

**DEPARTMENT OF ACCOUNTS**  
**RICHMOND, VIRGINIA**

**REPORT ON AUDIT**  
**FOR THE YEAR ENDED**  
**JUNE 30, 2003**



## **AUDIT SUMMARY**

Our audit of the internal controls over the Commonwealth's financial reporting process and the central accounting and reporting systems as administered by the Department of Accounts for the year ended June 30, 2003, found the following.

- The Comptroller needs to improve several areas in the internal controls over the report preparation process including informing the Auditor of material journal entries; developing and updating procedures documenting the financial statement preparation process in a timely manner; and educating agency financial staff on the financial reporting process.

***Agency Response:***      *The State Comptroller plans to address the issues and recommendations included in the audit finding.*

- The Comptroller should indicate for the transfers in Part 3: Miscellaneous of the Appropriation Act the revenue stream from which the transfer was made to comply with the "Virginia Truth in Revenue Source Reporting Act."

***Agency Response:***      *The State Comptroller plans to revise the reporting of revenue on the website.*

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## **AGENCY HIGHLIGHTS**

### **Central Systems**

The Department of Accounts (Accounts), under the direction of the State Comptroller, maintains the Commonwealth's centralized automated accounting, payroll, and fixed asset systems. To maintain appropriation controls and provide statutory budget reports, the State Comptroller requires the reporting of all revenue and expense transactions involving state funds in the accounting system. Accounts is responsible for ensuring that controls over the centralized systems are adequate. The centralized systems administered by Accounts include the following:

- *Commonwealth Accounting and Reporting System (CARS)* – This system records the state's financial transactions and is the official accounting record of the Commonwealth. Any agency-based accounting system must interface electronically or through magnetic media with CARS.
- *Commonwealth Integrated Personnel Payroll System (CIPPS)* – This system processes payrolls for classified and hourly employees.
- *Fixed Asset Accounting and Control System (FAACS)* – This system tracks fixed assets owned or controlled by the Commonwealth. Agencies record detailed or summarized fixed asset accounting information in this system.
- *Electronic Data Interchange (EDI)* – This system electronically transmits payments to localities, non-state agencies, vendors, and state employees.

EDI, payroll direct deposit, and the Small Purchase Charge Card are payment options offered by Accounts as part of its electronic commerce initiative to reduce the number of state-issued checks. These options are more reliable, cost effective, and secure than traditional paper checks.

### **Financial Reporting**

Accounts coordinates the Commonwealth's statewide reporting efforts and prepares the Commonwealth's Comprehensive Annual Financial Report (CAFR) and the Popular Report to inform the general public, Governor, and other state officials of the state's financial condition. Accounts also issues policies and procedures that provide agencies with guidance for maintaining internal controls over state funds. The State Comptroller produces a quarterly Report on Statewide Financial Management and Compliance that reports the degree of agency compliance with Commonwealth accounting and financial management policies, procedures, regulations, and practices. The Commonwealth follows the Governmental Accounting Standards Board (GASB) statements when preparing financial reports.

### **State Internal Auditor**

As of July 1, 2002, the State Internal Auditor became a division of Accounts.

## **AUDIT FINDINGS**

### Improve Controls Over Financial Reporting Process

During the 2003 audit of the Commonwealth's Comprehensive Annual Financial Report (CAFR), we noted the need for the Comptroller to improve several areas in the internal controls over the report preparation process. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of the information contained in the financial reports prepared by an entity.

In planning and performing our audit, we consider the Comptroller's internal controls over financial reporting in order to determine the nature, timing, and extent of our auditing procedures. The internal control improvements suggested below resulted from our auditors having to propose several material adjustments.

- *Inform the Auditor of Material Journal Entries* – The Comptroller's staff recorded several material journal entries before discussing the nature of or the process used to prepare the entries with the Auditor. Failure to notify the Auditor in a timely manner of material adjustments to the financial statements and the process used to develop the adjustments could result in a scope limitation on the audit. Because there is a risk of misstatement often linked to nonstandard journal entries and other adjustments, the Comptroller should disclose such entries to the Auditor to ensure there is sufficient time to perform an audit to review the internal control process surrounding the development of these entries.
- *Update Procedures in a Timely Manner* – Accounts often updates its procedures that document the financial statement preparation process as they are preparing or after they have completed the financial statements. The procedures used to prepare the financial statements are an important internal control over the financial reporting process and should serve as a tool to ensure the proper recording of all necessary journal entries and balances and use of the appropriate sources of the financial data. In order for the internal control to be effective, staff should update the procedures before preparing the financial statements and provide the information to the auditors.
- *Educate Agency Financial Staff on the Financial Reporting Process* – Since the Comptroller has ultimate responsibility for the financial information included in the CAFR, he must ensure that the information submitted by agencies outside of Accounts is accurate. During the audit, we noted several instances where an agency submitted incorrect or incomplete information. In some cases, these submission errors arose because agency personnel sending the information lacked an understanding of how and why the Comptroller needed the information. In other cases, the submission errors were the result of agency personnel not taking the time to properly prepare the information in order to meet established deadlines.

The Comptroller and his staff should ensure that each agency submitting financial information understands how its information fits into the financial reporting process and the annual report. In addition, the Comptroller should cite agencies for noncompliance with the Comptroller's directives if they submit incomplete information in order to meet established deadlines. Finally, the Comptroller should ensure the internal controls governing the financial reporting process at the agency level are adequate since those controls are a vital element of the overall internal control process for preparing the CAFR.

The Comptroller and his staff have the ultimate responsibility for the completeness and reliability of the information presented within the CAFR. Receiving accurate and timely information depends on the strength of the internal controls surrounding the financial reporting process. The Comptroller and his staff often rely on the review of the Auditor of Public Accounts to ensure the controls are operating as intended. As previously stated, we consider the internal controls when developing our audit procedures in order to provide reasonable assurance about whether the financial statements are free of material misstatements. However, the Auditor's reviews cannot serve as substitute for the Comptroller's responsibility to have well trained and informed staff in all agencies providing information for the CAFR. The Comptroller needs to take the appropriate on-going steps to ensure the accuracy and timeliness of information used in the financial reporting process.

**Agency Response:** *The State Comptroller plans to address the issues and recommendations included in the audit finding. We have included the Comptroller's response to this finding on pages 6 through 8.*

#### Comply with the Virginia Truth in Revenue Source Reporting Act

Section 2.2-813.1 of the Code of Virginia, the "Virginia Truth in Revenue Source Reporting Act", became effective July 1, 2003, and subsequently, the State Comptroller posted to Accounts' Internet site the listing of revenue by source of collection. Prior to its implementation, our office informed the State Comptroller that the intent of the Code Section dealt with the use of the revenue "for any purpose other than the purpose originally established in law for such revenue source."

Therefore, in order to comply with the intent of the Code Section, the State Comptroller should include on his Internet site any transfers in the Appropriation Act that redirect revenues for purposes different than those originally established in law. The State Comptroller indicated that without a control finding, he believed his posting was correct.

This point serves as a control finding that the State Comptroller should work with the Department of Planning and Budget to identify those items in the Appropriation Act that transfer or redirect funds for any purpose other than that originally established by law.

We advised the State Comptroller that, at a minimum, he should include all of the transfers in "Part 3: Miscellaneous of the Appropriation Act" that do not represent payments for services and indicate the revenue stream from which the transfer was made. While the State Comptroller has posted all of the transfers in Part 3 of the Appropriation Act that do not represent payments for services to his Internet site, he has not indicated the revenue stream from which the transfer was made. The State Comptroller should work with the Department of Planning and Budget and appropriate legislative committees to obtain this information as quickly as possible after the enactment of the Appropriation Act.

**Agency Response:** *The State Comptroller plans to revise the reporting of revenue on the website. We have included the Comptroller's response to this finding on pages 6 through 8.*



# Commonwealth of Virginia

**Walter J. Kucharski, Auditor**

**Auditor of Public Accounts**

**P.O. Box 1295**

**Richmond, Virginia 23218**

January 27, 2004

The Honorable Mark R. Warner  
Governor of Virginia  
State Capitol  
Richmond, Virginia

The Honorable Lacey E. Putney  
Vice-Chairman, Joint Legislative Audit  
and Review Commission  
General Assembly Building  
Richmond, Virginia

We have audited selected financial records and operations of the **Department of Accounts** (Accounts) for the year ended June 30, 2003, in support of the Comprehensive Annual Financial Report for the Commonwealth of Virginia.

## Audit Objectives, Scope, and Methodology

Our audit's primary objectives were to review the internal controls over the Commonwealth's financial reporting process, the central accounting and reporting systems, and the centralized services provided to agencies and institutions. In support of these objectives, we evaluated the accuracy of recording financial transactions in the Commonwealth's central accounting and reporting systems, reviewed the adequacy of Accounts' internal control over those systems and other central processes, and tested for compliance with applicable laws and regulations.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the following operations:

- Financial Reporting
- Commonwealth Accounting and Reporting System
- Commonwealth Integrated Payroll and Personnel System
- Fixed Asset Accounting and Control System
- State Indirect Cost Allocation Plan

We reviewed and gained an understanding of the overall internal controls, both automated and manual, including controls for administering compliance with applicable laws and regulations, sufficient to plan the audit. We also considered materiality and control risk in determining the nature and extent of our audit procedures.

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 tested transactions and controls and performed other audit tests we deemed necessary to determine whether Accounts' controls were adequate, operating and being followed.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

#### Audit Results

We noted certain matters involving internal control and its operation that we consider to be reportable conditions relative to the Comprehensive Annual Financial Report for the Commonwealth. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect Account's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. The reportable condition, "Improve Controls Over Financial Reporting Process," is in the subsection entitled "Audit Findings." The finding will be included in the Commonwealth of Virginia Single Audit Report for the year ending June 30, 2003. We do not believe that the reportable condition is a material weakness.

We noted another matter involving the internal control over compliance with the Code of Virginia that the Comptroller and Accounts also need to address. This matter entitled "Comply with the Virginia Truth in Revenue Source Reporting Act" is also in the subsection entitled "Audit Findings."

#### EXIT CONFERENCE

We discussed this letter with management at an exit conference held on January 30, 2004.

AUDITOR OF PUBLIC ACCOUNTS

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# COMMONWEALTH of VIRGINIA

DAVID A. VON MOLL, CPA  
COMPTROLLER

*Office of the Comptroller*

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

February 5, 2004

Mr. Walter J. Kucharski  
Auditor of Public Accounts  
James Monroe Building  
101 N. 14<sup>th</sup> Street  
Richmond, Virginia 23219

Dear Mr. Kucharski:

The Department of Accounts appreciates the opportunity to respond to the recommendations contained in your audit of the internal controls over the Commonwealth's financial reporting process and the central accounting and reporting systems administered by the Department of Accounts for the year-ended June 30, 2003. Thank you in advance for publishing this response with your report.

DOA's Response to Informing the Auditor of Material Journal Entries

DOA understood that auditors had reviewed and approved the process used to develop all adjustments to the financial statements. However, in the future DOA will revise CAFR procedures to ensure APA is alerted to all material adjustments in a timely manner and that these adjustments are thoroughly discussed and reviewed with the auditor prior to recordation. In addition, DOA will expand our efforts to work with agency financial reporting staffs prior to, and during, CAFR preparation to increase DOA and the APA's knowledge of potential financial reporting risks in order to provide sufficient time to resolve financial reporting issues prior to CAFR preparation.

DOA's Response to Update Procedures in a Timely Manner

In conjunction with the revised procedures mentioned above, DOA will alert APA to any CAFR preparation procedural updates prior to implementation.

DOA's Response to Educate Agency Financial Staff on the Financial Reporting Process

DOA acknowledges the merits of additional monitoring, oversight and training of agency financial reporting staff. When DOA's budget reductions and the resulting staff layoffs necessitated elimination of DOA's Financial Management Training Program, DOA's

financial reporting staff continued their diligent efforts to provide targeted agency assistance. Recent budget reductions have also resulted in the elimination of our Disbursements Review unit, severely curtailing our Disbursements Review program. Past DOA budget reductions resulted in the elimination of DOA's Agency Review and Assistance unit. Both of these actions, resulting directly from budget reductions, severely affected DOA's agency monitoring, oversight and training capabilities. DOA will make every effort to increase resources dedicated to these critical areas through budget adjustments or redeployment of existing resources in order to strengthen the Commonwealth's internal control structure.

DOA will optimize and target our scarce training resources to those agencies that provide material financial information to the CAFR to ensure these agencies maintain a well-trained agency financial reporting staff. In this regard, your report acknowledges DOA's reliance on APA staff to ensure controls are operating as intended. DOA closely monitors APA audit reports and reports all internal control findings in the Comptroller's Quarterly Report. We will focus additional attention on financial reporting findings related to agencies that provide material financial information to the CAFR and will target these agencies for additional training and assistance.

DOA Response to Virginia Truth in Revenue Source Reporting Act Control Finding:

While DOA disagrees with the APA's interpretation of the Virginia Truth in Revenue Source Reporting Act (VTRSRA) – Code §2.2-813.1, DOA has taken all reasonable steps within existing budgetary constraints to accommodate the auditor's recommendations. The Comptroller's office will continue to work with the Auditor of Public Accounts to publish on DOA's web site the appropriate CARS reports that will identify the revenue sources of funds affected by Part III transfers.

Our different interpretations of legislative intent stem from changes to the originally drafted legislation (HB1393). This original bill required the State Comptroller to post on DOA's website the total amount of each fee collected by the Commonwealth for consecutive six month periods and the amount of any such fee that was used for any purpose other than the purpose originally established in law for the fee. The fiscal impact statement for the bill described the high cost of such requirements resulting in amendments that changed the bill substantially.

The final legislation approved by the General Assembly (Code §2.2-813.1) required only the posting of each revenue source collected along with any control findings reported by the Auditor of Public Accounts that indicated a revenue source was used for any purpose other than the purpose originally established in law for such revenue source. This language modification was significant in that it shifted the responsibility for detecting instances in which a fee was used for something other than its original purpose from the State Comptroller to the State Auditor. Presumably the detection of redirected revenue sources would take place through the audit of each state agency performed by the State Auditor, with instances of redirected revenue reported in agency audit reports along with other control

Mr. Walter J. Kucharski

February 5, 2004

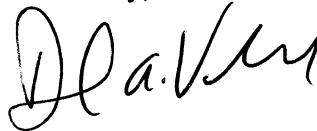
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findings. The responsibility for posting Auditor of Public Accounts control findings on the VTRSRA web-page was left to the State Comptroller.

The recommendations noted in the APA report seem to hold the State Comptroller responsible for meeting the requirements of the original bill, not the enacted legislation. Notwithstanding our different interpretations of the law, when your audit staff reported the control finding that all Part 3 transfers outlined in the Appropriation Act except those transfers representing payments for services met the criteria, DOA posted Part 3 transfers (amended for service payments) on the VTRSRA web-page. The audit report acknowledges this posting, but recommends reporting the specific revenue source from which each transfer was made. DOA plans to post an additional report identifying the revenue sources associated with each fund. DOA will continue to take all reasonable steps within budgetary constraints to post APA control findings related to the VTRSRA.

Thank you again for the opportunity to comment on your audit report.

Sincerely,

A handwritten signature in black ink, appearing to read "D. A. Von Moll", written in a cursive style.

David A. Von Moll

cc: Ronald D. Necessary, Manager  
Financial Reporting