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**State of Maine
Report on Internal Control Over
Financial Reporting and on
Compliance and Other Matters**

**For the Year Ended
June 30, 2013**



**Office of the State Auditor
Pola A. Buckley, CPA, CISA
State Auditor**



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OFFICE OF THE STATE AUDITOR

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POLA A. BUCKLEY, CPA, CISA
STATE AUDITOR

TEL: (207) 624-6250
FAX: (207) 624-6273

MARY GINGROW-SHAW, CPA
DEPUTY STATE AUDITOR

MICHAEL J. POULIN, CIA
DIRECTOR OF AUDIT and ADMINISTRATION

LETTER OF TRANSMITTAL

Honorable Justin L. Alford
President of the Senate

Honorable Mark W. Eves
Speaker of the House

Honorable Paul R. LePage
Governor of the State of Maine

Honorable H. Sawin Millet, Jr.
Commissioner
Department of Administrative and Financial Services

We are pleased to submit our Report on Internal Control over Financial Reporting and on Compliance and Other Matters for the Year Ending June 30, 2013. In the course of our audit of the basic financial statements of the State of Maine, and our consideration of internal control, we identified a deficiency in internal control that we consider to be a significant deficiency according to Statement on Auditing Standard No. 115 (SAS 115) issued in October 2008 by the American Institute of Certified Public Accountants Auditing Standards Board effective for financial statement audits for periods ending on or after December 15, 2009. SAS 115 applies whenever an auditor expresses an opinion on financial statements. It establishes standards on communicating matters related to internal control over financial reporting and requires written communication of control deficiencies identified in an audit of financial statements within sixty days. Our opinion on the basic financial statements of the State of Maine was issued on December 23, 2013.

Please feel free to contact me with any questions that you may have. Like you, we are committed to improving our State Government for the benefit of our citizens. I welcome your thoughts and inquiries on these matters.

Respectfully submitted,

A handwritten signature in blue ink that reads "Pola A. Buckley".

Pola A. Buckley, CPA, CISA
State Auditor
February 21, 2014

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**INDEPENDENT AUDITORS' 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***

Honorable Justin L. Alford
President of the Senate

Honorable Mark W. Eves
Speaker of the House of Representatives

Honorable Paul R. LePage
Governor of the State of Maine

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Commissioner
Department of Administrative and Financial Services

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Maine, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the State of Maine's basic financial statements, and have issued our report thereon dated December 23, 2013. Our report includes a reference to other auditors who audited the financial statements of the following component units: Child Development Services, ConnectME Authority, Efficiency Maine Trust, Finance Authority of Maine, Loring Development Authority, Maine Community College System, Maine Educational Center for the Deaf and Hard of Hearing, Maine Educational Loan Authority, Maine Governmental Facilities Authority, Maine Health and Higher Educational Facilities Authority, Maine Maritime Academy, Maine Municipal Bond Bank, Maine Port Authority, Maine Public Employees Retirement System, Maine State Housing Authority, Maine Technology Institute, Maine Turnpike Authority, Midcoast Regional Redevelopment Authority, Northern New England Passenger Rail Authority, Small Enterprise Growth Fund, and the University of Maine System, as described in our report on the State of Maine's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the Maine Educational Loan Authority, the Maine Technology Institute, the Northern New England Passenger Rail Authority, and the Small Enterprise Growth Fund were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies that we consider to be material weaknesses. However, material weaknesses may exist that may not have been identified. We did identify a deficiency in internal control, described in the accompanying schedule of findings and responses that we consider to be a significant deficiency.

Compliance and Other Matters

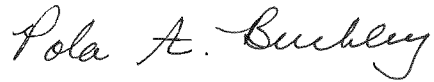
As part of obtaining reasonable assurance about whether the State of Maine's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

State of Maine's Response to Findings

The State of Maine's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The State of Maine's response was not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it.

Purpose of this Report

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

A handwritten signature in cursive script that reads "Pola A. Buckley".

Pola A. Buckley, CPA, CISA
State Auditor
Office of the State Auditor

Augusta, Maine
February 21, 2014

2013 Finding
Internal Control over Financial Reporting

Title: Accounting for the employer-funded unemployment insurance program needs to be improved

Prior Year Finding: 12-0308-01

State Department: Labor, Administrative and Financial Services

State Bureau: Unemployment Compensation, Security and Employment Service Center, Office of the State Controller

Type of Finding: Significant Deficiency

Criteria: Generally Accepted Accounting Principles

Condition: The Department of Labor, Bureau of Unemployment Compensation and the Department of Administrative and Financial Services did not have controls in place to ensure proper accounting and estimation procedures. For at least fourteen years, the same percentages and assumptions have been used to estimate the Allowance for Uncollectible Accounts without taking into account relevant collection experience and general economic conditions. In addition, the Restricted Deposits and Investments account was overstated by \$1.5 million and \$1.1 million for fiscal years ended June 30, 2013 and 2012, respectively.

Context: The Employment Security Enterprise Fund provides an accounting of assets and liabilities; and operating activity such as revenue from Maine's employers, State-funded payments to claimants, and interest income.

On June 30, 2013 and 2012, the U.S. Treasury held Maine's employer-funded unemployment contributions in the amount of \$279.3 and \$268.5 million, respectively. During fiscal year 2013 unemployment claims totaled \$169.3 million. Fiscal year 2012 unemployment claims totaled \$184.9 million. For fiscal year 2013 and 2012, the Allowance for Uncollectible Accounts of \$20.8 and \$19.2 million was calculated for receivables of \$61.9 and \$50.6 million.

Cause: Inadequate procedures to prevent, or detect and correct errors in the State's Employment Security accounting records and financial statements.

Effect: The financial statements for the Employment Security Enterprise Fund may not be accurate.

Recommendation: We recommend that personnel employed by the Bureau of Unemployment Compensation, the Security and Employment Service Center, and the Office of the State Controller combine their efforts to improve their procedures and scrutiny of accounting estimates.

Management's Response/Corrective Action Plan:

OSC is responsible for making the accounting estimates included in the financial statements. Estimates are based on subjective as well as objective factors and, as a result, judgment is required to estimate an amount at the date of the financial statements. OSC has a process for estimating the amount to be reserved for uncollectible receivables using an aging method, which is a common, acceptable method within the industry. We believe that this method is not overly sensitive to variations, is consistent with historical patterns and is not overly subjective or susceptible to bias. Using this method, OSC and Labor accumulate relevant, sufficient, and reliable data on which to base the estimate. Additionally, we believe that the estimate is presented in conformity with applicable accounting principles and that disclosure is adequate.

During the course of the 2012 audit, the Security and Employment Service Center (SESC) agreed with the audit finding regarding the overstatement of Restricted Deposits and Investments and altered its methodology for processing draws beginning in December 2012. Through an oversight, the errors for 2012 and the portion of 2013 that had been processed under the old methodology were not corrected. SESC has corrected that error by a journal processed December 23, 2013, and has added a step to the reconciliation process that includes comparing the General Ledger to the Advantage ME system.

Contact: *Heidi McDonald, Manager, Financial Reporting and Analysis, OSC, 626-8437
Patricia K. O'Brien, Deputy Bureau Director, Labor, 621-5161*

Auditor's Concluding Remarks: The reasonableness of the percentages applied to the aging of receivables in order to estimate the Allowance for Uncollectible Accounts is not based on fact or quantitative analysis. Subjectivity should not be the singular or overwhelmingly predominant factor that determines these percentages. We know that the Office of the State Controller (OSC), the Security and Employment Service Center (SESC), and the Department of Labor (DOL) do not have relevant, sufficient, and reliable data to substantiate the percentages used. We also know that quantitative support is not available that supports the conclusion that the collectability of unemployment receivables is not overly sensitive to variations.

We continue to recommend that OSC, the Security and Employment Service Center, and the DOL continue to improve their valuation method for financial statement purposes.