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AUDITOR GENERAL

October 30, 2015

To: Government Operations and Audit Committee

From: Bob Christianson

Subject: Separately issued audit reports

The following is a listing of the audits performed by the Department of Legislative Audit and the audit reports issued by the Department of Legislative Audit and by Independent Public Accountants through October 30, 2015. I have attached copies of all findings issued as a part of the audits. Once completed, the audit reports will be available on our website.

FINANCIAL STATEMENT AUDITS

Reports issued for Fiscal Year 2015 by the Department of Legislative Audit:

1. South Dakota Economic Development Finance Authority

Report covers: Audit of the Economic Development Finance Authority, a component unit of the State of South Dakota.
Opinion: Unmodified
Written findings: None

2. Governor's Office of Economic Development – REDI Fund

Report covers: Revolving Economic Development and Initiative Fund, an enterprise fund of the State of South Dakota.
Opinion: Unmodified
Written findings: None

3. South Dakota Investment Council

Report covers: Audit of certain portfolios managed by the Investment Council including: Cash Flow Portfolio, Dakota Cement Trust Portfolio, Education Enhancement Trust Portfolio, and, Health Care Trust Portfolio.
Opinion: Unmodified
Written findings: None

4. South Dakota Lottery

Report covers: South Dakota Lottery Fund, an enterprise fund of the State of South Dakota.
Opinion: Unmodified
Written findings: None

Note: The audit report will be contained in the 2015 annual report of the Lottery.

The following audits have been completed and the reports will be issued shortly:

5. South Dakota Building Authority

Report covers: Audit of the South Dakota Building Authority, a component unit of the State of South Dakota.
Opinion: Unmodified
Written findings: None

6. Education Enhancement Funding Corporation

Report covers: Audit of the Education Enhancement Funding Corporation, a component unit of the State of South Dakota.
Opinion: Unmodified
Written findings: None

7. Board of Water and Natural Resources - Clean Water State Revolving Fund

Report covers: Audit of the Clean Water State Revolving Fund, a fund of a component unit of the State of South Dakota.
Opinion: Unmodified
Written findings: None

8. Board of Water and Natural Resources - Drinking Water State Revolving Fund

Report covers: Audit of the Drinking Water State Revolving Fund, a fund of a component unit of the State of South Dakota.
Opinion: Unmodified
Written findings: None

Audits of financial statements that are in progress:

- South Dakota Comprehensive Annual Financial Report
- South Dakota Science and Technology Authority

AUDITS OF FEDERAL GRANTS

As a part of the FY2015 South Dakota Single Audit, the following federal grant programs are being audited by the Department of Legislative Audit, except as noted:

Department of Social Services

- Medicaid Cluster – *in progress*
- Low-Income Home Energy Assistance – *in progress*
- Child Care and Development Fund Cluster – *in progress*
- Supplemental Nutrition Assistance Program – *in progress*

Department of Labor

- Unemployment Insurance - *in progress* (Ketel Thorstenson audits the benefit payments)

Department of Transportation

- Highway Planning and Construction Cluster - *in progress*
- Federal Transit - Capital Investment Grants - *in progress*
- Formula Grants for Rural Areas - *in progress*
- Transit Services Programs Cluster - *in progress*

Department of Education

- Gaining Early Awareness and Readiness for Undergraduate Programs - *in progress*

Department of Public Safety

- Hazard Mitigation - *not started*

Department of Veterans Affairs

- Grants to States for Construction of State Home Facilities – *not started*
- Veterans State Domiciliary Care - *in progress*

Department of Environment and Natural Resources

- Capitalization Grants for Clean Water State Revolving Funds – *no audit findings*

Science and Technology Authority

- Lawrence Berkley National Lab contract - *in progress*

South Dakota Housing Development Authority (performed by Eide Bailly)

- Home Investment Partnerships Program - *no audit findings*

ADDITIONAL AUDITS PERFORMED

The following audits are being performed for Fiscal Year 2015 by Independent Public Accountants. The final reports will be available on our website.

1. South Dakota Housing Development Authority

Report covers: South Dakota Housing Development Authority, a component unit of the State of South Dakota.
IPA: Eide Bailly
Opinion: Unmodified – based upon draft approved
Written findings: None – based upon draft approved

2. South Dakota Department of Labor

Report covers: Unemployment Insurance Fund, an enterprise fund of the State of South Dakota.
IPA: Ketel Thorstenson, LLP
Opinion: Unmodified
Written findings: None

3. South Dakota Department of Agriculture

Report covers: Corn Check-Off Fund of the South Dakota Corn Utilization Council, a special revenue fund of the State of South Dakota.
IPA: Eide Bailly
Opinion: Not issued yet
Written findings:

4. South Dakota Department of Agriculture

Report covers: Soybean Research and Promotion Council, a special revenue fund of the State of South Dakota.
IPA: Eide Bailly
Opinion: Not issued yet
Written findings:

5. South Dakota Department of Revenue and Regulation

Report covers: South Dakota Real Estate Commission, an enterprise fund of the State of South Dakota
IPA: East, Vander Woude & Co., P.C.
Opinion: Not issued yet
Written findings:

6. South Dakota Ellsworth Development Authority

Report covers: South Dakota Ellsworth Development Authority, a component unit of the State of South Dakota.
IPA: Ketel Thorstenson, LLP
Opinions: Not issued yet
Written findings:

7. South Dakota Retirement System

Report covers: South Dakota Retirement System, a pension fund of the State of South Dakota, South Dakota Retirement System Supplemental Retirement Plan, and, South Dakota Retirement System Special Pay Plan
IPA: Eide Bailly
Opinions: Not issued yet
Written findings:

8. South Dakota Board of Directors for Educational Telecommunications

Report covers: South Dakota Board of Directors for Educational Telecommunications, an agency of the South Dakota Bureau of Information and Telecommunications
IPA: Quam and Berglin, P.C.
Opinions: Not issued yet
Written findings:

9. South Dakota Board of Dentistry

Report covers: Financial statements of the South Dakota Board of Dentistry, an enterprise fund of the State of South Dakota
IPA: Ronald G. Tedrow, CPA
Opinion: Not issued yet
Written findings:

10. South Dakota Health and Educational Facilities Authority

Report covers: Financial statements of the Health and Educational Facilities Authority
IPA: Eide Bailly
Opinion: Not issued yet
Written findings:

DEPARTMENT OF REVENUE

CURRENT AUDIT FINDINGS AND RECOMMENDATIONS

Financial Statement Audit Finding:

Finding No. 2015-001:

Internal controls were not adequate to ensure all financial institutions licensed by the South Dakota Division of Banking were submitting the required returns and payments to the Department of Revenue.

Type of Finding: Significant Deficiency

Analysis:

During fiscal year (FY) 2015, the Department of Revenue did not have effective controls to ensure the Bank Taxes collected and recorded were complete. The following errors were noted:

- The Department of Revenue (DOR) utilizes an internally developed Cedar computer system to record and track Bank Taxes. Financial institutions licensed by the Division of Banking (DOB) were not entered onto the Cedar system, and therefore not tracked for tax purposes.
 - For a sample of four months we performed a comparison between the financial institutions licensed by the DOB in those months and the taxpayers listed on the DOR's Cedar system. There were 30 new financial institutions on the DOB report, of which the following exceptions were noted on the Cedar system:
 - Thirteen financial institutions licensed by the DOB from the beginning of FY15 until April 30, 2015 were not entered onto the Cedar system.
 - Four institutions were entered onto the system only after a payment was received by the DOR.
 - Five institutions licensed by the DOB in November and December of 2014 were not recorded on the DOR's system until April 2015.
 - Eight of the financial institutions entered onto the Cedar system were not contacted to provide pertinent tax documentation or to verify the DOB's information.

As a result, the information on the DOR's Cedar system was not complete and financial institutions licensed in the State of South Dakota were not tracked to ensure their compliance with bank tax requirements and the submission of accurate and timely bank taxes.

RECOMMENDATION:

1. We recommend that controls be implemented to ensure that information being used by the DOR is complete and institutions licensed in the State of South Dakota are tracked to ensure taxes are being collected in an accurate and timely manner.

Auditee's Corrective Action Plan:

The Department of Revenue concurs with this finding and submits the following Corrective Action Plan.

The Bank Franchise Tax Specialist receives a list of newly licensed financial institutions from the Division of Banking, Department of Labor and Regulation, on a monthly basis. Upon receipt, the Bank Franchise Tax Specialist enters the basic information received onto the Cedar system and a letter is sent to the financial institution to verify the information provided by the Division of Banking and seeking additional pertinent information and documentation. The Bank Franchise Tax Specialist will also follow-up by other communication methods if they do not hear back from an institution within a reasonable timeframe.

The Bank Franchise Tax Specialist will request a comprehensive list of licensed financial institutions semi-annually to compare against the comprehensive Department of Revenue listing to identify any institutions previously missed.

DEPARTMENT OF REVENUE

CURRENT AUDIT FINDINGS AND RECOMMENDATIONS

Financial Statement Audit Finding:

Finding No. 2015-002:

Internal controls were not adequate to 1) ensure accuracy of the information provided by the International Fuel Tax Agreement (IFTA) Explore system and 2) ensure proper reporting of the State's revenue.

Type of Finding: Significant Deficiency

Analysis:

During FY15, the Department of Legislative Audit began receiving phone calls concerning IFTA account statements that were intended to be directed to the Department of Revenue (DOR). Upon further investigation, we determined that the phone calls concerned IFTA statements billing taxpayers trivial amounts and many of the taxpayers were displeased with the bills. Through review and inquiry it became apparent that the DOR was unaware that the Department of Legislative Audit's phone number had incorrectly been added to the statements or that statements of this nature were being sent to taxpayers. Also during this review we noted that the Explore system used by the DOR's IFTA staff did not provide crucial information on the fees being collected and that the staff utilizing the system were not sufficiently trained to identify how to effectively operate the system.

Due to turnover, inadequate training and a lack of oversight, the DOR did not have adequate controls in place to ensure the Explore system was providing accurate information or to ensure fees were proper. Also, a lack of formal policies and procedures increased the risk of errors. The following errors were noted:

- IFTA statements are to be sent out daily to taxpayers; however, during a time period of over a month these statements were not sent.
- There are no reports to identify if a taxpayer has submitted or failed to submit a return or to show inconsistencies in the amount due versus submitted to the State.
- Taxpayers were receiving statements of taxes due for under \$5 although there is an informal policy of not sending those statements.
- Multiple discrepancies were noted for amendments, interest and penalties on the IFTA statements and the lack of formal policies and procedures made it difficult to discern whether such penalties and interest were accurate and justified.
- We noted that staff is unaware of how to generate the appropriate Explore system reports to ensure revenue received is accurate and complete.

As a result, we were not able to verify the accuracy or completeness of the IFTA information provided by the DOR's Explore system. This increases the risk that revenues are not collected and recorded in the correct amount; that interest and penalties are improperly assessed, and that year-end receivables are improperly reported in the State's financial statements.

RECOMMENDATIONS:

1. We recommend that the DOR provide adequate supervision and training of personnel to ensure they are able to perform their duties accurately and consistently.
2. We recommend controls be implemented to ensure the information provided for IFTA fees and used on the State's financial statements is accurate and complete.
3. We recommend formal policies and procedures be developed that provide guidance on the duties to be performed by personnel responsible for IFTA accounts and billing statements.

Auditee's Corrective Action Plan:

The Department of Revenue concurs with this finding and submits the following Corrective Action Plan.

First, the Interstate Fuel Tax Agreement (IFTA) program is operated within the Division of Motor Vehicles. The IFTA team within the Division of Motor Vehicles will begin a process mapping initiative to document all processes within the IFTA program and review staff assignments to ensure the work is being completed timely and accurately. This documentation will be used to create policies and procedures manuals as well as training materials for employees.

Second, requests for program, form and statement modifications will now only be submitted to Explore by a supervisor to ensure those modifications are properly reviewed and approved before the modifications have been made.

To address the errors noted specifically:

- IFTA statements will be automatically generated quarterly by the Explore program. Statements are checked against each account to ensure accuracy before being mailed to the taxpayer.
- The Explore system does generate letters to non-filing taxpayers. Currently, this process is a manual process. IFTA staff members are working with system programmers to automate the Non-Filer Notices to be generated 15 days after the quarterly filing is due. We will also be working with Explore programmers to determine if there are other reports available to identify inconsistencies in the amount due versus what was submitted to the State.
- The Division of Motor Vehicles will formalize the policy of not sending statements of taxes due for under \$5. The Write-Off job in Explore will be automated to run on a weekly basis. The policy will be in writing and staff will be trained on the policy. Further, steps will be included in the process to ensure the policy is followed.
- The Explore system is accurately calculating penalties and interest. Penalties and interest are set by the International Fuel Tax Agreement program, not by the State of

South Dakota. We will formally document in our policy manual how penalties and interest are calculated. We will also be looking at the statements to determine if charges are clearly identified. A new policy has been enforced that all amendments must be reviewed by the Division Accountant.

- Because this area has recently experienced some staff turnover, the process mapping initiative and documentation will assist with properly training staff and assuring that they have a full understanding of the program responsibilities. Further, we are working with programmers of the Explore system to gain a better understanding of the system and the reports available for use to ensure that we are accurately operating the IFTA program within the State of South Dakota.