



AGENCIES OF THE SECRETARY OF FINANCE

REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2013

Audit Summary

This report summarizes our fiscal year 2013 audit results for the five agencies under the Secretary of Finance and arises from our work on the Comprehensive Annual Financial Report. Overall, our audit for the year ended June 30, 2013, found the following:

- Proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System and in the agencies' accounting systems;
- Matters requiring management's attention that are included in the section entitled "Comments to Management"; and
- Adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

This report also includes information on significant initiatives and issues for agencies under the Secretary of Finance summarized below.

Status of System Development Projects

The Commonwealth is in the process of implementing multiple new statewide budgeting and financial reporting systems. The Performance Budgeting System has been implemented and is operational. This system covers several processes including budget development and execution, six-year financial planning, and strategic planning.

The Commonwealth is also in the process of implementing the Cardinal System, a statewide accounting and financial reporting system. The Commonwealth implemented Phase 1 of the Cardinal System project in December 2011 with the implementation of the Department of Transportation's financial system. Phase two of the implementation occurred in October of 2012 with the Department of Accounts implementing the base modules of Cardinal. Phase three, which involves an incremental rollout to all state agencies, will occur over the next two years with Cardinal becoming the official system of record by the end of fiscal year 2017.

The Commonwealth has developed a funding methodology to support system maintenance and operation costs for both systems. The funding model is an internal service fund model that relies on user charges based on rates that are approved by the Joint Legislative Audit and Review Commission.

Upcoming Pension Accounting Changes

This report includes a summary of the impact of new pension accounting and reporting standards on the Commonwealth in the section entitled "Comments to Management." These new standards will increase the amount of pension liability and expenses the Commonwealth and its localities report in their financial statements.

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Comments to Management

Status of System Development Projects and Other Modernization Efforts

Status of System Development Projects

Applicable to: Secretary of Finance, Secretary of Transportation, Department of Accounts, Department of Planning and Budget, Virginia Information Technologies Agency, and Virginia Department of Transportation

Cardinal System

The Commonwealth has continued to make progress on its Cardinal system, which will replace the Commonwealth's financial system (CARS) with a modern, enterprise-wide financial system (base financial system). Due to their age and lack of integration, the Commonwealth's current systems either do not contain the information or cannot easily exchange information to support current state and federal initiatives related to government transparency and timelier financial reporting.

This is a key project for the Commonwealth since the current accounting systems are outdated both in terms of the technology and available functionality.

Cardinal's first implementation phase occurred in December 2011, with the implementation of the Virginia Department of Transportation's (Transportation) financial system. Phase two of the implementation occurred in October of 2012 with the Department of Accounts (Accounts) implementing the base modules of Cardinal. The base modules consist of general ledger, accounts payable, and a portion of the accounts receivable module. Phase three, which involves an incremental roll out of the base modules to all state agencies, will occur over the next two years with Cardinal becoming the official system of record for the Commonwealth beginning in fiscal year 2017. The base modules will provide the foundation for a modern financial system for the Commonwealth with the ability to add other modules and expand functionality in future phases.

The project development and implementation cost was \$58 million for phases one and two and was funded by Transportation and a working capital advance of approximately \$7.3 million. The project development and implementation budget is \$60 million for phase three and is funded by a working capital advance. Transportation funded all operating costs through fiscal year 2013. Charges to agencies in the form of an internal service fund rate will fund operating costs and repayment of the working capital advance starting in fiscal year 2014. A detailed description of the internal service fund rate is described on the following page in the section titled, "*Enterprise Applications Internal Service Fund.*"

As part of Cardinal's development and implementation process, the Departments of Accounts, Transportation, and General Services and the Virginia Information Technologies Agency (VITA)

worked together to develop and incorporate vendor data standards. In January 2013, the Cardinal project team adopted chart of account data standards, which incorporate the existing CARS chart of accounts.

Performance Budgeting System

Planning and Budget and the Enterprise Applications Division at VITA have implemented the Performance Budgeting System. This system addresses several functional areas including budget development (operating and capital), six-year financial planning, budget execution, and strategic planning.

Funding for this \$14.7 million project comes from a working capital advance administered by Accounts. The Appropriation Act directs the repayments of the advance from enhanced collections, cost recoveries, inter-agency collaborative projects, and other initiatives.

Enterprise Applications Internal Service Fund

Item 260 of Chapter 806, 2013 Acts of Assembly, provides the authority for a new internal service fund that Accounts will manage and authorizes the Secretary of Finance to establish a fee charged to agencies to support enterprise system administration.

The rate for the Cardinal system will be \$1.05 per transaction for agencies. Transportation is using additional modules not being used by any other agency and therefore will be charged a separate additional rate of 36.2 percent of budgeted annual operating costs of the system. The rate will be collected through quarterly payments beginning in fiscal year 2014. Fiscal year 2015 and subsequent years' rates will be adjusted based on profit/loss in the fund. Rates will increase in fiscal year 2017 to account for the repayment of the working capital advance.

Accounts and Planning and Budget developed a funding methodology to support system maintenance and operation costs for both systems, and in October 2012, the Joint Legislative Audit and Review Commission approved the rates.

Rates for the Performance Budgeting system are based on an agency's appropriations and collected through quarterly payments. The retroactive rate for fiscal year 2013 equated to \$99.24 per \$1 million in appropriations and will decrease to \$95.98 per one million dollars in appropriations for fiscal year 2014. The decrease is due to an increase in statewide appropriations. The rate includes the repayment of the working capital advance over a ten-year period.

Modernization of Financial Reporting Processes

Applicable to: Department of Accounts

As we have previously recommended, while a modern financial system will provide some of the flexibility and technology needed, without changing its current financial reporting processes, due to the changing accounting and regulatory environment and reduced administrative personnel at the

agency level, there is the risk of the Commonwealth issuing inaccurate financial reports or not being able to comply with state or federal mandates for more comprehensive and timely reporting. We recognize that it takes time to implement these changes and that Accounts has focused their efforts primarily on the development and implementation of the Cardinal System. As the Commonwealth moves closer towards implementing the Cardinal System at the statewide level, we continue to emphasize the importance of Accounts re-examining the Commonwealth's financial reporting process to identify opportunities for improving their use of technology, communication with agencies, and analysis of financial activity.

Upcoming Pension Accounting Changes

As previously reported, Governmental Accounting Standards Board (GASB) Statement No. 67, which covers accounting and reporting by pension plans, will be implemented by the Virginia Retirement System in fiscal year 2014. Additionally, GASB Statement No. 68, which covers accounting and reporting of pension activity by employers, will be implemented by the Commonwealth and its various localities in fiscal year 2015. Accounts and the Virginia Retirement System will work together to coordinate the Commonwealth's implementation of these new standards.

The new standards have a conceptual shift in the reporting of liabilities and expenses from a funding approach to an earnings approach. Currently, the Commonwealth only reports a liability to the extent it did not fully fund the annually required contribution as determined by its actuary. Under the new standards, the Commonwealth will report a pension liability as employees earn their benefits by providing services, which will result in a large increase in the Commonwealth's net pension liability and expense in its financial statements. The Commonwealth is allowed to offset the pension liability by the assets it has accumulated to fund the benefits to arrive at the net pension liability in its financial statements. These changes will result in pension liability being reported in a similar manner as other long-term obligations by including them on the face of the financial statements and not just in the notes to the financial statements.

The Commonwealth's pension expense under Statement No. 68 will be based on the change in total pension liability from year to year. The Commonwealth will recognize some of the expense immediately and defer part of the expense to later years. Currently, the GASB expense, which is based on the annual required contribution, was also the standard for responsible funding. The Virginia Retirement System has recently adopted a new policy for funding pension plan costs, which is consistent with guidance developed by a national Pension Funding Task Force. This policy encompasses actuarial cost and asset smoothing methods and amortization policies that appropriately balances pension costs to the generation of taxpayers that received the services.

If the government has adopted a funding strategy to fully fund the net pension liability, they are allowed to continue to use the long-term expected rate of return during the period that assets are accumulated to reach the fully funded status.

Current standards require a discount rate equal to the long-term expected rate of return on the pension plan's investments. Under the new standards, if the pension plan's investments are not sufficient to cover all of the projected benefit payments, the Virginia Retirement System will be required to use a blended rate consisting of the long-term expected rate of return and the municipal borrowing rate for the portion not covered.

Statement No. 68 will also require pension obligations and Required Supplementary Information (RSI), which are currently only reported in the Commonwealth's Comprehensive Annual Financial Report, to now be reported in the financial statements of higher education institutions and certain agencies that produce their own financial statements, such as the State Lottery Department and Department of Alcoholic Beverage Control. The Virginia Retirement System will provide these entities with the liability amounts and RSI information for inclusion in their financial statements.

Finally, government employers participating in cost-sharing multiple-employer plans must recognize their proportionate share of the collective amounts for the plan as a whole. Currently, the main impact of this change will be an increase in the net pension liability reported in the financial statements of the Commonwealth's localities. The amount of the pension liability required to be reported by the localities could be reduced if the General Assembly passed legislation that modifies how the Commonwealth makes the payment for its portion of teachers' pension. The Virginia Retirement System has provided information to the localities estimating the extent of this increase and will annually provide the localities with liability amounts and other required information, which will be audited by the Auditor of Public Accounts so that it can be relied upon by the localities' auditors.

Under current statutes, the Commonwealth's localities will be required to report a large net pension liability in their individually published financial statements for teachers covered under the cost-sharing multiple-employer plan administered by the Virginia Retirement System.

Internal Control and Compliance Findings and Recommendations

Improve SQL Server Database Security

Applicable to: Department of Accounts

Accounts has not implemented certain controls in their Payline System SQL database that contains sensitive information. We identified five control weaknesses that we communicated to management in a separate document marked Freedom of Information Act Exempt under Section 2.2-3705.2 of the Code of Virginia due to it containing descriptions of security mechanisms. The Commonwealth's IT Security Audit Standard, SEC501-07.1, requires implementing specific controls to reduce unnecessary risk to data confidentiality, integrity, and availability.

Accounts should dedicate the necessary resources to implement the controls discussed in the communication marked FOIA-Exempt in accordance with the Commonwealth's IT Security Audit Standard, SEC501-07.1.

Update the Physical Security Policy and Monitor Physical Access to the Data Center

Applicable to: Department of Accounts

Accounts is not monitoring access to their data center nor updating facilities security policies to reflect their changing environment. Sensitive information resides on the servers located at Accounts, and physical access should be monitored to safeguard the equipment storing this information.

Accounts relocated their data center in fiscal year 2013 but has not updated their policies since fiscal year 2007. Therefore, the policies are not relevant to their current environment and not in compliance with the Commonwealth's IT security standard. In addition, the current authorized users consist of 15 individuals who have badge access to the data center, eight of which are outside contractors. Accounts shares data center space with the Department of General Services, and no memorandum of understanding exists delegating responsibility for reviewing access. Having a significant number of individuals with access, including outside contractors, coupled with no monitoring of access to the data center, increases the risk that unauthorized individuals gain access to the data center.

We recommend that Accounts update their Facilities Security Policy and Data Center Access Policy and review the policies annually as stated in the Commonwealth's IT security standard. We further recommend that Accounts decrease the number of contractors that have access to the data center and implement a process of monitoring that access as stated in the Standard. In doing so, a memorandum of understanding between Accounts and General Services will be necessary in order to assign responsibility to each agency.

Improve Financial Reporting and Communication with Agencies

Applicable to: Department of Accounts

During the 2013 audit of the Commonwealth's Comprehensive Annual Financial Report (CAFR), we identified the need for Accounts to continue to improve communications with state agencies over the report preparation process. Adequate communication with agencies that are providing material amounts for inclusion in the CAFR is essential to Accounts' ability to report complete and reliable information in its decentralized environment. Additionally, we identified the need to strengthen the analysis performed over areas identified as being more susceptible to material errors.

The financial reporting process surrounding the preparation of the CAFR is susceptible to material misstatements due to the nature and extent of information consolidated by Accounts in this effort. Over the course of the audit, we proposed several material audit adjustments related to a variety of items including inaccurate financial information received from agencies and errors related to the calculation of Net Investments in Capital Assets. The calculation of Net Investments in Capital Assets represents an area that we have identified in previous years as having errors associated with it. A majority of the data impacting this calculation derives from activity reported by the Department of the Treasury and the Department of Transportation. Due to the complexity of the data received by Accounts from agencies in this regard, this area is more susceptible to having misstatements.

We recognize the progress that Accounts has made over the past couple of years in responding to our recommendations to improve communication with agencies that provide financial information that is significant to the CAFR. We recommend that Accounts continue to improve the level and nature of communication that occurs with agencies to create a more proactive and collaborative financial reporting process, including further leveraging of agency-level expertise to assist in this endeavor. Accounts should continue to develop and share their expectations of what they anticipate to receive from agencies, which could help reduce the amount of agency resubmissions and overall CAFR audit adjustments. Lastly, Accounts should further enhance their analysis performed over areas identified as being more inherently at risk to material error in an effort to minimize the risk of future misstatements.

Improve Financial Reporting for Corporate Tax Refund Liability

Applicable to: Department of Taxation

The Department of Taxation (Taxation) made an error in their Corporate Tax Refund liability reported to Accounts. The error occurred when Taxation did not follow their policies and procedures, which require they subtract an amount already reported as a notes payable. In addition, Taxation did not detect the error during the review process or in the analysis performed to identify significant variances between the years. This error resulted in a \$20,319,551 overstatement of the estimated Corporate Tax Refund liability.

Taxation should follow their agreed-upon policies and procedures and strengthen their review and analysis process to ensure material errors in year-end liabilities are detected before information is submitted to Accounts.

Improve Internal Controls over Advantage Revenue Access

Applicable to: Department of Taxation

The Department of Taxation (Taxation) needs to improve their internal controls over granting and monitoring system access to the Advantage Revenue system. During our audit, we identified several areas where controls need to be improved including documentation of access structure and controls, granting of system access, and the annual recertification process. Although we did not find instances where these weaknesses had resulted in unauthorized transactions, Taxation needs to strengthen their controls in the areas discussed below.

Taxation uses the System Access for Employees (SAFE) tool to monitor and track all types of user access from physical building access to access to the Advantage Revenue System. We reviewed information in SAFE to gain an understanding of and review employee access capabilities for the Advantage Revenue System, which is their critical financial reporting system. Taxation uses an access structure which has several components including resources, security groups, and workgroups.

Resources represent access to menus and potentially editable screens within Advantage Revenue. Security groups represent a set of resources for a specific group of similar functional users. For example, every employee in the Internal Audit security group is given a standard list of resources designed for their business function. Workgroups are collections of worklists, which can allow the user assigned to the worklist to review, approve, complete, correct, or add details to information in Advantage Revenue.

System Documentation

Taxation does not have adequate documentation of resources and workgroups within Advantage Revenue. Written documentation of all resources within the Advantage Revenue system and the specific privileges associated with these resources, including whether these resources possess the ability to edit financial records, does not currently exist. A data field exists in the underlying table structure of Advantage Revenue that identifies whether resources are either read only or can edit underlying records, but this data field is a new addition to the table structure and is currently populated with placeholders that do not contain accurate information.

Additionally, Taxation does not have adequate documentation related to workgroups. Assignment to a workgroup provides access to critical functions in Advantage Revenue, such as the ability to post or cancel journal vouchers. Written documentation describing the purpose of and accessible resources associated with the 41 workgroups at Taxation did not exist during fieldwork. Written documentation of system resources whose access privileges are reliant upon assignment to a workgroup does not currently exist. The lack of adequate system documentation makes it difficult to determine exactly what capabilities a user has within the system and whether user access to these capabilities is truly appropriate.

Inappropriate Systems Access

We reviewed access in Advantage Revenue for the twenty-one employees assigned to the Revenue Accounting security groups and found five of the 21 (24 percent) employees had inappropriate access to a security group based on job function. Of these twenty-one employees, we also found three (14 percent) who had inappropriate access to the REV1 workgroup, which controls the ability to approve or cancel journal vouchers. Journal vouchers are used to make adjustments to the financial information in Advantage Revenue.

We expanded our sample to include an additional ten employees with access to the REV1 workgroup. Of the additional sample, all ten (100 percent) employees had inappropriate access to the REV1 workgroup based on their job function.

Although Taxation has compensating controls that would ideally prevent and detect any unauthorized transactions, access needs to be granted under the principle of least privilege, which translates to giving people the lowest level of user access that they can have and still do their jobs. Granting access under this principle is a best practice and minimizes the risk of unauthorized transactions.

Systems Access Recertification Process

Taxation currently performs an annual review and recertification of systems access for all employees as required by Commonwealth of Virginia Information Technology Resource Management standard SEC 509-00. This recertification is designed to ensure that appropriate access is documented; granted on the principles of least privilege; and role based.

Of the eighteen instances of inappropriate systems access we discussed above, all were deemed appropriate by the designated SAFE approver during the fiscal year 2013 recertification. This brings into question how effective Taxation's current recertification process is. We reviewed the instructions given to SAFE approvers for the recertification process and found they were provided adequate instructions on how to review employee access privileges within SAFE. However, SAFE approvers are not provided with adequate documentation of workgroup and resource capabilities to properly determine the appropriateness of their users' access. Managers need complete information when approving and reviewing system access for their employees.

Improve Monitoring of Administrative and Compliance Activities

Applicable to: Department of the Treasury

The Department of the Treasury (Treasury) should evaluate its monitoring and related documentation of certain administrative and compliance activities to ensure they are conducive to effective operations. We acknowledge that Treasury was understaffed during fiscal year 2013, which may have impacted its ability to monitor these administrative and compliance activities increasing Treasury's susceptibility to possible internal control weaknesses. The areas where we noted the opportunity for Treasury to evaluate their current processes are monitoring compliance with the State

and Local Government Conflict of Interests Act training requirements and adhering to their internal policies regarding access reviews and disabling access for terminated employees.

Treasury has already begun the process of reviewing its policies and procedures for monitoring its administrative and compliance activities by modifying the processes associated with training and disabling access, and we acknowledge their timely response to address these issues. As Treasury continues its review, we recommend that they make the necessary changes to ensure that the proper processes are in place and that these processes are being followed in accordance with the applicable policies and procedures. When reviewing its policies and procedures Treasury should take into consideration its current staffing levels and ensure the policies are not cumbersome, yet are in line with best practices and external mandates, while providing adequate assurance over internal controls. In addition, we recommend that Treasury maintain adequate documentation to support its monitoring activities.

Improve Process for Paying Risk Management Administrative Invoices

Applicable to: Department of the Treasury

Treasury's Division of Risk Management (Risk Management) should improve its procedures for paying invoices for expenses other than claims. Aside from claims, Risk Management receives invoices for insurance premiums, administrative fees, etc., which are authorized for payment by Risk Management and then forwarded to Treasury's Operations Division for processing. An oversight by Risk Management while processing an invoice resulted in the duplicate payment of a \$4.5 million invoice for an insurance premium. In this instance, the vendor promptly noticed the duplicate payment and remitted the funds back to the Commonwealth. To reduce the risk of duplicate payments, Risk Management should strengthen its procedures for tracking and reviewing invoices to ensure that they have not already been paid.

As a result of the duplicate payment, the Operations Division has implemented additional internal controls to prevent duplicate payments. Since Risk Management personnel are responsible for reviewing and approving payments related to their operations, we recommend that additional internal controls be instituted during Risk Management's approval and review of invoices to detect duplicate payments prior to the invoice being sent to the Operations Division for processing.

Introduction

The Departments of Accounts, Planning and Budget, Taxation, and Treasury and the Treasury Board report to the Secretary of Finance. The individual audits of these agencies primarily support the audit of the Commonwealth's CAFR for the fiscal year ended June 30, 2013, and this report is intended to report on the results of this work.

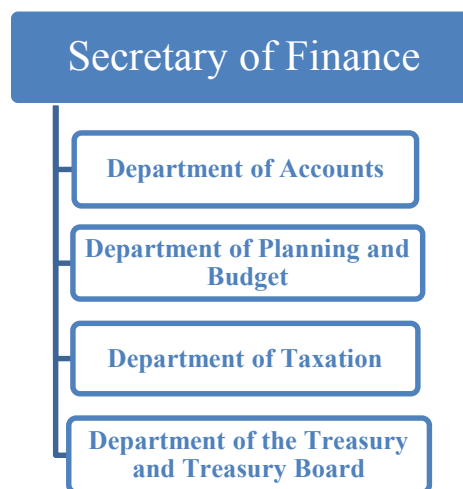
Our office also issues other reports related to activities or agencies under the Secretary of Finance, these include:

- The "Governor's Cabinet Secretaries" report, which was issued in October 2013. This report summarizes activities of the cabinet secretaries, including the Secretary of Finance.
- The "Statewide Performance Measures" report, which summarizes work on performance measures reported on the Virginia Performs website, which Planning and Budget maintains. We expect to issue this report in Spring 2014.

The following section provides a brief overview of the Secretariat and financial information related to the agencies in this area.

Finance Secretariat Overview

The Secretary of Finance (Secretary) assists the Governor in the management and direction of the finance agencies and performs program coordination, policy planning, and budget formulation activities. To accomplish this, the Secretary oversees the following agencies, which perform critical functions in the Commonwealth's statewide financial management system.



These four agencies work closely together in the budgeting, management, and reporting of the Commonwealth's financial resources. They handle all the financial transactions of the

Commonwealth from collecting taxes to paying bills to distributing aid to localities. Their primary responsibilities include:

- forecasting and collecting revenues;
- preparing and executing the Commonwealth's budget;
- managing the Commonwealth's cash and investments;
- issuing bonds on behalf of various boards and authorities;
- administering the Commonwealth statewide accounting and payroll systems;
- overseeing the Commonwealth's financial reporting processes; and
- making strategic financial plans.

These agencies primarily serve other agencies within the Commonwealth in a central support capacity. A more detailed discussion of these activities is included in Appendix A along with the interaction of the agencies within the Finance Secretariat while performing these activities.

The operations of these four agencies are primarily funded with general funds. The following table summarizes the original and final operating budgets, as well as expenses for all finance agencies except the Treasury Board. The Treasury Board's financial activity is not included since its activities consist primarily of the payment of debt service on general obligation debt rather than administrative expenses.

Summary of Budget and Expenses for Fiscal Year 2013

	Original Budget	Final Budget	Expenses
Secretary of Finance	\$ 424,910	\$ 526,124	\$ 524,587
Department of Accounts	10,841,049	32,233,078	19,593,697
Department of Planning and Budget	7,099,898	7,457,774	6,171,372
Department of Taxation	96,284,771	100,061,095	95,887,707
Department of the Treasury	19,417,233	19,704,553	18,402,206
Total – Finance Agencies	\$ 134,067,861	\$ 159,982,624	\$ 140,579,569

The budget for Accounts changed significantly during the year as the agency is transitioning to a new funding model with the implementation of Cardinal and the Performance Budgeting System. While the original budget approved by the General Assembly was consistent with previous years, there were significant adjustments processed during the year to establish an internal service fund model that is financed with user charges for the two systems. Actual expenses were lower than the final budget due to this being a year of transition, but these are ongoing projects and it is expected that Accounts' expenses will increase going forward to reflect the costs of these systems.

The majority of expenses in the Finance Secretariat are for personal services (approximately 59 percent) and contractual services (approximately 35 percent). The following table summarizes the type of expenses each of the Finance Secretariat agencies incurred during fiscal year 2013.

Summary of Expenses by Type for Fiscal Year 2013

	Secretary of Finance	Accounts	Planning and Budget	Taxation	Treasury
Personal services	\$ 492,546	\$ 9,354,790	\$ 4,710,707	\$ 60,953,477	\$ 8,069,161
Contractual services	7,150	9,524,734	1,107,229	30,603,614	8,068,959
Supplies and materials	1,206	41,106	11,230	295,789	186,825
Transfer payments	-	982	299	82,147	1,111,113
Continuous charges	23,685	504,412	340,470	2,824,762	756,494
Equipment	-	137,873	1,437	1,127,918	209,654
Plant and Improvements	-	29,800	-	-	-
Total expenses	\$ 524,587	\$ 19,593,697	\$ 6,171,372	\$ 95,887,707	\$18,402,206



Martha S. Mavredes, CPA
Auditor of Public Accounts

Commonwealth of Virginia

Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

January 24, 2014

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable John M. O'Bannon, III
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the agencies under the **Secretary of Finance** for the year ended June 30, 2013. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our primary audit objectives for the audit of the Departments of Accounts, Planning and Budget, Taxation, and Treasury for the fiscal year ended June 30, 2013, include the following:

- to determine whether management has established and maintained internal controls over the Commonwealth's financial reporting and other central processes and the centralized services provided to agencies and institutions in support of the preparation of the financial statements as indicated in the scope section of this report;
- to determine whether management has established and maintained adequate operating and application system controls over CARS, CIPPS, FAACS, LAS, the Integrated Revenue Management System, the Performance Budgeting System, and other central systems;
- to evaluate the accuracy of financial transactions related to the processing of payroll and leave activity by Accounts' Payroll Service Bureau;
- to evaluate the accuracy of financial transactions related to tax collections including accounts receivable, deferred revenues and taxes, accounts payable and other liabilities, and tax and interest revenue as reported in CARS and the

Integrated Revenue Management System and in supplemental information prepared by Taxation;

- to evaluate the accuracy of financial transactions related to cash and cash equivalents, investments, debt, risk management, and unclaimed property activity which is controlled by Treasury as reported in CARS and Treasury's accounting records, and in supplemental information prepared by Treasury (including the activity of the Treasury Board, the Local Government Investment Pool, the Virginia College Building Authority, the Virginia Public School Authority, and the Virginia Public Building Authority);
- to evaluate whether the budget approved by the General Assembly is appropriately recorded in CARS and appropriation controls in CARS are adequate to ensure program expenses do not exceed appropriations;
- to evaluate the proper approval and documentation of administrative budget adjustments;
- to evaluate the accuracy of financial and budgetary transactions of the administrative activities as reported in CARS for certain agencies included in the Secretary of Finance;
- to determine whether the agencies have complied with applicable laws, regulations, contracts and grant agreements; and
- to review corrective actions related to audit findings from the prior year report.

Audit Scope and Methodology

Management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We reviewed and gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following processes and systems.

Department of Accounts

Financial Reporting*

Commonwealth Accounting and Reporting System (CARS)

Commonwealth Integrated Payroll/Personnel System (CIPPS)

Fixed Asset Accounting and Control System (FAACS)

Lease Accounting System (LAS)

Administrative Activities

Department of Planning and Budget

Performance Budgeting System
Budget Execution

Department of Taxation

Financial Reporting
Tax Return Processing
Tax Revenue Collections
Integrated Revenue Management System
Administrative Activities

Department of the Treasury (including Treasury Board operations)

Financial Reporting*	Bank Reconciliation System
Bond Issuance	Trust Accounting
Debt Service Expenses	Check Processing System
Investment Trading	Risk Management Claim System
Investment Accounting	Unclaimed Property Management System
Investment Accounting System	Administrative Activities
Securities Lending Transactions	

*including preparation of the Comprehensive Annual Financial Report and Schedule of Expenditures of Federal Awards by Accounts and the preparation of financial statements of the Local Government Investment Pool, the Virginia College Building Authority, the Virginia Public Building Authority, and the Virginia Public School Authority by Treasury.

We performed audit tests to determine whether controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the agencies' operations. We tested transactions and performed analytical procedures, including budgetary and trend analysis.

Audit Conclusions

We noted no matters involving internal controls related to the Commonwealth's central processes and the centralized services provided to agencies and institutions in support of the preparation of the financial statements as indicated in the scope section of this report. We noted a matter at Accounts involving internal control related to the Commonwealth's financial reporting process that we consider necessary to be reported to management, which is described in the findings entitled "Improve Financial Reporting and Communication with Agencies" in the section entitled "Internal Control and Compliance Findings and Recommendations."

We noted matters at Accounts and Taxation involving internal control and compliance with applicable laws and regulations that are required to be reported under Government Auditing Standards

related to operating and application system controls of central systems, which are described in the findings entitled “Improve SQL Server Database Security,” “Update the Physical Security Policy and Monitor Physical Access to the Data Center,” and “Improve Internal Controls over Advantage Revenue Access” in the section entitled “Internal Control and Compliance Findings and Recommendations.”

We found that Accounts’ Payroll Service Bureau properly stated, in all material respects, the financial records reviewed in support of payroll and leave activity.

We found that Taxation properly stated, in all material respects, the financial records reviewed in support of the tax collections activity detailed in the audit objectives as reported in CARS, the Integrated Revenue Management System, and supplemental information. We noted a matter involving supplemental information prepared by Taxation that we consider necessary to report to management, which is described in the findings entitled “Improve Financial Reporting for Corporate Tax Refund Liability” in the section entitled “Internal Control and Compliance Findings and Recommendations.”

We found that Treasury properly stated, in all material respects, the financial records reviewed in support of the cash and investments, securities lending, debt, risk management and unclaimed property activity reported in CARS, Treasury’s accounting records, and supplemental information. We noted matters at Treasury involving internal control and compliance with applicable laws and regulations that are required to be reported under Government Auditing Standards, which are described in the findings entitled “Improve Monitoring of Administrative and Compliance Activities” and “Improve Process for Paying Risk Management Administrative Invoices” in the section entitled “Internal Control and Compliance Findings and Recommendations.”

We found that the budget approved by the General Assembly is appropriately recorded in CARS, and appropriation controls in CARS were adequate to ensure program expenses do not exceed appropriations.

We found that administrative budget adjustments were properly approved and documented.

For the agencies specified in the scope section of this report, we found they properly stated, in all material respects, the financial and budgetary transactions related to their administrative activities recorded and reported in CARS. The financial information presented in this report related to the administrative activities of the agencies came directly from CARS and is recorded on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

The agencies of the Secretary of Finance have taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

Exit Conference and Report Distribution

We discussed this letter with management of the respective agencies of the Secretary of Finance and have included their response at the end of this report. We did not audit management's response and, accordingly, we express no opinion on it.

This report is for the information and use of the Governor and General Assembly, management, and citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

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Appendix A

This Appendix includes more detailed information on the various services, programs, and activities managed by the agencies in the Finance Secretariat.

Planning, Budgeting, and Evaluation Services

Planning and Budget aids in the development and administration of the state budget, ensuring that agencies conduct their activities within fund limitations provided in the Appropriation Act and in accordance with gubernatorial and legislative intent. Planning and Budget relies on information from all agencies and universities in developing revenue estimates and expense budgets. Accounts provides Planning and Budget with information regarding unspent balances and carry forward amounts. Taxation develops the General Fund revenue forecast because the largest source of revenue for the Commonwealth is individual and fiduciary income taxes and state sales and use taxes. Taxation also develops the revenue forecasts for certain non-general fund revenues, which are primarily transportation-related.

Once the General Assembly and the Governor have approved the budget, Planning and Budget provides an electronic copy to Accounts to upload into the Commonwealth Accounting and Reporting System (CARS). CARS contains automated edit controls to ensure agencies do not exceed the spending authority established in the budget.

Throughout the year, along with the Governor, Planning and Budget has certain statutory authority to increase, decrease, or transfer funds and personnel positions within constraints set forth in the Appropriation Act. Jointly, Planning and Budget and Accounts ensure that CARS properly reflects these adjustments. During fiscal year 2013, the administrative adjustments processed by Planning and Budget resulted in a \$4.5 billion increase to the Commonwealth's operating budget.

Revenue Administration Services

Taxation administers and enforces the tax laws of the Commonwealth. Due to its tax return processing duties, Taxation is the single largest collector of Commonwealth revenue, which it primarily deposits to the General Fund. During fiscal year 2013, Taxation collected \$16 billion in net revenue, depositing \$15.4 billion into the General Fund. In addition, both Taxation and Accounts collect money owed to the Commonwealth through a debt set-off program that they jointly administer in accordance with the Code of Virginia's Debt Collection Act.

Taxation also collects and distributes Communication Sales and Use Tax and Motor Vehicle Fuel Sales Tax to localities and members of the transportation districts as required by the Code of Virginia. During fiscal year 2013, Tax distributed \$433.5 million of Communication Sales and Use Tax revenues and \$78.3 million of Motor Vehicle Fuel Sales revenues.

Check Processing and Bank Reconciliation

Treasury processes agency disbursements from revenue the Commonwealth collects. Treasury is responsible for the printing and distribution process of checks and distributes electronic payments

for individual agencies. Monthly, the Commonwealth's two disbursement banks are responsible for full reconciliation of check disbursement activity. Treasury's fully automated system, "Frontier," interfaces with other bank systems and allows Treasury to reconcile accounts within 45 days of month end.

Unclaimed Property Administration

Additionally, under the Unclaimed Property Act, Treasury serves as custodian of certain personal properties (intangible and tangible personal property and real property) until the Commonwealth can locate the owner. Treasury identifies abandoned personal property through annual reporting requirements and the performance of audits and compliance reviews, administers the fund under the Commonwealth's control, and uses its best efforts to return the property to its owner.

Investment, Trust, and Insurance Services

Treasury, under the direction of the State Treasurer, invests the Commonwealth's funds and provides trust and insurance services. Treasury manages and invests the Commonwealth's funds throughout the year striving to preserve capital and liquidity while earning the best possible return, in accordance with Treasury Board approved investment guidelines. The largest portfolio Treasury manages is the General Account of the Commonwealth, a pool of investments representing assets of the Commonwealth's General Fund, highway maintenance, and transportation trust funds. The General Account has two portfolios: the primary liquidity portfolio and the extended duration and credit portfolio. Treasury internally manages the primary liquidity portfolio, which provides the major source of liquidity for the disbursement requirements and operational needs of the Commonwealth. The externally managed "Extended Duration and Credit Portfolio" seeks to generate higher total returns over time. Treasury's target allocation for the overall general account asset mix is 75 percent for the primary liquidity pool and 25 percent for the total return pool.

Treasury also manages the Local Government Investment Pool (LGIP), a short-term investment pool offered to counties, towns, cities, state agencies, departments, and authorities of the Commonwealth of Virginia. It is an open-ended money market type fund that offers public funds investors daily liquidity, diversification, and professional management. Further, Treasury manages the Commonwealth's statewide banking network and monitors its own and other agencies' specialized banking services.

Through providing staff services to the Treasury Board, Treasury is also responsible for the issuance and management of debt of the Commonwealth and several of its boards and authorities. Treasury monitors outstanding Commonwealth debt issued by certain boards and authorities for financial reporting and analysis purposes and provides staff support to the Virginia Public School Authority, the Virginia College Building Authority, the Virginia Public Building Authority, the Debt Capacity Advisory Committee, and the Treasury Board.

Finally, Treasury administers insurance programs on behalf of the Commonwealth that cover state government, other public entities, and certain individuals serving in the public interest. Administered insurance programs are either self-insured or commercially insured. Treasury bills state

agencies, the Compensation Board, and local governments for insurance premiums to cover current and future costs. Types of insurance include liability and property insurance and fidelity bonds.

We performed an audit of the financial activity of the Local Government Investment Pool, the Virginia College Building Authority, the Virginia Public School Authority, and the Virginia Public Building Authority for the year ended June 30, 2013, and reported our audit results in a separate audit report issued in January 2014.

Bond and Loan Retirement and Redemption

The Code of Virginia sets forth the appointments to the Treasury Board, which includes the State Treasurer, the State Comptroller, the State Tax Commissioner, and four members appointed by the Governor. Treasury provides support services to the Treasury Board in fulfilling its responsibilities, which include the following.

- Exercise general supervision over the investment of state funds
- Administer the Virginia Security for Public Deposits Act
- Control and manage sinking and other funds that the Commonwealth holds as fiduciary
- Contract with an outside manager for the administration of the State Non-Arbitrage Program
- Provide advice and supervision in the financing of state buildings
- Approve the terms and structure of proposed state educational institution bond issues and other financing arrangements
- Approve the terms and structure of proposed bond issues secured by state appropriations
- Administer the regional jail financing reimbursement program
- Issue all general obligation debt of the Commonwealth
- Manage its bond issues in compliance with federal taxation and arbitrage laws

In addition, the Treasury Board makes payments for the Virginia College Building Authority and the Virginia Public Building Authority for lease payments and/or bond principal and interest on the Authorities' appropriation-supported debt. The Board also pays debt service on Article X, Section 9(b) general obligation bonds and processes debt service payments to trustees and/or paying agents on behalf of the Commonwealth Transportation Board.

Financial Systems Development and Management

Accounts operates and maintains the Commonwealth's centralized automated accounting, payroll, and fixed asset systems. CARS is a cash-basis accounting system that records all of the Commonwealth's cash receipts and disbursement transactions and provides a means to enforce state

appropriation law for all state agencies through automatic edits and manual reviews. The Commonwealth Integrated Payroll/Personnel System (CIPPS) is the Commonwealth's central payroll and leave system. Agencies and institutions use CIPPS to process employee salaries and wages, tax computations, payroll deductions, and leave transactions. The Fixed Asset Accounting and Control System (FAACS) and Lease Accounting System (LAS) record the Commonwealth's capital and controllable assets and equipment leases.

Accounting Services

To facilitate the operation of CARS, CIPPS, FAACS, and LAS, Accounts has developed policies and procedures for entering transactions in the systems and offers periodic training courses to other agencies. In addition, Accounts grants access to the systems, monitors activity in the systems, provides assistance to agencies on financial reporting issues, performs reconciliations, and resolves errors as necessary.

Accounts processes certain transactions in CARS including reoccurring or correcting journal entries, transfers as required by the Appropriation Act, and the quarterly calculation and allocation among the various funds of interest earned by Treasury on the Commonwealth's cash and investments. Accounts is responsible for all aspects of the payroll process including payroll production, payroll and benefits accounting, and compliance with state and federal tax regulations.

Accounts calculates and distributes certain revenues collected by Taxation to local governments as required by the Code of Virginia. The Appropriation Act budgets and Accounts records these transfer payments under agency 162, Department of Accounts Transfer Payments. Accounts distributed the following amount of revenue during fiscal year 2013.

Sales and use tax for education	\$1,201,739,278
Personal Property Tax Relief Act	950,000,000
Recordation taxes	16,798,604
Other	<u>3,003,402</u>
Total	<u>\$2,171,541,284</u>

Source: Commonwealth Accounting and Reporting System

Accounts also made recordation tax transfers to the Department of Transportation for the Northern Virginia Transportation District Fund and the Transportation Improvement Set-Aside Fund in the amounts of \$20,457,317 and \$1,031,356, respectively.

Another accounting services item Accounts completes is the preparation of several key reports used to monitor the Commonwealth's activity throughout the year and report year-end results. The other agencies within the Finance Secretariat contribute to this process due to the significance of their roles in the budgeting and financial management activities of the Commonwealth.

During the year, the Commonwealth monitors its General Fund revenue collections using the Monthly Revenue Report, which the Secretary of Finance issues. Accounts accumulates the financial

information for this report from CARS and various agencies. Taxation provides Accounts with the General Fund revenue forecast for the report and provides detailed information on certain actual revenue collections. Treasury provides Accounts with information on the Commonwealth's investing activity.

At year-end, Accounts prepares two reports: The General Fund Preliminary Report and the Comprehensive Annual Financial Report (CAFR). Accounts prepares the General Fund Preliminary Report using CARS financial activity and information provided by Planning and Budget for the classification of remaining General Fund balances. Accounts prepares the CAFR using financial activity recorded in CARS as well as information submitted by agencies. Due to the significance of the activity controlled by Taxation and Treasury, these agencies must work closely with Accounts in providing the information necessary to prepare the CAFR. To ensure accuracy of the data in the General Fund Preliminary Report and CAFR, the Financial Reporting division of Accounts performs periodic quality assurance reviews of agency submitted information.

Other reports prepared throughout the year include the Popular Annual Financial Report, the federal and full-costing Statewide Indirect Cost Allocation Plan, and the Statewide Schedule of Expenditures of Federal Awards.

Service Center Administration

The Payroll Service Bureau division of Accounts processes payroll, leave accounting, and certain benefits data entry functions for selected agencies. Additionally, the Finance and Administration Division of Accounts provides services for selected agencies, including processing payroll, vendor payments, and revenues.



COMMONWEALTH of VIRGINIA

DAVID A. VON MOLL, CPA
COMPTROLLER

Office of the Comptroller

P. O. BOX 1971
RICHMOND, VIRGINIA 23218-1971

January 31, 2014

Ms. Martha S. Mavredes
Auditor of Public Accounts
James Monroe Building
101 N. 14th Street
Richmond, Virginia 23219

Dear Ms. Mavredes:

The Department of Accounts (Accounts) appreciates the opportunity to respond to the *Comments to Management* contained in your 2013 Secretary of Finance Audit Report. We give your comments the highest level of importance and consideration as we continue to review and improve our current practices. Accounts appreciates your acknowledgement of the progress made and the recognition that some issues take significant time and resources to resolve.

Comments to Management

Status of System Development Projects and Other Modernization Efforts

Status of Systems Development Projects

Accounts understands the risks associated with older computer systems and ramifications of potential system failures and appreciates your role in helping to ensure the Commonwealth is appropriately addressing these risks. As noted in previous years, Accounts has been directly involved in the Cardinal project for several years. With the successful completion of the first two implementation phases, the State Comptroller is now the primary project sponsor and Chairman of the Enterprise Applications Steering Committee, and the Assistant State Comptroller of Accounting and Reporting is also a voting member. To date, Accounts has assigned seven permanent project members to the Cardinal project team and has dedicated resources to address the vendor standardization initiative and expanding efforts to strengthen agency oversight. As noted, Accounts has established the Enterprise Applications Internal Service Fund and applicable rates, which have been approved by JLARC, and will fully fund the Cardinal and Performance Budgeting systems.

Modernization of Financial Reporting Processes

Accounts appreciates the recognition that the financial reporting landscape is changing and that additional process changes are required to successfully navigate additional reporting complexities arising from new accounting standards, laws and regulations while facing decreasing numbers of financial reporting staff in the Commonwealth. Accounts' General Accounting and Financial Reporting Divisions are striving to identify new systems applications or changes to existing applications in order to evaluate the appropriate accounting and reporting treatment. Additionally, the Financial Reporting Division has incorporated, and continues to explore the expanded use of, databases into the reporting process. Accounts will continue using a risk-based approach when evaluating agency financial information. The Finance and Administration Division will continue to evaluate both efficiency and effectiveness of

agency processes when performing agency quality assurance reviews. Accounts will strengthen partnership arrangements with line agencies to facilitate the agencies' understanding and process improvements. Accounts will continue to evaluate the best means of communicating with agencies and provide comprehensive policies and procedures governing the Cardinal operation prior to implementation.

Upcoming Pension Accounting Changes

As noted, the newly issued Governmental Accounting Standards Board standards for accounting and reporting pension activity for state and local governments will change the way the Commonwealth and localities compute and report pension obligations. Accounts will work with the Virginia Retirement System to implement necessary changes to the System's financial statements in fiscal year 2014 and the Commonwealth's financial statements in fiscal year 2015.

Improve SQL Server Database Security

Accounts recognizes the need to improve security controls to reduce the unnecessary risk to data confidentiality, integrity and availability of sensitive data. Accounts has taken the steps necessary to address the five control weaknesses communicated to Accounts management in the document marked Freedom of Information Act Exempt under Section 2.2-3705.2 of the Code of Virginia. Additionally, Accounts has dedicated the newly hired Information Security Officer (ISO) and other technical resources to implement the security controls discussed in the communication marked FOIA-Exempt in accordance with the Commonwealth's IT Security Audit Standard, SEC501-07.1.

Update the Physical Security Policy and Monitor Physical Access to the Data Center

Accounts concurs that the Security and Access Policies for the newly built facility that houses Accounts' servers needs to be updated. Since the Department of General Services (DGS) controls the automated access to the new facility, Accounts will work with DGS to develop and implement a Memorandum of Understanding (MOU) to control access, since both departments house sensitive data and equipment in the new facility.

Improve Financial Reporting and Communication with Agencies

Accounts agrees with the Auditor's recommendation to continue to improve the communication between Accounts and agencies that provide complex and significant financial information for inclusion in the Commonwealth's Comprehensive Annual Financial Report. As noted in the recommendation, Accounts has taken steps to improve communications with agencies in recent years. We will continue to strengthen these efforts to include targeted communications with agencies whose business processes generate financial information that is susceptible to higher risk of material reporting errors.

Sincerely,



David A. Von Moll

Copy: The Honorable Richard D. Brown, Secretary of Finance
Lewis R. McCabe, Jr., Assistant State Comptroller – Accounting & Reporting



COMMONWEALTH of VIRGINIA

Department of Taxation

January 20, 2014

Ms. Martha S. Mavredes
Auditor of Public Accounts
101 N. 14th Street
Richmond, Virginia 23219

Dear Ms. Mavredes:

Thank you for the opportunity to provide the Department of Taxation's response to the findings identified as part of your audit of Taxation's financial records and operations for the year ended June 30, 2013. A short summary of Taxation's plan to address the report findings follows:

Improve Financial Reporting for Corporate Tax Refund Liability

Although, we believe the error detected in this estimate calculation to be isolated, we understand the importance of Taxation's activities to the CAFR. To ensure accurate financial reporting for the Corporate Tax Refund Liability estimate, Taxation will add the following three additional controls:

- 1) TAX will ensure the estimate calculation does not include any corporate tax refunds included as a note payable;
- 2) To facilitate management review, the preparer of the estimate will explicitly identify any unusual items on the work paper lead schedule; and
- 3) Two additional employees will review the estimate before it is submitted to the Department of Accounts.

The development plan for this finding will have a completion date of October 31, 2014.

Improve Internal Controls over Advantage Revenue Access

We appreciate the acknowledgment that your testing did not detect any unauthorized transactions and that there were compensating controls designed to prevent or detect any unapproved transactions. Nonetheless, Advantage Revenue security is of paramount importance at Taxation. In response to the audit finding, Taxation will improve documentation of user access in the Advantage Revenue application down to the workgroup and resource level. In addition, TAX will also improve the guidance provided to Advantage Revenue access approvers during the annual access recertification. The development plan for this finding will have a completion date of October 31, 2014.

Taxation strives to maintain strong internal controls and business processes that ensure high standards of integrity, efficiency, and control. Completely addressing your report finding will clearly promote this goal. Again, thank you for the opportunity to respond to your report.

Sincerely,

A handwritten signature in black ink, appearing to read "Craig M. Burns".

Craig M. Burns
Tax Commissioner

cc: The Honorable Richard D. Brown



COMMONWEALTH of VIRGINIA

MANJU S. GANERIWALA
TREASURER OF VIRGINIA

Department of the Treasury

January 30, 2014

P. O. BOX 1879
RICHMOND, VIRGINIA 23218-1879
(804) 225-2142
Fax (804) 225-3187

Ms. Martha S. Mavredes
Auditor of Public Accounts
James Monroe Building
101 N. 14th Street
Richmond, Virginia 23219

Dear Ms. Mavredes:

The Department of the Treasury (Treasury) appreciates the opportunity to respond to both the *Improve Monitoring of Administrative and Compliance Activities* and the *Improve Process for Paying Risk Management Invoices* recommendations in your Report on Audit of the Agencies of the Secretary of Finance for the fiscal year ended June 30, 2013. Your comments and recommendations are appreciated and given the highest level of consideration by Treasury as we continually strive to improve our processes.

Comments to Management

Improve Monitoring of Administrative and Compliance Activities

Treasury management agrees that monitoring activities are essential to ensure efficient and effective operations. As noted in your report, we have already reviewed our processes and made subsequent improvements in our State and Local Government Conflict of Interest Act training and disabling access processes. Additionally, we will further review our documentation of internal monitoring processes.

Improve Process for Paying Risk Management Invoices

As noted in your report, the duplicate payment cited was quickly remitted back to the Treasury resulting in no lost funds to the Commonwealth. After discovering this oversight, Treasury management modified its internal review processes to further reduce the risk of a duplicate payment. Treasury will also review its Risk Management approval of invoices to ensure there are sufficient internal controls.

Sincerely,

A handwritten signature in cursive script that reads "Manju S. Ganeriwala".

Manju S. Ganeriwala

cc: The Honorable Ric Brown, Secretary of Finance
Mr. Robert Young, Deputy Treasurer
Ms. Brandy Mikell, Director of Internal Review

SECRETARY OF FINANCE AGENCY OFFICIALS

As of June 30, 2013

Richard D. Brown
Secretary of Finance

David A. Von Moll
Comptroller

Daniel S. Timberlake
Director of the Department of Planning and Budget

Craig M. Burns
Tax Commissioner

Manju S. Ganeriwala
Treasurer