

**AGENCIES OF THE
SECRETARY OF FINANCE**

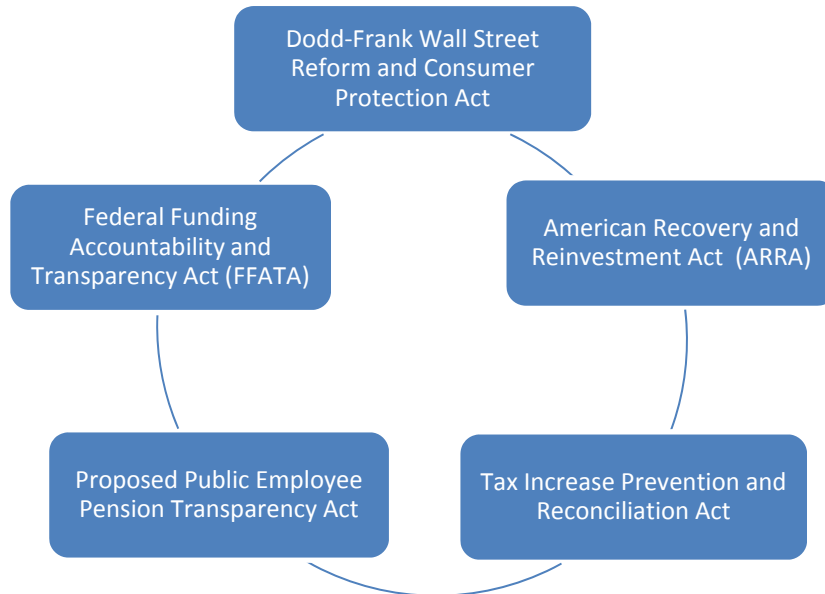
**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2010**



PENDING CHANGES IN GOVERNMENT FINANCIAL REPORTING:

The future may take us where we have never been . . . Are we ready?

The governmental financial reporting landscape is changing. Citizens, federal and state legislatures, and investors all have called on state and local governments to provide additional and more timely financial information concerning government financial activities. You only need to take a look at regulations that the federal government has passed or proposed in recent years to get a perspective on the breadth of changes that are coming our way.



The Dodd-Frank Act requires studies of the municipal securities market and of the role and importance of the Governmental Accounting Standards Board. The Tax Increase Prevention and Reconciliation Act requires governments to withhold three percent of their payments for many goods and services and remit the withheld amount to the federal government. Further, the ARRA and FFATA require additional disclosures on how the Commonwealth spends funds it receives from the federal government. Because of these regulations, the Commonwealth has already made changes to the Commonwealth's existing financial systems and processes. Further, the proposed regulations and studies have the potential to require extensive changes in the future.

Are we ready in Virginia? We all recognize that it takes time to implement such changes as replacing outdated financial systems and reengineering our financial processes. While the Commonwealth is taking steps in the right direction in modernizing its financial systems as we state in this report, it still has work to do in this area. In addition, while a modern financial system will provide some of the flexibility and technology needed to address future reporting requirements, the Commonwealth needs to implement additional changes to its financial reporting processes to meet these demands. In this report we provide a status on the Commonwealth's efforts to modernize its financial systems and processes.

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COMMENTS TO MANAGEMENT

Modernize Financial Systems and Processes (*Status of Prior Year Finding*)

Financial Systems

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

The Commonwealth has continued to make progress on its Cardinal system, which will replace the Commonwealth's financial system (CARS) and the Virginia Department of Transportation's (Transportation) financial system with a modern, enterprise-wide financial system (base financial system). This is a key project for the Commonwealth as its current accounting systems are outdated in terms of the technology they use and available functionality. For example, due to their age and lack of integration, the Commonwealth's current systems either do not contain the information, or cannot easily exchange information, to support current state and federal initiatives related to government transparency and timelier financial reporting.

Cardinal will implement the base financial system in two phases. The first implementation phase in July 2011 will provide Transportation's financial system. Phase two of the implementation will provide the Commonwealth's base financial system for Accounts by July 2012 and will consist of general ledger and accounts payable modules. All other executive branch agencies will convert to the new system in future phases, at which time Accounts has the opportunity to retire CARS and, potentially, other redundant financial systems. These modules will provide the foundation for a modern financial system for the Commonwealth with the ability to add other modules and expand functionality in future phases.

Cardinal Phase 1 is currently on schedule, but the project team believes there could be a six week go-live postponement due to a limited cushion in the project schedule to absorb project delays. The project's total estimated budget is \$58.3 million and as of November 30, 2010, the project costs are \$27.2 million, including \$4.8 million for software and \$19.5 million for services.

Relative to the Commonwealth's Data Standards, Transportation is working with the Department of General Services to create an interface enabling Cardinal to use eVA vendor information to populate its vendor tables. In addition, Transportation is working with the Department of Human Resource Management to interface Cardinal with the Commonwealth's human resources systems. Finally, Transportation and Accounts are working to develop chart of account field values.

Additional details about the status of the Cardinal project are located in our "Progress Report on Selected Systems Development Projects in the Commonwealth" report which we plan to issue in February 2011. We recommend the Secretary of Finance and State Comptroller continue to work with Transportation and the Virginia Information Technologies Agency in their efforts to implement Cardinal as the statewide accounting system.

Financial Reporting Processes

Applicable to: Department of Accounts

While a modern financial system will provide some of the flexibility and technology needed, the Commonwealth needs to implement additional process changes to meet these demands. The landscape for financial reporting is continuing to change with reporting standards becoming more complex, changing laws and regulations at the state and federal level, decreasing numbers of financial reporting staff at State agencies, and an increasing demand from the federal government for timelier financial reporting. Without changing its current processes, due to the changing accounting and regulatory environment and reduced administrative personnel at the agency level, there is the risk of the Commonwealth issuing inaccurate financial reports or not being able to comply with state or federal mandates for more comprehensive and timely reporting.

Therefore, it is imperative that along with the implementation of Cardinal, Accounts should reexamine the Commonwealth's financial reporting process to identify opportunities for improving their use of technology, communication with agencies, and analysis of financial activity. Better use of technology will not only help improve the timeliness of financial reporting, it will also provide Accounts with additional time to analyze financial activity, in order to identify unusual or erroneous transactions.

As part of this re-examination, Accounts should also focus on its process for analyzing the financial reporting impact of new programs or changes to existing programs. This will involve working closely with agencies to ensure they fully understand how Accounts uses their financial information in the accounting and financial reporting process, so that Accounts can obtain all of the information it needs to evaluate the impact of the changes.

In addition, agencies submit via e-mail much of the information needed to prepare the Commonwealth's financial statements, which Accounts must then manually analyze and record in spreadsheets. We recommend Accounts continue to explore the use of software or databases to accumulate this data, which will allow more time and tools for analysis. Accounts should also continue to develop data analysis tools and processes to identify and follow up on unusual activity throughout the year.

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Improve Database Administrator Access Oversight

Applicable to: Department of Taxation

Taxation has not implemented controls and processes to address certain weaknesses in security over databases we identified during the prior year's audit. Taxation does not provide adequate oversight for its database administration user accounts to address the risk of unauthorized disclosure of taxpayer information. Database administrator accounts have the highest level of privileges in a database. Without adequate oversight over high-privileged administration accounts, Taxation cannot determine accountability for the adding, deleting, or changing of data in the systems that Taxation has classified as containing confidential or mission critical data.

We have communicated the details of this issue separately from this report because they contain the descriptions of a security system. Such information is exempt from public disclosure by the Freedom of Information Act. This recommendation is precautionary and our work did not include a review to determine if the lack of oversight resulted in a compromise of confidential taxpayer data.

We recommend that Taxation improve database administrator user account oversight. Improving oversight for these accounts will allow Taxation to reduce the risk of unauthorized access and improve accountability.

Improve System Access Management

Applicable to: Department of Taxation

Taxation has not implemented sufficient controls and processes to address weaknesses in system access management that we identified during the prior year's audit. In the prior year, we found processes that resulted in inefficient access management and inappropriate user privileges.

To address the prior year's issues, Taxation planned to develop an automated system to improve the accuracy and efficiency of its system access management; however, Taxation is still in the process of deciding what product to use, and therefore, has not made adequate progress toward resolving this issue.

Without adequate controls for system access management, Taxation does not comply with the Commonwealth's Security Standard 501, and Taxation employees could have unnecessary access to sensitive and high-risk applications. We recommend that Taxation develop and implement efficient controls to reduce the risk of improper access to systems. Taxation should ensure that, at a minimum, these controls meet the Commonwealth's Security Standard.

FINANCE SECRETARIAL OVERVIEW

The Secretary of Finance assists the Governor in the management and direction of the finance agencies and performs program coordination, policy planning, and budget formulation activities. We performed an audit of the financial activity of the Secretary of Finance for the year ended June 30, 2010, and reported our audit results in a separate audit report entitled “The Governor’s Cabinet Secretaries” issued in September 2010.

The Departments of Accounts, Planning and Budget, Taxation, and the Treasury and the Treasury Board report to the Secretary of Finance, and they primarily serve other agencies within the Commonwealth in a central support capacity. The individual audits of these agencies primarily support the audit of the Commonwealth’s CAFR for the fiscal year ended June 30, 2010. These agencies perform critical functions in the Commonwealth’s statewide financial management system, working closely together in the budgeting, management, and reporting of the Commonwealth’s financial resources. Additionally, the agencies provide administrative services to other agencies throughout the Commonwealth. An overview of these activities is included below along with the interaction of the agencies within the Finance Secretariat while performing these activities.

Planning, Budgeting, and Evaluation Services

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

Once the General Assembly and the Governor have approved the budget, Planning and Budget provides an electronic copy to Accounts to upload into the Commonwealth Accounting and Reporting System (CARS). CARS contains automated edit controls to ensure agencies do not exceed the spending authority established in the budget. Throughout the year, along with the Governor, Planning and Budget has certain statutory authority to increase, decrease or transfer funds and personnel positions within constraints set forth in the Act. Jointly, Planning and Budget and Accounts ensure that CARS properly reflects these adjustments.

During fiscal year 2010, the administrative adjustments processed by Planning and Budget resulted in a \$7.1 billion increase to the Commonwealth’s operating budget and a \$4.9 billion increase to the capital budget. These increases were primarily federal stimulus funding appropriations, re-appropriations of prior year’s balances, and increases for items not estimated in the original budget. We provide more detail on the adjustments in the “Review of Budget and Appropriation Processing and Control System” report referred to below.

We performed a review of the budget and appropriation processing control system administered by Planning and Budget for the fiscal year ended June 30, 2010, primarily in support of the audit of the Commonwealth's CAFR for the fiscal year ended June 30, 2010. We plan to issue a separate report on the results of this review in February 2011. In addition, we performed a review of the accuracy, reasonableness, and completeness of key performance measure information reported on the Virginia Performs website, which Planning and Budget maintains. We plan to issue a separate report on the results of this review in March 2011.

Performance Budgeting System

During fiscal year 2010, Planning and Budget operated the Program Budget System (PROBUD), for state agencies to submit their budget requests to Planning and Budget over the Internet, and the Form 27 Automated Transaction System (FATS), for executing administrative adjustments to the approved budget. However, subsequent to year end, Planning and Budget and the Virginia Information Technologies Agency (VITA) Enterprise Applications Division, have started implementation of the Performance Budgeting System project to replace the legacy budgeting systems PROBUD and FATS, as well as other ancillary databases, spreadsheets, and documents currently supporting the Commonwealth's strategic planning and budgeting processes. In September 2010, Phase I implementation occurred and addressed four functional areas: budget development (operating and capital), six-year financial planning, and budget execution. In April 2011, Phase II implementation should occur and will address the remaining two areas: agency spending plans and strategic planning.

The funding for this \$11.4 million project comes from a working capital advance administered by VITA. The Appropriations Act directs the repayments of the advance from enhanced collections, cost recoveries, inter-agency collaborative projects, and other initiatives. No repayment from these sources has occurred to date. Additionally, the Commonwealth has not finalized the funding methodology to support system maintenance and operation costs. The 2011 Budget Bill includes language introducing a new internal service fund that Accounts will manage to capture fees to support enterprise system administration. The language offers multiple options for assessing these fees including based on licenses, transactions, or other meaningful identifiers, as determined by the Secretary of Finance and the owner of the enterprise application. Additional details about the status of the Performance Budgeting project are located in our "Progress Report on Selected Systems Development Projects in the Commonwealth" report which we plan to issue in February 2011.

Revenue Administration Services

Taxation administers and enforces the tax laws of the Commonwealth. Due to its tax return processing duties, Taxation is the single largest collector of Commonwealth revenue, which it primarily deposits to the General Fund. During fiscal year 2010, Taxation collected \$17.4 billion in revenue, depositing \$15.5 billion into the General Fund. In addition, both Taxation and Accounts collect money owed to the Commonwealth through a debt set-off program that they jointly administer in accordance with the Code of Virginia's Debt Collection Act.

Check Processing and Bank Reconciliation

Treasury processes agency disbursements from revenue the Commonwealth collects. Treasury is responsible for the printing and distribution process of all checks and distributes electronic payments for individual agencies. Monthly, the Commonwealth's two disbursement banks are responsible for full reconciliation of check disbursement activity. Treasury's fully automated system, "Recon Plus," interfaces with other bank systems and allows Treasury to reconcile accounts within 45 days of month end.

Unclaimed Property Administration

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

Investment, Trust and Insurance Services

Treasury, under the direction of the State Treasurer, invests the Commonwealth's funds and provides trust and insurance services. Treasury manages and invests the Commonwealth's funds throughout the year trying to achieve the highest level of returns based on the operational needs of the Commonwealth. The largest portfolio Treasury manages is the General Account of the Commonwealth, a pool of investments representing assets of the Commonwealth's General Fund and higher education (operating), highway maintenance, and transportation trust funds. The General Account has two pools: the primary liquidity pool and the total return pool. Treasury internally manages the primary liquidity pool, which provides the major source of liquidity for the disbursement requirements and operational needs of the Commonwealth. The externally managed total return pool seeks to generate higher total returns over time, as compared to the liquidity pool. Treasury's target allocation for the overall general account asset mix is 75 percent for the primary liquidity pool and 25 percent for the total return pool.

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

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

Authority, the Virginia College Building Authority, the Virginia Public Building Authority, the Debt Capacity Advisory Committee, and the Treasury Board. As a result of their efforts, Virginia is one of only seven states with an “AAA” bond rating for general obligation debt from three rating services: Moody’s Investors Service, Standard and Poors Corporation, and Fitch Ratings, Inc.

Finally, Treasury administers insurance programs on behalf of the Commonwealth that cover state government, other public entities, and certain individuals serving in the public interest. Administered insurance programs are either self-insured or commercially insured. Treasury bills state agencies, the Compensation Board, and local governments for insurance premiums to cover current and future costs. Types of insurance include liability and property insurance and fidelity bonds.

We performed an audit of the financial activity of the Local Government Investment Pool, the Virginia College Building Authority, the Virginia Public School Authority, and the Virginia Public Building Authority for the year ended June 30, 2010, and reported our audit results in a separate audit report issued in December 2010.

Bond and Loan Retirement and Redemption

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

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

In addition, the Treasury Board makes payments to the Virginia College Building Authority and the Virginia Public Building Authority for lease payments and/or bond principal and interest on the Authorities’ appropriation-supported debt. The Board also pays debt service on Article X,

Section 9(b) general obligation bonds and processes debt service payments to trustees and/or paying agents on behalf of the Commonwealth Transportation Board.

Financial Systems Development and Management

Accounts operates and maintains the Commonwealth's centralized automated accounting, payroll, and fixed asset systems. CARS is a cash-basis accounting system that records all of the Commonwealth's cash receipts and disbursement transactions and provides a means to enforce state appropriation law for all state agencies through automatic edits and manual reviews. The Commonwealth Integrated Payroll/Personnel System (CIPPS) is the Commonwealth's central payroll and leave system. Agencies and institutions use CIPPS to process employee salaries and wages, tax computations, payroll deductions, and leave transactions. The Fixed Asset Accounting and Control System (FAACS) and Lease Accounting System (LAS) record the Commonwealth's capital and controllable assets and equipment leases.

Accounting Services

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

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

Accounts calculates and distributes certain revenues collected by Taxation to local governments as required by the Code of Virginia. The Appropriation Act budgets and Accounts records these transfer payments under a separate agency number. Accounts distributed the following amount of revenue during fiscal year 2010.

Sales and use tax for education	\$ 964,211,252
Personal Property Tax Relief Act	950,000,000
Recordation taxes	18,003,549
Other	<u>1,753,916</u>
Total	<u>\$ 1,933,968,717</u>

Source: Commonwealth Accounting and Reporting System

Accounts also made recordation tax transfers to the Department of Transportation for the Northern Virginia Transportation District Fund and the Transportation Improvement Set-Aside Fund in the amounts of \$18,547,298 and \$1,132,694, respectively.

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

During the year, the Commonwealth monitors its General Fund revenue collections using the Monthly Revenue Report, which the Secretary of Finance issues. Accounts accumulates the financial information for this report from CARS and various agencies. Taxation provides Accounts with the General Fund revenue forecast for the report and provides detailed information on certain actual revenue collections. Treasury provides Accounts with information on the Commonwealth's investing activity.

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

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

Service Center Administration

The Payroll Service Bureau division of Accounts processes payroll, leave accounting, and certain benefits data entry functions for selected agencies.

AGENCY FINANCIAL INFORMATION

The following information provides a summary of budget and actual expenses of each of the finance secretariat agencies. General Funds are the primary resource for funding the Secretary of Finance agencies' operations and account for approximately 82 percent of the overall operating expenses. The original operating budget for agencies in the Finance Secretariat totaled approximately \$138.1 million. The final operating budget for agencies totaled \$616.9 million, an increase of \$478.8 million as a result of various budget adjustments.

Taxation's budget increased by \$461.9 million, primarily due to a required change in the accounting and reporting of Virginia Communication Sales and Use Tax activity. Chapter 872 of the 2010 Virginia Acts of Assembly required that all Virginia Communication Sales and Use Tax activity be accounted for as part of the General Fund, when previously the Commonwealth reported this activity in a separate fund in an agent capacity. Because this change did not occur until the final month of the fiscal year, Taxation did not process any payments from this appropriation resulting in a large budget to actual variance. Taxation distributed \$437.5 million in communication sales and use taxes from the non-general fund in use prior to the change occurring and Accounts reclassified this activity to the General Fund for financial reporting purposes.

The Secretary of Finance budget increased by \$14.3 million, with the majority of the increase attributable to assistance provided to localities for the implementation of recommendations of the 2005 Base Realignment and Closure Commission. Accounts' budget increased by approximately \$2.7 million, with the majority attributable to grants associated with the Commonwealth Health Research Fund and the creation of an Internal Service fund for the Payroll Service Bureau. The remaining increase is due to other miscellaneous changes throughout the agencies. During fiscal year 2010, the actual expenses of each of the Finance Secretariat agencies was less than the final budgeted expenses primarily as a result of the agencies' efforts to reduce administrative expenses in anticipation of further budget cuts.

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

Summary of Budget and Expenses for 2010

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
Secretary of Finance	\$ 654,846	\$ 14,980,644	\$ 14,980,554
Department of Accounts	11,509,421	14,255,511	13,099,440
Department of Planning and Budget	7,549,849	7,215,417	6,337,734
Department of Taxation	100,185,126	562,128,744	103,166,013
Department of the Treasury	<u>18,166,101</u>	<u>18,347,507</u>	<u>16,914,696</u>
Total – Finance Agencies	<u>\$138,065,343</u>	<u>\$616,927,823</u>	<u>\$154,498,437</u>

Source: Commonwealth Accounting and Reporting System



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

January 13, 2011

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable Charles J. Colgan
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the agencies under the **Secretary of Finance** for the year ended June 30, 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our primary audit objectives for the audit of the Departments of Accounts, Planning and Budget, Taxation, and the Treasury for the fiscal year ended June 30, 2010, include the following:

- to determine whether management has established and maintained internal controls over the Commonwealth's financial reporting and other central processes and the centralized services provided to agencies and institutions in support of the preparation of the financial statements as indicated in the scope section of this report;
- to determine whether management has established and maintained adequate operating and application system controls over CARS, CIPPS, FAACS, LAS, the Integrated Revenue Management System, the Form 27 Automated Transaction System, and other central systems;
- to evaluate the accuracy of financial transactions related to tax collections including accounts receivable, deferred revenues and taxes, accounts payable and other liabilities, and tax and interest revenue as reported in CARS and the

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

- to evaluate the accuracy of financial transactions related to cash and cash equivalents, investments, debt, risk management, and unclaimed property activity which is controlled by Treasury as reported in CARS and Treasury's accounting records, and in supplemental information prepared by Treasury (including the activity of the Treasury Board, the Local Government Investment Pool, the Virginia College Building Authority, the Virginia Public School Authority, and the Virginia Public Building Authority);
- to evaluate whether appropriation controls in CARS are adequate to ensure program expenses do not exceed appropriations;
- to evaluate the proper approval and documentation of budget adjustments;
- to evaluate the accuracy, reasonableness, and completeness of key performance measure information reported on the Virginia Performs website;
- to determine whether the agencies have complied with applicable laws and regulations; and
- to review corrective actions related to audit findings from the prior year report.

Audit Scope and Methodology

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

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

Department of Accounts

Financial Reporting*

Commonwealth Accounting and Reporting System (CARS)

Commonwealth Integrated Payroll/Personnel System (CIPPS)

Fixed Asset Accounting and Control System (FAACS)

Lease Accounting System (LAS)

Department of Planning and Budget

Form 27 Automated Transaction System
Budget Execution
Performance Measures

Department of Taxation

Financial Reporting	Lifeworks System
Tax Return Processing	Remittance and Data Capture System
Tax Revenue Collection	Total Automated Capture System
iFile System	Joint Electronic Filing System
Integrated Revenue Management System	Key From Image System

Department of the Treasury (including Treasury Board operations)

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

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

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

Audit Conclusions

We noted no matters involving internal controls related to the Commonwealth's financial reporting and other central processes and the centralized services provided to agencies and institutions in support of the preparation of the financial statements as indicated in the scope section of this report.

We noted certain matters involving operating and application system controls over systems at Taxation that we consider necessary to be reported to management. These matters are described in the section entitled "Internal Control and Compliance Findings and Recommendations".

We found that Taxation properly stated, in all material respects, the financial records reviewed in support of the tax collections activity detailed in the audit objectives as reported in CARS, the Integrated Revenue Management System, and in supplemental information.

We found that Treasury properly stated, in all material respects, the financial records reviewed in support of the cash and investments, debt, risk management and unclaimed property activity reported in CARS and in Treasury's accounting records, and supplemental information.

We found that appropriation controls in CARS were adequate to ensure program expenses do not exceed appropriations.

We found that budget adjustments were properly approved and documented.

We found that key performance measure information was reasonable and properly stated, in all material respects, on the Virginia Performs website.

We noted a matter involving compliance with applicable laws and regulations at Taxation that is required to be reported under Government Auditing Standards. This matter is described in the finding entitled "Improve System Access Management" in the "Internal Control and Compliance Findings and Recommendations" report section.

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

Exit Conference and Report Distribution

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

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

AUDITOR OF PUBLIC ACCOUNTS

SAH: alh



COMMONWEALTH of VIRGINIA

DAVID A. VON MOLL, CPA
COMPTROLLER

Office of the Comptroller

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

February 2, 2011

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

Dear Mr. Kucharski:

The Department of Accounts (Accounts) appreciates the opportunity to respond to the *Comments to Management* contained in your 2010 Secretary of Finance Audit Report. Your comments are given the highest level of importance and consideration by Accounts as we continue to review and improve our current practices. Accounts appreciates your acknowledgement of the progress made and the recognition that some issues take time to resolve.

Comments to Management

Modernize Financial Systems and Processes (Status of Prior Year Finding)

Financial Systems

Accounts understands the risks associated with older computer systems and ramifications of potential system failures. As noted in previous years, Accounts has been directly involved in the Virginia Enterprise Application Project (Cardinal) over the past several years. The State Comptroller is one of the project sponsors and the Assistant State Comptroller of Accounting and Reporting is a voting member of the Enterprise Steering Committee. Additionally, Accounts has assigned two permanent project members to the Cardinal project and has requested two additional analyst positions for the Cardinal team. Accounts also recognizes the benefits of adopting standardized data requirements and several senior management representatives are participating on the project team to develop these standardized data requirements.

Financial Reporting Processes

Accounts appreciates the recognition that the financial landscape is changing and that additional process changes are required to successfully navigate additional reporting complexities arising from new accounting standards, laws and regulations at the same time we are facing decreasing numbers of financial reporting staff in the Commonwealth. The Department of Accounts' General Accounting and Financial Reporting Divisions are striving to identify new programs or changes to existing programs in order to evaluate the appropriate accounting and reporting treatment. Additionally, the Financial Reporting Division is exploring the expanded use of databases. We will continue to use a risk-based approach in our evaluation of agency financial information. The Financial Reporting Division will continue to evaluate both efficiency and effectiveness of agency processes when performing agency reviews. Accounts will strive to continue partnership arrangements with line agencies to facilitate the agencies' understanding and process improvements. Accounts will continue to evaluate the best means of communicating with agencies and will strive to provide policies and procedures governing the Cardinal project prior to implementation.

Sincerely,

A handwritten signature in black ink, appearing to read "D. A. Von Moll". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

David A. Von Moll

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



COMMONWEALTH of VIRGINIA

Department of Taxation

January 12, 2011

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

Dear Mr. Kucharski:

Thank you for the opportunity to provide the Department of Taxation's (TAX) response to the findings identified as part of your audit of TAX's financial records and operations for the year ended June 30, 2010. We also appreciate the professional manner in which your staff conducted the review. A short summary of TAX's plan to address the report findings follows:

Improve Database Administrator Access Oversight

We agree that TAX should improve the oversight of Database Administrators. TAX has made progress addressing this previously reported finding, but we need to take the appropriate action to completely address this issue. TAX will complete the necessary changes by February 28, 2011.

Improve System Access Management

We agree that TAX should take action to improve system access management. As of the date of this response, TAX has selected the product to address this issue. The development plan for this application reflects a completion date of July 31, 2011.

TAX strives to maintain strong internal controls and business processes that ensure high standards of integrity, efficiency, and control. Completely addressing your report findings will assist us in this endeavor.

Again, thank you for the opportunity to respond to your report.

Sincerely,

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

Craig M. Burns
Tax Commissioner

c: The Honorable Richard D. Brown

SECRETARY OF FINANCE AGENCY OFFICIALS

As of June 30, 2010

Richard D. Brown
Secretary of Finance

David A. Von Moll
Comptroller

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

Craig M. Burns
Tax Commissioner

Manju S. Ganeriwala
Treasurer