STATE OF IOWA

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

JUNE 30, 2007

State of Iowa

Officials

Name	Title
Executive Branch	
Honorable Chester J. Culver	Governor
Charles J. Krogmeier	Director, Department of Management
Legislative Branch	
John P. Kibbe	President of the Senate
Patrick J. Murphy	Speaker of the House of Representatives
Dennis C. Prouty	Director, Legislative Services Agency
Judicial Branch	
Marsha K. Ternus	Chief Justice of the Supreme Court

OFFICE OF AUDITOR OF STATE
STATE OF IOWA

David A. Vaudt, CPA
Auditor of State

State Capitol Building
Des Moines, Iowa 50319-0004

Telephone (515) 281-5834 Facsimile (515) 242-6134

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

To the Governor and Members of the General Assembly:

We have audited 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 Iowa as of and for the year ended June 30, 2007, which collectively comprise the State basic financial statements, and have issued our report thereon dated December 14, 2007 under separate cover. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Iowa's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of the State of Iowa's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Iowa's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the State of Iowa's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood a misstatement of the State of Iowa's financial statements that is more than inconsequential will not be prevented or detected by the State of Iowa's internal control. We consider the deficiencies in internal control described in the accompanying Schedule of Findings to be significant deficiencies in internal control over financial reporting. We also noted other matters involving the internal control over financial reporting which will be reported to management in separate departmental reports.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood a material misstatement of the financial statements will not be prevented or detected by the State of Iowa's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. We do not believe the significant deficiencies described above are material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Iowa's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance 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 non-compliance or other matters that are required to be reported under Government Auditing Standards. However, we noted certain immaterial instances of non-compliance or other matters which will be reported to management in separate departmental reports.

The State of Iowa's responses to findings identified in our audit are described in the accompanying Schedule of Findings. While we expressed our conclusions on the State's responses, we did not audit the State of Iowa's responses and, accordingly, we express no opinion on them.

This report, a public record by law, is intended solely for the information and use of the officials, employees and citizens of the State of Iowa and other parties to whom the State of Iowa may report, including federal awarding agencies and pass-through entities. This report is not intended to be and should not be used by anyone other than these specified parties.

DAVID A. VAUDT, CPA
Auditor of State

WARREN G. JENKINS, CPA
Chief Deputy Auditor of State

December 28, 2007

Findings Related to the Financial Statements:

SIGNIFICANT DEFICIENCIES:

(A) Capital Assets – Chapter 7A.30 of the Code of Iowa requires each department of the state to maintain a written, detailed and up-to-date inventory of property under its charge and control. Findings were noted for the following departments:

(1) **Iowa Department of Administrative Services**

(a) The Department did not perform a reconciliation of capital asset additions to Integrated Information for Iowa (I/3) system expenditures. The following items were noted:

(1) Five asset additions totaling $9,592 were recorded at estimated cost rather than actual cost.

(2) Five assets totaling $32,934 previously leased under operating leases were purchased during the current fiscal year but were not added to the capital asset listing.

(3) One asset for $8,420 purchased during the fiscal year was not added to the capital asset listing.

(4) Additions for buildings and building improvements were overstated by $1,291,670 due to adding retainage payable, which was already included as a prior year addition.

(b) Accumulated depreciation included $20,723 for two assets previously deleted.

(c) Twenty-five assets were selected for recalculation of deprecation expense.

(1) Depreciation expense was calculated incorrectly, resulting in an overstatement of accumulated depreciation for land improvements of $139,939 and buildings of $20,238.

(2) Depreciation expense could not be recalculated for eleven non vehicle assets due to manual adjustments made by the Department.

(d) Two of twenty-five assets selected for observation could not be located.

(e) Five assets with a cost of $150,361 were sent to surplus property in previous fiscal years but were still included on the capital asset listing.

(f) The Department does not have written accounting procedures for the reconciliation of State Vehicle Dispatch records to the Department's capital asset listing and the reconciliation of the Department's capital asset additions to I/3 asset purchases.

Recommendation – The Department should develop written procedures to ensure a detailed, up-to-date capital asset listing is maintained. Procedures should include, but not be limited to, ensuring capital asset additions are reconciled to I/3 asset purchases, depreciation expense is properly calculated and recorded and asset deletions are properly authorized, supported and promptly removed from the capital asset listing. Also, the Department should develop written procedures for the reconciliation of the State Vehicle Dispatch records to the Department's capital asset listing and the reconciliation of the Department's capital asset additions to I/3 asset purchases.

Response – The Department is reviewing its policies and procedures and the following items will be implemented before the end of fiscal year 2008 and the early part of fiscal year 2009.

- Reports will be generated and monitored to ensure the timely processing of capital asset transactions.
- Quarterly reconciliations and comparisons will be performed on the following items;
    - I3 expenditures to capital asset additions
    - Vehicles reported on the I3 system to the Motor Pool Inventory, and
    - Depreciation expense will be recalculated.
- Training of the Fixed Asset Coordinators to ensure capital asset transactions are correctly inputted.
- Quarterly meetings with the Fixed Asset Coordinators will be held for the first nine months of the fiscal year and monthly meetings the last quarter to ensure consistent handling of capital asset transactions.
- Procedures will be reviewed to develop a "Department wide" policy.

Conclusion – Response accepted.

(2) **Iowa Department of Human Services**

(a) Forty-two deletions were tested to determine whether they were deleted from the I/3 system within a reasonable time (within one month). For 26 deletions, the disposal date was unknown. For nine deletions, the disposal date ranged from 36 to 336 days.

(b) Two of 71 assets tested for existence were not tagged with a state property tag.

Recommendation – The Department should develop procedures to ensure an accurate inventory of all real and personal property belonging to the state is maintained.

Response – The Department of Human Services acknowledges the importance of maintaining accurate tracking of a detailed, up-to-date inventory of all real and personal property belonging to the state.

(a) The 26 assets were part of a Department effort to ensure the inventory is current. During the annual physical inventory it was determined these assets had been disposed of in prior years and the deletion of the asset had not been recorded. The disposal dates were not recorded so the assets were deleted without that information. These assets were no longer in the custody of the Department and were removed from the inventory.

(b) The Department issued a tag number and entered both assets in the inventory system by tag number. Both of these assets are located in the Information Technology Enterprise (ITE) unit of the Department of Administrative Services (DAS). The tag was given to DAS-ITE to be affixed to the asset. After the tag was attached the asset was inserted into equipment and the tag is not visible.

In the future the department will remind DAS-ITE they must ensure tags are affixed so as to be visible for inspection.

Conclusion – Response accepted.

(3) **Iowa Judicial Branch**

(a) An accurate year-end capital asset listing, including the cost and book value of each asset, was not maintained to support the amounts reported on the GAAP package. The following items were noted:

(1) Current year additions were reported on the GAAP package but were not added to the capital asset listing. Also, an asset with a cost of $117,098 acquired in a previous fiscal year is included on the GAAP package but has not been added to the capital asset listing.

(2) Certain prior year deletions reported on previous fiscal year GAAP packages and fiscal year 2007 deletions have not been removed from the capital asset listing.

(3) The value of certain assets was increased $6,238 during fiscal year 2005. The cost adjustment for these assets is properly included in the GAAP package but the acquisition

cost of the assets has not been adjusted on the capital asset listing.

(4) Adjustments of $321,374 were made to the fiscal year 2007 GAAP package to remove assets which had been deleted in previous fiscal years. The assets have not been removed from the capital asset listing.

(5) Depreciation on the fiscal year 2005 additions was properly calculated to include a partial year of depreciation. However, the fiscal year 2005 balance (book value) on the capital asset listing was incorrectly transferred from fiscal year 2005 to fiscal year 2006 to reflect a full year of depreciation in the year of acquisition. The error still exists on the current asset listing.

(b) Several errors were noted in the amounts reported in the GAAP package, including errors in depreciation calculations:

(1) Accumulated depreciation was understated by $1,368 due to several errors made in calculating the depreciation of assets which had value increases in fiscal year 2005. While a similar error was made in the prior year, an adjustment was made during fiscal year 2007 to correct this error. However, the current year depreciation calculation was not adjusted.

(2) The current year depreciation for two assets was understated by $1,808.

(3) One asset was depreciated $720 in excess of its cost.

(4) The amount removed from accumulated depreciation for two assets deleted during fiscal year 2007 was overstated by $4,344.

(5) Current year depreciation was understated by $36,458 due to including an adjustment both as a reduction to the current year depreciation and in the adjustments column on the GAAP package.

(6) The $117,098 asset referred to in (a) (1) above has not been depreciated so the accumulated depreciation is understated $117,098.

(7) An asset with a cost of $16,245 was deleted from the capital asset listing but not included in deletions on the GAAP package.

(8) Adjustments and deletions totaling $63,128 were incorrectly reported on the fiscal year 2007 GAAP package as capital asset and accumulated depreciation reductions. The net effect of the errors is zero, but both the cost and

accumulated depreciation amounts reported on the GAAP package are understated.

(c) Two assets included on the capital asset listing could not be located due to the asset being either discarded or traded-in during a previous fiscal year.

(d) A physical observation of capital assets has not been performed periodically by an employee having no responsibility for the assets.

Recommendation – The Iowa Judicial Branch should develop capital asset procedures to ensure a detailed, up-to date capital asset listing is maintained to support the amounts reported on the GAAP package. Procedures should include, but not be limited to, ensuring capital asset additions are included in the capital asset listing when acquired, deletions are promptly reported and removed from the capital asset listing, identified errors are corrected promptly, depreciation calculations are accurate and an observation of assets is performed periodically by an independent person.

Response – There appears to be data integrity issues with our capital asset data base. Because of the numerous errors noted we intend to redesign our system and develop an easier to maintain and reconcile capital asset system and listing.

Conclusion – Response accepted.

(4) **Iowa Department of Natural Resources**

(a) The Department performs a monthly reconciliation of capital asset additions to I/3 expenditures. However, the reconciliation is not reviewed by someone independent of the reconciliation process.

(b) The Department utilizes an Access database and the MEGA System to track capital asset activity. These systems cannot generate a listing of additions and deletions for financial statement reporting. Information is downloaded and additions and deletions are determined for financial reporting independently. A reconciliation is not performed between the tracking systems and information reported in the GAAP package for financial reporting. The following variances were noted:

(1) One land addition was reported as an addition on the GAAP package twice for $275,427.

(2) Three land additions were not reported as additions on the GAAP package for $521,724.

(3) Two buildings deleted during the fiscal year were not reported as deletions on the GAAP package for $505,384.

Recommendation – The Department should ensure a detailed, up-to-date capital asset listing is maintained and an independent review of the reconciliation is performed by accounting staff and a reconciliation between the Department's tracking system and amounts utilized on the GAAP package for financial reporting should be performed.

Response – The Department does maintain a detailed, up-to-date capital asset listing for all assets. All of the Department's capital assets (except for equipment) are currently tracked on a mainframe computer system, however this system does not allow us to quickly and easily pull out and report the detailed information required for the GAAP package (depreciation calculations and listings of assets meeting the reporting thresholds). Equipment capital assets are tracked on an MS Access database, but this database is currently not set up to track depreciation. This has made it difficult for us to report accurate and complete information while attempting to meet the GAAP package reporting deadline (prior to the actual close of the fiscal year). We are in the process of developing a new capital assets tracking system which will track depreciation and enable us to develop custom reports to more quickly and accurately produce the information required for the GAAP package. As a part of revising our system, we will rewrite our existing procedures to ensure that applicable reviews and reconciliations are performed.

Conclusion – Response accepted.

(5) **Iowa Department of Workforce Development**

(a) The Department did not reconcile capital asset additions to I/3 expenditures.

(b) Nine of nineteen capital asset expenditures tested were coded to an incorrect expenditure object code. Five of twenty-six capital asset additions tested were incorrectly coded to an expenditure object code for non-inventory assets.

(c) Two of ten capital assets observed at the Department had a value over the capitalization policy amount of $5,000 but were not on the Department's capital asset listing.

(d) Two of twenty-five capital assets tested for existence did not have the correct serial number recorded on the capital asset listing. Also, one asset did not have a state property tag affixed to it.

(e) During the site visits to two field offices, three of the sixteen capital assets selected for observation were not properly tagged with a state property tag.

Recommendation – The Department should review capital asset policies and procedures to ensure accurate and current records are maintained. This includes ensuring capital asset additions are reconciled to capital expenditures and all assets are properly accounted for, included on the capital asset listing and tagged with a state property tag.

Response – Iowa Workforce Development (IWD) will review asset policies and procedures, make any needed revisions and provide additional instructions and guidance to employees who are responsible for maintaining IWD capital asset records. In addition, steps will be implemented to ensure IWD capital asset records are reconciled with I/3 capital asset records.

Conclusion – Response accepted.

(B) Financial Reporting – Departments record receipts and disbursements on the I/3 system throughout the year, including the accrual period. Activity not recorded on the I/3 system is reported to the Iowa Department of Administrative Services – State Accounting Enterprise (DAS – SAE) on a GAAP package. Findings were noted for the following departments:

(1) **Iowa Department of Administrative Services**

(a) Proper accounting procedures should be followed when reclassifying revenue or reversing an expenditure transaction. The following items were noted:

(1) The Department recorded various revenues to an improper sub-organization. To correct this error, the Department recorded an expenditure to the improper sub-organization and a revenue to the correct sub-organization rather than adjusting revenues in both sub-organizations, overstating revenues and expenditures by $15,920,477. This item was properly adjusted for reporting purposes.

(2) The Department initially transferred an incorrect amount from one general fund to another. When correcting the error of $12,548,902, the Department recorded another transfer in rather than reversing the transfer out. Transfers in and out between general funds are eliminated for reporting purposes.

Recommendation – The Department should ensure proper accounting procedures are followed when reclassifying revenue or reversing an expenditure transaction.

Response – The Department has discussed with staff and re-emphasized the importance of proper revenue reclassifications and expenditure reversals.

Conclusion – Response accepted.

(b) Receipts and expenditures occurring near the end of the fiscal year are to be reviewed and recorded on I/3 as an accrual or coded to the following fiscal year.

(1) The Department coded deferred compensation payments of $1,780,015 relating to the pay period ended June 28, 2007 as fiscal year 2008 expenditures rather than an accrual for the year ended June 30, 2007.

(2) The Department also coded receipts of $436,553 from the Iowa Department of Transportation relating to the pay period ended June 28, 2007 as fiscal year 2008 revenues. The revenues related to deferred compensation, the state share of deferred compensation, dependent care, health care and the SLIP program.

Recommendation – The Department should develop procedures to ensure receipts and expenditures occurring near the end of the fiscal year are reviewed and properly recorded on I/3.

Response – The Department will review the procedures for coding to the proper fiscal year and take the appropriate actions to correct this issue for future fiscal years.

Conclusion – Response accepted.

(2) **Iowa Department of Commerce – Alcoholic Beverages Division (ABD)**

(a) ABD records revenues on I/3 and identifies the applicable fiscal year. Certain liquor sales and other revenues of $1,169,288 collected in June 2007 were inadvertently entered into I/3 as revenues for fiscal year 2008. This item was properly adjusted for reporting purposes.

(b) The GAAP package completed by ABD included accounts payable of $1,982,105 for liquor purchases. However, the amount should have been $653,183, which resulted in an overstatement of accounts payable and expenses of $1,328,922.

Recommendation – The GAAP package and financial statements should be accurately completed and reviewed by management prior to submission.

Response – ABD now has a manager dedicated to the Accounting section. Internal controls are now in place for management review of all financial statements. All financial statements will be more thoroughly reviewed for content and accuracy prior to release by the Accounting Manager.

Conclusion – Response accepted.

(3) **Iowa Judicial Branch**

The GAAP package includes accounts receivable and an allowance for uncollectible accounts for unpaid fines and other fees due to the State and payable at the Clerk of Court offices. The following items were noted:

(1) The calculations of the allowance for uncollectible accounts and the aging of receivables is based on percentages of actual collections during 2002. The percentages have not been updated to reflect current trends in actual collections.

(2) The GAAP package included an input error which resulted in understating the total and current portion of receivables and overstating the noncurrent portion of receivables by $2,409,700. This item was properly adjusted for reporting purposes.

Recommendation – The Iowa Judicial Branch should review and update the method used to estimate the allowance for uncollectible and aging of receivables. The estimate for uncollectible amounts should be based on averages over the past several years. The amounts reported, including the detailed calculations, should be reviewed by management for accuracy prior to submission of the GAAP package.

Response – We have already begun work to update our method used to estimate the allowance for uncollectible accounts and aging of receivables. We plan to have updated and accurate numbers for our next GAAP package submission.

Conclusion – Response accepted.

(4) **Iowa Department of Transportation**

The Department performs additional procedures after September 1 to identify additional accounts payables which were not included as expenditures on the I/3 system. At June 30, 2007, approximately $8.2 million were not reported to the DAS – SAE.

Recommendation – The Department should work with the Department of Administrative Services – State Accounting Enterprise (DAS – SAE) to report the additional accounts payable to DAS - SAE to be reported in the State's financial statements.

Response – The Department contacted DAS – SAE and discussed administrative procedures which will be used to submit additional payable information for inclusion in GAAP package. As payments are processed after the GAAP package has been submitted, those payments determined to be accruals of the reporting period will be communicated to DAS – SAE for inclusion in the State's financial statements.

Conclusion – Response accepted.

(5) **Iowa Department of Workforce Development**

(a) The balance of the Washington Trust Fund was inadvertently omitted from the Cash and Investments page of the GAAP package. This balance was identified and included by DAS - SAE.

(b) Revenues for fiscal year 2008 totaling $4,214,831 were not originally reported on the Unearned Revenue page of the GAAP package as required. A revision was submitted to DAS - SAE.

(c) Various smaller errors were also noted on other pages of the GAAP package.

Recommendation – The GAAP Package should be accurately completed and reviewed by management prior to submission.

Response – Now that IWD has been made aware of the reporting errors, management will ensure the report is carefully reviewed with the portions of the report that contained errors receiving extra scrutiny and review with the State Auditor's office prior to submission.

Conclusion – Response accepted.

(6) **Iowa Department of Education**

The Department performs additional procedures after September 1 to identify additional accounts payable which were not included as expenditures on the I/3 system. However, at June 30, 2007, there were approximately $7.4 million in requests for payments submitted by subrecipients which were not reported in the GAAP package to DAS-SAE.

Recommendation – The Department should obtain and process requests for payments from subrecipients more timely or the Department should consider estimating payables to more accurately report the payables at year end.

Response – The Department understands and agrees with the auditor's comment on the need for timely payment of claims to subrecipients. In FY08, the Department revamped its contract databases to track payables on contracts to better estimate and note unpaid claims. We are also researching additional methods to track grant and allocation payments to subrecipients in FY09.

Conclusion – Response accepted.

(C) Payroll

(1) **Iowa Department of Administrative Services**
Woodward Resource Center
Iowa Department of Natural Resources

Departments process and record payroll and personnel information on the Human Resource Information System (HRIS). The Human Resource Associates utilize an online P-1 document to initiate and approve payroll actions, such as adding new employees and recording pay raises. Individuals at the above entities have the ability to initiate and approve timesheets.

Recommendation – To strengthen controls, the Departments should develop and implement procedures to segregate the duties of the Human Resource Associates from the duties of payroll.

Responses –

Iowa Department of Administrative Services – DAS implemented procedures for fiscal year 2007 to review all P-1 transactions. This report is available for review in the office of the Accounts Payable Supervisor. The process has the Supervisor reviewing the P-1 transactions report and initials all transactions approved by the Human Resource Associates. This report is kept and filed by the Supervisor.

Woodward Resource Center – Woodward Resource Center has a process in place for P-1 documents which require more than one level of approval at the facility. The HR Associate will do one level of approval and the HR Administrative Assistant 2 will do the other level on the documents. On rare occasions these individuals may have to do both levels of facility approval. In these instances HR staff will add a comment to the P-1 document explaining why they had to do both levels. In should be noted that even when HR staff do both levels this does not automatically process the P-1. Both DAS-SAE Central Payroll staff and DAS – Human Resource Enterprise (HRE) staff review the P-1 and must each apply their level of approval before the P-1 will process.

Iowa Department of Natural Resources - The Department employs two Human Resource Associates in our payroll and personnel section. Because both of these employees must process and record payroll and personnel information and serve as each others' backup, it is not possible to completely segregate the duties of initiating and approving payroll actions on the HRIS system. We do plan to work with the Auditor of State's office to develop and implement alternative methods of strengthening controls in this area.

Conclusions –

Iowa Department of Administrative Services – Response accepted.

Woodward Resource Center – Response acknowledged. The Department should implement procedures to ensure no one individual at the Department can apply both approval levels.

Iowa Department of Natural Resources – Response accepted.

(2) **Iowa Department of Economic Development**

Timesheet approval – The Department's employee timesheets should be approved by an individual who does not have the authority to enter new employees into the payroll HRIS system. An individual at the Department has the ability to enter new employees into the HRIS payroll system, approve timesheets and approve pay rate changes.

Recommendation – The Department should develop and implement policies and procedures to segregate duties so the same individual does not enter information on the HRIS payroll system and approve timesheets and pay rate changes.

Response – Effective with the pay period ended February 7, 2008, both the Administrative Division Coordinator and Accountant 3 will approve timesheets on the HRIS payroll system. The Administrative Division Coordinator and Human Resource Associate will review the pre-final payroll register. This process will provide adequate segregation of duties for the timesheet approval process.

Conclusion – Response accepted.

(3) **Iowa Vocational Rehabilitation Services**

Segregation of Duties - Payroll Authorizations – Employee timesheets used for time and leave reporting require supervisor approval. Supervisors are responsible for overseeing the vacation and sick leave used is accurately posted to the employee's account and employees are only utilizing the amount of leave earned. In 14 of 40 instances tested, employee timesheets were approved by employees in non-supervisory positions.

Recommendation – The agency should review its policies and procedures regarding approval of timesheets and limit approval of timesheets to those individuals who are in supervisory positions.

Response – Iowa Vocational Rehabilitation Services acknowledges the issue and has directed supervisory staff to take responsibility for approving vacation, sick leave, and timesheets for employees.

Conclusion – Response accepted.