THOMAS M. SALMON, CPA
STATE AUDITOR

STATE OF VERMONT
OFFICE OF THE STATE AUDITOR

January 23, 2008

Mr. Christopher D. Winters, Director of Professional Regulation
State of Vermont
Office of the Secretary of State, Professional Regulation
National Life Building, North, FL2
Montpelier, VT 05620-3402

Dear Mr. Winters:

This letter represents our response to a resolution by the Vermont Board of Nursing (the Board) that the Office of Professional Regulation ask the Office of the State Auditor to audit the fiscal accounts of the Nursing Board.

We understand the Board has two primary concerns, relating to 1) whether the Board's fiscal accounts are in order and 2) whether the Board was appropriately charged for indirect expenses. Our letter addresses these concerns as well as other matters which have come to our attention during our review.

Although we reviewed the financial reporting process of the Office of Professional Regulation (OPR) as it relates to the Professional Regulatory Fee Fund (the Fund) and interviewed key personnel, we did not conduct a formal of audit of the fiscal accounts of the Board or the Fund.

Background
The OPR is funded through a special fund called the Professional Regulatory Fee Fund created by the General Assembly. All professional regulation revenues received by the OPR are deposited into the Fund and may not be used for any purpose other than professional regulation. Subordinate accounts are maintained by the OPR to track the revenue and expenses of each board.

The Vermont Board of Nursing is one of approximately 35 professional boards whose revenues and expenses are charged to the Fund.

As of June 30, 2008, we noted that the Board regulated the licenses of approximately 19,000 individuals; the Board's fund balance at June 30, 2007 and June 30, 2008 was approximately $1.9 and $2.5 million, respectively.

132 State Street • Montpelier, Vermont 05633-5101
Auditor: (802) 828-2281 • Toll-Free (in VT only): 1-877-290-1400 • Fax: (802) 828-2198
email: auditor@sao.state.vt.us • website: www.state.vt.us/sao

Methodology
Jeff Kellar, CPA, and I took several steps to review this issue. We contacted the Executive Director and a member of the Board of Nursing, as well as the OPR to discuss the accounting policies and procedures related to the Fund. We also interviewed the Administrative Services Director of the Secretary of State's Office.

We reviewed financial documentation provided by the OPR, including information describing the budgeting, financial reporting, monitoring and cost allocation processes. We learned from the Administrative Services Director that the Fund costs consists of

> 1) direct costs of regulation being borne directly by the board that regulates the profession; and
>
> 2) indirect costs of regulation (costs which cannot be charged directly to each individual profession) that are allocated to the professions through an allocation formula.

We also reviewed quarterly and annual reporting packages prepared by the OPR and distributed to the Board, the indirect cost allocation tables, VISION fund balances, correspondence provided by the OPR and Board of Nursing, and other documentation.

Reporting Overview
There appear to be several internal controls in place and functioning adequately to monitor and review the financial results of the Fund and its subordinate accounts. Further, these controls include the monitoring and review of financial information by the boards and OPR management. For example, the OPR publishes reports annually on the revenue and expenses for each board and profession. Each year the boards are provided with an annual budget and an explanation of the method for allocating indirect expenses. Interim and final reports of expenses and revenue are provided to the boards as well.

Also, the annual budget of the Office of the Secretary of State, including the OPR, is reviewed by the Department of Finance and Management; and the annual appropriation for the Office is approved by the General Assembly. Moreover, any changes in license fees must be approved by the General Assembly and all spending by the Office of the Secretary of State is subject to the administrative bulletins and internal control policies of the Secretary of the Agency of Administration.

We reviewed a sample of the interim and final reports of expense and revenue prepared by the OPR and provided to management and the boards. From our review we observed that specific budget-to-actual revenue and expense by category is being reported and available for review.

In addition, Paul Daley, Director of Administrative Services, has recently conducted a thorough review of the Professional Regulatory Fee Fund for fiscal years 2002-2007, including the accounts of the Board of Nursing. This review resulted in a reduction of the

Board of Nursing's fund balance in the amount of $109,908. We discussed the reasons for this review, including the fact that when VISION (the State's financial system) began on July 1, 2001 a decision was made to zero-out all the sub-accounts of the Fund, and to roll approximately $450,000 in sub-account balances into a single undesignated fund balance.

We also reviewed how a $75,000 grant from the Agency of Human Services (Department of Aging and Independent Living) was booked in a different manner in two different fiscal years, which led to a further difficulty in correctly reconciling the Fund's balances, a situation which was subsequently corrected.

Majority of Costs Charged to the Board are Allocated Costs

The OPR is responsible for distributing both the costs borne at or allocated to the OPR to the Fund's subordinate accounts on behalf of various boards regulated by the OPR. The Fund reported total expenses of approximately $3.6 million during FY2008, of which $2.9 million or 80% was borne at the OPR and $727,000 or 20% was allocated to the OPR from the Office of the Secretary of State as its share of centralized administrative services. $3.3 million of the Fund's expenses have been charged to the various boards and $275,000 has been charged to the Fund but remains unassigned to the boards during FY2008. Approximately 84% of expenses charged to the Fund's subordinate accounts are allocated costs and approximately 16% have been directly incurred by the individual boards or remained unassigned. Refer to tables 1 and 2 below.

Table 1								
Office of the Secretary of State								
Expense Distribution by Program								
FY 2008								
Program	**Total Direct Expenses**		**Total Indirect Expenses**	**Total Expenses Prior to Allocation**	**% of Total**	**Indirect Expense Allocation**	**% of Total**	**Total Expenses**
Executive Administration & Administrative Services	-		1,217,479	1,217,479		(1,217,479)		-
Other Administration	122,415		-	122,415	80%	30,164	20%	152,579
State Archives	515,458		-	515,458	80%	127,216	20%	642,674
Professional Regulation (OPR)	2,869,986		-	2,869,986	80%	726,828	20%	3,596,814
Corporations	398,598		-	398,598	80%	98,375	20%	496,973
Elections	964,213		-	964,213	80%	234,896	20%	1,199,109
Total Expenses	**4,870,670**		**1,217,479**	**6,088,149**		**-**		**6,088,149**
% of Total Expenses	**80%**		**20%**	**100%**				

Office of the Secretary of State							
Professional Regulatory Fee Fund Expense Summary							
FY 2008							
Board	**Share of Secretary of State's Indirect Expenses**		**Share of OPR Expenses**	**Total Allocated Expenses**	**Total Direct Expenses**	**Other Expenses**	**Total Expenses**
Nursing Board Expenses	245,000	*	784,446	1,029,446	60,818	-	1,090,264
Other Board Expenses	481,828	*	1,506,950	1,988,778	242,512	-	2,231,290
Total Board Expenses	726,828		2,291,396	3,018,224	303,330	-	3,321,554
Other Expenses not Assigned to the Boards	-		-	-	-	275,260	275,260
Total Professional Regulatory Fee Fund Expenses	**726,828**	*	**2,291,396**	**3,018,224**	**303,330**	**275,260**	**3,596,814**
% of Total Expenses	**20%**		**64%**	**84%**	**8%**	**8%**	**100%**

* The allocation of Secretary of State's share of indirect expense between the nursing and other boards has been estimated for use in this table based on the percent of total allocated expenses. The total expenses reflect the actual cost allocated expense.

The amounts charged to the OPR generally represent costs originating from two sources. The first source consists of costs which are borne at the OPR day-to-day operational level such as salaries for full-time OPR staff, as well as costs for investigators and attorneys, printing materials, rent, utilities and other primary expenses.

The second source consists of costs that originate from the Office of the Secretary of State (Office) and are allocated to the OPR. These include costs such as a portion of the salaries and benefits of the Secretary and Deputy Secretary of State, and the Secretary's executive assistants, and others. The Office of Professional Regulation is one of several programs operated by the Office of the Secretary of State. All programs are provided with centralized administrative support services. These services include executive management, human resource management, information technology management, facilities management and accounting services. The Office of the Secretary of State also receives administrative services provided on a centralized basis by other state agencies. These include property management, human resources, insurance, accounting, audit, and legal services. Such indirect expenses are assigned to benefiting programs through the application of an office-wide indirect cost plan developed and approved in accordance with OMB Circular A-87 - *Cost Principles for State, Local, and Indian Tribal Governments.*

The majority of the individual board's costs are allocated costs. Because it is not considered practical by the OPR to assign an expense directly to a board or profession, the OPR uses an allocation method to assign expenses. Licensing administration expenses are assigned primarily on a per-capita basis using the number of active licensees for the profession at the close of the prior fiscal year. Investigation and prosecution expenses are assigned on a per-case basis, using the number of investigations and prosecutions initiated for the profession in the prior fiscal year. Whenever practical, expenses are directly charged to a board, but these costs are the minority. Direct expenses include board member per diem and expense

reimbursement, printing and postage for board newsletters and license renewal forms, and costs for witnesses and transcripts for disciplinary cases.

Some Allocated Charges Should be Reviewed

The Secretary of State's Office uses the "modified total direct method" for allocating indirect costs to its programs. This method has been approved by the U.S. Election Assistance Commission for use by Office of the Secretary of State on grants and contracts with the Federal Government to which Office of Management and Budget Circular A-87 applies. We believe this method is subject to any applicable statutory limitations, including 3 V.S.A. §124(c) as noted below.

The Office uses this allocation method to allocate administrative costs to its programs; each program is allocated a share of the Office's indirect costs based on its proportion of direct expenses incurred. For example, in FY2008 the Office allocated approximately $1.2 million of indirect costs to its various programs. This is approximately 20% of the total costs of the Office. Refer to table 1. In this process, the Fund was charged approximately $727,000 for its share of FY2008 indirect costs.

Thus, the Fund revenues are the source of $727,000 paid to the Secretary of State's Office for costs that have not been shown to be directly related to professional regulation.

The Board of Nursing should review this matter to determine if the $727,000 indirect charge for FY2008 meets the statutory obligation that:

> **"All revenues received by the office shall be deposited into the [regulatory fee] fund, credited to the appropriate board or to the professions regulated by the director as a group, as appropriate, shall be used to offset up to two years of the costs incurred by that board or that group and shall not be used for any purpose other than professional regulation."** 3 V.S.A. §124(c).

On a limited basis, we verified that costs allocated from the Fund to the individual boards were allocated according to adopted allocation methods. Our aim was not to assess the appropriateness of the adopted allocation methods but to understand how the adopted methods were applied to the Fund expenses. We feel it is management's responsibility to assess the appropriateness of the cost allocation methods. Overall, the allocation of the Fund's costs to the individual boards does not appear to be a complex process, and offers a number of advantages, such as costs relating to prosecutions. (Investigations and prosecutions are billed on a flat fee basis, which protects small boards from a potentially expensive prosecution which, under a different methodology, could burden that profession's licensed members for several years). Costs are in part allocated to each professional board based on the number of licenses issued, and the number of complaints or investigations made, rather than based on actual time incurred by OPR personnel devoted to each license type. This is an acceptable method, but it should be reviewed and approved periodically by the boards.

Interboard Advisory Committee
State law [3 VSA 123(f)] requires at least an annual meeting of an "Interboard Advisory Committee." However, this group has not been met in recent years. The law states:

> **"An interboard advisory committee consisting of one member of each board, designated by that board, is created. In the case of a profession which has advisor appointees, the appointees shall designate one of the appointees or another licensed member of the profession to serve on the committee. The committee shall meet at least annually with the director to discuss the operation of the office and matters of concern to boards."**

The Interboard Advisory Committee could be re-established to at least annually review and discuss cost allocation policies and procedures.

Interest from Cash Balances
We noted that the Professional Regulatory Fee Fund carried a significant cash balance throughout the year. The question of whether the Fund should be allocated interest earned from its cash balance, which could be significant, came to our attention during our review. We reviewed applicable statutes and consulted with the Department of Finance & Management and concluded that the Professional Regulatory Fee Fund should not be allocated interest earned from its cash balance. According to 32 V.S.A. §435(b), the General Fund shall include "all other revenues accruing to the State not otherwise required by law to be deposited in any other designated fund or used for any other designated purpose." Since there is no specific statutory mandate to allocate interest of the Professional Regulatory Fee Fund back to the Fund, the accrued interest must be deposited into the General Fund. If the State law related to the Professional Regulatory Fee Fund was changed to require interest to accrue to the Fund, significant revenues would be generated for the Board of Nursing, in our opinion.

OPR Reports Should Agree to General Ledger
We also noted that the total expenses of the Fund for fiscal year 2008 totaling $3.6 million per the general ledger and indirect cost allocation work sheet did not agree with the total OPR expenses of $3.3 million reported to the Board. A difference of approximately $300,000 was noted.

As mentioned in a letter provided to the Board members, payments to the supplier of the Office's new eLicense system were not included in the expenses charged to the boards in fiscal year 2008, but rather were charged to an unallocated reserve account to offset for the elimination of the boards' fund balances which occurred at the time of State's VISION general ledger conversion in 2001. It is generally accepted that an Organization's financial reports should agree to its underlying records and ledgers.

We believe the Fund financial reports distributed to the individual boards should agree to general and subordinate ledgers.

Conclusion
Based on our limited scope review and the apparent internal controls underlying the accounting and reporting of the professional regulatory fee funds, the nature of the application of the adopted cost allocation methods and the recent examination undertaken by the Office's Director of Administrative Services, there appears to be sufficient monitoring and review to detect a material misstatement in the Board of Nursing's fund balance.

> **The fiscal accounts for the Board of Nursing appear to be in good order, and, based on a limited review, expenses charged to the Board appear to be in compliance with existing allocation procedures. However, we believe that the policy of charging the fund with indirect administrative costs unrelated to professional regulation should be reviewed, as well as the allocation methods established by the OPR for each license group. Subject to support for the recommendations below, we conclude that a formal audit by our Office is not warranted.**

Recommendations
We recommend the Board of Nursing and OPR consider the following comments resulting from our review:

- The Board should review whether it is appropriate under statute for the Secretary of State's Office to assess the Fund for a significant amount of administrative costs.

- The Board and OPR may benefit from a periodic review of the Fund's indirect cost allocation methods to determine if they are most appropriate to capture the true costs incurred by the Nursing Board or other licensed groups.

- The OPR should consider adopting a policy for establishing and reviewing cost allocation methods.

- The Executive Director should ensure that individual Nursing Board members receive the indirect cost allocation tables with the financial reporting packages as needed.

- The Interboard Advisory Committee should be re-established or the OPR should work to revise or eliminate the requirement from State law.

- The financial reports distributed to the boards should agree to general and subordinate ledgers.

Please feel free to contact our Office if you have any questions about this letter. In closing, I would like to thank the staff members we contacted for their professionalism and assistance with this inquiry.

Sincerely,

George Thabault
Deputy State Auditor

cc: Linda Rice, APRN, Chair, Vermont Board of Nursing
Alan H. Weiss, member, Vermont Board of Nursing
Deborah L. Markowitz, Secretary of State
Mary Botter, Executive Director, Vermont Board of Nursing
Paul Daley, Director of Administrative Services, Office of Professional Regulation
Thomas M. Salmon, CPA, Vermont State Auditor
Jeffrey Kellar, CPA, State Auditor's Office