and disposition policies regarding financial records need refinement and formalization. Internal controls are essential to the operating integrity of the system given its decentralized environment. Established procedures should be followed, written procedures completed, and security strengthened to help ensure transactions continue to process as intended.

Principal Findings

- Under the IFS, the State's centralized pre-audit function was shifted to state agencies. The pre-audit review is a key agency control designed to ensure transactions are processed as intended. Although agencies have developed procedures for conducting pre-audit reviews, we found that over half of the fiscal centers tested did not have evidence such reviews were done. (page 9)

- Quarterly post-audit reviews are required to be performed at each fiscal center. Conducted by independent agency staff, these reviews are designed to evaluate historical compliance with written policies and procedures. Only 8 of the 31 mandatory post-audit reviews, in calendar year 2002, were conducted at the nine fiscal centers visited. Failure to perform these reviews could result in the non-detection of serious patterns of non-compliance. (page 10)

- Tracking and reconciliation processes required by fiscal center procedures were often not performed. We examined 18 payroll periods at the 9 fiscal centers visited. We noted that reconciliations relative to the input of timesheets had not been conducted for 11 of the pay periods tested. We also found that payroll expenditures for nine of the pay periods had not been reconciled to the State's accounting records. Without good tracking and reconciliation processes, there is an increased risk that errors or improprieties will go undetected. (page 12)

- Written policies and procedures governing agency use of the IFS were deficient at many of the nine fiscal centers visited. These deficiencies included incomplete as well as out-dated procedures. Policies and procedures are a critical component of the IFS control environment. (page 14)

- Agency fiscal centers did not enter fixed asset codes for 6 of 10 requisitions we examined involving fixed asset purchases. In one of these instances, the asset was not included in the agency's inventory records. These codes indicate the item is a fixed asset and should be included in the inventory. Unless these codes are consistently entered, there is an increased risk that assets will not be recorded on the State's property and equipment records. (page 17)

- Seven of nine agencies had not conducted a recent inventory using the IFS to update their property and equipment inventory records. The Purchasing

Division maintains the State's official inventory records, but each agency has a responsibility to update inventory records on an annual basis. Annual property and equipment inventories are important in securing state assets. Inaccurate or incomplete records increase the risk that assets will be misplaced or lost through theft. (page 17)

- Access to the IFS is controlled by the assignment of user identification codes and passwords. These controls are designed to limit system access and to track the identity of users responsible for executing financial transactions. Although these controls generally worked as intended, key user actions were not always documented in the electronic system logs or underlying physical records. To ensure system accountability, the identity of all individuals involved in the execution of a transaction should be documented. If this documentation is absent, individual responsibility for improper transactions cannot be fully established. (page 19)

- Fiscal centers did not always report terminated personnel with system access to the IFS's security administrators. For example, at five of the nine fiscal centers visited, system access for terminated employees had not been removed for periods ranging from two weeks to over a year. To promote system integrity, user access to the IFS should be continually monitored and maintained. The untimely removal of terminated employees from the system increases the risk of unauthorized use. (page 20)

- With the implementation of the IFS, the responsibility for storing original financial records shifted to state agencies. Our audit tests indicated these records were being properly maintained. However, there were inconsistencies in the retention practices at the nine fiscal centers ranging from no policies to keeping records for seven years. In addition, there were no formalized retention procedures for the electronic records stored centrally on the IFS. (page 22)

Recommendations

This report contains 10 recommendations to improve controls over the IFS. The recommendations help ensure key control procedures are performed. In addition, they improve fiscal center policies and procedures and property and equipment reporting. Finally, the recommendations help ensure proper security over system access and the formalization of the records retention schedules for both physical and electronic records. (page 35)

Agency Response

The Department, in its response to our report, accepted all ten recommendations. (page 30)

Introduction

Background

On April 18, 1997, The State of Nevada issued a request for proposal for the development of an Integrated Financial System (IFS). The purpose of this system was to replace the State's financial and human resource systems. According to design documentation, the new system was to improve data integrity, and reduce costs through the elimination of redundant systems, processes, and data. On October 2, 1997, the State awarded a contract to American Management Systems, Inc. (AMS) for the development and implementation of this system. Since inception, the Legislature has appropriated $56,207,054 for the project. As of July 9, 2003, over $52 million had been expended or obligated.

The Integrated Financial System developed for the State consists of system modules covering statewide financial reporting, human resources management, materials procurement, and administrative reporting requirements unique to the Nevada Department of Transportation (NDOT). The IFS provides agency-specific and statewide financial information to users, and is the source of financial information available to the public through the State's data warehouse Internet website.

Overall management of the IFS is the responsibility of the Department of Administration. The State Controller's Office, Department of Information Technology, and the Department of Personnel play important roles with regard to system operations. While AMS has completed its work for the State, plans call for it to play a role in system maintenance.

Implementation of IFS

Implementation of the IFS used a comprehensive approach over a period of several years. This approach was necessary to blend appropriate technology. It also helps to ensure users understand the system, are adequately prepared and trained, and their needs met. Financial information was initially entered into the system in December 1998, and the human resources module became active in March 1999.

The implementation of the financial reporting component was completed as of June 30, 2003. This component allows agencies to input and process certain financial transactions such as cash receipts, payment vouchers, and purchase requisitions directly into the IFS. Though the financial component is complete, work on the system continues and additional applications will eventually be added. Applications currently in process include work flow management, travel, and journal voucher processing.

The human resources component was rolled out in two stages. The first stage allowed agencies only inquiry access to the human resources databases, with employee time sheets and personnel actions still processed centrally. The second stage allowed agencies to enter timesheets and personnel actions directly into IFS. Implementation of the second stage was substantially complete as of June 30, 2003.

In addition, the IFS will soon interface with the new Nevada Employee Action and Timekeeping System (NEATS). State employees will be able to input their timesheets through the State's intranet, providing a paperless format for the entry of timesheets as well as an approval system for agency supervisors. The Department of Personnel and NDOT are pilot testing NEATS.

Changes in the Control Environment

The implementation of IFS has resulted in significant changes to the State's financial control environment. As a result, new initiation and approval practices apply to almost all financial transactions processed by state agencies. One of the more significant changes relates to expenditure processing. Under the old system, the Department of Administration housed a pre-audit function that served as a key control element in the State's expenditure process. The Pre-Audit Section sampled expenditure transactions submitted by agencies for payment. These transactions were reviewed to determine if they were accurate and appropriate before being processed centrally.

With the implementation of the IFS, agencies process expenditures electronically, without the use of a centralized pre-audit function. This method is more efficient, but places greater responsibility on state agencies to ensure transactions are handled appropriately. To compensate for the loss of the centralized pre-audit function, the Financial Management, Training and Controls Section (FMTC) of the Division of

Internal Audits required each agency to develop internal pre-audit review procedures. In addition, a post-audit review process was established that requires each agency to sample its financial transactions on a quarterly basis. These post-audits evaluate the agency's compliance with its written procedures and all applicable regulations.

The Division of Internal Audits' Post Review Section also periodically visits each state agency. Post Review selects a sample of completed financial transactions and determines compliance with laws, regulations, contracts, and policy.

To further safeguard the system due to its decentralization, users are assigned security profiles that govern what functions of the IFS they can access. Users are then assigned unique user identifications and passwords that are used to approve expenditures. Through electronic tracking of user access, the system prevents an individual who initiated a transaction from subsequently approving that transaction. As such, the unique user identifications represent a significant system control of the IFS.

Scope and Objective

This audit is part of the ongoing program of the Legislative Auditor, as authorized by the Legislative Commission, and was made pursuant to the provisions of NRS 218.737 to 218.893. The Legislative Auditor conducts audits as part of the Legislature's oversight responsibility for public programs. The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions.

The audit included the controls over processing transactions at the fiscal center level in the financial and human resources modules of the IFS. The audit included system and agency controls over processing receipts, expenditures, purchasing, payroll, and fixed assets transactions. The audit reviewed the online IFS transactions processed in calendar year 2002. The audit did not include a detailed assessment of the computer system's technical environment and system controls for all applications being used by the IFS. The objective of our audit was to determine if internal controls have been established to provide reasonable assurance that financial and payroll transactions were processed as intended.

Findings and Recommendations

Internal controls associated with the Integrated Financial System (IFS) provided reasonable assurance that financial and payroll transactions were processed as intended. However, certain aspects of the control environment at the State's fiscal centers could be strengthened. For example, key control practices were not always performed and written policies and procedures could be improved. In addition, requirements for maintaining property and equipment records were not always complied with and security over system access could be strengthened. Finally, retention and disposition policies regarding financial records need refinement and formalization. Internal controls are essential to the operating integrity of the system given its decentralized environment. Established procedures should be followed, written procedures completed, and security strengthened to help ensure transactions continue to process as intended.

Key Control Processes Are Not Always Performed

With the implementation of the IFS, new agency practices, such as pre-audit reviews, post-audit reviews, and data tracking and reconciliation processes, were required. However, we found that evidence of pre-audit reviews was not always available, post-audit reviews were not always done, and tracking and reconciliation practices were not always documented. Historically, the State's financial transactions have been submitted and processed centrally. The IFS created a more decentralized control environment. This provides state agencies with greater control over the approval and execution of transactions. As such, not completing these practices creates a risk that improper transactions could occur and go undetected.

Pre-Audit Reviews Not Documented

Although agencies have developed procedures for conducting pre-audit reviews, we found that over half of the fiscal centers tested did not have evidence such reviews were done. Of the 135 expenditures transactions tested, 80 did not have evidence of a pre-audit review. Further, 37 of the 59 purchase requisitions tested also lacked documentation of the review. The agency's pre-audit review is a key control designed to compensate for the elimination of a centralized control process. It is intended to verify a transaction prior to payment. If performed correctly, this review increases the likelihood that transactions will be processed as intended.

Agency staff indicated that pre-audit reviews were performed, just not formally documented. For example, staff at one fiscal center stated that approval signoff was their evidence of the review. At another fiscal center, it was indicated that pre-audit checklists were used but not retained. Proper documentation establishes individual responsibility and increases the likelihood that the review occurs. This position is supported by the Financial Management, Training and Controls Section of the Division of Internal Audits. In one of their internal control reviews, an agency was instructed to establish procedures to evidence the utilization of the pre-audit checklist prior to finalizing payment approvals. While this evidence can take many formats, it is important that it be produced.

The elimination of the Department of Administration's Pre-Audit Section was a key change of decentralizing financial control. Prior to the IFS, all payment vouchers were submitted to the Pre-Audit Section for review and central processing. This review ensured key aspects of a transaction were in order prior to payment. Under the IFS, each agency processes payments directly and is responsible for their own pre-audit review.

Because of this decentralization, agencies were required to develop procedures for a pre-audit review. As such, procedures for conducting pre-audit reviews were developed at each of the nine fiscal centers included in our audit. These procedures included a checklist for performing the review and also identified the responsible agency personnel. However, only two of the fiscal centers had a procedure for documenting the review.

<u>Post-Audit Reviews Not Performed</u>

Before agencies were authorized access to the IFS, each fiscal center had to develop policies and procedures establishing a quarterly post-audit review. Although all nine fiscal centers examined have post-audit review procedures, only 8 of the 31 mandatory post-audit reviews for calendar year 2002 were conducted at these centers. Further, we noted that post-audit reviews, when conducted, did not include payroll transactions. Payroll costs represent a significant portion of state expenditures. As such, they should also be subject to post-audit review. Exhibit 1 illustrates the nine fiscal centers' compliance with the quarterly post-audit review requirement, as of the date of our visit.

Exhibit 1

Compliance with Quarterly Post-Audit Review Requirement

Calendar Year 2002

Fiscal Center	Required	Conducted
Prison Industries	2 (1)	0
So. Nevada Adult Mental Health Services	4	0
Nevada State Dairy Commission	4	4
Division of Wildlife	4	0
Community Connections	4	1
Division of Parole & Probation	2(1)	0
Insurance Division	4	0
Nevada State Museum	4	2
Department of Taxation	3(1)	1
Totals:	**31**	**8**

Source: Analysis of Fiscal Center Records.
(1) Fiscal center approved for IFS during calendar year 2002. All quarterly reviews were not required.

Similar to the pre-audit review function, the post-audit review represents a compensating control added in response to financial decentralization. Performed by agency personnel, it occurs "after-the-fact" and is designed to evaluate compliance with the agencies written policies and procedures. Essentially, it monitors the fiscal center's review and approval processes and requires corrective action be taken as needed. Not performing post-audit reviews could impact the integrity of processing financial transactions.

When performed, post-audit reviews were conducted properly and the goals of the process were achieved. For example, at the Dairy Commission, non-compliance issues were identified and corrective actions were taken. The benefit realized by this effort is especially important since financial transactions are no longer subject to their previous level of scrutiny. For instance, in the past, the Budget Division reviewed journal vouchers before they were processed by the State Controllers Office. This centralized review was eliminated with the implementation of the IFS. Post-audit reviews compensate for the elimination of this control. However, since the reviews are often not performed, the overall control environment associated with journal vouchers is weakened.

Tracking and Reconciliation Processes Not Performed

Although most fiscal centers did a good job of tracking and reconciling revenues, over half lacked evidence that expenditure and payroll transactions were always monitored. These tracking and reconciliation procedures have increased importance due to the elimination of centralized control processes. These reconciliations are intended to enhance budgetary control and ensure transactions were properly reflected in the state's accounting system.

Expenditure Transactions

Of the nine centers examined, seven were using a formalized budget tracking and reconciliation system. This included the Dairy Commission, Community Connections, Department of Wildlife, Prison Industries, Nevada State Museum, Division of Parole and Probation, and the Department of Taxation. At the other two fiscal centers, a formalized tracking and reconciliation system was not being used. However, the Insurance Division did use an informal monitoring system and the Southern Nevada Adult Mental Health Services indicated they began tracking transactions subsequent to our audit period.

Payroll Transactions

Another problem in this area relates to the processing of payroll expenditures. Payroll is processed by a separate module of IFS. When timesheets are input into IFS, the payroll is executed and automatically recorded in the state's accounting records. Two reconciliation procedures have been developed by the Department of Personnel to verify the integrity of this process. The first reconciliation involves computing manual "hash-totals" from employee timesheets and comparing them with system input. The second involves a comparison of payroll expenses for specific periods with similar information in the Budget Status Report.

To determine compliance with reconciliation procedures, we examined 18 pay periods at 9 fiscal centers. We noted that timesheet reconciliations had not been conducted for 11 of the pay periods tested. In addition, nine of the payrolls had not been reconciled to the State's accounting records. These exceptions involved eight of the fiscal centers examined. In many cases, the fiscal center was behind or had started performing the reconciliation subsequent to our audit period. However, in other cases, the fiscal center had not yet implemented these reconciliation procedures.

Reconciliation procedures are especially important in the IFS payroll module. Unlike many other IFS transactions, payroll documents do not require multiple approval levels for processing. When used, these approval levels ensure the involvement of at least two individuals in every transaction executed. Because of their absence in the payroll module, transactions can be input and processed by only one individual. This is a concern because payroll processing was the responsibility of only one or two individuals at six of the fiscal centers we visited. Although this lack of duty segregation was generally mitigated by close management involvement, risk is increased by absence of the approval level controls inherent in other aspects of the system. The reconciliations described above provide a compensating control.

Recommendations

1. Ensure pre-audit and post-audit reviews are conducted and establish a requirement to document the reviews.
2. Enforce requirement to maintain budget-tracking systems and perform all recommended financial reconciliation procedures.

Policies and Procedures Need Improvement

Written policies and procedures governing agency use of the IFS need improvement. We found various deficiencies at many of the nine fiscal centers visited.

These deficiencies included incomplete as well as out-dated procedures. Policies and procedures are a critical component of the IFS control environment. They establish a system of practices necessary to accomplish the financial objectives of the agency. Unless these documents are complete and accurate, there is an increased risk that transactions will not be executed as intended.

IFS Procedures Were Incomplete

Although all fiscal centers visited had developed written IFS procedures, key processes were often missing from these documents. Consequently, procedures were incomplete at many of the nine fiscal centers visited. Common omissions included payroll processing, the maintenance of property and equipment inventory, and the use of the miscellaneous vendor capability.

Payroll Process

Even though agency payroll practices have been altered, only four of the nine fiscal centers have developed some IFS-related procedures, of which two centers' procedures were not complete. The payroll function is a key example of a centralized process that was shifted to state agencies by the implementation of the IFS. Agency fiscal centers, rather than Central Payroll, are now responsible for entering timesheet information into the system. The Department of Personnel provides extensive procedures regarding the general use of the payroll system. However, they do not address the practices specific to each agency. Consequently, the Department of Personnel stated each agency is responsible for establishing controls for processing payroll documents.

Payroll expenditures comprise a significant portion of the State's budget. To ensure the integrity of these expenditures, it is important that agency personnel clearly understand their responsibilities in this area. Written policies and procedures are critical to this understanding. With the eminent shift to a paperless timesheet format, this becomes even more important.

Property and Equipment Inventory

Eight of nine fiscal centers' written procedures did not adequately address the maintenance of property and equipment inventories using the IFS. Control over agency assets is an important fiscal center responsibility. Written procedures help ensure these assets are accounted for and properly safeguarded.

Under the IFS, property and equipment purchases are automatically updated to an inventory listing if the fiscal center executes the transaction properly. Fiscal centers also have a continuing responsibility to monitor and maintain these listings. Changes in the status of each asset must be accounted for to ensure the integrity of the inventory listings. The lack of property and equipment procedures contributed to the inventory control problems discussed in a subsequent section of this report.

Miscellaneous Vendor Capability

The miscellaneous vendor capability is primarily used to simplify the payment to a one-time vendor. Although many agencies did not use this capability, or used it very little, the miscellaneous vendor function is a powerful feature that has the potential for misuse. However, of the five fiscal centers using the miscellaneous vendor capability only the Department of Taxation developed policies and procedures specifying the terms of its use. The remaining four centers have not, although the Division of Parole and Probation is in the process of putting procedures together. Written policies and procedures would improve accountability and minimize the risk associated with this feature.

The miscellaneous vendor function enables a fiscal center to enter a vendor directly into the IFS and make a payment. In generating this payment, the normal process of verifying payee information against the State Controller's centralized vendor file is bypassed. Refunds are the primary use of the miscellaneous vendor function. As an example, the Department of Taxation uses this capability to refund tax overpayments. Uses other than refunds must be approved by the State Controller's Office. For example, the Division of Parole and Probation uses the miscellaneous vendor function to pay restitution to the victims of crime. Although other standard control features apply to the processing of these transactions, agency controls are necessary to ensure the integrity of the payments.

IFS Procedures Not Current

At eight of nine fiscal centers visited, we noted instances where written procedures differed from actual practice. This generally involved processes that had been modified or suspended without a corresponding update to the procedures. However, in some instances these differences were more pervasive. For example, at three fiscal centers we identified two distinct and conflicting sets of procedures. One set addressed the processing environment prior to the IFS, while the other addressed the environment after the inception of IFS. Non-current and bifurcated procedures could generate confusion and possibly diminish the effectiveness of the control environment.

NRS 353A requires each agency to develop and periodically review a written system of internal and administrative control. In compliance with this statute, each fiscal center was required to develop and encouraged to update written procedures for processing transactions in the IFS. Before receiving access to the system, these procedures had to be approved. As a result, procedures were often developed by agency staff with no prior experience using the system. This environment likely contributed to many of the discrepancies noted above. Nevertheless, to be effective, written procedures must be complete and accurate.

Recommendation

3. Require fiscal centers to eliminate duplicate or conflicting procedures and update their procedures for current processes and controls of the IFS, including procedures for payroll, inventory, and the miscellaneous vendor function.

Problems With Property and Equipment Records

The fixed asset module of the IFS system has control features to help ensure the proper recording of fixed assets. However, we found these control features are not routinely used. Specifically, asset codes are not always entered and inventory records not always updated. Agency duties related to the maintenance of property and equipment records have changed since the introduction of the IFS. Under the new system, agencies bear a greater responsibility for ensuring property and equipment purchases are accurately recorded in the State's official inventory records. However, there is a general lack of understanding at the fiscal centers examined regarding the use of the fixed asset system. While most fiscal center staff involved in this function indicated they had attended relevant training, many other key financial managers had not. Additional training could help improve the use and understanding of the fixed asset module.

Asset Codes Not Entered in the IFS

Agency fiscal centers did not consistently enter asset codes on the IFS when purchasing property and equipment items. In most instances, when an item valued at $1,000 or more is purchased, agencies are required to add an "FA" designation to the commodity code on the IFS purchase requisition. This code indicates the item is a fixed asset and should be included on the State's official property and equipment inventory. If the code is not entered, the asset may not be recorded in the inventory. Unrecorded assets not only impact the Division's asset management responsibility, they could impact the accuracy of financial reports.

Fiscal centers did not enter the "FA" code for 6 of the 10 requisitions we examined involving purchases of property and equipment. The Purchasing Division subsequently added the code in five of the six instances, and the inventory records were properly updated. However, in the one instance, the code was never added for computer equipment costing $1,430 purchased by the Division of Insurance. Consequently, this equipment was not reported on the agency's property and equipment inventory records.

Standards of internal control require assets be safeguarded and transactions be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. If fixed asset codes are not consistently entered in the IFS, there is an increased risk assets will not be recorded on the state's property and equipment inventory.

Inventory Records Not Updated Using the IFS

Seven of nine agency fiscal centers had not conducted a recent inventory using the IFS to update their property and equipment records. The Purchasing Division maintains the State's official inventory records, but each agency has responsibility to update their portion of those records on an annual basis. This responsibility is explicit in the language of NRS 333.220(4), which states, in part:

Each using agency shall conduct an annual physical count of all personal property charged to it and reconcile the results of the annual physical count with the records of inventory maintained by the chief.

In addition to the statutory requirement, system procedures require agencies to enter the date of the inventory into the official IFS records. Annual property and equipment inventories are important in securing state assets. Inaccurate or incomplete records increase the risk that assets will be misplaced or lost through theft.

There are several reasons why annual inventories have not been conducted or inventory records maintained using the IFS. First, State agencies assign a low priority to conducting these responsibilities. This is evidenced by the fact that only the Department of Wildlife, of the nine fiscal centers visited, had developed policies and procedures related to the use of the IFS for inventories.

Second, both old and new location codes are maintained in the State's official inventory records. These codes specify the physical address of each asset listed. According to the Purchasing Division, the old location codes relate to assets acquired prior to the implementation of the IFS. Conversely, the new location codes relate to assets acquired subsequent to the implementation of IFS. As a result, two distinct property and equipment records could exist for each agency address. This has caused confusion among fiscal center staff trying to update their inventory records using the IFS.

Recommendations

4. Consolidate location codes used for inventory purposes.
5. Provide additional IFS training regarding property and equipment inventory, emphasizing the need to input "FA" codes when purchasing property and equipment and using IFS for inventory purposes.

Security Over System Access Can Be Improved

Access to the IFS system is controlled by the assignment of pre-established security profiles that are linked to a user's identification code and password. Although we generally found these controls to be adequate, aspects of the system could be improved. Specifically, system practices did not always ensure the individuals involved in a transaction were documented. Further, access to the system was not always promptly deleted upon a user's termination.

Background of Security Profiles

To control system activity, the IFS incorporates security profiles with varying levels of capability. These profiles define the IFS applications and budget accounts accessible by the user. For example, data entry personnel are typically given a lower security profile than staff responsible for transaction review and approval. Although IFS has five approval level profiles, only two levels are generally used. These profiles are commonly referred to as level 3 and level 4 approval authority.

A level 3 user is allowed to enter a transaction and initially approve it. However, this approval does not allow the transaction to execute. Only a level 4 user can provide the final approval and allow the transaction to fully process. This hierarchy is required for most transactions and is designed to ensure at least two individuals are involved in the execution process. For example, to make a payment, a payment voucher is entered in the IFS and given level 3 approval. Before the payment voucher can be processed, a level 4 user must review and approve the transaction. Once the level 4 approval is applied, the transaction processes and a check is issued by the State Treasurer's Office.

Security profiles also restrict access to those system applications and budget accounts appropriate to the users' duties. These determinations are made by each agency, based on their specific resources and needs. To facilitate this process, security administrators have developed a set of standard profiles for agencies to consider. The configuration of these profiles within a fiscal center should ensure that each financial transaction receives proper review and approval.

Involvement in Transactions Not Always Documented

When a transaction is processed, the system monitors and logs the user identification code of each individual involved in the transaction. In addition, each fiscal center was required to develop written procedures outlining the specific responsibilities assigned to system users. These procedures also establish practices for documenting user actions in the underlying physical records. Although our audit tests indicate these controls generally function as designed, we identified circumstances that could result in inadequate user documentation.

It is possible for an authorized user to input a document but not provide the level 3 approval. If this occurs, the transaction is in a pending status with no approval levels applied. As a result, when approved by the level 4 user, both approvals (level 3 and level 4) are provided at the same time. In this case, the electronic approval log will only reflect the identity of the level 4 individual. Consequently, to determine the identity of the level 3 input person, the underlying physical records must be examined. However, we noted instances where the individual was not documented in the underlying physical records. As a result, the identity of the individual was not readily available.

IFS system documentation widely available to fiscal center employees states:

> **Approving a document electronically is the same as signing off on a paper voucher. Employees are responsible for all approvals made with their User ID.**

To ensure the accountability implied by the above statement, all individuals involved in the execution of a transaction should be adequately documented. If the individual's identification is absent, their involvement may not be determinable. Consequently, individual responsibility for improper transactions cannot be fully established.

User Access Not Always Current

In five of the nine fiscal centers examined, we found instances where system access for terminated employees had not been suspended for periods ranging from two weeks to over a year. The untimely removal of terminated employees increases the risk of unauthorized system access. With the increased sophistication of computer networks, the importance of monitoring user access has increased. Strong controls are needed to protect a system against inappropriate use. Important in this regard is the revocation of user access for reassigned or terminated employees.

Guidelines for the maintenance of user access in computer systems have been established by the State Information Technology Security Committee's Standard 4.60, which states:

> **A System/User Master List of all users and their respective user-ID codes shall be maintained, kept secured and up-to-date, reflecting all computer**

systems each person has access to so that their privileges may be expediently revoked on short notice. Access rights and privileges for every State system shall be included to ensure quick notification is given to all system administrators of those systems in the event of a change of access, whether by termination of contract, termination of employment, revocation of rights, reassignment, or other separation from agency, department, or service.

To comply with the above requirements, IFS security administrators have established forms and procedures to facilitate the removal of system access. Since access to the financial and human resource modules is distinct, separate termination forms are required. There is also a system default that disables a user's access after a period of inactivity, but not if kept active by an occasional logon.

Overall, we equate the above problems with the low priority placed on this responsibility by agency fiscal centers. As evidence, only two of the nine fiscal centers examined maintained user lists for employees with access to the IFS financial functions. None of the fiscal centers maintained a list of users with access to the human resource functions. A contributing problem mentioned by fiscal center staff was the lack of communication from the system's security administrators. For example, when a termination form was submitted, no communication was received to confirm the employee was actually removed. Increased communication between agencies and security administrators would enhance control over system access. A positive step in this direction began in May 2003. At that time, the human resources security administrator began providing each agency a monthly list of their system users for review. Efforts of this nature should continue.

Recommendations

6. Require employees to complete the electronic level 3 approval at data entry and document this approval on the underlying physical records.
7. Periodically provide user access listings to agency fiscal centers for review and require notification for any changes.
8. Require fiscal centers maintain a user access listing and emphasize the centers responsibility for timely additions and deletions.

Record Retention Practices Need Formalization

Prior to the implementation of the IFS, agencies submitted original documentation to the Pre-Audit Section of the Department of Administration for processing. When processed, these physical documents were stored at the Controller's Office, Pre-Audit, and various other sources. With the implementation of the IFS, this responsibility was shifted to agency fiscal centers. In addition to the physical documentation retained at the agency, an electronic record of each transaction is kept centrally on the system. While our audit tests indicate this documentation is being properly maintained, record retention practices generally need refinement and formalization.

Retention Practices at Fiscal Centers Need Refinement

The nine fiscal centers we examined were complying with the requirement to maintain original documentation to support financial transactions. However, fiscal center procedures related to the disposition of records were undocumented or inconsistent. We understand that agency needs are unique so schedules will not be similar. However, we found no evidence the schedules addressing IFS records were approved by the Committee to Approve Schedules for the Retention and Disposition of Official State Records (Committee) to ensure the reasonableness of the schedules. Since records are no longer kept at locations other than the agency, it is very important that retention schedules be appropriate.

NRS 239.080 establishes that official state records may be disposed of only in accordance with an approved schedule of retention and disposition. Further, it states agencies must submit the schedules to the Committee for approval. To this end, State Library and Archives has developed a general schedule that addresses records commonly found throughout state government. For the financial records reviewed in our audit, this period is generally 3 years from the end of the fiscal year that a document pertains.

However, references to the State's general schedule or other retention policy were missing from almost half of the fiscal center procedures we reviewed. When a policy was included, it was broad and the retention period was typically longer than the 3-year standard established by the State's general schedule. Since these retention schedules have not been approved by the Committee, it is unknown if the retention periods shown in Exhibit 2 are appropriate. Exhibit 2 illustrates the retention policy noted at each of the nine fiscal centers examined.

Exhibit 2

Fiscal Center Retention Policies

Fiscal Center	Retention Policy in IFS Procedures
Prison Industries	No reference in procedures
So. Nevada Adult Mental Health Services	No reference in procedures
Nevada State Dairy Commission	6 years after end of fiscal year
Division of Wildlife	One year after completion of state or federal audit
Community Connections	Reference to State's general retention schedule
Division of Parole & Probation	No reference in procedures
Insurance Division	3-5 years
Nevada State Museum	7 years from close of fiscal year
Department of Taxation	No reference in procedures

Source: Analysis of IFS fiscal centers' policies and procedures

NAC 239.697 states that agencies should refrain from accumulating unnecessary records. Not only are agencies at risk of discarding important records, they may keep records too long incurring additional costs. The Committee states:

> **Without established retention policies, agencies would keep records too long, spend too much money to store them, ... and fail to protect mission-critical information from loss or destruction.**

Proper records management by fiscal centers will preserve valuable state records while avoiding unnecessary storage costs.

Policies for Electronic Records Retention Need Formalization

During our audit, we noted the State lacked comprehensive retention criteria for the electronic records centrally stored in the IFS and its related data warehouses.

Although criteria related to the storage of this information has been discussed, no formal retention and disposition schedule has been developed.

The IFS and the related data warehouses represent a valuable resource for historical financial research. Fiscal center staff, policy makers, and the general public can use this information to monitor the financial affairs of the state. In fact, early system documentation states:

> **The greatest benefits to be derived from implementation of the IFS are extensive improvements in the quality and quantity of information available to the State's decision-makers....**

The IFS has improved the general availability of financial information. However, without well-conceived criteria, there is a risk this data will be discarded prior to the end of its reasonable useful life. Conversely, there is also the risk this information could be retained too long, resulting in the waste of scarce technical resources. NRS 239.080 requires each agency to develop a schedule for the retention and disposition of each type of official state record. Electronic computer data would be included in this requirement. These electronic records are strategic financial assets that need to be preserved. Formal retention and disposition schedules are a critical component of this preservation effort.

Recommendations

9. Encourage agency fiscal centers to develop or refine their record retention and disposition policies and obtain Committee approval.
10. Formalize retention and disposition schedules for the electronic records maintained on the IFS and the data warehouses and obtain Committee approval.

Appendices

Appendix A

Audit Methodology

To gain an understanding of the Integrated Financial System's (IFS) control environment, we conducted preliminary interviews with responsible officials and staff of the State Controller's Office, Department of Information Technology, Department of Administration, and the Department of Personnel. In addition, we reviewed related documentation, policies, procedures, and past audits. Finally, we reviewed statutes, regulations, and legislation significant to the IFS.

To accomplish our objective, we selected 9 of the 109 agency fiscal centers responsible for processing IFS transactions within the state. To ensure a diverse representation of state agencies for testing, we selected nine fiscal centers based on their size and geographic location (See Appendix B). We then obtained and reviewed procedures developed by these fiscal centers to evaluate controls over the processing of IFS transactions. This control review included an evaluation of password security, expenditures, revenues, post-audits, and payroll functions. We also tested these controls to ensure transactions were processed correctly.

To test password security, we identified employees with system access and determined if their access profiles were appropriate to their duties. We also reviewed security records to verify compliance with established procedures for initiating and terminating system access. To ensure passwords were adequately safeguarded, we discussed the sharing of passwords with agency staff. We also compared access logs and payroll records to determine if an employee's system access had been used during reported absences. Finally, we selected a sample of nine employees and confirmed that they had attended training relevant to their system duties.

To test controls over expenditures, we selected a sample of 65 online requisitions processed through State Purchasing. We traced these transactions to documentation supporting the approval, order, receipt, and recording of the purchased goods. We also selected a sample of 160 payment vouchers to verify the expenditure was properly accounted for and documentation was maintained to support the proper execution of the transaction. For both expenditure samples, we determined if the expenditure had evidence of a pre-audit review and been accounted for in the agency's internal budget tracking system and reconciled to the state's accounting records. Finally, we reviewed miscellaneous vendor transactions processed by each fiscal center for proper documentation and control.

To test controls over revenues, we selected a sample of 160 cash receipts. We tested this sample to ensure the transaction was recorded properly and that supporting documentation was maintained. We also verified that each cash receipt had been accounted for in the agency's internal budget tracking system and reconciled to the state's accounting records.

To test controls over the post-audit process, we requested agency staff provide documentation supporting the performance of quarterly post-audits during calendar year 2002. For each audit performed, we determined it was conducted by an individual independent of the function under review. We also verified the post-audit findings were communicated to agency management and that necessary corrective action had been taken.

To test controls over payroll, we selected two pay periods at each of the nine fiscal centers in our sample. For each pay period selected, we confirmed that properly executed timesheets were maintained. We then selected a sample of timesheets to verify the performance of processing controls over payroll. To ensure proper input, we verified the agency performed a reconciliation of timesheet totals to system reports. We also traced the hours reported on the sample timesheets to recording in the payroll system. We then determined that the agency had reconciled payroll expense to the state's accounting records and also examined payroll adjustments to identify problems inherent in the agency's management of the process.

Finally, we interviewed agency personnel to determine any impact the IFS has had on the journal voucher process and records retention function.

Our audit work was conducted from October 2002, to June 2003, in accordance with generally accepted government auditing standards.

In accordance with NRS 218.821, we furnished a copy of our preliminary report to the Director of the Department of Administration. On January 6, 2004, we met with Agency officials to discuss the results of the audit and requested a written response to the preliminary report. That response is contained in Appendix D that begins on page 30.

Contributors to this report are:

George Allbritten, CPA
Deputy Legislative Auditor

Ian J. Allan
Deputy Legislative Auditor

Dennis Klenczar, CPA
Deputy Legislative Auditor

Roy B. Cage, CIA, CISA
Deputy Legislative Auditor

Timothy K. Brown, CPA
Audit Supervisor

Stephen M. Wood, CPA
Chief Deputy Legislative Auditor

Appendix B

Selected Fiscal Centers

Fiscal Center	Location
Prison Industries Department of Corrections	Las Vegas
Southern Nevada Adult Mental Health Services Department of Human Resources	Las Vegas
Nevada State Dairy Commission Department of Business and Industry	Reno
Department of Wildlife	Reno
Community Connections Department of Human Resources	Reno
Division of Parole & Probation Department of Public Safety	Carson City
Insurance Division Department of Business and Industry	Carson City
Nevada State Museum Department of Cultural Affairs	Carson City
Department of Taxation	Carson City

Appendix C

Prior Audit Recommendations

As part of our audit, we requested the Department of Administration determine the status of the five recommendations made in our prior audit of the Integrated Financial System. The Department indicated that all five recommendations had been fully implemented. The scope of our current audit did not include the prior recommendations. Therefore, we did not verify the Department's response to the prior recommendations.

Appendix D

Response From the Department of Administration

KENNY C. GUINN
Governor

JOHN P. COMEAUX
Director

STATE OF NEVADA

DEPARTMENT OF ADMINISTRATION
209 E. Musser Street, Room 200
Carson City, Nevada 89701-4298
(775) 684-0222
Fax (775) 684-0260

MEMORANDUM

January 16, 2004

TO: Paul V. Townsend, CPA
Legislative Auditor

FROM: John P. Comeaux, Director
Department of Administration

SUBJECT: PRELIMINARY AUDIT REPORT – INTEGRATED FINANCIAL SYSTEMS CONTROLS

The following is a written statement of explanation to the preliminary audit report on the Integrated Financial Systems Controls as submitted by the Legislative Counsel Bureau in your December 15, 2003 letter:

RECOMMENDATION NO. 1: Ensure pre-audit and post-audit reviews are conducted and establish a requirement to document the reviews.

RESPONSE: ACCEPTED

Pre-audit Reviews - Financial Management, Training and Controls (FMTC) will continue to recommend during its reviews and trainings that agencies should establish standardized guidelines for reviewing expenditures before payment. FMTC Post Review section will continue to sample expenditures to ensure that they have level 3 and 4 initials or signatures, which evidence approval and review of the transaction prior to payment.

Post-audit Reviews – FMTC Post Review section will continue to periodically review agencies' expenditures for compliance with laws, regulations, and policy. Revisions to the State Administrative Manual (2418) will require agencies to evaluate their system of internal accounting and administrative controls annually and report the results to FMTC.

Please see the attached Memorandum from Bill Chisel, Chief of the Division of Internal Audits for a more detailed response.

RECOMMENDATION NO. 2: Enforce requirement to maintain budget-tracking systems and perform all recommended financial reconciliation procedures.

RESPONSE: ACCEPTED

FMTC Post Review section will periodically review agencies financial reconciliations and recommend, when necessary, that agencies maintain a budget tracking system and perform financial reconciliations.

Please see the attached Memorandum from Bill Chisel, Chief of the Division of Internal Audits for a more detailed response.

RECOMMENDATION NO. 3: Require fiscal centers to eliminate duplicate or conflicting procedures and update their procedures for current processes and controls of the IFS, including procedures for payroll, inventory, and the miscellaneous vendor function.

RESPONSE: ACCEPTED

As of November 2003, FMTC had requested each executive branch agency update and consolidate its procedures. When performing reviews, Post Review will continue to recommend agencies update and consolidate for current processes and controls of IFS, including procedures for payroll and inventory. While performing reviews, FMTC and Post Review will request agencies using the miscellaneous vendor function document the related controls.

Please see the attached Memorandum from Bill Chisel, Chief of the Division of Internal Audits for a more detailed response.

RECOMMENDATION NO. 4: Consolidate location codes used for inventory purposes.

RESPONSE: ACCEPTED

The Purchasing Division has been working with state agencies, since the inception of the IFS Fixed Asset subsystem, to consolidate location codes and avoid confusion. Some agencies have chosen to use a second set of customized location codes to satisfy their internal procedures for reconciling inventories. The Purchasing Division will continue to work with those agencies that only need one set of codes and assist in their clean up and change over.

Please see the attached Memorandum from Greg Smith, Administrator, Nevada State Purchasing Division for a more detailed response.

RECOMMENDATION NO. 5: Provide additional IFS training regarding property and equipment inventory, emphasizing the need to input "FA" codes when purchasing property and equipment and using IFS for inventory purposes.

RESPONSE: ACCEPTED

The Purchasing Division offers 12 classes per year to all agencies regarding the management of personal property, in addition to visits to individual agencies to provide refresher or new employee training. The importance of the "FA" commodity codes, and the responsibilities of the agencies to update personal property records is addressed. In an effort to emphasize these issues further, the Purchasing Division will now send the annual letter reminding agencies of these issues, semi-annually, and will contact using agency staff when errors are discovered.

Please see the attached Memorandum from Greg Smith, Administrator, Nevada State Purchasing Division for a more detailed response.

Please see Department of Administration All Agency Memorandum #02-04, dated January 13, 2004 for additional emphasis.

RECOMMENDATION NO. 6: Require employees to complete the electronic level 3 approval at data entry and document this approval on the underlying physical records.

RESPONSE: ACCEPTED

FMTC will continue to recommend agencies' level 3 and 4 sign or initial transactions evidencing approval. This will be verified by Post Review on a sample basis.

Please see the attached Memorandum from Bill Chisel, Chief of the Division of Internal Audits for a more detailed response.

RECOMMENDATION NO. 7: Periodically provide user access listings to agency fiscal centers for review and require notification for any changes.

RESPONSE: ACCEPTED

As noted on page 21 of the preliminary audit report, the human resources security administrator (Department of Personnel) began providing each agency a monthly list of their system users for review in May 2003. Due to resource constraints, the list is now being provided quarterly. This list includes users of the Advantage HR and HR Data Warehouse. The Department of Personnel will add Nevada Employee Action and Timekeeping System (NEATS) users to this list by April 1, 2004.

The Controller's Office has a user deletion form and process in place for Statewide Advantage Financial. Beginning April1, 2004 the Controller's Office will begin providing agencies with a list of all users, on a quarterly basis.

Please see the attached Memorandum from Kim Huys, Acting Chief Deputy Controller for a more detailed response concerning Statewide Advantage Financial users.

RECOMMENDATION NO. 8: Require fiscal centers maintain a user access listing and emphasize the centers responsibility for timely additions and deletions.

RESPONSE: ACCEPTED

An All Agency Memorandum has been distributed reminding agencies of the requirement for their fiscal centers to maintain a user access list. This Memorandum further emphasizes the responsibility of each agency's fiscal center to provide timely additions and deletions, particularly with regard to the Statewide Advantage Financial, Advantage HR, HR Data Warehouse, and NEATS.

Please see Department of Administration All Agency Memorandum #03-04, dated January 14, 2004 for more details.

RECOMMENDATION NO. 9: Encourage agency fiscal centers to develop or refine their record retention and disposition policies and obtain Committee approval.

RESPONSE: ACCEPTED

An All Agency Memorandum has been distributed reminding agencies of the requirement of developing or refining their record retention and disposition schedules. This Memorandum further reminds agencies of the requirement to submit these schedules to the Records Committee for approval.

Please see Department of Administration All Agency Memorandum #04-04, dated January 14, 2004 for more details.

RECOMMENDATION NO. 10: Formalize retention and disposition schedules for the electronic records maintained on the IFS and the data warehouses and obtain Committee approval.

RESPONSE: ACCEPTED

The Department of Personnel has drafted an Electronic Data Retention and Disposition Schedule for the Advantage HR, HR Data Warehouse, and NEATS. Upon completion of these schedules, the Department will obtain Records Committee approval.

Please see the attached Memorandum from Kim Foster, Administrative Services Officer, Department of Personnel for a more detailed response.

The Controller's Office has drafted an Electronic Data Retention and Disposition Schedule for Advantage Financial and the Financial Data Warehouse. These schedules are ready for review by the IFS core agencies. Upon completion of this review, the schedules will be submitted to the Records Committee for approval.

Please see the attached Memorandum from Kim Huys, Acting Chief Deputy Controller for a more detailed response.

Director

cc: David L. McTeer, Chief
Division of Information Technology

Department of Administration's Response to Audit Recommendations

Recommendation Number		Accepted	Rejected
1	Ensure pre-audit and post-audit reviews are conducted and establish a requirement to document the reviews..	X	
2	Enforce requirement to maintain budget-tracking systems and perform all recommended financial reconciliation procedures	X	
3	Require fiscal centers to eliminate duplicate or conflicting procedures and update their procedures for current processes and controls of the IFS, including procedures for payroll, inventory, and the miscellaneous vendor function.	X	
4	Consolidate location codes used for inventory purposes	X	
5	Provide additional IFS training regarding property and equipment inventory, emphasizing the need to input "FA" codes when purchasing property and equipment and using IFS for inventory purposes	X	
6	Require employees to complete the electronic level 3 approval at data entry and document this approval on the underlying physical records	X	
7	Periodically provide user access listings to agency fiscal centers for review and require notification for any changes	X	
8	Require fiscal centers maintain a user access listing and emphasize the centers responsibility for timely additions and deletions	X	
9	Encourage agency fiscal centers to develop or refine their record retention and disposition policies and obtain Committee approval	X	
10	Formalize retention and disposition schedules for the electronic records maintained on the IFS and the data warehouses and obtain Committee approval	X	
	TOTALS	10	0