State of Nevada
Governor's Finance Office
Division of Internal Audits

Audit Report

Department of Administration Administrative Services Division Bond Management and Accounting

DIA Report No.
20-08 July 6, 2020

EXECUTIVE SUMMARY
Department of Administration
Administrative Services Division
Bond Management and Accounting

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Objective: Improve Bond Management and Accounting

Assist the State Public Works Division Improve the Precision of Bond Spending Forecasts .... page 2

Premature bonding increases costs incurred to the state due to imprecise and overstated Capital Improvement Program (CIP) bond spending forecasts. The Administrative Services Division does not evaluate the methodology underlying CIP bond spending forecasts. Assisting the State Public Works Division (SPWD) improve the precision of bond spending forecasts will help effectively manage the CIP, minimize costs to the state, and secure the public trust. Improving the precision of bond spending forecasts will benefit the state up to $6.8 million annually.

Imprecise and overstated SPWD and Administrative Services Division (ASD) bond spending forecasts are the primary cause of premature CIP bonding. Overstated SPWD/ASD forecasts resulted in unspent bond proceeds in excess of actual spending by an estimated $69.3 million annually for the two years reviewed in the bond cycle, as well as opportunity costs in unearned interest on state cash balances used for debt repayment. Premature bonding will continue to impact costs to the state unless forecasts are improved.

A new ASD position was created for improved CIP management and forecasts but ASD involvement in SPWD bond spending forecast activities are inadequate. ASD does not obtain documentation or review underlying methodology for reasonable assumptions, accurate calculations, or statistical soundness. ASD's involvement in spending forecast activities is key to forecast precision and reducing or eliminating premature bonding costs to the state. ASD expects to fully implement this recommendation by September 1, 2020.

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The state incurred an opportunity cost of $2 million as a result of an expired CIP project and related unspent federal funds. ASD did not perform a detailed analysis for all expiring 2015 CIP projects and funds as part of fiscal and advisory services provided to SPWD. Enhancing fiscal management and advisory services provided to SPWD will help improve agency functions and carry out agency responsibilities more effectively. Enhanced fiscal management and advisory services provided to SPWD could have benefited the state by $2 million in the current biennium.

SPWD did not fully spend federal project funds and did not pursue project reauthorization or funding reallocation for a Nevada Army National Guard (NVARNG) CIP project. ASD is responsible for assisting SPWD in ensuring project closing, reauthorization, and reallocation forecasts ultimately submitted to the Legislature are accurate. Other expiring 2015 CIP federal project funds were repurposed for NVARNG state operations.

The disposition of CIP projects and related funding at the end of a CIP four-year cycle is a key activity in CIP management and must include analysis of the benefits and detriments to the state for each decision affecting project status. As SPWD's fiscal service provider and financial advisor, ASD is responsible for assisting SPWD in CIP management across all funding sources, including planning, accounting for, measuring, and reporting financial and project-related measures and successes. ASD's involvement in CIP financial, budgetary, and planning processes is integral to CIP management overall and is required by statute. ASD expects to fully implement this recommendation by July 1, 2021.

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CIP program and financial accounting records are inaccurate due to nonconforming ASD accounting practices. ASD internal controls over accounting practices must be improved to ensure conformance. Ensuring accounting practices conform to accounting standards and federal and state requirements will: reduce the risk of management override of accounting controls and fraud; reduce the risk of financial statement misstatements; and help ensure accurate program and financial accounting records.

Nonconforming accounting practices increase the risk to the state for fraud and management override of accounting controls. ASD's nonconforming accounting practices are pervasive and include: departures from governmental GAAP; deviations from federal and state requirements; and improperly issued CIP project payments. These practices could result in: inaccurate program and funding source records; increased risks of fraud, management override of controls, and materially misstated financial statements; and violations of statute. State Accounting Procedures Law requires state agencies to conform to governmental GAAP, while federal and state requirements mandate compliance. ASD expects to fully implement this recommendation by July 1, 2020.

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INTRODUCTION

At the direction of the Executive Branch Audit Committee, the Division of Internal Audits conducted an audit of the Nevada Department of Administration, Administrative Services Division (ASD). Our audit focused on ASD bond management and accounting practices. The audit's scope and methodology, background, and acknowledgements are included in Appendix A.

Our audit objective was to develop recommendations to:

✓ Improve bond management and accounting.

Administrative Services Division Response and Implementation Plan

We provided draft copies of this report to ASD for review and comment. ASD's comments have been considered in the preparation of this report and are included in Appendix B. In its response, ASD accepted our recommendations. Appendix C includes a timetable to implement the recommendations.

NRS 353A.090 requires within six months after the final report is issued to the Executive Branch Audit Committee, the Administrator of the Division of Internal Audits shall evaluate the steps ASD has taken to implement the recommendations and shall determine whether the steps are achieving the desired results. The administrator shall report the six-month follow-up results to the committee and ASD.

The following report (DIA Report No. 20-08) contains our *findings, conclusions,* and *recommendations*.

Respectfully,

Warren Lowman
Administrator

Improve Bond Management and Accounting

The Nevada Department of Administration, Administrative Services Division (ASD) can improve bond management and accounting by:

- Assisting the State Public Works Division improve the precision of bond spending forecasts;
- Enhancing fiscal management and advisory services provided to the State Public Works Division; and
- Ensuring accounting practices conform with accounting standards and federal and state requirements.

Improving bond management and accounting will:

- Reduce costs to the state;
- Reduce the risk of management override of accounting controls and fraud;
- Reduce the risk of financial statement misstatements; and
- Help ensure accurate program and financial accounting records.

Improving the precision of bond spending forecasts will benefit Nevada up to $6.8 million annually. Enhanced fiscal management and advisory services provided to the State Public Works Division could have saved the state $2.0 million in the current biennium.

Assist SPWD Improve the Precision of Bond Spending Forecasts

The Administrative Services Division (ASD) should assist the State Public Works Division (SPWD) improve the precision of bond spending forecasts by evaluating underlying Capital Improvement Program (CIP) spending assumptions, calculations, and forecast methodology.[1,2] More precise bond spending forecasts will assist in effectively managing the CIP, minimizing costs to the state, and securing the public trust. Improving the precision of bond spending forecasts will benefit the state up to $6.8 million annually.

[1] The term “bonds” in this report is limited to State of Nevada general obligation bonds issued to finance various CIP projects.
[2] CIPs include SPWD statewide maintenance programs, as well as capital construction, advanced planning, design, and major maintenance projects valued at over $100,000.

Premature Bonding Results in Unnecessary Costs to the State

Imprecise and overstated bond spending forecasts caused the state to prematurely issue bonds. Prematurely issuing bonds increases costs to the state through unnecessary interest and principal payments paid to bondholders from the General Fund, Highway Fund, and other state sources. Additionally, there is an opportunity cost in unearned interest on state cash balances used for debt repayment on prematurely issued bonds. Exhibit I shows estimated annual costs incurred to the state across two periods in the CIP bond cycle as a result of premature bonding.[3]

Exhibit I

Premature Bonding Resulting in Unnecessary Costs Incurred to the State

Costs Incurred by Bond Period	2015 CIP	2017 CIP	Totals
11/1/2017 – 10/31/2018			
Principal and Interest Payments	$ 1,838,062	$ 6,592,222	$ 8,430,284
Lost Interest on Cash Balances	5,948	21,202	27,150
Subtotal, Period 1	$ 1,844,010	$ 6,613,424	$ 8,457,434
11/1/2018 – 10/31/2019			
Principal and Interest Payments	$ 1,682,931	3,382,045	5,064,976
Lost Interest on Cash Balances	6,298	10,465	16,763
Subtotal, Period 2	$ 1,689,229	$ 3,392,510	$ 5,081,739
Totals, Both Periods	$ 3,533,239	$ 10,005,934	$ 13,539,173
		Total Average Annual Costs	**$ 6,769,587**

Source: State of Nevada accounting records; CIP bond issue disclosures; biennial legislative bills authorizing CIP funding; State Treasurer's quarterly investment general portfolio reports; and estimates derived from DIA-calculated bond amortization schedules.

Notes: [a] 11/1/2017-10/31/2018 includes the third and first years of the 2015 and 2017 CIP bond cycles, respectively. The final 2015 CIP bond issue occurred within this year.
[b] 11/1/2018-10/31/2019 includes the fourth and second years of the 2015 and 2017 CIP bond cycles, respectively. The fourth year of the 2015 CIP bond cycle concluded 6/30/2019 at the end of the original legislatively authorized four-year CIP period.

SPWD/ASD Bond Spending Forecasts Overstated

CIP bond documentation and spending data for the 2015 and 2017 CIPs revealed SPWD/ASD bond spending forecasts were overstated.[4] Overstated forecasts resulted in unspent bond proceeds in excess of actual spending by an estimated $69.3 million annually. Exhibit II shows excess bond proceeds by bond cycle period.

[3] For purposes of analysis, a period in a CIP bond cycle is the period between each annual forecast date (November 1), which approximates the date of each bond issue in the cycle.
[4] SPWD/ASD provide bond spending forecasts to the State Treasurer's Office each calendar year for the period between the mid-year forecast report date and November 1 of the same year and the entire subsequent year.

Exhibit II

Excess Bond Proceeds by Bond Cycle Period

CIP	11/1/17 – 10/31/18[a]	11/1/18 – 10/31/19[a]	Totals
2015 CIP	$ 18,201,450	$ 10,137,726	$ 28,339,176
2017 CIP	53,301,680	56,870,606	110,172,286
Totals	**$ 71,503,130**	**$ 67,008,332**	**$ 138,511,462**
		Total Average Annual Excess Bond Proceeds	**$ 69,255,731**

Source: State of Nevada accounting records, CIP bond issue disclosures, and biennial legislative bills authorizing CIP funding.

Notes: [a] See Exhibit I, notes a and b regarding bond period parameters.
[b] DIA calculated annual excess bond proceeds for each bond cycle period as bond proceeds-to-date less cumulative spending-to-date at period-end. This calculates the amount of unspent bond proceeds remaining at period-end, or amount of bonds prematurely issued.

Records indicate the SPWD/ASD spending forecast for the fall 2018 bond issue included an arbitrary $20 million added to the forecast by the former Department of Administration Director and former ASD Administrator. ASD reported the $20 million was added to the forecast to cover spending through year-end to prevent the need for a General Fund loan to cover bond funding shortfalls within fiscal year 2018. The $20 million increase represented almost 30% of the $71.5 million spending forecast overstatement.

Precise Forecasts Are Necessary to Minimize Costs to the State

Precise bond spending forecasts are necessary to minimize costs to the state. ASD and SPWD collaborate to prepare and submit a CIP bond spending forecast to the State Treasurer's Office mid-year, each calendar year. The annual spending forecast is used to determine the dollar amount in new bonds SPWD/ASD will request the State Treasurer's Office issue in the fall of the same year.

Premature Bonding Will Continue to Impact Costs Unless Forecasts Are Improved

With the historical level of bond funding for CIPs, premature bonding will continue to impact costs to the state unless bond spending forecasts are improved. The bonding process was changed beginning with the 2015 CIP to reduce bond repayment costs and the potential for arbitrage penalties.[5] Bonds are no longer issued in the entire legislatively authorized bonding amounts at the beginning of a CIP. CIP bond issue amounts are now based on the SPWD/ASD bond spending forecasts submitted annually to the State Treasurer's Office. New bond proceeds are the principal funding mechanism for CIPs with more than half of total

[5] The previous bonding method created a situation where some CIP project bond proceeds remained unspent for extended periods of time, resulting in federal arbitrage penalties levied against the state for earning interest in excess of interest paid on bonds.

authorized CIP funding since 2011 derived from bond proceeds.[6] Exhibit III shows legislative funding authorizations for each of the last five CIPs.

Exhibit III

Legislative Funding Authorizations 2011-2019 CIPs

CIP Year	Newly Issued Bonds	General Fund & Reallocated Bonds	State Highway Fund	Other Funding[a]	Total Authorized Funding
2011	$ 27,133,179	$ 14,279,016	$ 2,413,578	$ 9,348,320	$ 53,174,093
2013	55,505,257	31,389,261	7,370,471	8,414,175	102,679,164
2015	121,450,650	11,962,979	5,162,832	76,770,171	215,346,632
2017	201,428,802	90,304,070	4,346,066	111,520,420	407,599,358
2019	191,344,346	84,874,862	8,841,972	61,948,869	347,010,049
Totals	**$ 596,862,234**	**$ 232,810,188**	**$ 28,134,919**	**$ 268,001,955**	**$ 1,125,809,296**

Source: Biennial legislative bills authorizing CIP funding.
Note: [a] Other Funding includes federal funds, agency funds, and other funding sources.

Bond principal and interest payments are funded by state sources designated by the Legislature. Consequently, these state funding sources are also impacted by premature bonding. The Legislature has authorized bond principal and interest payments from the following state funding sources: the annual tax on slot machines; the Pollution Control Account of the General Fund; the Highway Fund; and ad valorem tax revenue. These funding sources will continue to be negatively impacted without more precise bond spending forecasts.

New ASD Position Created for Improved CIP Management and Forecasts

A new ASD management analyst position was authorized by the Legislature during the 2019 legislative session to help improve CIP management and forecasts. This position is also responsible for oversight of CIP project accounting, reporting, and other CIP related duties. Members of the Legislature expressed concerns in public budget hearings regarding over-bonding and unnecessarily incurred interest. The Director of the Department of Administration at the time responded to the concern by stating, "This process will always be imprecise, and the SPWD needs to do a better job in project-cash flow forecasting. We hope the new [ASD] management analyst position can aid in this process…"[7] However, it appears ASD did not adequately aid SPWD in the forecasting process prior to the creation of the management analyst position.

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[6] The Legislature specifies funding sources allocated to each CIP project, including: General Fund appropriations; bonds; bond proceeds reallocations; federal funds; agency funds; and other sources.

[7] Nevada State Legislature, minutes of the joint meeting of the Senate Committee on Finance and the Assembly Committee on Ways and Means Subcommittees on K-12/Higher Education/CIP, February 14, 2019, p. 9, https://www.leg.state.nv.us/Session/80th2019/Minutes/Senate/FIN/Final/260.pdf.

ASD Involvement in SPWD
Bond Spending Forecast Activities Inadequate

Previous ASD involvement in SPWD bond spending forecast activities were inadequate. Discussions with ASD management revealed ASD did not obtain documentation or review underlying methodology for reasonable assumptions, accurate calculations, or statistical soundness. Significantly overstated SPWD/ASD spending forecasts resulted in increased costs to the state. Moreover, recent bond accounting transactions show spending for 2019 CIP projects was recorded against 2017 CIP bond proceeds, indicating ASD does not adequately review bond accounting documentation for accuracy.

ASD's Involvement in Spending Forecast Activities
Key to Forecast Precision

ASD's involvement in SPWD spending forecast activities is key to forecast precision and reducing or eliminating premature bonding costs to the state. The ASD management analyst position was created to aid SPWD with improving bond spending forecasts and to oversee other CIP-related fiscal duties. Going forward, ASD must be more actively involved in CIP fiscal management.

CIP Management Involves a Public Trust

The Legislature recognized the magnitude of spending involved in public works and CIPs, declaring "…the planning, maintenance, and construction of public buildings…involves a large amount of public money which, whatever their particular constitutional, statutory or governmental source, involve a public trust."[8] Each legislative session, the state Legislature authorizes CIP spending for the improvement of buildings and other structures on state property and vests its management, and therefore the public trust, to SPWD. The SPWD function that has the greatest impact on state operations, costs to the state, and safeguarding of the public trust is its responsibility for CIP management. Accordingly, ASD also carries this responsibility as the fiscal advisor to SPWD.

[8] NRS 341.1405(1).

Conclusion

Imprecise and overstated SPWD/ASD bond spending forecasts are the primary cause of premature bonding for Capital Improvement Programs (CIPs). Premature bonding increases costs incurred to the state through unnecessary principal and interest bond payments, as well as opportunity costs in unearned interest on state cash balances used for debt repayment on prematurely issued bonds. Management of CIP spending is a public trust vested in both SPWD and ASD. Assisting SPWD improve the precision of bond spending forecasts by evaluating underlying CIP spending assumptions, calculations, and forecasting methodology will reduce costs to the state up to $6.8 million annually.

Recommendation

1. Assist the State Public Works Division improve the precision of bond spending forecasts.

Enhance Fiscal Management and Advisory Services Provided to SPWD

The Administrative Services Division (ASD) should enhance fiscal management and advisory services provided to the State Public Works Division (SPWD) to help improve agency functions and carry out their responsibilities more effectively. Enhanced fiscal management and advisory services provided to SPWD could have saved the state $2 million in the current biennium.

SPWD Did Not Fully Spend Project Funds or Pursue Reauthorization

Review of Capital Improvement Program (CIP) accounting records indicate SPWD did not fully spend federal project funds and did not pursue project reauthorization or funding reallocation. For example, one project expired per legislative mandate on June 30, 2019. Federal funds authorized for the project expired unspent on September 30, 2019 at the end of the federal award period. The expired project and unspent federal funds resulted in an opportunity cost of $2 million because these dollars could have been reallocated for other purposes to benefit the state.

CIP project 15-C79 was authorized by the Legislature during the 2015 legislative session to construct a new Nevada Army National Guard (NVARNG) facility maintenance shop at the Washoe County Armory. Exhibit IV shows legislatively authorized funding sources and spending for project 15-C79.

Exhibit IV

Legislatively Authorized Funding Sources and Spending
Project 15-C79

Funding Source	Amount Authorized	Amount Spent	Unspent Amount
Federal Funding	$ 8,692,000	$ 6,703,329	$ 1,988,671
General Obligation Bonds	200,000	173,791	26,209[a]
Totals	**$ 8,892,000**	**$ 6,877,120**	**$ 2,014,880**

Source: Source: State of Nevada accounting records and the Nevada Project Accounting System.
Note: [a] Unspent bond proceeds transferred back to bond custodial accounts on May 14, 2019 for reallocation to other CIP projects.

ASD Collaborates with SPWD to Prepare
CIP Funding Allocation Requests to the Legislature

ASD collaborates with SPWD to prepare CIP funding allocation requests to its board, the Governor, and the Legislature. Funding allocation planning involves SPWD calculating:

- New CIP project estimates;
- Final spending forecasts to close completed projects;
- Reallocations or reversions for unspent project funding; or
- Spending forecasts for project and funding reauthorizations.

ASD is responsible for assisting SPWD in ensuring calculations for project closings and reallocations, reversions, or reauthorizations are accurate for submission to the Governor, the Legislative Counsel Bureau, and ultimately the Legislature. However, discussions with ASD management disclosed ASD did not perform a detailed analysis for all expiring 2015 CIP projects and funds. If a detailed analysis had been performed, ASD could have worked with SPWD to ensure project 15-C79 was either reauthorized and federal funds extended or federal funds were reallocated at project closure.

Other Expiring 2015 CIP Federal
Project Funds Were Repurposed

Other expiring 2015 CIP federal project funds were repurposed for NVARNG state operations going forward. ASD management did not have records and could not provide an explanation for why all available federal funding was not spent or why project reauthorization or funding reallocation were not pursued. The ultimate disposition of CIP projects and related funding at the end of a CIP four-year cycle is a key activity in CIP management and must include analysis of the benefits and detriments to the state for each decision affecting project status.

ASD Is Integral to CIP Management

ASD's involvement in CIP financial, budgetary, and planning processes is integral to CIP management overall. ASD is responsible for providing centralized fiscal and administrative support services to the divisions of the Department of Administration and other state agencies.[9] These services include: accounting; developing, adjusting, and maintaining budgets; managing grants; developing rates; handling federal reporting and forecasts; analyzing work flow; measuring and reporting statistics; and assisting client agencies to comply with legislative intent to efficiently execute their business plans.

[9] NRS 232.219, NRS 232.2195.

As SPWD's fiscal service provider and financial advisor, ASD is responsible for assisting SPWD in CIP management across all funding sources, including planning, accounting for, measuring, and reporting financial and project-related measures and successes.

NRS Requires ASD to Furnish Fiscal Services and Advice to SPWD

NRS 232.2195 requires the Administrative Services Division to furnish fiscal and accounting services to the Director and each division of the Department of Administration, as well as the Governor's Finance Office. Additionally, ASD must also advise and assist these agencies in carrying out their functions and responsibilities. ASD's involvement in CIP financial, budgetary, and planning processes are a key component to provision of services required by statute.

Conclusion

SPWD did not fully spend federal project funds and did not pursue project reauthorization or funding reallocation, resulting in an opportunity cost to the state of $2 million. ASD is responsible for assisting SPWD in ensuring project closing, reauthorization, and reallocation forecasts are accurate. However, ASD did not perform a detailed analysis for all expiring 2015 CIP projects and funds. If a detailed analysis had been performed, ASD could have worked with SPWD to ensure project reauthorization and funding extension or reallocation. ASD's involvement in CIP financial, budgetary, and planning processes is integral to CIP management overall and is required by statute. Enhancing fiscal management and advisory services provided to SPWD will help improve agency functions and carry out their responsibilities more effectively. Enhanced fiscal management and advisory services provided to SPWD could have benefited the state by $2 million in the current biennium.

Recommendation

2. Enhance fiscal management and advisory services provided to the State Public Works Division.

Ensure Accounting Practices Conform to Accounting Standards and Federal and State Requirements

The Administrative Services Division (ASD) should ensure accounting practices conform to accounting standards and federal and state requirements. Ensuring accounting practices conform to accounting standards and federal and state requirements will: reduce the risk of management override of accounting controls and fraud; reduce the risk of financial statement misstatements; and help ensure accurate program and financial accounting records.

Nonconforming Accounting Practices Increase Risks to the State

Nonconforming accounting practices increase the risk of fraud and management override of accounting controls. Review of ASD Capital Improvement Program (CIP) project accounting records and supporting documentation for fiscal years 2018 and 2019 revealed the following issues:

- Some ASD accounting practices depart from governmental generally accepted accounting principles (GAAP);
- Some ASD fiscal activities deviate from federal and state requirements; and
- ASD improperly issued CIP project payments.

Testing indicates pervasive nonconforming accounting practices, which could result in inaccurate program and financial accounting records. Inaccurate program and financial accounting records increase the risk of materially misstated financial statements.

<u>ASD's Nonconforming Accounting Practices Are Pervasive</u>

ASD's nonconforming accounting practices are pervasive. For the period reviewed, 150 of 6,005 transactions were judgmentally selected for testing.[10] Data tested from fiscal years 2018 and 2019 resulted in 33 exceptions involving 77 of the 150 (51%) transactions tested and affected 12 funding source codes.[11]

None of the exceptions appeared to materially affect actual fund balances for the periods reviewed; however, there were substantial impacts to accounting records when reviewed on a project or funding source basis. Pervasive nonconforming accounting practices could result in errors that materially impact future state financial statements and federal program reporting. Exhibit V shows fiscal year 2018 and 2019 accounting transaction testing results for departures from

[10] Transactions included in the population were recorded beginning fiscal year 2017 through April 15, 2020, the end of fieldwork.

[11] Funding source codes associate revenues/inflows and expenditures/outflows with a specific funding source, identified as "Job Number" in the state's accounting system.

governmental GAAP, deviations from federal and state requirements, and a combination of both.

Exhibit V

Departures from Governmental GAAP and Deviations from State Policies/Procedures Fiscal Years 2018 and 2019

Testing Attribute	Departure from GAAP	Deviation from State P&P	Combination of Exceptions	Totals
# of Exceptions	15	15	3	33
# of Transactions Involved	21	39	17	77
Federal Program Advances	$ -	$ 6,497,957	$ 3,519,695	$ 10,017,652
Revenue/Inflow Errors[a]	2,052,701	-	2,902,268	4,954,969
Expenditure/Outflow Errors[a]	3,146,149	-	2,275	3,148,424
Totals	$ 5,198,850	$ 6,497,957	$ 6,424,238	$ 18,121,045

Source: State of Nevada accounting records, Nevada Project Accounting System, and supporting documentation.

Notes: [a] Revenue/Inflow and Expenditure/Outflow errors do not materially affect prior and current year fund balances. Totals reflect the effects of the errors when evaluating accounting data on an aggregated project or funding source basis.

Some ASD Accounting Practices Depart from Governmental GAAP

Some ASD accounting practices depart from governmental GAAP. Testing indicated prior and current year fund balances were not materially affected because most transactions occurred within the same fund. However, project and funding source data was significantly impacted, including for bond and federally funded projects. ASD corrected prior year accounting and coding errors using current year activity accounts, when balance sheet accounts should have been used.[12] Likewise, ASD staff applied coding to uncoded cash transfers using revenue accounts, not balance sheet accounts. Consequently, project and funding source records in both the prior and current years are inaccurate.

ASD management confirmed staff use current year activity accounts to make accounting and coding corrections, regardless of transaction type or associated fiscal period. In addition, some accounting errors remained uncorrected, such as significant incoming federal funds never coded to the federal funding source. This transaction when combined with an improperly recorded cash transfer resulted in a $941,000 understatement of federal revenues reported to the State Controller for the affected federal program.

[12] Activity accounts refer to nominal (temporary) general ledger accounts that are closed to a zero balance at the end of each fiscal year and are reported in the statement of activities and the statement of revenues, expenditures, and changes in fund balance. Activity accounts are not balance sheet accounts, such as cash or capital asset accounts.

Departures from Governmental GAAP
Increase Risk of Financial Statement Misstatements

Departures from governmental GAAP increase the risk of financial statement misstatements and inaccurate financial accounting records. The risk is especially high if departures affect interfund transactions. Current ASD accounting practices do not ensure revenues and expenditures are recognized in appropriate accounting periods because current year activity accounts are used to record prior year activity and cash balance corrections.

Governmental GAAP requires prior period corrections affecting an entity's financial statements to be reported as a prior period adjustment and disclosed.[13] Additionally, governmental GAAP states "The budget, the accounts, and the financial reports are inseparable elements of the financial administration process. Terminology and classification consistency among them is essential to achieving viable accounting systems and comparable, unambiguous financial reporting."[14]

State Accounting Procedures Law
Requires Governmental GAAP

NRS 353 codifies the Nevada State Accounting Procedures Law (SAPL), which requires governmental GAAP to be applied in accounting procedures and reporting of the state's financial position and results of operations in each fiscal period for each fund and account group.[15] The state's accounting system is defined as "the total structure of records and procedures which discover, record, classify, summarize and report information on the financial position and results of operations of the State's funds, account groups and organizational components."[16] As a result, Executive Branch agencies are subject to SAPL and must conform to governmental GAAP.

SAPL also defines capital projects funds as governmental funds and requires the modified accrual basis of accounting to be applied.[17] SAPL mandates that modified accrual accounting requires revenues to be recognized in the accounting period in which they become available and measurable; expenditures must be recognized in the accounting period in which the liability of the fund is incurred, if measurable.[18]

[13] GASB Codification 2250.151-.152. Only material adjustments would be recorded and reported.
[14] GASB Codification, Section 1700.124.
[15] NRS 353.3076; NRS 353.3245(1).
[16] NRS 353.2965.
[17] NRS 353.323.
[18] NRS 353.3241(1)-(2). Applies equally to other types of inflows and outflows.

Federal Regulation Requires Accounting to Conform with State Laws and Procedures

Federal regulation requires states to expend and account for federal award expenditures in accordance with the same state laws and procedures used for the state's own funds. Additionally, the state's financial management system must provide for accurate, current, and complete disclosure of the financial results of each federal award or program in accordance with federal reporting requirements. Records must be sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have been used according to federal statutes, regulations, and the terms and conditions of the federal award.[19] Therefore, accounting for federally-funded CIP projects must also conform to state accounting requirements.

Some ASD Fiscal Activities Deviate from Federal and State Requirements

Some ASD fiscal activities deviate from federal and state requirements, including policies, procedures, and internal controls. Deviations include: improperly handling a $4.9 million higher education CIP project mispayment; misinterpreting federal funding procedures; and ASD procedures do not require supervisory review and approval of bond draw requests. Deviation from federal and state requirements constitutes management override of controls and increases the risk of fraud to the state. Review of ASD project accounting records indicate that controls over fiscal activities could be improved.

ASD Mishandled A $4.9 Million Higher Education CIP Project Mispayment

ASD mishandled a $4.9 million higher education CIP project mispayment. Records indicate the mispayment went unnoticed by ASD until the requesting university contacted ASD to advise the payment had been issued to another higher education payee. The university advised ASD it would work directly with the other payee to obtain the funds. ASD did not intervene to recover the funds and reissue payment directly to the university. Consequently, state accounting records reflect a large payment to an entity that was not the intended or ultimate payee. Moreover, state vendor payment records are incorrectly stated.

The Accounting Policies and Procedures manual issued by the State Controller's Office requires a warrant cancellation request form to be submitted to the Office for an incorrect payment amount or incorrect payee. If the error had been discovered within a few days of recording the payment voucher, ASD could have submitted the form and requested a hold to be placed on electronic payment until payee corrections were made. Once electronic payment is issued, a request to reverse the payment may be submitted to the State Treasurer's Office. The

[19] 2 CFR 200.302.

reversal would then be processed through both the State Treasurer's and State Controller's Offices.

ASD Misinterpreted
Federal Funding Procedures

ASD misinterpreted federal funding procedures for a CIP project active in the period audited. The federal cooperative agreement for the program requires payment to the state on a reimbursement basis, not through program advances. However, both ASD and the state recipient agency were unaware requests for reimbursement submitted to the federal cognizant agency should be based on actual issued payments instead of pending unpaid invoices. As a result, the state received a majority of federal funds for the project in advance of actual expenditure in violation of the federal cooperative agreement.[20] Federal regulation requires the state to comply with all requirements of the federal award.[21]

ASD Procedures Do Not Require
Supervisory Review and Approval

ASD procedures do not require supervisory review and approval of bond draw requests prepared in part by the management analyst. The ASD management analyst position was created to help improve CIP spending forecasts and oversee CIP project accounting, reporting, and other CIP related duties. Review of ASD written internal procedures indicates the management analyst prepares and approves the entire Journal Voucher Document (JVD) and part of the supporting documentation submitted to the State Treasurer's Office to request bond funding transfers to the capital project budget accounts. According to written procedures, no ASD staff other than the management analyst reviews the JVD or the supporting documentation prior to request submission.

Lack of supervisory review and approval of transactions increases the risk of management override of controls and the potential for significant errors to go undetected. The state's Self-Assessment Questionnaire (SAQ) documents the minimum required written internal controls state agencies must have in place for agency operations.[22] The SAQ requires agencies to have written controls in place to ensure staff: select appropriate accounting policies; properly apply accounting principles; disclose important information; and accurately prepare information. The SAQ requires controls over authorization of transactions to be established at an appropriate level. Therefore, transactions must be reviewed by someone other than the preparer who has supervisory and approval authority. Supervisory review and approval for all transactions reduces the risk of management override of controls and undetected errors.

[20] 2 CFR 200.3 defines an advance payment as a payment made before the non-federal entity disburses the funds for program purposes.
[21] 2 CFR 200.303(b).
[22] NRS 353A.020; State Administrative Manual, Section 2416.

ASD Improperly Issued CIP Project Payments

ASD improperly issued CIP project payments from incorrect funding sources in fiscal years 2018 and 2019 for project 17-M01, Nevada System of Higher Education (NSHE) Deferred Maintenance. All 17-M01 project payments issued in fiscal year 2018 and almost half of all payments made in fiscal year 2019 were issued from incorrect funding sources. Exhibit VI shows improperly issued NSHE CIP project payments by fiscal year and by funding source.

Exhibit VI

Improperly Issued NSHE CIP Project Payments
Fiscal Years 2018 and 2019

Testing Attribute	Fiscal Year 2018	Fiscal Year 2019	Totals
Total Payments Issued	12	8	20
Number of Improperly Issued Payments	12	5	17
Total Project Payments in the Fiscal Year	$ 2,931,216	$ 10,534,735	$ 13,465,951
Improper Payments, Bond Funding	2,931,216	907,055	3,838,271
Improper Payments, General Fund	-	4,005,325	4,005,325
Total Improper Payments	$ 2,931,216	$ 4,912,380	$ 7,843,596
Percent of Total Payments Made	100.0%	46.6%	58.3%

Source: State of Nevada accounting records, Nevada Project Accounting System, and supporting documentation.

<u>Issuing CIP Payments from Incorrect Funding Sources Violates Statute</u>

Issuing CIP payments from incorrect funding sources violates statute. NRS 341.146(3) requires money received by the State Public Works Division for a capital improvement project funded by more than one source to be expended in the following order:

1. Money received from the federal government;
2. Agency generated money;
3. Reallocated money from the same or other project;
4. Money received from any other source;
5. Money from the issuance of general obligation bonds;
6. Money from the State Highway Fund; and
7. Money from the State General Fund.

Issuing payments from incorrect funding sources affects funding source budgets, may skew spending forecasts, and increases costs to the state. For example, if bonds are issued prematurely, the costs of bond principal and interest payments incur unnecessary costs to the state.[23] Review of legislative hearing records indicate legislative intent for this section of statute was to preserve the integrity of the State Highway Fund and the State General Fund and to "…provide a better administrative framework to guarantee that the taxpayers' money is spent wisely and effectively on important public works projects."[24]

Conclusion

ASD accounting practices do not conform to accounting standards or federal and state requirements resulting in violations of statute and millions of dollars in errors affecting project and funding source data. Nonconforming accounting practices include departures from governmental GAAP, potential management override of controls, and improperly issued CIP project payments. Pervasive nonconforming accounting practices can result in inaccurate program and financial accounting records. Inaccurate program and financial accounting records increase the risk of materially misstated financial statements. Controls over ASD accounting practices could be improved. Ensuring accounting practices conform to accounting standards and federal and state requirements will: reduce the risk of management override of accounting controls and fraud; reduce the risk of financial statement misstatements; and help ensure accurate program and financial accounting records.

Recommendation

3. Ensure accounting practices conform to accounting standards and federal and state requirements.

[23] See Recommendation 1 for evaluation of unnecessary costs incurred to the state as a result of premature bonding.
[24] Nevada State Legislature, minutes of the meeting of the Senate Committee on Government Affairs, April 2, 2007, p. 14 and Exhibit F, https://www.leg.state.nv.us/Session/74th2007/Minutes/Senate/GA/Final/828.pdf.

Exhibit VII

Summary of Audit Benefits

	Recommendation	Benefit
1.	Assist the State Public Works Division improve the precision of bond spending forecasts.	$ 6.8 million
2.	Enhance fiscal management and advisory services provided to the State Public Works Division.	$ 2.0 million
3.	Ensure accounting practices conform with accounting standards and federal and state requirements.	Effective, accurate, and proper accounting for federal and state funds and programs.
	Total estimated benefit:	$ 8.8 million

Appendix A

Scope and Methodology, Background, Acknowledgements

Scope and Methodology

We began the audit in October 2019. In the course of our work, we interviewed members of management from the Administrative Services Division (ASD) and the State Treasurer's Office to discuss processes inherent to bond management and accounting. We reviewed ASD records and researched legislative history, Nevada State Treasurer procedures, Nevada State Controller procedures, applicable Nevada Revised Statutes, State Administrative Manual, governmental generally accepted accounting principles, and other state and federal guidelines. We concluded fieldwork in April 2020.

We conducted our audit in conformance with the *International Standards for the Professional Practice of Internal Auditing.*

Background

The Administrative Services Division (ASD) is one of 11 divisions organized under the Department of Administration (DofA) that give internal support to state agencies and employees, provide business opportunities for vendors and contractors, and offer services for citizens. ASD's mission is to provide efficient, cost-effective fiscal and administrative support services to the DofA divisions and other state agencies. Principal services include accounts payable, payroll, revenue collection, financial reporting, budgeting, contract administration, and management analysis. ASD is organized into five functional areas of service: Contracts; Accounting; Budget; Training; and Rate Support. ASD seeks to provide collaborative organizational assistance to support each client agency's unique mission.

ASD is funded mostly by internal service assessments allocated to client agencies and less than 1% by the state General Fund. ASD's budgeted revenues for fiscal year 2018 and 2019 were $3.3 million and $3.4 million respectively.

Acknowledgments

We express appreciation to the Department of Administration, Administrative Services Division management and staff, the Governor's Finance Office, Budget Division, the State Treasurer's Office, and the State Controller's Office for their cooperation and assistance throughout the audit.

Contributors to this report included:

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Appendix B

Nevada Department of Administration
Administrative Services Division
Response and Implementation Plan

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To: Warren Lowman, Administrator, Division of Internal Audits

From: Matthew Tuma, Administrator, Administrative Services Division

Date: June 3, 2020

Re: Response to DIA Audit Report No. 20-08 Bond Management

Thank you for the Administrative Services Division (ASD) Bond Management and accounting practices audit report. ASD commends the professional demeanor of your staff throughout the audit process and appreciate the opportunity to respond to recommendations made in the report.

- **Recommendation 1:** ***Assist the State Public Works Division to improve the precision of bond spending forecasts.***

ASD agrees with the audit recommendation and we look forward to refining our processes to improve the precision of bond spending forecasts. The Division would like to clarify that no funding was ever added to the bond spending forecast to prevent the need for a General Fund Loan and believe that a note in the backup provided might have been misinterpreted. However, ASD agrees that broadening our evaluation activities regarding State Public Works Division (SPWD) spending assumptions, calculations and forecast methodology will enable both agencies to understand funding needs in greater detail. This more detailed knowledge should enable both agencies to fine-tune projections in order to reduce prospective overstatements regarding bonding needs. ASD also intends to implement retrospective forecast reviews in order to provide a tool for both agencies to understand why projections are imprecise and to create a tool for continual process improvement and analysis, as well as greater accountability. ASD plans to implement this recommendation as requests for FY 2021 bond sales are prepared.

- **Recommendation 2:** ***Enhance fiscal management and advisory services provided to the State Public Works Division.***

ASD agrees with this recommendation and we look forward to assisting SPWD to fulfill legislative intent regarding business plans related to the Capital Improvement Program. This would involve ASD's participation in every phase of the CIP process, including budgetary and planning processes as well as performance of detailed analysis of projects during implementation and at the conclusion of construction. ASD will actively work to formalize and document fiscal analysis related to expiration, extension and reallocation of projects. ASD plans to implement this recommendation as requests are prepared for the 2021 Legislative Session and projects authorized in the 2019 Legislative Session are updated.

- **Recommendation 3:** ***Ensure Accounting Practices Conform to Accounting Standards and Federal and State Requirements.***

ASD understands and accepts the audit recommendation. The Division is currently in the process of documenting accounting procedures to eliminate knowledge gaps that staffing changes may have created. ASD also acknowledges the need for augmented secondary reviews of accounting entries and staff education regarding federal and state accounting standards and is exploring ways to mechanize reconciliation practices in order to partially eliminate the opportunity for human error. ASD plans to implement this recommendation immediately as transactions are approved with a fully staffed CIP team.

Again, ASD staff wishes to thank the DIA for their diligent work to understand our current practices and suggest areas of improvement. We look forward to reporting our success in that regard as we move forward.

Appendix C

Timetable for Implementing Audit Recommendations

In consultation with the Nevada Department of Administration, Administrative Services Division (ASD), the Division of Internal Audits categorized the recommendations contained within this report into two separate implementation time frames (i.e., *Category 1* – less than six months; *Category 2* – more than six months). ASD should begin taking steps to implement all recommendations as soon as possible. The target completion dates are incorporated from Appendix B.

Category 1: Recommendations with an anticipated implementation period less than six months.

	Recommendation	Time Frame
1.	Assist the State Public Works Division improve the precision of bond spending forecasts. (page 2)	Sep 2020
3.	Ensure accounting practices conform with accounting standards and federal and state requirements. (page 11)	Jul 2020

Category 2: Recommendations with an anticipated implementation period exceeding six months.

	Recommendation	Time Frame
2.	Enhance fiscal management and advisory services provided to the State Public Works Division. (page 8)	Jul 2021

The Division of Internal Audits shall evaluate the action taken by ASD concerning the report recommendations within six months from the issuance of this report. The Division of Internal Audits must report the results of its evaluation to the Executive Branch Audit Committee and ASD.