

**REVIEW OF THE  
BUDGET AND APPROPRIATION  
PROCESSING CONTROL SYSTEM**

**REPORT ON AUDIT  
FOR THE YEAR ENDED  
JUNE 30, 2006**



## AUDIT SUMMARY

Through the Appropriation Act (Act) and general law, the Governor and the Department of Planning and Budget (Planning and Budget) have certain statutory authority to increase, decrease, or transfer funds and personnel positions during the fiscal year within constraints of the Act. Planning and Budget commonly refers to these budgetary changes as administrative adjustments. Planning and Budget operates a budget system to ensure that agencies conduct their activities within the fund limitations provided in the Appropriation Act, and in accordance with gubernatorial and legislative intent.

Overall, administrative adjustments to the 2005 Acts of General Assembly, Chapter 951 budget resulted in a \$3.7 billion increase in the operating budget, a 12 percent increase. These adjustments result for a variety of reasons, some of which are necessary to process General Assembly actions, and we provide more detail on the adjustments by type in this report. These adjustments are within the authority granted to Planning and Budget and the Governor by the General Assembly through the Appropriations Act. As shown in the table below, administrative adjustments resulted in the appearance of close to a \$3 billion decrease in the general fund budget and a \$6.7 billion increase in the non-general fund budget.

### Fiscal Year 2006 Summary of Operating Budget Adjustments

	<u>General Fund</u>	<u>Non-General Fund</u>	<u>Total</u>
Original Budget, Chapter 951	\$14,632,160,021	\$16,957,490,348	\$31,589,650,369
Subsequent legislative amendments	483,591,611	(77,212,678)	406,378,933
Administrative adjustments	<u>(2,921,063,614)</u>	<u>6,669,682,713</u>	<u>3,748,619,099</u>
Adjusted budget, June 30, 2006	<u>\$12,194,688,018</u>	<u>\$23,549,960,383</u>	<u>\$35,744,648,401</u>
Net increase/decrease in original budget	\$ (2,437,472,003)	\$ 6,592,470,035	\$ 4,154,998,032

Our analysis of these administrative adjustments, as well as our experience maintaining budgeting and accounting information on our Data Point website, have brought several budget transparency issues to our attention which we have included in this report. These issues affect the ability of the average citizen to understand where and how the state is using its resources. The most significant of these issues is the transfer of General Funds to other funds that occurs after the budget's approval for programs such as Personal Property Tax Relief. This process makes it difficult to follow the actions of the Governor and General Assembly from the approved budget to the accounting reports. Further, except for individuals familiar with the budget and accounting process, there is a loss of transparency of over \$3.1 billion of general funds.

Addressing these budget transparency issues will involve both executive and legislative leadership, and it is important that resolution of these issues occurs before the Commonwealth invests substantial resources in the Enterprise System initiative. Two of the first applications of the Commonwealth's Enterprise System are the Budget Development and Execution, and General Ledger Accounting modules. The importance of tracking all General Funds from their collection to disbursement should be a high priority of the new system.

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## **REVIEW OF THE BUDGET AND APPROPRIATION**

### **PROCESSING CONTROL SYSTEM**

#### **Discussion of Statewide Budget Transparency Issues**

Through the Act and general law, the Governor and Planning and Budget have certain statutory authority to increase, decrease, or transfer funds and personnel positions during the fiscal year within constraints of the Act. Planning and Budget commonly refers to these budgetary changes as administrative adjustments. As part of this review, we analyzed and reviewed administrative adjustments and have included detailed analyses on these adjustments in the following sections of the report, “Operating Budget Adjustments” and “Capital Budget Adjustments”. Our analysis of these administrative adjustments, as well as our experience maintaining budgeting and accounting information on our Data Point website, have brought several budget transparency issues to our attention.

Budget transparency allows any informed citizen sufficient ease in understanding and following the budget process without having any special training. This term describes a budget process which is clear, visible, and understandable to a citizen with an interest in the information. We believe the following practices affect the transparency of the budget and the Governor and Planning and Budget, in conjunction with the legislature, should consider how best to address these issues.

- Significant transfers of General Funds to other funds occur after the budget’s approval for programs such as Personal Property Tax Relief. As a result, these General Funds lose their identity, making it difficult to identify the source of funds for these programs in the accounting records. These transfers occur to comply with various requirements in the Appropriation Act, which require setting aside and spending these funds from a separate fund.

While the intention of the requirement is the segregation of these funds to track and monitor their activity, this practice creates a disconnect between the budgeting and accounting for the program. There are several issues contributing to this practice; first, the legislature frequently creates these separate or segregated funds as part of the budget process with the intent to isolate the accounting for certain funds. Second, the current accounting structure does not allow for a mechanism to separately account for these funds without moving them to a special revenue fund, which loses their classification as General Funds. These transfers totaled \$1.7 billion in 2006 and we have a detailed discussion below in the “Operating Budget Adjustments – Transfers” section.

- Significant transfers of General Funds to higher education operating funds also occur after budget approval. The Act gives Planning and Budget the authority to make these transfers. The General Assembly originally permitted these transfers over twenty years ago to simplify accounting for these funds at each university. This practice has the same result as described above, with general funds losing their identity in the process, thus creating a lack of transparency in the budget with regards to general funds used for higher education. These transfers totaled almost \$1.5 billion in 2006, and represented 25 percent of the total higher education budget.

- There are significant increases to the non-general fund budget occurring after budget approval for items not included in the original budget proposal. These increases typically occur for two specific reasons. First, agencies collect additional revenues that they did not anticipate during the budget development process. These adjustments totaled \$1 billion in 2006 and are in the “Operating Budget Adjustments – Additional Revenue Appropriations” section. Second, there are increases to allow agencies to spend their unspent cash balances remaining at the end of the prior year. These adjustments totaled \$760 million, most of which were Transportation cash balances.
- Currently, there is no requirement that Planning and Budget report on administrative adjustments processed during the year and their effect on the approved budget. While the Comptroller’s year-end preliminary financial report does show some original and final budget information, it focuses primarily on the General Fund. Other than the Comptroller’s report and our Data Point website, there is no statewide budget information reported that includes the administrative budget adjustments. Without a formal reporting mechanism in place, legislators and the average citizen have no mechanism to understand changes to the budget after its approval.

The difference between the final budget and the Appropriation Act adopted by the Governor and General Assembly is the result of a number of actions that occur through the normal operations of any governmental unit. Unlike a city or county governing body, which individually considers these matters throughout a fiscal year, the General Assembly has delegated this responsibility to the Governor and Planning and Budget. Some of these changes are the result of external factors such as an increase in Federal funds for a specific purpose or the unanticipated sales of cars causing additional fee collections at the Department of Motor Vehicles. Other changes are the result of actions taken by the General Assembly to authorize the sale of bonds or grant raises to employees, which require an allocation to individual agencies and institutions.

As previously discussed, many of these actions and the methods used to record them tend to obscure the effect of the transactions on both the budgeted amounts and in some case, the use of such funds as the moneys in the General Fund. The following sections in the report discuss the type and amount of these adjustments, transfers and other actions.

Since the Commonwealth is undertaking the development of a new enterprise application to serve both as a budget development and accounting system, this document and its discussion of the issues of budget transparency is opportune. Looking at the nature and method of the budget adjustments, transfers and other actions would provide the chance to correct these items to enhance transparency in the new system.

## Operating Budget Adjustments

As already discussed, the Governor and Planning and Budget have the authority to make changes to the budget after its approval. Planning and Budget refers to these adjustments as “administrative adjustments”, which resulted in a \$3.7 billion (12 percent) increase to the fiscal year 2006 budget. There are a variety of reasons for administrative adjustments and the following table shows the amount of each type of adjustment and the effect on the General Fund and Non-General Fund operating budgets. These adjustments are within the authority granted to Planning and Budget and the Governor by the General Assembly through the Appropriation Act. For purposes of this analysis, we have divided the administrative adjustments into two categories in the table below – transfers, and adjustments and reappropriations. We provide more detail in the sections that follow the table on the administrative adjustments listed that had significant activity in 2006.

### Detailed Schedule of Fiscal Year 2006 Operating Budget Adjustments

	<u>General Fund</u>	<u>Non –General Fund</u>	<u>Total</u>
Original budget, Chapter 951	\$14,632,160,021	\$16,957,490,348	\$31,589,650,369
Subsequent legislative amendments	483,591,611	(77,212,678)	406,378,933
Administrative adjustments:			
Transfers:			
General Fund to Non-General Funds	(3,186,507,255)	3,186,507,255	-
Other transfers	(12,737,452)	(3,725,031)	(16,462,483)
Adjustments and reappropriations:			
Sum sufficient appropriations	9,122,671	1,497,304,390	1,506,427,061
Additional revenues	675,893	1,081,632,382	1,082,308,275
Carry forward of prior year balances	-	763,226,968	763,226,968
Deficit appropriations	158,477,436	-	158,477,436
Other Non-General Fund appropriations	-	144,736,749	144,736,749
Mandatory reappropriations	87,608,625	-	87,608,625
Discretionary reappropriations	<u>22,296,468</u>	<u>-</u>	<u>22,296,468</u>
Adjusted budget as of June 30, 2006	<u>\$12,194,688,018</u>	<u>\$23,549,960,383</u>	<u>\$35,744,648,401</u>

*Source: Commonwealth Accounting and Reporting System (CARS)*

### Transfers

There are three categories of transfer adjustments; transfers within general funds, transfers within non-general funds and transfers between general funds and non-general funds. The first two types have no effect on the final budget. However, the third type of transfer between general and non-general funds has a significant effect on the budget. These transfers usually occur to comply with a requirement set forth in the Appropriation Act, requiring the separation of the funds to monitor and control the spending of the appropriation.

While the current statewide accounting system “Commonwealth Accounting and Reporting System (CARS)” could accommodate creating separate sub-funds within the General Fund, Accounts has not attempted to do this. Instead, Accounts has elected to create separate special revenue funds to meet the Act’s

requirement to separate a portion of the General Fund for special monitoring and control. The creation of these funds changes the nature of how both the accounting and budget systems show these funds.

As the prior table shows, appropriation transfers from the General Fund to the Non-General Fund totaled \$3.1 billion in 2006. The following table lists the major types of General to Non-General fund transfers. The largest item, the transfer of general funds to higher education operating funds, accounts for over half of all these transfers. In addition, the higher education transfers represent approximately 25 percent of the total budget for higher education, which was close to \$6 billion in fiscal year 2006.

Transfers from General Fund to Non-General Funds for Fiscal Year 2006

Description of Transfer	Amount
To Higher Education Operating Funds (Chapter 951, 4-1.03)	(\$1,457,871,274)
To Personal Property Tax Relief (Chapter 951, Item 503)	(737,189,232)
To Revenue Stabilization Fund (Chapter 951, Section 280)	(584,160,131)
To Priority Transportation Fund (Chapter 951, Section 493)	(185,002,289)
To Virginia Water Quality Improvement Fund (Chapter 951, Item 382 and 388)	(153,962,000)
To Other Non-General funds	(68,322,329)
 Total Transfers from General Fund to Non-General Funds	 <u>(\$3,186,507,255)</u>

Sum Sufficient Appropriations

A sum sufficient appropriation is a mechanism within the Act to allow the Governor and agencies to deal with unique programs where either the amount of the program revenue or expenses require some flexibility to manage the program. An example is the sum sufficient appropriation that the Governor has to cover declared disasters.

Sum sufficient appropriations may have limits set by a “not to exceed” amount within the language of the Act, or it provides no specific dollar spending limit but instead is limited from amounts collected. Planning and Budget has the authority to process adjustments to increase the budget to cover sum sufficient appropriations.

The Administration of Health Insurance accounts for most of the sum sufficient appropriation. The Department of Human Resource Management manages the Administration of Health Insurance program by collecting premiums from state agencies for employees to cover state employee health claims. The current budget process includes the cost of employee health insurance at the agency level. Therefore, the Administration of Health Insurance costs are budgeted as a sum sufficient so as not to double count these amounts in the Budget Bill and the Appropriation Act. The adjustment is an increase in the state’s budget because there is an offset by the corresponding increase in revenues that the Department of Human Resources collects from agencies.

In fiscal year 2006, there were the following sum sufficient adjustments by agency and program. The Appropriation Act included the authority for each sum sufficient amount shown in the table that follows:

Sum Sufficient Budget Adjustments for Fiscal Year 2006

<u>Act Item #</u>	<u>Agency Name</u>	<u>Program</u>	<u>Amount</u>
87	Administration of Health Insurance	Personnel Management Services	\$ 868,000,000
463, 464	Virginia Information Technologies Agency	Various	243,704,274
519	State Lottery Department	Enterprise	200,000,000
76-83	Department of General Services	Various	95,306,171
521	Virginia College Savings Plan	Investment, Trust and Insurance Services	90,293,945
47	Office of the Governor	Disaster and Planning Operations	8,810,359
290	Department of the Treasury	Investment, Trust and Insurance Services	<u>312,312</u>
Total			<u>\$1,506,427,061</u>

Additional Revenue Appropriations

These types of adjustments occur when resources exceed the amount initially budgeted and appropriated. Agencies request these increases so they can spend the additional funds. For example, additional funds may become available under a federal grant that an agency did not anticipate during budget development. In this case, an agency would need to request an additional appropriation to spend these funds. In some cases, the additional resource may not represent solely revenue collections, but may also be in the form of bond proceeds or other sources of receipts not originally anticipated. The following agencies made up the majority of these adjustments in fiscal year 2006.



Additional Revenue Adjustments for Fiscal Year 2006

<u>Fund Source</u>	<u>Agency Name</u>	<u>General Explanation for Adjustment</u>	<u>Amount</u>
Various Funds	Department of Transportation	Additional revenues from FRANS sale and reappropriation of 6/30/05 balances	\$294,469,785
Federal	Dept of Education-Direct Aid To Public Education	Funds from 2006 grants to support payments to school divisions	228,400,000
Federal	Department of Emergency Management	Funds for disaster related payments	79,891,002
University Hospitals	University of Virginia Medical Center	Increased operations cost for Lynchburg Dialysis Center	74,000,000
Special and Federal	Department of Medical Assistance Services	Funds for increased Medicaid expenses and continued payment for services at mental health and retardation facilities	53,506,159
Federal	Department of Social Services	Funds for energy assistance, administration and support services	43,427,271
Premiums paid by Agencies	Administration of Health Insurance	Funds to cover anticipated claims and expenses for balance of year	35,300,000
Higher Ed	Virginia Community College System	Funds for technology, and funds for operating expenses	<u>23,761,834</u>
Total			\$832,756,051

Carry Forward of Prior Year Cash Balances

In fiscal year 2006, about 18 percent of the administrative adjustment amounts represented Planning and Budget reauthorizing agencies to spend their unused prior year non-general fund cash balances. These balances represent unspent cash in non-general funds at the end of a fiscal year, which agencies request to use in the next fiscal year. Of the \$763 million in this type of adjustment, \$600 million came from Department of Transportation year-end cash balances. The Act specifically allows Planning and Budget to take these administrative actions with both general and non-general funds.

Deficit Appropriations

This adjustment type represents additional General Fund appropriations as authorized in the Act or by the Governor. The following agencies made up these adjustments in fiscal year 2006.

Deficit Appropriation Adjustments for Fiscal Year 2006

<u>Agency Name</u>	<u>Explanation for Adjustment</u>	<u>Amount</u>
Central Appropriations-Administration	Movement of 7/3/06 payroll to 6/30/06	\$133,846,906
Department of Social Services	Additional funding for home heating assistance	14,943,953
Secretary of Commerce and Trade	Funding for the City of Virginia Beach (BRAC)	7,289,250
Dept of Housing and Community	Funding of additional weatherization assistance	<u>2,397,327</u>
	Total	<u>\$158,477,436</u>

Other Non-general Fund

This adjustment type represents an increase in appropriations for additional non-general fund resources not considered revenues. In fiscal year 2006, the increase primarily reflected an adjustment to move the first payroll for fiscal year 2007 to the end of fiscal year 2006 creating an additional payroll in fiscal year 2006.

**Central Appropriations Accounts Adjustments**

Planning and Budget also has responsibility for executing items within the Central Appropriations section of the Act. The Act uses a section known as Central Appropriations to implement budget actions, which will affect multiple agencies and funds. Central Appropriations also serve to deal with budgetary decisions, which do not require the action of an individual agency, but may require multiple agencies to execute the action. Central Appropriations includes the funding for the Personal Property Tax Relief Act, which require the segregation of the funding and the joint cooperation of the Departments of Motor Vehicles and Accounts.

Planning and Budget and Accounts establish an agency on their systems to control the budgetary transactions arising from the Central Appropriation actions in the Act. Planning and Budget relies on information from other agencies to determine the amount and allocation of the Central Appropriations to individual agencies. For example, Planning and Budget uses payroll information from Accounts and agencies to distribute increases in salary and fringe benefit amounts. In fiscal year 2006, Planning and Budget processed \$1 billion in Central Appropriations administrative budget adjustments, some of which we have already discussed in this report.

The following sections below discuss the largest appropriations from Central Appropriations by purpose, program description, and item number in Chapter 951. The tables show the amount appropriated for each program, any adjustments, the amount transferred out, and any remaining balance at year-end. For comparison, the 2007 budget approved by the 2006 General Assembly in Acts of the Assembly, Chapter 3 is included in each table.

Personnel Management Services (Program 704, Item 500)

This program provided funding for across the board increases in the state employee health insurance program. The revision of the budget structure results in this program becoming the service area “Supplements to Employee Benefits” which is part of the program “Compensation and Benefit Supplements (757)” for fiscal year 2007.

Appropriation per Chapter 951	\$ 64,942,256
Carry forward (prior year)	829,110
Transfer to agencies for increase in employer health insurance premiums	<u>(64,645,360)</u>
Unexpended balance	<u>\$ 1,126,006</u>
Proposed Appropriation for 2007 (Supplements to Employee Benefits, Item 461)	\$ 70,284,004

Tobacco Settlement Funds (Program 745, Item 502)

This item provides spending authority for the Tobacco Indemnification and Community Revitalization Fund and the Virginia Tobacco Settlement Fund from amounts awarded to the Commonwealth under the Master Settlement Agreement with tobacco manufacturers.

Appropriation per Chapter 951	\$ 76,662, 113
Transfers to Tobacco Indemnification and Community Revitalization Fund and Tobacco Settlement Fund	(63,885,094)
Transfer to Tobacco Settlement Fund	<u>(12,777,019)</u>
Unexpended Balance	<u>\$ -</u>
Proposed Appropriation for 2007	\$ 46,971,974

Personal Property Tax Relief (Program 746, Item 503)

This item includes the Commonwealth’s portion of the Personal Property Tax Relief amounts paid to localities for registered vehicles assessed at \$20,000 or less and limited to personal use. The General Assembly capped the total amount for the tax year 2006 at \$950 million. In fiscal year 2006, Planning and Budget made quarterly transfers of \$185.5 million from this account to Agency 850-Personal Property Tax Relief (PPTR) so that Accounts could distribute the amount to localities.

Appropriation per Chapter 951	\$ 742,389,232
Quarterly transfers to Agency 850	<u>(742,389,232)</u>
Unexpended balance	<u>\$ -</u>
Proposed appropriation for 2007	\$ 950,000,000

Compensation Supplements (Program 757, Item 505)

This item provides a mechanism for funding for increases in state employee salaries and benefits.

Appropriation per Chapter 951	\$ 151,154,479
Appropriation per Chapter 2	523,132
Reappropriation of Health Insurance Funding Carry Forward (prior year)	5,522,004
Appropriation for the 7/3/06 payroll to be paid in fiscal 2006	143,015,032
Deficit appropriation for the 7/3/06 payroll	133,846,906
Transfer for allocation of the 7/3/06 payroll to agencies	(327,669,059)
Transfer for state employee salary increase	(79,104,407)
Transfer for sheriffs' salary increase	2,975,722
Transfer for local salary increases	(18,754,394)
Transfer to agencies for increase in state disability rates	(5,397,632)
Other transfers	<u>(75,094)</u>
 Unexpended balance	 <u>\$ 6,036,689</u>
Proposed appropriation for 2007	\$ 137,085,279

Economic Contingency (Program 758, Item 506)

This item provides funding to address emergency or other unbudgeted costs to state agencies for essential commodities and services, which agencies cannot absorb in their existing appropriations.

Appropriation per Chapter 951	\$36,516,615
Appropriation per Chapter 2	7,617,385
Reappropriation of economic contingency factor	7,940,422
Transfer to Governor's Opportunity Fund	(9,000,000)
Transfer to Semiconductor Memory or Logic Wafer Manufacturing	(6,720,000)
Transfer to Social Services (cooling assistance program)	(1,500,000)
Transfer to support economic, cultural and tourism programs	(5,110,917)
Transfer for higher education	(3,796,206)
Transfer for grant for the Virginia Horse Center	(900,000)
Transfer for school nutrition	(1,172,020)
Transfers for sheriff salary increases	(2,975,722)
Transfer for VCU Grace E. Harris Leadership Institute	(2,100,000)
Transfer for legal funding	(1,039,067)
Other transfers	<u>(3,164,166)</u>
 Unexpended Balance	 <u>\$14,596,324</u>
Proposed Appropriation for 2007	\$53,057,985

## **Capital Budget Adjustments**

In fiscal year 2006, administrative adjustments to the capital budget resulted in a net increase of approximately \$4.5 billion. Most of the adjustments represent unspent appropriations at the end of a fiscal year rolled over into the next fiscal year. Due to the nature of capital projects, which can span several years, Planning and Budget routinely processes these adjustments directly in CARS. The following table shows capital budget adjustments by type. Following the table is a discussion of the largest adjustments by type.

### **Detailed Schedule of Fiscal Year 2006 Capital Budget Adjustments**

	<u>General Fund</u>	<u>Non-General Fund</u>	<u>Total</u>
Original Budget, Chapter 951	\$112,444,118	\$ 261,694,600	\$ 374,138,718
Subsequent legislative amendments	\$ 8,150,000	\$ 91,706,170	\$ 99,856,170
Administrative adjustments:			
Transfers:			
Transfer from second to first year	(22,671,000)	(2,125,640)	(24,796,640)
Other transfers	(4,534,323)	5,350,897	816,574
Appropriations and re-appropriations:			
Carry forward of prior year balances	114,830,068	4,234,472,929	4,349,302,997
Additional revenues	3,042,657	20,119,027	\$23,161,684
Other Non-General Fund Appropriations	-	213,222,442	213,222,442
Reversions	<u>(135)</u>	<u>(81,063,829)</u>	<u>(81,063,964)</u>
Adjusted Budget as of June 30, 2006	<u>\$211,261,385</u>	<u>\$4,743,376,595</u>	<u>\$4,954,637,981</u>

*Source: CARS*

### **Carry Forward of Prior Year Balances**

This adjustment type is most of the \$4.5 billion increase to the budget. It represents unused appropriations for projects previously approved by the General Assembly. In the second year of a biennium, these reappropriations roll forward by an automated process in the CARS system, and do not require processing through Planning and Budget's system.

### **Other Non-General Funds**

This adjustment type represents an increase in appropriations to supplement the appropriation for a capital project from available balances, operating revenue, or from the proceeds of bond issues. This type of adjustment is primarily to show the inflows of funds from bond proceeds.

### **Reversions**

Unexpended appropriations from completed or closed capital projects revert back to their funding source. This is an automated process completed and recorded directly in CARS.

## **Background Information on Budget Execution Process**

Virginia has a biennial budget system, which means it adopts a two-year budget. The budget development process involves many participants and spans several months. The Act is a special piece of legislation to authorize the spending of the projected revenues approved by the General Assembly and the Governor. The Virginia Constitution limits appropriation acts to a life of two years and six months, unless shortened by the Act and requires a balanced budget.

The following chart shows the projected revenue and appropriation for fiscal year 2006 during the 2004-2006 biennium as shown in the original and then amended in subsequent Acts. Chapter 4 represents the original budget for the first year of the biennium. Chapter 951 amended the budget at the end of the first fiscal year of the biennium and Chapter 2 amended Chapter 951 at the end of the second year of the biennium. Although revenues appear to exceed appropriations in Chapter 951, the Act did meet the Constitutional requirement of a balanced budget. The Virginia Constitution requires balancing the total biennial budget not the amount for any one year. Therefore, showing only one year does not show the overall balancing.

### **2006 Projected Revenues and Appropriations Approved by the General Assembly**

<u>General Assembly Session</u>	<u>Appropriation Act Chapter</u>	<u>Projected Revenues</u>	<u>Appropriation</u>
2004	Chapter 4	\$29,909,564,374	\$29,806,156,463
2005	Chapter 951	31,556,504,827	31,963,789,087
2006	Chapter 2	33,121,530,524	32,455,944,190

The Commonwealth budgets expenses based on projected state revenues. State statutes differentiate revenues into two broad categories: general and non-general funds. Non-general funds are revenues that, by law or external authorities, support specific programs, activities, or purposes.

General funds consist primarily of taxes paid by Virginia citizens and businesses, including fees and other revenues that support basic governmental programs. The Governor and General Assembly have more discretion in allocating general funds to programs than non-general funds. The Commonwealth budgets separately for operating expenses and capital projects due to the long-term and non-recurring nature of capital expenses.

The Governor and Planning and Budget have certain statutory authority to increase, decrease, or transfer funds and positions during the implementation of the budget. This authority is primarily set forth in Section 4-1.00 of the Act, but there are also other requirements throughout the Act.

Section 4-1.00 establishes the overall criteria by which an agency can request appropriation adjustments. The Director of Planning and Budget has further delegated his authority over certain types of adjustments to Planning and Budget staff, and documented this delegation of authority in a memorandum, effective October 18, 2006. Under this delegation, for example, Planning and Budget analysts have the authority to transfer appropriations between programs within an agency; however, appropriations transfers between agencies require authorization by a Planning and Budget Associate Director or the Director.

Upon approval of the Act, the Division of Legislative Services sends an electronic file with the appropriation data to Planning and Budget. Planning and Budget performs various control procedures to ensure the file's completeness and accuracy and then creates a budget development master (BDM) file on the mainframe. Planning and Budget then creates an execution master (EXM) file from the BDM file along with a copy for the Department of Accounts (Accounts). Planning and Budget procedures vary depending on whether the file contains a new biennial budget or amendments to an existing budget. Accounts accesses its appropriation file copy and uploads the data to CARS.

The appropriations set forth in the Act set annual legal spending limits by secretarial area, agency, program, and project. Automated edit controls within CARS ensure agencies do not exceed their spending authority at each of these levels. CARS edit controls analyze expenses to determine if appropriations and allotments are sufficient before paying an expense transaction. However, there are instances where Accounts can override transactions that do not meet appropriation edit controls. Although Accounts may override the controls, Accounts implements additional manual control procedures to ensure that agencies do not exceed their authorized appropriation levels.

Planning and Budget operates several information systems that support the budget process. The Form 27 Automated Transaction System (FATS) processes most administrative changes to the budget. Planning and Budget maintains FATS and controls the granting and deleting of access for individual users. Agency personnel initiate most budget adjustments and staff of Planning and Budget approve and process these adjustments through FATS. During fiscal year 2006, Planning and Budget processed over 9,500 budget adjustments through FATS.

The level of supervisory review within Planning and Budget depends on the type of the transaction. FATS transactions are subject to a series of edits that verify the accuracy of the information. These edit controls include verifying funding availability, validity of program codes, agency codes, project codes, fund detail and the completion of transaction briefs. Planning and Budget staff complete transaction briefs in FATS and maintain additional documents that explain details of certain FATS transactions.

After Planning and Budget approval, staff upload FATS transactions into an EXM file on the mainframe, which updates CARS on a nightly basis. Planning and Budget and Accounts staff review a daily listing to verify the proper processing of FATS transactions in CARS. Amendments to the Act approved by the General Assembly do not go through FATS, but go directly to Accounts for loading to CARS. Within FATS, Planning and Budget uses alpha codes to differentiate types of budget adjustments. The FATS adjustment type code initiates the proper program budgeting adjustment and when uploaded to CARS identifies the correct transaction codes for recording in CARS.

There are a few types of routine appropriation adjustments that do not flow through FATS that Accounts records directly in CARS. An example is the transfer of the initial higher education general funds appropriations to non-general funds and the transfer of transportation general funds to non-general funds.

## **AUDIT FINDINGS AND RECOMMENDATIONS**

### **Complete an Information Security Program**

Planning and Budget does not have a complete or current information security program; therefore they do not meet Virginia's information technology security standard, ITRM Standard SEC 2001-01.1. Although Planning and Budget does have informal security procedures, the security plan is undocumented. Planning and Budget should have a documented security program that includes policies and procedures to provide reasonable assurance that appropriate levels of confidentiality, integrity, and availability exist over data in their possession, and would meet the Commonwealth's new IT Security Standard 501-01. A well developed security program should include documented policies and procedures consisting of the following components:

- Information Security Responsibilities and Separation of Duties
- Information Security Officer Role
- Risk Management
- IT Contingency Planning
- IT Systems Security
- Logical Access Control
- Data Protection
- Facilities Security
- Personnel Security
- Threat Management
- IT Asset Management

A comprehensive information security program provides the essential framework to protect the data on information systems and the data handled by employees. The lack of a comprehensive information security program prevents Planning and Budget's management from assessing the current or potential risks to their data, and enabling them to adequately prevent or minimize those risks. Planning and Budget should allocate the time and resources necessary to complete a comprehensive information security program that will meet industry best practices.

### **Improve Documentation of Appropriation Adjustments**

Planning and Budget staff should follow the procedures in the Form 27 Automated Transaction (FATS) Manual when preparing and approving transaction briefs. Transaction brief is the term used to define the narrative explanation supporting a budget adjustment along with the transaction amount. The manual specifies the documentation necessary for the transaction brief that accompany certain types of FATS adjustments.

We reviewed a sample of 46 FATS adjustments from fiscal year 2006, and identified seven (15 percent) transactions where the transaction brief did not meet the criteria in the Manual. We also identified six FATS transactions from fiscal year 2007 where the transaction brief did not meet the criteria in the manual. Without the required documentation to support the adjustments, it is not possible to determine whether Planning and Budget staff appropriately analyzed these adjustments before approval.



We recommend Planning and Budget staff follow the requirements of the FATS Manual. As part of this, management should ensure that budget analysts, both at Planning and Budget and at the agencies have adequate training to properly record and document transaction briefs. These recommendations are similar to recommendations in our previous report.

In response to our previous report, Planning and Budget responded by saying they would take several actions, including updating the FATS manual to reflect current agency practices, and have FATS training for all analytical staff by March 31, 2006. We received an updated FATS manual in January 2007, after the completion of our audit work. We encourage Planning and Budget to make training on these updated procedures a priority to strengthen internal controls over the appropriation adjustment processes.



# Commonwealth of Virginia

**Walter J. Kucharski, Auditor**

**Auditor of Public Accounts  
P.O. Box 1295  
Richmond, Virginia 23218**

January 26, 2007

The Honorable Timothy M. Kaine  
Governor of Virginia  
State Capital  
Richmond, Virginia

The Honorable Thomas K. Norment, Jr.  
Chairman, Joint Legislative Audit  
and Review Commission  
General Assembly Building  
Richmond, Virginia

## INDEPENDENT AUDITOR'S REPORT

We have completed a **Review of the Budget and Appropriation Processing Control System** administered by the Department of Planning and Budget for the year ended June 30, 2006. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

### Audit Objectives

The overall purpose of our audit was to evaluate the adequacy of statewide budget and appropriation processing controls. The following objectives satisfy the audit's purpose by determining whether policies and procedures were adequate to ensure:

1. Planning and Budget is in compliance with requirements in the Appropriations Act and the Code of Virginia that could materially affect the Commonwealth's annual financial statements;
2. The budget approved by the General Assembly is properly recorded in the Commonwealth Accounting and Reporting System (CARS);
3. Appropriation controls in CARS are adequate to ensure program expenses do not exceed appropriations;
4. Budget adjustments processed by Planning and Budget in the Form 27 Automated Transaction System (FATS) are properly approved, documented; and reconciled to CARS at the statewide level;
5. User access to FATS is reasonable;
6. Systems security over critical systems, applications and data is in compliance with established state standards; and
7. Review of corrective actions of audit findings from the prior year audit report.

## Audit Scope and Methodology

Planning and Budget's 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 gained an understanding of the overall internal controls, automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the significant cycles, classes of transactions, and account balances.

We performed audit tests to determine whether Planning and Budget's 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 and records, and observation of Planning and Budget's operations.

We tested transactions and performed analytical procedures, as we considered necessary to achieve audit objectives. Our review included research of relevant sections of the Code of Virginia, the Act, and applicable policies and procedures at Planning and Budget and the Department of Accounts. It included gaining an understanding of the budget process, including reconciling, and monitoring the budget approved by the General Assembly. In addition, we reviewed and analyzed adjustments made to the budget, appropriation controls in CARS, and access to budget systems.

## Conclusions

We found that Planning and Budget's policies and procedures for the budget and appropriation process control system were adequate to ensure that:

1. Planning and Budget is in compliance with requirements in the Act and the Code of Virginia that could materially affect the Commonwealth's annual financial statements;
2. The budget approved by the General Assembly is properly recorded CARS;
3. Appropriation controls in CARS are adequate to ensure program expenses do not exceed appropriations;
4. Budget adjustments processed by Planning and Budget in the Form 27 Automated Transaction System (FATS) are properly approved, documented; and reconciled to CARS at the statewide level;
5. User access to FATS is reasonable;
6. Systems security over critical systems, applications and data is in compliance with established state standards; and

We noted certain matters involving internal control and its operation and compliance that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations."

The results of our test of compliance with applicable laws and regulations disclosed an instance of noncompliance that is required to be reported under Government Auditing Standards. This matter is described in the section entitled “Audit Findings and Recommendations.”

Planning and Budget has taken adequate corrective action with respect to those audit findings reported in the prior year that are not repeated in this letter.

#### EXIT CONFERENCE AND REPORT DISTRIBUTION

We discussed this report with Planning and Budget management on April 3, 2007. Management’s response has been included at the end of this report.

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

AUDITOR OF PUBLIC ACCOUNTS

LCW:sks



**COMMONWEALTH of VIRGINIA**  
*Department of Planning and Budget*

**Richard D. Brown**  
Director

1111 E. Broad St., Room 5040  
Richmond, VA. 23219

April 4, 2007

Mr. Walter J. Kucharski  
Auditor of Public Accounts  
P.O. Box 1295  
Richmond, Virginia 23218

Dear Mr. Kucharski:

I have reviewed the Auditor of Public Accounts' 2006 audit of the Department of Planning and Budget (DPB) and recognize the internal control findings and recommendations. DPB's corrective action plan follows each finding.

**Finding: Complete an Information Security Program**

The Department of Planning and Budget (DPB) does not have a complete or current information security program; therefore they are not in compliance with Virginia's IT security standard, ITRM Standard SEC 2001-01.1. Although DPB does have procedures in place, these procedures are not in writing, therefore the plan is not fully documented. The DPB should have a security program that includes policies and procedures to provide reasonable assurance that appropriate levels of confidentiality, integrity, and availability exist over data in their possession. In addition, a more comprehensive standard, ITRM Standard SEC 501-01, was recently approved which will supersede SEC 2001-01.1 on July 1, 2007. The IT Security Standard 501-01 provides that a well developed security program should include documented policies and procedures consisting of the following components.

- Information Security Responsibilities and Separation of duties
- Information Security Officer Role
- Risk Management
- IT Contingency Planning
- IT Systems Security
- Logical Access Control
- Data Protection
- Facilities Security
- Personnel Security
- Threat Management
- IT Asset Management

A comprehensive information security program provides the essential framework to protect the data on information systems and the data handled by employees. The lack of a comprehensive

information security program prevents DPB's management from assessing the current or potential risks to their data, and enabling them to adequately prevent or minimize those risks. Specifically, DPB lacks the following components:

- Adequate Security Awareness Training
- Business Impact Analysis
- Up-to-date Risk Assessment, Business Continuity Plan and Disaster Recovery Plan
- Incident Response Plan
- Adequate IT Systems Security Policies
- Adequate Logical Access Control Policies
- Adequate Change Management and Software Change Management Policies

DPB should allocate the time and resources necessary to complete a comprehensive information security program that will meet industry best practices.

**Agency's Response:**

The Department of Planning and Budget (DPB) recognizes the Auditor of Public Accounts' (APA) security program finding and concurs that specific updates and written policies and procedures should further enhance the protection of DPB's data. DPB also recognizes, as should the APA, that the Virginia Information Technologies Agency (VITA) should assume full responsibility for the protection of all DPB data within VITA's control and oversight. In this regard, lines of responsibility are blurred at best now that VITA owns DPB's hardware/software and administers the agency's information technology network, where all DPB's applications reside.

It appears that soon to be implemented ITRM Standard SEC 501-01 assumes that agencies with limited resources will be able to meet the same high standard as agencies with larger budgets and/or manpower. This is an unrealistic expectation for a small agency that lack the resources and expertise to execute the requirements of the standard. Therefore, DPB will attempt to join with other small agencies to request additional resources (funding and staff) from the General Assembly so that DPB and other small agencies can meet this standard.

Prior to the audit, DPB recognized the importance of conducting another risk assessment and business impact analysis to update its Business Recovery Plan. DPB is currently working on this effort and has targeted May 1, 2007 for completion.

With regard to the APA's recommendation to provide adequate security awareness training, DPB believes that it can do so but at an estimated cost of \$2,500 to purchase an online security package currently used by VITA. Once the package is purchased and delivered, DPB will make security training mandatory for all employees by folding it into the annual training program. DPB will also ensure that new employees take the training within 30 days of employment.

**Finding: Improve Documentation of Appropriation Adjustments**

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**Agency's Response:**

DPB acknowledges this finding and will continue to work toward its elimination by making yearly Form 27 Automated Transaction (FATS) training mandatory for all budget analysts. This training will be added to DPB's annual training program.

Sincerely,



Richard D. Brown

cc: Paul Bender  
Don Darr  
Nancy Willson

OFFICIALS PAGE

As of June 30, 2006

Jody M. Wagner  
Secretary of Finance

Richard D. Brown  
Director, Department of Planning and Budget