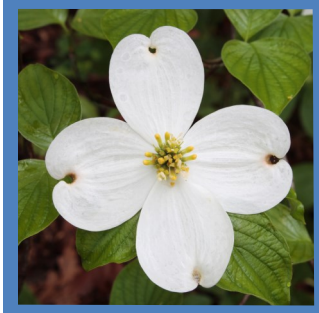


AGENCIES OF THE SECRETARY OF FINANCE

REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2021

Auditor of Public Accounts
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AUDIT SUMMARY

This report summarizes our fiscal year 2021 audit results for the following four agencies under the Secretary of Finance (Secretary):

- *Department of Accounts*
- *Department of Planning and Budget*
- *Department of Taxation*
- *Department of the Treasury and the Treasury Board*

Our audits of these agencies for the year ended June 30, 2021, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth's accounting and financial reporting system, each agency's financial systems, and in supplemental information and attachments submitted to the Department of Accounts;
- four prior year findings involving internal control and its operations discussed in the Status of Prior Year Findings and Recommendations section, where corrective action is ongoing;
- three new findings involving internal control and its operations discussed in the Internal Control and Compliance Findings and Recommendations section, necessary to bring to management's attention;
- four of the seven findings are considered to be instances of non-compliance with applicable laws and regulations that are required to be reported; and
- adequate corrective action with respect to prior audit findings identified as resolved in the Findings Summary included in the Appendix.

This report also includes information on significant initiatives for the Secretary and Department of Accounts, including the status of the Commonwealth's Human Capital Management System development project and upcoming financial reporting changes for leases. In addition, it includes Risk Alerts, which are applicable to the Department of Accounts and Department of Taxation.

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SIGNIFICANT INITIATIVES

The following section provides an update on two major Commonwealth initiatives affecting Secretary of Finance agencies.

Status of System Development Project

Applicable to: *Secretary of Finance and Department of Accounts*

Commonwealth's Human Capital Management System Project

Accounts implemented the first release of the Human Capital Management project in October 2021 and plans to implement release two in April 2022, with estimated total costs of approximately $131.8 million dollars.

In August 2016, Department of Accounts (Accounts) launched a payroll project to replace the Commonwealth's existing payroll system that has been in place since 1986. Accounts expanded this project in May 2018 to also replace the Commonwealth's human resources; time, attendance, and leave; and benefits administration systems for an all-encompassing Human Capital Management (HCM) project. Accounts implemented a "dress rehearsal" in December 2020 and January 2021 in preparation for the March and October 2021 planned releases. The dress rehearsal was designed to execute every step required to prepare the Cardinal application for HCM deployment. To address issues experienced during the dress rehearsal, Accounts pulled resources from other critical activities such as interface testing, system testing, and parallel testing. To mitigate the issues identified and allow the HCM team to redirect efforts to complete the critical activities, Accounts delayed the release.

In October 2021, 18 state agencies and three localities went live with the first release of the HCM application. Accounts plans to roll out a second release to more than 200 state agencies and 350 localities in April 2022. It is essential for Accounts to meet the target implementation date for the second release because the vendor for the Commonwealth's current payroll system will cease providing software support on April 30, 2022.

Accounts estimates a total cost of $131.8 million for the HCM project. As of November 30, 2021, Accounts spent approximately $114.9 million and estimates an additional cost of $16.9 million to complete the project. The Governor authorized a working capital advance for the total estimated cost of the project. Accounts has drawn approximately $102.4 million of the working capital advance to plan, develop, configure, and roll-out new software as of June 30, 2021.

The HCM project scope is set to integrate with the Commonwealth's accounting and financial reporting system, reduce risks by replacing several aging statewide systems, improve performance with all Commonwealth system applications using cloud infrastructure, and meet the majority of the Commonwealth's payroll and human resource requirements. Further, by integrating with the accounting and financial reporting system, the Commonwealth will have a variety of new reporting capabilities and more streamlined processes.

The HCM deployment is the largest and most complex initiative of any Cardinal project to date. As with all projects, Accounts identified risks associated with the HCM deployment during the first release and continues to monitor these risks and outline mitigation procedures. Accounts is factoring lessons learned from the first release into the spring deployment efforts. The conversion data is complex and comes from multiple sources. Accounts is preparing for the dress rehearsal, which will convert and validate data for the larger release two. Accounts faces increased challenges for the second release due to the number of agencies, the volume of data, and the short time frame in which the data conversion must happen before going live. If the data conversion is not accurate, there is a risk that employees will not get paid or benefits will be incorrect. Additionally, while Accounts must adhere to task and release deadlines, the COVID-19 pandemic could impact Accounts ability to do so based on scheduling and staffing difficulties and agency training limitations. Accounts, the Department of Human Resource Management, and all agencies that use the Commonwealth's payroll and human resource systems will need to continue to devote key personnel, time, and technology resources to mitigate the risks associated with the Human Capital Management project.

New Lease Accounting Standard

Applicable to: *Department of Accounts*

Governmental Accounting Standards Board Statement No. 87 Leases

GASB delayed implementation of Statement No. 87, Leases, to fiscal year 2022. When the new standard becomes effective, most of the Commonwealth's $468.8 million in operating leases will become new lease liabilities in the financial statements.

In 2017, the Governmental Accounting Standards Board (GASB) issued Statement No. 87, Leases. Originally, GASB's effective date for this accounting standard was fiscal year 2021; however, due to the COVID-19 pandemic, GASB issued Statement No. 95, Postponement of the Effective Dates of Certain Authoritative Guidance. This standard delayed implementation of Statement No. 87, Leases, to fiscal year 2022. This new accounting standard will significantly change the way governments account for leases. Under the new model, operating and capital leases no longer exist. Governments will report all leases as financing transactions, which results in recording an intangible asset and a liability for every lease except short term leases (less than 12 months). This will dramatically change the Commonwealth's financial statements by increasing the amount of assets and liabilities.

For fiscal year 2021, the Commonwealth's primary government had $27.8 million in capital lease liabilities and $468.8 million in operating lease commitments, which are not reported as liabilities in the Commonwealth's Annual Comprehensive Financial Report (ACFR). Under the new standard, most of this $468.8 million in operating lease commitments will become new lease liabilities. This will impact the Commonwealth's debt capacity model, resulting in a reduced capacity for debt issuance.

The Commonwealth has two systems that state agencies use to account for leases. The Department of General Services (General Services) manages a system that includes all real estate leases. Accounts manages a system that includes all other leases, such as equipment leases. GASB Statement

No. 87 requires that governments recognize and measure existing leases using the facts and circumstances that exist at the beginning of the period of implementation, which is July 1, 2021, not the inception of the lease. Accounts and General Services began using their updated systems to record leases in compliance with GASB Statement No. 87 as of July 1, 2021. We will audit the implementation during the fiscal year 2022 audit.

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

This section is organized by agency, and each finding reported includes information on the type of finding and the severity classification for the finding. The severity classifications are discussed in more detail in the section titled "Independent Auditor's Report."

Department of Planning and Budget

Improve Information Technology Change and Configuration Management Policy and Process
Type: Internal Control and Compliance
Severity: Significant Deficiency
Repeat: No

The Department of Planning and Budget (Planning and Budget) does not follow an IT change and configuration management process that includes all elements required by the Security Standard. Change management is a key control to evaluate, approve, and verify configuration changes to security components.

We identified eight control weaknesses and communicated them to management in a separate document marked FOIAE under § 2.2-3705.2 of the Code of Virginia, due to it containing descriptions of security mechanisms. The Security Standard requires agencies to implement certain controls that reduce unnecessary risk to the confidentiality, integrity, and availability of Planning and Budget's information systems and data.

Planning and Budget's change management policy (policy) excludes certain elements required by the Security Standard, causing several of the weaknesses identified. Additionally, some weaknesses were due to Planning and Budget not performing and documenting certain change management processes as required by its policy or the Security Standard.

Planning and Budget should review and revise its change and configuration management policy and procedures to align with the requirements in the Security Standard. Additionally, Planning and Budget should dedicate resources to implement, manage, and enforce its change and configuration management process to address the weaknesses discussed in the communication marked FOIAE to protect the confidentiality, integrity, and availability of sensitive and mission critical data.

Department of Treasury

Improve IT Risk Management and Contingency Planning Documentation
Type: Internal Control and Compliance
Severity: Significant Deficiency
Repeat: No

Treasury developed a Continuity of Operations Plan (COOP) and Business Impact Analysis (BIA) that document recovery time objectives (RTO) and recovery point objectives (RPO) for its mission

essential and primary business functions. However, Treasury has established RTOs and RPOs that are not supported by contractual agreements with VITA. Without procuring the necessary services to meet the expected RTOs and RPOs for mission essential and primary business functions, Treasury cannot guarantee the timely availability of its sensitive systems, potentially impacting critical services to citizens of the Commonwealth.

Additionally, we found the following issues in the way Treasury is developing its Information Technology Risk Management (ITRM) documentation.

- Treasury does not document the RTO and RPO by IT system, but instead documents the RTO and RPO by business function based on VITA's BIA template. The Security Standard requires that Treasury develop IT disaster components of the agency continuity plan, which identifies each IT system that is necessary to recover agency business functions or dependent business functions and the RTO and RPO for each system (*Security Standard, Section CP-1-COV-1 Contingency Planning Policy and Procedures*). Without outlining which RTO and RPO to follow for each IT system, Treasury may not appropriately recover systems necessary for more than one business function.

- Treasury does not have a formal policy in place to define the periodic testing of its Disaster Recovery Plans (DRP). Treasury has conducted tests of IT disaster recovery components in two of the last three years but does not define the minimum time period acceptable between tests. The Security Standard requires Treasury to perform periodic review, reassessment, testing, and revision of the IT DRP to reflect changes in mission essential functions, services, IT system hardware and software, and personnel (*Security Standard, Section CP-1-COV-2 Contingency Planning Policy and Procedures*). Without defining the period to test its DRPs, Treasury may not ensure processes exist and function properly to restore sensitive systems within RTOs in the event of a system failure or disaster.

- Treasury does not have System Security Plans (SSP) for 19 of 20 systems (95%). The Security Standard requires Treasury to document a SSP for the IT system based on the results of the Risk Assessment (RA) (*Security Standard, Section PL-2-COV System Security Plan*). Without documenting SSPs for all its sensitive systems, Treasury cannot determine if proper information security controls are in place. This could lead to a breach of data or unauthorized access to sensitive and confidential data.

- Treasury does not adequately document the annual self-assessments of its RAs and SSPs to determine the continued validity of the documents. The Security Standard requires Treasury to conduct an annual self-assessment of the RA and review the SSP on an annual basis or more frequently to address environmental changes (*Security Standard, Sections: 6.2 Risk Assessments; PL-2 System Security Plans*). Without having proper documentation of self-assessments, Treasury increases the risk it will not detect and mitigate existing weaknesses in sensitive systems, which could result in a

malicious user compromising confidential data and impacting the system's confidential data and its availability.

The formal definition for RTO is the period of time in which systems, applications, and/or functions must be recovered after an outage, typically starting at the time of the failure. However, Treasury's internal understanding is that RTOs are defined as the time it will take for Treasury to recover the systems after VITA's "best effort" disaster recovery service is complete, causing Treasury to document the RTOs as seen in its BIA. Additionally, Treasury's absence of formally documented policies and procedures led to Treasury not defining the process for including the DRP in annual COOP tests and performing annual self-assessment reviews of its RAs. Lastly, Treasury did not have formal SSPs for most of its sensitive systems because it documents the data required for an SSP in other locations instead of one central document.

Treasury should consider purchasing disaster recovery services for its sensitive systems to guarantee it can recover the systems in a set timeframe. If Treasury does not purchase the services, it should revise its ITRM documentation to reflect its current disaster recovery services and RTO definition. Additionally, Treasury should complete ITRM documentation for its sensitive systems and review those documents annually to validate that the information reflects the current environment. Further, Treasury should document the process for including the DRP within the COOP test, or a process for testing the DRPs themselves periodically. This will help to ensure Treasury protects the confidentiality, integrity, and availability of its sensitive and mission critical systems.

Improve Procedures for Calculating Penalty Periods for Undercollateralized Depositories

Type: Internal Control
Severity: Significant Deficiency
Repeat: No

Treasury did not accurately calculate nor consistently apply the penalty timeframe for which previously undercollateralized depositories must post additional collateral in fiscal year 2021. Treasury does not have written procedures in place to calculate the penalty timeframe or to apply the penalty timeframe to the Security for Public Deposits Act (SPDA) Database. As a result, manual miscalculations occurred in the email notifications of the penalty time frame for three of the eight instances where opt-out depositories did not meet minimum collateralization requirements on the public depository weekly report. Additionally, in seven of the eight instances, Treasury did not enter the dates correctly into the SPDA database.

According to § 2.2-4405 of the Code of Virginia, the Treasury Board has the authority to make and enforce regulations and guidelines necessary and proper to enforce the provisions of the SPDA and may require additional collateral, in excess of the required collateral of any or all qualified public depositories as it may determine prudent under the circumstances. Section C of Treasury's Opt-Out Guidelines, state that the minimum collateralization requirement should increase by five percent for the next six reporting months for undercollateralized depositories as of the end of the week as shown on its public depository weekly report.

Undercollateralized opt-out depositories present specific risks to Virginia's public deposits as opt-out depositories are responsible for securing only their public deposits and are not part of the SPDA collateral pool. The added penalty rate protects public deposits, and the guidelines require a six-month penalty to reduce the risk of the undercollateralized depository. Additionally, inconsistencies between the penalty period emailed to depositories and the penalty period recorded in the SPDA database could result in confusion between Treasury and the depository regarding the start and end of the penalty period and collateralization requirements. As a result of the current process, Treasury may not identify cases where depositories are undercollateralized twice within the same period which may result in pledged collateral that does not increase in accordance with the guidelines for multiple instances of a depository failing to satisfy minimum collateral requirements.

Treasury should reassess its methodology for calculating penalty periods for undercollateralized opt-out depositories and should clearly document procedures and controls that support the proper calculation, communication, and recording of the penalty period in accordance with Treasury's opt-out depository guidelines.

STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS

This section is organized by agency and reports the status of findings from the prior years' audit where corrective action is ongoing. Each status of prior year finding reported includes information on the type of finding, the severity classification for the finding, and an update on progress made since the issuance of the prior year's audit report. The severity classifications are discussed in more detail in the section titled "Independent Auditor's Report."

Department of Accounts

Continue to Improve Controls over ChartField Maintenance
Type: Internal Control
Severity: Significant Deficiency
Repeat: Yes (first issued in fiscal year 2020)
Prior Title: Ensure Timely Approval of ChartField Changes

Accounts' General Accounting has not finalized their new process for ChartField maintenance. Not performing timely reviews over data elements within the Commonwealth's accounting and financial reporting system (system) could lead to inaccurate reporting in the Commonwealth's ACFR, financial statements individually issued by state agencies, and other reports used by management and those charged with governance to monitor financial activity.

Per § 2.2-803 of the Code of Virginia, Accounts is responsible for financial data classification and coding structures for agencies. Further, Accounts must approve changes to any established financial related code or set of codes for agencies. Section 60100 in the Commonwealth Accounting Policies and Procedures (CAPP) Manual requires Accounts' General Accounting division to enter and approve changes to the statewide ChartFields within the system. Accounts uses a ChartField Maintenance form to ensure consistency of information reviewed to sufficiently support the reason for the change and required approvals. General Accounting had additional resource demands during the fiscal year that limited their staff's availability to reassess the ChartField maintenance procedures. Additional demands included calculating and making distributions of funding from the Coronavirus Relief Fund and the American Rescue Plan Act of 2021, distributing Broadband and Municipal Utility funds, reviewing communications related to these distributions, complying with additional federal reporting requirements, and creating additional fund codes for agencies to record this funding in the system.

General Accounting should continue to devote the necessary resources to update and implement the processes involved in maintaining ChartFields, to include capturing management's approval of ChartField changes.

Department of Taxation

Continue to Improve Patching to Mitigate Vulnerabilities

Type: Internal Control and Compliance
Severity: Significant Deficiency
Repeat: Yes (first issued in fiscal year 2020)
Prior Title: Improve Patching to Mitigate Vulnerabilities

Taxation continues to make progress installing patches to software running on its systems in a timely manner in accordance with the Security Standard. While Taxation relies on the contractors procured by VITA to install security patches to its IT infrastructure components, Taxation remains responsible for applying patches to certain agency-specific software. We communicated the specific control weaknesses to management in a separate document marked Freedom of Information Act Exempt (FOIAE) under § 2.2-3705.2 of the Code of Virginia due to its sensitivity and description of security controls.

The Security Standard requires Taxation to install security-relevant software and firmware updates within 90-days of the release of the updates. Software vulnerabilities are common flaws that potentially malicious actors use to infiltrate a network and initiate an attack, which can lead to financial, legal, and reputational damages for Taxation. Without appropriate software patching and vulnerability management controls, Taxation increases the risk of unauthorized access to sensitive and mission critical systems.

While Taxation has made progress to improve its vulnerability management program to identify specific vulnerabilities it is responsible for remediating, competing priorities to fulfill legislative mandates has hindered Taxation from applying all the necessary security patches within the required 90-day timeframe. Taxation should continue dedicating the necessary resources to apply security patches within 90-days to mitigate the outstanding vulnerabilities within its IT environment. This will help maintain the confidentiality, integrity, and availability of sensitive and mission critical data.

Department of the Treasury

Prepare and Review Unclaimed Property Reconciliations Timely

Type: Internal Control
Severity: Significant Deficiency
Repeat: Yes (first issued in fiscal year 2019)
Prior Title: Continue to Improve Policies and Procedures over Unclaimed Property Reconciliations

In fiscal year 2020, we recommended that the Department of Treasury's (Treasury) Unclaimed Property Division (Unclaimed Property) improve its policies and procedures over the reconciliation between the unclaimed property system and the Commonwealth's accounting and reporting system. During fiscal year 2021, Unclaimed Property developed policies and procedures in response to the prior year recommendation; however, we found that the preparation and the timely review of the

reconciliations was not in alignment with the newly developed policies and procedures, and in one case, with Department of Accounts (Accounts) requirements.

For one out of three (33%) reconciliations sampled, staff prepared the reconciliation 11 days after the Accounts' established month-end closing date, which exceeds the five business days included in the new Unclaimed Property policies and procedures. For one out of three (33%) reconciliations sampled, the Unclaimed Property Director reviewed the reconciliation six days after the preparation sign-off date, which exceeds the five business days required by the Unclaimed Property policies and procedures. In addition, the review timeframe was not in accordance with Accounts' CAPP Manual requirements, which are less rigorous than Unclaimed Property's policy.

Unclaimed Property's reconciliation policies and procedures indicate that staff will complete reconciliations and submit them to the Unclaimed Property Director for review within five business days after the close of the fiscal month. The policies require the Director to sign and date the reconciliation package indicating review within five business days of receipt of the reconciliation from staff. The Unclaimed Property reconciliation is used as support for Treasury certifying monthly compliance with Accounts' requirement to reconcile the Commonwealth's accounting and reporting system to underlying activity. Accounts' CAPP Manual Topic 20905 – Cardinal Reconciliation Requirements requires all internally prepared accounting records, data submission logs, and other accounting data to be reconciled to reports produced by the Commonwealth's accounting and financial reporting system by the last business day of the month following the period close.

Reconciliations are a key internal control for ensuring financial activity recorded in multiple systems is accurate in each of those systems and for preventing improper payments. In addition, late preparation and review of reconciliations increases the risk that staff will not timely detect errors or discrepancies of account balances related to Unclaimed Property activity. Staffing issues contributed to the delayed preparation and review of the reconciliations. Reconciliations should be prepared and reviewed timely in accordance with Unclaimed Property's policies and procedures and Accounts' CAPP Manual requirements.

Continue to Improve Process for Payment of Risk Management Invoices

Type: Internal Control and Compliance
Severity: Significant Deficiency
Repeat: Yes (first issued in fiscal year 2019)

In our fiscal year 2020 audit, we reported that Treasury's Risk Management Division (Risk Management) is not adequately monitoring or ensuring compliance with the prompt payment provisions of the Code of Virginia. Section 2.2-4347 of the Code of Virginia states that agencies are required to pay invoices no later than 30 calendar days after the receipt of the goods, services, or invoice, whichever is later, or the due date specified in the vendor's contract. Failure to follow the Commonwealth's prompt pay requirements may harm the Commonwealth's reputation as a buyer, damage relationships with vendors, and result in late fees.

Treasury is in the process of implementing changes to its existing payment process including using existing systems to monitor incoming invoices and send alerts to staff; leveraging existing Treasury information systems to create automated workflows surrounding invoice approval and payment; and assigning additional staff and redistributing responsibility to better balance staff workloads. As Treasury is still implementing corrective action, we did not perform procedures over this process during the fiscal year 2021 audit. We will review the implementation of Treasury's corrective actions in a future audit.

We recommend Risk Management continue its efforts to improve its processes and oversight surrounding the payment of risk management invoices to ensure compliance with prompt payment provisions including ensuring that adequate staffing is available in both the Risk Management and Operations Divisions during the high-volume periods anticipated during the year.

RISK ALERTS

During the course of our audit, we encountered internal control and compliance issues that are beyond the corrective action of agency management alone and require the action and cooperation of management and Virginia Information Technologies Agency (VITA). The following issues represent such a risk to the agency and the Commonwealth during fiscal year 2021.

Access to Audit Log Monitoring Tool

Repeat: No
Applicable to: *Department of Accounts*

Accounts relies on the Commonwealth's Information Technology Infrastructure Services Program (ITISP) to install, maintain, operate, and support information technology (IT) infrastructure components, such as servers, routers, firewalls, and virtual private networks. As part of these services, Accounts relies on contractors procured by VITA to provide Accounts access to a centralized monitoring tool that collects audit log information about activities in Accounts' IT environment so that Accounts can review logged activity. Additionally, Accounts relies on VITA to maintain oversight and enforce the service level agreements and deliverables with the ITISP contractors.

While VITA did not originally enforce the deliverable requirement when the ITISP contracts were ratified in 2018, VITA has since tried to compel the ITISP contractor responsible for granting agencies access, such as Accounts, to provide access to the monitoring tool and audit log information for the last two years. However, as of September 2021, VITA and the ITISP contractor have not been able to grant access to individual agencies due to software limitations. VITA is overseeing the ITISP contractor's current efforts to replace the existing centralized monitoring tool with a new system to grant Accounts access to monitor audit log information.

The Commonwealth's Information Security Standard, SEC 501 (Security Standard), requires a review and analysis of audit records at least every 30 days for indications of inappropriate or unusual activity (Security Standard: Section AU-6 Audit Review, Analysis, and Reporting). Without VITA enforcing the deliverable requirements from the ITISP contractors, the risk associated with the Commonwealth's data confidentiality, integrity, and availability is increased.

Accounts is working with VITA and the ITISP contractors to obtain access to the audit log information within the centralized monitoring tool to ensure Accounts can review the activities occurring in its IT environment in accordance with the Security Standard. Additionally, our separate audit of VITA will also address this issue.

Unpatched Software

Repeat: Yes (first issued in fiscal year 2015)
Prior Title: Mitigate Server Vulnerabilities
Applicable to: *Department of Taxation*

VITA's contractual partnership with various IT service providers to create the Commonwealth's ITISP provides agencies with installation, maintenance, operation, and support of IT infrastructure components, such as servers, routers, firewalls, and virtual private networks. The Department of Taxation (Taxation) relies on contractors procured by VITA for the installation of security patches in systems that support Taxation's operations. Additionally, Taxation relies on VITA as the contract administrator to maintain oversight and enforce the contract agreements with the ITISP contractors. While VITA is responsible for enforcing the service level agreement, it has not been able to compel the current ITISP contractors to install certain security patches to Taxation's systems to remediate vulnerabilities in a timely manner or taken actions to obtain these required services from another source.

The Security Standard requires the installation of security-relevant software updates within 90 days of release. The Security Standard does allow for varying time periods depending on factors such as the criticality of the update, but generally the ITISP uses a 90-day window from the date of release as its standard for determining timely implementation of security patches (Security Standard Section: SI-2 Flaw Remediation).

As of October 2021, the ITISP contractors had not applied a significant number of critical and highly important security patches to Taxation's server and workstation environment, all of which are past the 90-day Security Standard requirement. Missing system security updates cause an increased risk of cyberattack, exploit, and data breach by malicious parties.

Taxation is working with VITA and the ITISP contractors to ensure that all servers have all critical and highly important security patches installed. Additionally, our separate audit of VITA will address this issue.

RETAIL SALES AND USE TAX COLLECTION AND DISTRIBUTION

In accordance with § 30-133.2 of the Code of Virginia, we perform work related to retail sales and use tax distributions as part of our annual audit of Taxation. Our review covers retail sales and use tax with a focus on the collection and distribution of local sales and use taxes. As part of our initial review, we reviewed activity for fiscal years 2009 through 2012 and established a benchmark by which to evaluate errors in the process. During the fiscal year 2021 audit, we expanded our work to include a review of Taxation's procedures that ensure the proper distribution of retail sales and use taxes to the locality in which the property sold was delivered, including localities that share postal zip codes.

In fiscal year 2021, Taxation collected approximately $7.9 billion in retail sales and use taxes, with $1.5 billion of these revenues being distributed to localities as a one percent local option tax. Taxation collects the tax and determines the local portion, which is distributed to the locality where the sale or activity occurred.

The sales and use tax distribution process requires a joint effort between Taxation, localities, and businesses. There are controls and processes in place to help ensure that locality distributions are accurate and made to the correct locality. When Taxation detects an error, they process an adjustment to correct the distribution and transfers the funds to the correct locality. Common errors with sales and use tax generally consist of taxpayers not allocating the proper amounts to the locality, taxpayers having a liability in more than one locality, or taxpayers submitting a mailing address that does not correspond to the locality in which they or the related consumers are located.

Table 1 shows the local distribution amount for retail sales and use tax, as well as the amount and rate of distribution errors identified and corrected by Taxation in each of the last three fiscal years.

Error Rate for Local Sales Tax Distributions

Table 1

	2019	2020	2021
Local distribution amount	$1,292,803,736	$1,358,988,341	$1,477,201,024
Errors identified and corrected*	4,979,795	6,286,195	3,758,397
Error rate	0.39%	0.46%	0.25%

Source: Taxation's financial accounting and reporting system

*Includes all retail sales and use tax, including those with an unassigned locality.

As shown above, the error rate for fiscal year 2021 was 0.25 percent. This is within the one percent benchmark established and a decrease from the fiscal year 2020 error rate of 0.46 percent. Based on these results, it appears that the error rate is within the established benchmark, and Taxation is properly distributing the local portion of the retail sales and use tax. We do not recommend any changes in the established benchmark or to Taxation's procedures for ensuring localities receive the correct distribution based on locality sales, including those of remote merchants.

Commonwealth of Virginia

Auditor of Public Accounts

Staci A. Henshaw, CPA
Auditor of Public Accounts

P.O. Box 1295
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December 15, 2021

The Honorable Glenn Youngkin
Governor of Virginia

The Honorable Kenneth R. Plum
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records, operations, and federal compliance of the **Agencies of the Secretary of Finance** for the year ended June 30, 2021. We conducted this audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, in support of the Commonwealth's Annual Comprehensive Financial Report and Single Audit. 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 the Treasury for the fiscal year ended June 30, 2021, include the following:

- to evaluate the accuracy of financial transactions related to tax collections, including accounts receivable, unearned revenues and taxes, accounts payable and other liabilities, tax abatements, and tax and interest revenue as reported in the Commonwealth's accounting and financial reporting system and Taxation's accounting and financial reporting system and in supplemental information prepared by Taxation;

- to evaluate the accuracy of financial transactions related to cash and cash equivalents, investments, debt, and unclaimed property activity, which is controlled by Treasury as reported in the Commonwealth's accounting and financial reporting system, Treasury's internal systems and 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 the Commonwealth's accounting and financial reporting system and controls in this system are adequate to ensure program expenses do not exceed appropriations;

- 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 Audit Scope and Methodology section of this report;

- to determine whether management has established and maintained adequate operating and application system controls over the Commonwealth's accounting and financial reporting, payroll, budget, capital asset, and lease accounting systems and other internal systems as referenced in the Audit Scope and Methodology section;

- to determine whether the agencies have complied with applicable laws, regulations, contracts, and grant agreements;

- to test federal compliance in support of the Commonwealth's Single Audit; 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, regulations, contracts, and grant agreements. 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, regulations, contracts, and grant agreements.

We 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's accounting and financial reporting system
Commonwealth's payroll system
Commonwealth's capital asset system
Commonwealth's lease accounting system
Administrative activities
Information security and general system controls (including access controls)
Coronavirus Relief Fund – Assistance Listing Number 21.019

*Including preparation of the Annual Comprehensive Financial Report and Schedule of Expenditures of Federal Awards.

Department of Planning and Budget

Budget execution
Commonwealth's budgeting system
Information security and general system controls (including access controls)
Administrative activities

Department of Taxation

Financial reporting
Tax return processing
Tax revenue collections
Taxation's accounting and financial reporting system
Information security and general system controls (including access controls)

Department of the Treasury (including the Treasury Board operations)

Financial reporting*
Bond issuance
Debt servicing
Investment trading
Investment accounting
Investment accounting systems
Bank reconciliation system
Trust accounting
Management of unclaimed property
Information security and general system controls (including access controls)

*Including preparation of financial statements of the Local Government Investment Pool Program, the Virginia College Building Authority, the Virginia Public Building Authority, and the Virginia Public School Authority.

The Virginia Board of Accountancy falls under the control of the Secretary of Finance; however, it is not material to the Annual Comprehensive Financial Report for the Commonwealth of Virginia. As a result, this agency is not included in the scope of this audit.

We performed audit tests to determine whether the controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws, regulations, contracts, and grant agreements. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the agencies' operations. We performed analytical procedures, including budgetary and trend analyses. We confirmed cash, investments, and loan balances with outside parties. We also tested details of transactions to achieve our objectives.

A nonstatistical sampling approach was used. Our samples of transactions were designed to support conclusions about our audit objectives. An appropriate sampling methodology was used to ensure the samples selected were representative of the population and provided sufficient, appropriate evidence. We identified specific attributes for testing each of the samples and when appropriate, we projected our results to the population.

Our consideration of internal control over financial reporting (internal control) was for the limited purpose described in the section "Audit Objectives" and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control as described in the sections entitled "Internal Control and Compliance Findings and Recommendations" and "Status of Prior Year Findings and Recommendations," that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial information will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We have explicitly identified seven findings in the sections titled "Internal Control and Compliance Findings and Recommendations" and "Status of Prior Year Findings and Recommendations," as significant deficiencies for the Commonwealth.

Conclusions

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 the Commonwealth's accounting and financial reporting system, Taxation's accounting and financial reporting system, and supplemental information.

We found that Treasury properly stated, in all material respects, the financial records reviewed in support of the cash and cash equivalents, investments, debt, and unclaimed property activity reported in the Commonwealth's accounting and financial reporting system, Treasury's internal systems and accounting records, and supplemental information.

We found that the budget approved by the General Assembly is appropriately recorded in the Commonwealth's accounting and financial reporting system, and controls in this system were adequate to ensure program expenses did not exceed appropriations.

We noted certain matters at Accounts, Planning and Budget, Taxation, and Treasury involving internal control and its operation and compliance with applicable laws and regulations that require management's attention and corrective action. These matters are described in the sections titled "Internal Control and Compliance Findings and Recommendations" and "Status of Prior Year Findings and Recommendations."

The agencies of the Secretary of Finance have taken adequate corrective action with respect to audit findings identified as resolved in the Findings Summary included in the Appendix.

Since the findings noted above include those that have been identified as significant deficiencies, they will be reported as such in the "Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards," which is included in the Commonwealth of Virginia's Single Audit Report for the year ended June 30, 2021. The Single Audit Report will be available at www.apa.virginia.gov in February 2022.

Exit Conference and Report Distribution

We discussed this report with management of the respective agencies of the Secretary of Finance and have included their responses at the end of this report in the section titled "Agency Responses." We did not audit management's responses and, accordingly, we express no opinion on them. Additionally, VITA was made aware of the risk alerts and will respond to the issues in their separately issued audit report anticipated to be released in February 2022.

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.

Staci A. Henshaw
AUDITOR OF PUBLIC ACCOUNTS

DBC/clj

COMMONWEALTH of VIRGINIA

DAVID A. VON MOLL, CPA
COMPTROLLER

Office of the Comptroller

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

January 24, 2022

Ms. Staci A. Henshaw
Auditor of Public Accounts
James Monroe Building
101 N. 14th Street
Richmond, Virginia 23219

Dear Ms. Henshaw:

The Department of Accounts (Accounts) appreciates the opportunity to respond to the *Status of Prior Year Recommendations* and *Internal Control and Compliance Findings and Recommendations* contained in your 2021 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.

Status of Prior Year Recommendations

Continue to Improve Controls over ChartField Maintenance

Accounts acknowledges the importance of reviewing the changes made to the ChartField values and agrees that the reviews and documentation were not finalized during the audit period. Accounts would note that there continue to be mitigating controls that ensure the ChartField updates are entered correctly in Cardinal. The affected agencies that request these updates and utilize the ChartFields review these updates and notify Accounts if there are any discrepancies with the ChartField updates requested and entered into Cardinal. To date, there have been no issues identified with the ChartField updates from the agencies. Additionally, Financial Reporting performs an in-depth review of the funds in Cardinal during the Table A process and provides updates annually for ACFR Class and Long Description changes that may be necessary.

After a careful review, Accounts determined the Chartfield maintenance and review process to be in need of efficiency modifications, and Accounts finalized a more robust ChartField Maintenance Procedure that includes a timeline for preparation and review. As noted in Accounts' prior year Corrective Action Workplan (CAW), this new procedure was scheduled to be implemented effective at the end of calendar year 2021. A PDF Portfolio has been developed and put into production to streamline the process for the ChartField Maintenance documentation. Accounts implemented these changes to the documentation effective with ChartField Maintenance requests received as of January 3, 2022.

Sincerely,

David A. Von Moll

Copy: The Honorable Stephen E. Cummings, Secretary of Finance
Lewis R. McCabe, Jr., Deputy State Comptroller

(804) 225-2109 FAX (804) 786-3356 TDD (804) 371-8588

COMMONWEALTH *of* VIRGINIA
Department of Planning and Budget

JONATHAN D. HOWE
Acting Director

1111 E. Broad
Street Room 5040
Richmond, VA 23219-1922

January 24, 2022

Ms. Staci A. Henshaw
Auditor of Public Accounts
James Monroe Building
101 N. 14th Street
Richmond, Virginia 23219

Dear Ms. Henshaw:

The Department of Planning and Budget (DPB) appreciates the opportunity to respond to the findings and recommendations contained in the 2021 Secretary of Finance Report. DPB has reviewed the findings and recommendations provided by the Auditor of Public Accounts (APA) as part of its audit of financial records and operations for the fiscal year that ended on June 30, 2021. I offer the following response to the internal control and compliance findings and recommendations for DPB.

Internal Control and Compliance Findings and Recommendations

Improve Information Technology Change and Configuration Management Policy and Processes

DPB acknowledges the importance of strengthening its change and configuration management policies and processes in accordance with the Security Standard. In response to this finding, DPB is currently working to review its existing procedures and will consult with the Virginia Information Technologies Agency (VITA) and with its external vendors to address the APA finding and recommendation.

FAX (804) 225-3291 (804) 786-7455 TDD (804) 786-7578

DPB will use the findings and recommendations from the APA to continually improve its existing practices and policies. Thank you again for the opportunity to respond to your report.

Sincerely,

Jonathan D. Howe
Acting Director

c: The Honorable Stephen E. Cummings
Secretary of Finance

COMMONWEALTH of VIRGINIA

Department of Taxation

January 26, 2022

Ms. Staci A. Henshaw
Auditor of Public Accounts
James Monroe Building
101 N. 14th Street
Richmond, VA 23219

Dear Ms. Henshaw:

The Department of Taxation ("Virginia Tax") has reviewed the findings and recommendations provided by the Auditor of Public Accounts from your audit of the agency's financial records and operations for the year ended June 30, 2021. I appreciate the professionalism of your staff in the performance of the audit and the opportunity to provide the following responses to address the report findings.

Risk Alert-Unpatched Software

As your report documents, Virginia Information Technologies Agency (VITA) is responsible for addressing this risk alert. However, to facilitate remediation, Virginia Tax leadership formally communicates the status of this issue with VITA executive management each quarter. In addition, Virginia Tax technology staff meet routinely with VITA staff on other issues, including patching progress. Virginia Tax will continue to assist VITA where possible regarding this risk alert.

Continue to Improve Required Patching

I appreciate the report's recognition of the progress we have made on this issue. Virginia Tax technology staff will apply missing patches and comply with the requirements required by SEC 501 on a go-forward basis by September 30, 2022. For any systems where patches cannot be applied timely, a security exception will be filed with VITA. The exception will include a remediation strategy, timeline for implementation, and any risks associated with an extension. All identified exceptions will be provided to VITA by June 30, 2022.

If you or your staff have any questions, please contact me at 804-786-3332.

Sincerely,

Craig M. Burns
Tax Commissioner

Cc: The Honorable Stephen E. Cummings, Secretary of Finance

COMMONWEALTH of VIRGINIA
Department of the Treasury

MANJU S. GANERIWALA
TREASURER OF VIRGINIA

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

January 27, 2022

Ms. Staci Henshaw
Auditor of Public Accounts
101 N. 14th Street, 8th Floor
Richmond, VA 23219

Dear Ms. Henshaw:

The Department of the Treasury (Treasury) welcomes the opportunity to respond to the recommendations in your Report on the Audit of the Agencies of the Secretary of Finance for the fiscal year ended June 30, 2021. Treasury appreciates the recognition of our progress in addressing previous concerns as noted in the report. Additionally, your comments and recommendations are given the highest level of consideration by Treasury as we continually strive to improve our processes.

Comments to Management

Prepare and Review Unclaimed Property Reconciliations Timely

The Unclaimed Property Division (UCP) has updated the monthly reconciliation policy and procedures and will ensure compliance. As before, Treasury will continue to follow the guidance provided in the Commonwealth Accounting Policies and Procedures Manual.

Continue to Improve Process for Payment of Risk Management Invoices

The Risk Management Division will continue to work with the Operations Division to streamline the payment process and strengthen internal controls to ensure payments are made in compliance with the Prompt Pay Act, Code of Virginia § 2.2-4347.

Improve IT Risk Management and Contingency Planning Documentation

The Information Technology and Information Security Divisions will update the Continuity of Operations Plan and Business Impact Analysis to reflect Treasury's current recovery capability and continue to assess the need for additional recovery capabilities in the future. Additionally, the Information Security Division will improve Treasury's Information Technology Risk Management documentation and policy.

Improve Procedures for Calculating Penalty Periods for Undercollateralized Depositories

The Operations Division will re-evaluate its methodology for calculating the penalty period for weekly undercollateralization by opt-out depositories. The methodology adopted will be documented in the Security for Public Deposits desk procedures and will provide for proper calculation, communication and recording of the undercollateralization penalty period.

Sincerely,

Manju S. Ganeriwala

cc: The Honorable Stephen Cummings, Secretary of Finance

SECRETARY OF FINANCE AGENCY OFFICIALS

As of June 30, 2021

Aubrey L. Layne, Jr.
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

FINDINGS SUMMARY

Finding	Agency	Follow-Up Status	Year First Issued
Continue to Dedicate Resources to Timely Update CAPP Manual Topics	Accounts	Resolved	2019
Continue to Improve Controls over ChartField Maintenance	Accounts	Corrective Action Ongoing	2020
Continue to Improve Database Governance and Security	Planning and Budget	Resolved	2019
Improve Audit Logging and Monitoring Controls	Planning and Budget	Resolved	2020
Review and Update Baseline Configuration Standards	Planning and Budget	Resolved	2020
Improve Information Technology Change and Configuration Management Policy and Process	Planning and Budget	New	2021
Continue to Improve Controls Over User Access	Taxation	Resolved	2017
Continue to Improve Disaster Recovery Planning Documentation	Taxation	Resolved	2018
Continue Completing a Risk Assessment for Each Sensitive System	Taxation	Resolved	2019
Continue to Improve Patching to Mitigate Vulnerabilities	Taxation	Corrective Action Ongoing	2020
Ensure Employees Complete Required Conflict of Interest Training	Taxation	Resolved	2020
Prepare and Review Unclaimed Property Reconciliations Timely	Treasury	Corrective Action Ongoing	2019
Continue to Improve Process for Payment of Risk Management Invoices	Treasury	Corrective Action Ongoing	2019
Improve IT Risk Management and Contingency Planning Documentation	Treasury	New	2021
Improve Procedures for Calculating Penalty Periods for Undercollateralized Depositories	Treasury	New	2021