



CYCLED AGENCY PAYROLL REVIEW

FISCAL YEAR 2016

Auditor of Public Accounts
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AUDIT SUMMARY

Payroll is one of the most important accounting cycles for Commonwealth agencies. Employees depend on agency payroll and human resources personnel to process and deliver their pay accurately and timely. Our audit of payroll operations at nine cycled agencies had the following objectives:

- determine whether cycled agencies maintain adequate controls to ensure compliance with applicable statewide and agency-specific payroll policies and procedures; and
- determine through review of payroll operations whether cycled agencies are processing payroll effectively and accurately.

We found:

- agencies were processing and delivering payroll accurately and timely to state employees;
- no instances of inaccurate compensation to employees at the agencies audited; and
- matters involving internal control and compliance necessary to bring to management's attention.

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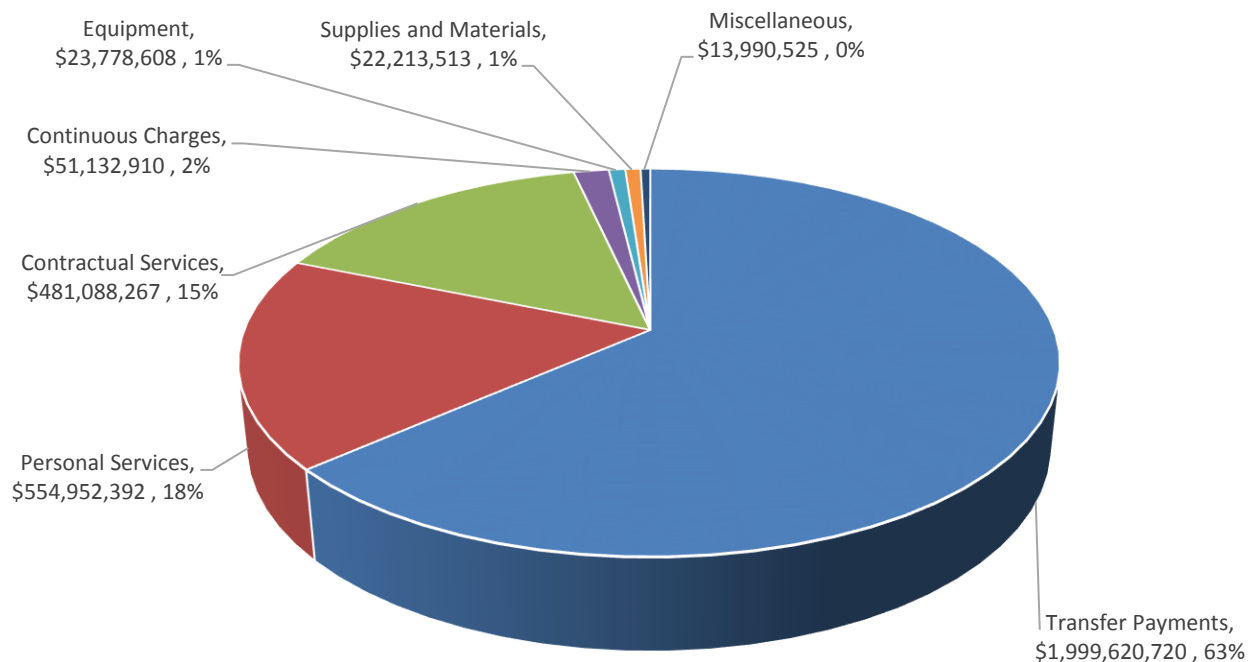
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INTRODUCTION

The Auditor of Public Accounts (APA), as required by the Code of Virginia, audits all Executive and Judicial branch Commonwealth agencies handling state funds. However, the Code of Virginia does not require audits of all agencies annually. Agencies audited by the APA on a periodic basis are referred to as cycled agencies. Historically, the APA has audited cycled agencies at least once every three years. Beginning with fiscal year 2016 audits, the APA developed a risk-based approach for auditing cycled agencies. The new audit approach allows the APA flexibility to focus on different areas of significant agency operations every year at any one or several of the pool of cycled agencies based on an assessment of risk factors. For fiscal year 2016, the APA chose payroll operations as the area of audit focus.

Payroll is one of the most critical business cycles for Commonwealth agencies, due to its financial impact, and is of the utmost importance to employees who depend on payroll to be accurate and timely. Personal Services (Payroll) makes up 18 percent of all expenses for the cycled agency population, totaling \$555 million for fiscal year 2016. Excluding Transfer Payments, which are typically agency transfers of federal funds to recipients of federal monies managed by the agencies, Personal Services is the largest expense category for agencies overall.

Chart 1



Source: Commonwealth's accounting and financial reporting system

Currently, approximately 200 Commonwealth agencies use the statewide payroll system to process payroll. The statewide payroll system, implemented in 1986, runs on an IBM mainframe and is written in COBOL (Common Business Oriented Language). However, the vendor for the current statewide payroll system will no longer support the application in the near future. The Commonwealth launched an initiative in August 2016 to utilize the Commonwealth's new accounting system of record, which came on line in fiscal year 2016, as the replacement for the aging payroll system. The project will transfer payroll functions to the Commonwealth's new accounting system of record in two releases. The first release is set for September 2018 and will cover 10 percent of state employees. The second release is scheduled for March 2019 and will incorporate the remaining state employees. Upon completion of the second release, the current statewide payroll system will be fully decommissioned. The implementation of the Commonwealth's accounting system of record as the new statewide payroll system increases the need for the APA to determine and ensure that existing internal controls are working effectively in this crucial area of Commonwealth operations.

PAYROLL AUDIT

Objectives, Scope, and Methodology

The overall objective for this audit is to gain an understanding of payroll internal controls and operations within the cycled agency population and to identify areas of concern for improvement or efficiency gains. This includes analysis of payroll processing, supporting documentation, terminated employee procedures, access to payroll systems, and various accounting functions associated with payroll. The specific objectives of this review are to:

- Determine whether cycled agencies maintain adequate controls to ensure compliance with applicable statewide and agency-specific payroll policies and procedures; and
- Determine through review of payroll operations whether cycled agencies are processing payroll effectively and accurately.

Test Work over the Pool of Cycled Agencies

We contacted staff at the Payroll Service Bureau (Bureau), the Department for Human Resource Management (Human Resources), and the Department of Accounts (Accounts) in order to better understand the role of these service providers in the processing of payroll at various agencies, as applicable, over the course of the audit. We reviewed statewide payroll policies in the Commonwealth Accounting Policies and Procedures (CAPP) Manual, the Code of Virginia, and the Appropriation Act to gain an understanding of the requirements surrounding payroll. We performed limited test work over the pool of thirty-seven cycled agencies, as applicable, based on payroll operations at each agency, and then performed detailed test work at nine agencies.

The limited audit procedures over the pool of thirty-seven cycled agencies, and the general conclusions drawn from that test work, apply to the subset of agencies where the control tested was

applicable, and not to agencies statewide. The agencies in the cycled agency pool are listed in Appendix A of this report. Appendix A also details which of the payroll controls below were tested for each of the agencies. We tested the following payroll controls for the thirty-seven cycled agencies, as applicable based on agency operations:

- Payroll system and human resource system segregation of system access
- Agency head salary

Payroll and Human Resources System Access: Segregation of Duties

We only tested systems' access for the twenty-five agencies in the pool of cycled agencies that have access to both the Commonwealth's payroll system and the Commonwealth's human resource system. We tested access types for each system and ensured that no employee had update access to both systems, which would indicate a segregation of duties issue and expose the Commonwealth to risks of employees keying inappropriate transactions. This type of access is called "dual" access. For example, if an employee had access to both systems, it would be possible to set up a ghost employee in the human resource system and then the same employee could enter payroll information to pay the ghost employee. We found no instances of agency employees having dual access. Internal controls over the proper granting of systems access over payroll operations appear to be performing effectively, as dual access was not found at any agency using both the Commonwealth payroll and Commonwealth human resource systems. For any agency that we selected for detailed test work, we performed additional procedures over the proper access to payroll and human resources systems, based on each agency's particular operations.

Agency Head Salary

The 2015 – 2016 Appropriation Act, Chapter 732, provides guidelines governing the use of general funds for compensation for agency head salaries, including language to allow for additional compensation from sources outside of general state funds. University presidents and museums, for example, allow for additional compensation based on the need to offer competitive compensation packages to attract the best possible talent for the role of agency head. We reviewed the agency head salary information of the thirty-six agencies governed by the Appropriation Act. We ensured that if additional compensation was allowed, the agency had the proper approvals of the Governor's office and Human Resources as required. We found no issues at any agency tested pertaining to agency head salary.

Agencies Selected for Detailed Review

We took the pool of thirty-seven cycled agencies and analyzed several factors in order to qualitatively determine the agencies where we would perform detailed test work. We created a matrix of the agencies and documented the factors we used to determine the agencies selected. We also considered the size of the agency so that we looked at agencies both small and large. Factors we considered included:

- How recently an audit was performed at the agency
- Payroll test work performed during past audits and the extent of test work

- Ratio of salaried to wage employees
- Turnover in employees
- Ratios for Special Pays, Overtime, Bonus pay, and changes in wage and salary
- Access to Commonwealth payroll and human resource systems
- Use of Service Providers (Bureau, Human Resources, Accounts)
- Past management recommendations concerning payroll

We analyzed the matrix of information and determined that we would perform test work at nine agencies. Table 1 below lists the agencies and provides the agencies' abbreviated names used in this report. Chart 2 below shows the number of salaried and wage employees for each agency selected.

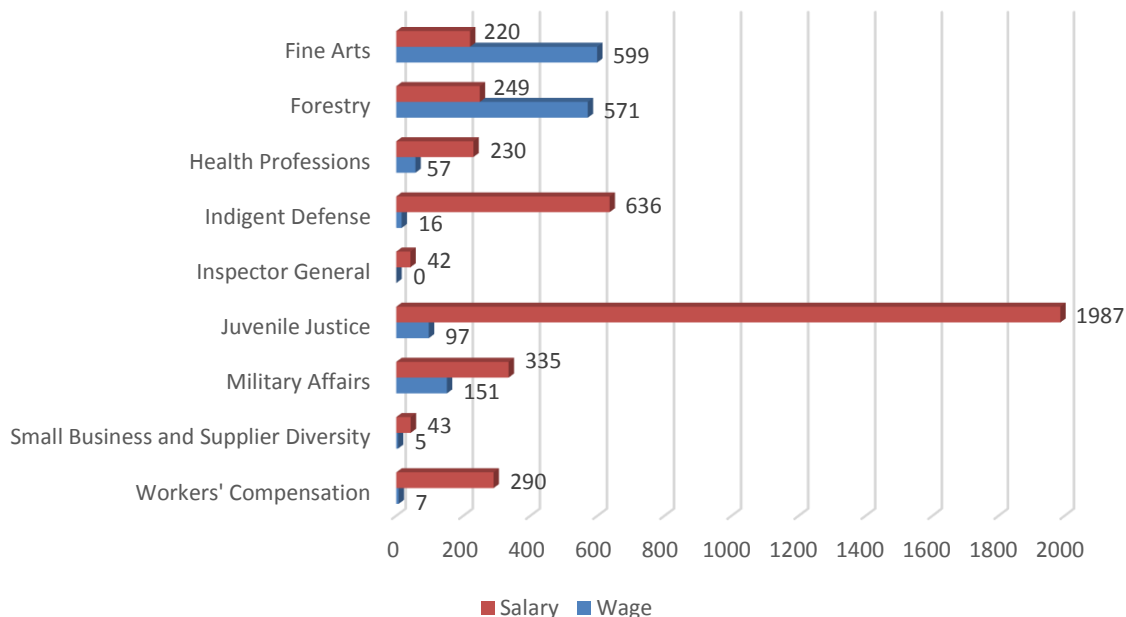
Agencies Selected for Detailed Test Work

Table 1

Agency Name	Abbreviated Name
Virginia Museum of Fine Arts	Fine Arts
Department of Forestry	Forestry
Department of Health Professions	Health Professions
Indigent Defense Commission	Indigent Defense
Office of the State Inspector General	Inspector General
Department of Juvenile Justice	Juvenile Justice
Department of Military Affairs	Military Affairs
Department for Small Business and Supplier Diversity	Small Business and Supplier Diversity
Virginia Workers' Compensation Commission	Workers' Compensation

Salary and Wage Employee Count for Fiscal Year 2016

Chart 2



Use of Service Providers in Support of Payroll Operations

Although the majority of agencies use the statewide payroll system to deliver pay to their employees, there are multiple ways payroll agencies can process payroll. Agencies may use a service provider to perform payroll and/or human resource functions supporting payroll operations. Service providers include: the Bureau, which performs payroll processing and functions related to payroll; Human Resources, which provides services supporting agency operations, including file management, hiring, human resource policy support and other functions; and Accounts, acting as the fiscal agent for agencies, taking responsibility for signing payroll certifications on behalf of an agency, for example. Table 2 below highlights the use of service providers in the payroll process at each agency selected for detailed test work.

Use of Service Providers

Table 2

Agency Name	Bureau	Human Resources	Accounts	None
Fine Arts	✓			
Forestry	✓			
Health Professions	✓	✓		
Indigent Defense	✓			
Inspector General	✓	✓	✓	
Juvenile Justice				✓
Military Affairs	✓			
Small Business and Supplier Diversity	✓	✓		
Workers' Compensation				✓

The Bureau provides payroll-processing services to over 50 state agencies. The Scope of Services Document, published on Accounts' website, is provided to all users of the Bureau's payroll services and defines agency and Bureau responsibilities during the payroll cycle. The Bureau performs a wide variety of payroll-related services for agencies and retains records of payroll processing and personnel information for the agencies they serve. Agencies who employ the Bureau will not have to perform some functions; for example, the reconciliations required by the CAPP manual are shared between the Bureau and the agency. The use of the Bureau's services is an important consideration when auditing agency payroll.

Human Resources provides human resource management support to state agencies, and can provide data entry into the statewide human resources system, which in turn, provides data to the Bureau for setting up employees' payroll. Agencies can use Human Resources' services to provide support for the hiring process, feedback on pay increases, policy assistance, and many other human resource functions. Shared Services are provided at some agencies whereby Human Resources' employees are resident at the agency to perform human resource functions. Agencies and Human Resources will enter into a Memorandum of Understanding (MOU) that defines the responsibilities of each party over the areas of service provided, providing for accountability for business functions provided.

Accounts can provide fiscal services to agencies and perform a variety of functions based on an MOU with the agency seeking services. Accounts can certify payroll, perform payroll reconciliations, perform accounting functions, and review documentation. Accounts will perform many of the duties for an agency in the payroll process, dealing with the agency and other service providers, the Bureau and Human resources in particular, directly.

Service providers are an important consideration in reviewing the payroll operations of agencies. We ensured that each agency's use of service providers was documented and understood during the audits at the agencies, by reviewing all applicable policies and procedures concerning the use of service providers.

AUDIT FINDINGS

The conclusions this audit draws, based on the detailed field work over fiscal year 2016 payroll operations and documented through the audit findings to follow, only apply to the nine agencies selected for detailed test work, and cannot be extrapolated to agencies statewide or to the entire pool of thirty-seven cycled agencies. Table 3 below shows the management recommendations, number of agencies receiving the finding, and the agencies receiving the recommendations. Forestry, Indigent Defense, and Workers' Compensation received no management recommendations as a result of the audit.

Management Recommendations

Table 3

Management Recommendations	Number of Agencies
Improve Internal Controls over Sensitive Information	4
Fine Arts	
Health Professions	
Military Affairs	
Small Business and Supplier Diversity	
Improve Internal Controls over Terminated Employees	4
Fine Arts	
Juvenile Justice	
Military Affairs	
Small Business and Supplier Diversity	
Update Policies and Procedures	2
Fine Arts	
Small Business and Supplier Diversity	
Follow 1500-Hour Rule for Wage Employees	1
Fine Arts	
Perform Post-Certification Activities	1
Small Business and Supplier Diversity	
Review and Update Fiscal Services Memorandum of Understanding	1
Inspector General	

Secure Transmission of Payroll Data

Agencies collect, manage, store, and transmit significant volumes of personal and financial data. Because of the highly sensitive and critical nature of this data, agency management must take all necessary precautions to ensure the integrity and security of the data during transmission. We compared agency practices to those required by the Commonwealth's Information Security Standards in the areas of data transmission, confidentiality, and integrity.

As the Bureau serviced seven out of nine agencies audited, email was potentially used extensively to send information and to communicate with the Bureau in the course of processing payroll during fiscal year 2016. Email is the quickest and easiest way to communicate and is used to support agency operations.

We issued management recommendations to the following agencies: Fine Arts, Health Professions, Military Affairs, and Small Business and Supplier Diversity. We refer to them collectively as "agencies" below in the finding, as the issue was basically the same at every agency.

Multiple Agency Finding: Improve Internal Controls over Sensitive Information

Agencies did not always ensure that they transmitted sensitive data securely. Agencies use the Bureau to process payroll and until March 2017, agencies regularly sent the Bureau unencrypted emails containing personally identifiable information. After March 2017, agencies began to use the Bureau's secure portal. In addition, agencies may not have adequate policies and procedures addressing the transmission of sensitive information through email.

The Commonwealth's Information Security Standard, SEC 501-09 (Security Standard) Section SC-8-COV, requires the use of data protection mechanisms for the transmission of all data that is sensitive. Sensitive data includes, but is not limited to, personally identifiable information. Personally identifiable information is considered information that describes, locates, or indexes anything about an individual, such as financial transactions, Social Security numbers, medical history, ancestry, religion, political ideology, criminal or employment records, and photographs.

Agencies misconstrued the Security Standard in relation to email security. Some indicated they assumed that since they were using the Commonwealth's network to send email, the emails were secured in some sort of closed system, and there was no need for encryption. The Commonwealth's email system is neither encrypted or immune from risks of breach by unauthorized parties. Given the agencies' interpretation of the requirement to secure emails adequately, it is probable that agency employees could have emailed other sensitive information over the years.

If agencies do not employ email encryption or another suitable, secure method of sending personally identifiable information, agencies could compromise the personal information of their employees and could expose those employees to risk of fraud or identity theft.

Agencies should ensure all employees accurately understand the Security Standard and use secure methods to send sensitive information. Agencies should develop and implement policies and procedures to ensure that they send personally identifiable information securely in accordance with the Security Standard.

Agencies' Controls over Terminations

Proper controls over terminations ensure a smooth and timely transition of an active employee to a terminated employee. Without proper controls over terminations, there is an increased risk that terminated employees may retain unauthorized access to systems, sensitive data, and physical property. We audit the controls over terminations, including the agency's policies that surround this process. Proper documentation of all aspects of the removal of an employee from an agency is crucial to internal controls over the process.

Four out of nine agencies audited received a management recommendation for internal controls over terminated employees including: Fine Arts, Juvenile Justice, Military Affairs, and Small Business and Supplier Diversity. We found that the cause and conditions at each agency differed, so the finding below reflects differences at each agency as applicable. Agencies either do not have written internal policies and procedures for terminated employees or have inadequate controls in place to ensure supervisory staff complete separation documentation evidencing the removal of access privileges and the return of Commonwealth property and information system-related property.

Multiple Agency Finding: Improve Internal Controls over Terminated Employees

Military Affairs and Small Business and Supplier Diversity did not have written policies and procedures over the termination process, resulting in a lack of documentation evidencing the removal of access privileges and the return of Commonwealth property and information system-related property. Fine Arts had conflicting policies for termination procedures and application of the policies was inconsistent, leading to inadequate documentation for some terminated employees. Juvenile Justice had policies and procedures in place, but staff at one facility did not adhere to them, which resulted in no documentation of agency removal of access privileges and the return of Commonwealth property and information system-related property for the terminated employees at the facility.

Without proper internal controls over terminated employees that ensure the removal of all access privileges and return of agency property, there is an increased risk that terminated employees may retain unauthorized access to Commonwealth systems and sensitive data and physical access to agency property. The Security Standard, Section PS-4, instructs organizations to retrieve all security-related, information system-related property upon termination of individual employment. Section PS-4 defines examples of information system-related property as hardware, authentication tokens, system administration technical manuals, keys, identification cards, and building passes. Section PS-4 advises organizations to disable information system access within 24-hours of employment termination.

Agency management should ensure termination policies and procedures are created and written concisely in accordance with the Security Standard. Management should communicate to supervisory

staff the importance of termination procedures that ensure the return of agency property and removal of terminated employees' access to Commonwealth systems in a timely manner. Management should ensure there is monitoring of all departments/divisions for compliance with termination policies and that supervisory staff coordinate adequately and timely, and follow policies consistently across the agency's operations.

Policies and Procedures

Agencies should implement and follow internal policies and procedures over payroll processes that comply with the CAPP Manual, the Appropriation Act, the Code of Virginia, Human Resources policies, and best practices. Policies and procedures guide employees in the performance of their job roles and ensure internal controls operate effectively, minimizing risks and errors associated with the payroll transactions focused on in this audit.

Two agencies out of the nine audited did not have adequate policies and procedures in place during fiscal year 2016. The issue expresses itself differently at each of the agencies. Fine Arts' finding is a repeat finding. Although the agency has continued to work and make progress on updating policies and procedures, the issue contributed significantly to the other management findings for Fine Arts detailed in this audit. Small Business and Supplier Diversity lacks adequate policies and procedures governing their use of the Bureau and Human Resources in its payroll operations and for agency responsibilities in the payroll process. Policies and procedures are; therefore, also directly tied to the other Small Business and Supplier Diversity findings in this audit.

Fine Arts Repeat Finding: Update Policies and Procedures

Fine Arts lacks clearly documented and approved policies and procedures over payroll and human resources functions. Best practices indicate that agencies review and update all policies and procedures regularly to ensure that they are clear, concise, and adequately address the operational risks identified by the organization. Without effective policies and procedures, organizations risk individuals diverging from the intended internal controls and increasing the opportunity for unauthorized and inappropriate activities. Agencies should make policies and procedures readily available to employees and train employees on the use of and the existence of all policies and procedures applicable to their position responsibilities.

Fine Arts submitted several policies and procedures to auditors; however, the policies and procedures were incomplete or lacking in sufficient detail in several areas, and in others had conflicting directives. Management continues the process of updating policies and procedures, and auditors noted improvement since the prior years' audit. Key human resources personnel joined Fine Arts during fiscal year 2016 and assumed responsibility for the policies and procedures in the human resources and payroll areas. Specific areas of concern found during the audit included: lack of policies and procedures over salary changes, 1500-hour wage employees, and terminated employees.

Management should continue to review and update policies and procedures to be clear, concise, enforced, and ensure that supervisory staff and employees in the several areas of Fine Arts' operations are aware of the policies and the need to follow them consistently.

Small Business and Supplier Diversity Finding: Update Policies and Procedures

Small Business and Supplier Diversity lacks sufficient, clearly documented, and approved policies and procedures over payroll and human resource functions. Small Business and Supplier Diversity outsources payroll processing to the Bureau and employs Human Resources for various human resource functions. While this unburdens the agency from the many functions performed by these service agencies, defined by the Bureau's Scope of Services and a memorandum of understanding with Human Resources, this reliance on service providers has led to a lack of clear responsibilities for agency personnel in the execution of payroll and human resource functions.

Small Business and Supplier Diversity submitted a payroll process; however, policies and procedures were incomplete or lacking in sufficient detail in several areas. Small Business and Supplier Diversity lacks specific policies and procedures concerning employees' responsibilities and job functions in relation to the Bureau and Human Resources who are significantly involved in the agency's payroll and human resource areas.

The Commonwealth created Small Business and Supplier Diversity from two parent agencies in 2014 and has had significant turnover in the payroll, fiscal, and human resource areas, which contributed to the lack of written policies addressing the complexities of the agency's operations. Management indicated that they are still in the process of updating policies and procedures, as key personnel joined Small Business and Supplier Diversity at the end of fiscal year 2016 and in fiscal year 2017.

Small Business and Supplier Diversity should continue to review and update policies and procedures to be clear, concise, enforced, and ensure that management and employees are aware of the policies and the need to follow them consistently in relation to their job responsibilities. Policies and procedures should also adequately address using the Bureau and Human Resource in payroll and human resource processes and outline the responsibilities of Small Business and Supplier Diversity employees in relation to these service providers.

Hours Worked by Wage Employees

For certain Commonwealth employees, Chapter 836 §4-7.01g of the 2017 Virginia Acts of Assembly requires that they may not work more than 29 hours per week on average over a twelve month period. To implement this requirement, Human Resource Policy 2.20 states that wage employees are limited to working 1,500 hours per agency per year.

Of the nine agencies audited, we found one agency, Fine Arts, did not adequately follow the 1500-hour wage employee rule, resulting in employees working over the threshold of hours for the measurement period.

VMFA Finding: Follow 1500-hour Rule for Wage Employees

Fine Arts is not complying with Human Resource Policy 2.20 (Policy) concerning the maximum number of hours a wage employee may work in a year. Fine Arts does not have adequate policies and procedures in place to ensure wage employees' total hours worked in the yearlong measurement period do not exceed 1,500 hours. Two non-benefited employees exceeded the maximum limit at 1,509 and 1,513.25 hours respectively, between May 1, 2015, and April 30, 2016.

Fine Arts makes use of a tracking spreadsheet for monitoring 1500-hour employees, but because compensating controls to review the worksheet data were not in place or included in policies and procedures, personnel did not catch keying errors to the tracking spreadsheet, and two employees exceeded the 1500 hour limit in fiscal year 2016.

The Policy limits non-benefit employees to working no more than an average of 29 hours per week, for a maximum not to exceed 1,500 hours in the one-year measurement period of May 1 to April 30. The Commonwealth developed this Policy to ensure that agencies comply with the requirements of Patient Protection and Affordable Care Act, which carries penalties for noncompliance.

Due to the variety of employee types at Fine Arts, the number of departments with significant numbers of wage employees, employees working multiple positions, and the variety of ways the agency tracks wage hours, accurately tracking employees' hours to ensure compliance with the 1,500-hour limit requires strong internal controls. Fine Arts should create policies and procedures that adequately monitor non-benefit employees so that employees do not exceed 1,500 hours annually. Coordination and communication between supervisory staff, payroll and human resource staff, and employees to monitor employees' hours carefully as they approach the 1500-hour limit will greatly reduce the risk of non-compliance with the Policy.

Controls over Payroll Certification

Payroll certification is an agency's formal authorization to process payroll. The payroll certification process involves multiple steps that help ensure complete and accurate payrolls. It is essential that agencies develop and apply consistent policies and procedures to control payroll certification. To determine if controls over payroll certification were adequate, we compared agency practices to those required by the CAPP Manual and the Scope of Services governing the services provided by the Bureau.

One agency out of the nine agencies audited did not perform adequate post-certification activities during fiscal year 2016.

Small Business and Supplier Diversity Finding: Perform Post-Certification Activities

Small Business and Supplier Diversity did not follow the appropriate post-certification activities as outlined within the CAPP Manual. CAPP Manual Topic 50820 outlines and describes the reports that should be minimally included during the post-certification review. Small Business and Supplier Diversity

does not have policies and procedures governing the post-certification process. Due to the lack of proper policies and procedures, Small Business and Supplier Diversity personnel did not understand their responsibilities over the post-certification activities as outlined within CAPP Manual. Agency personnel could not provide evidence of performing the required payroll to accounting system reconciliations during the fiscal year audited.

Agencies use the post-certification process to ensure that they properly certify payroll, address remaining reconciling items, identify and clear any exceptions, and to ensure programmatic coding is accurate for payroll expenses. The payroll to accounting system reconciliation is an integral part of the post-certification process. This reconciliation ensures that Small Business and Supplier Diversity charges payroll expenses to the correct programmatic codes. An adequate and complete post-certification process ensures payroll expense data is accurate and complete.

Management should create, implement, and distribute policies and procedures governing the post-certification process in accordance with CAPP Manual Topic 50820. Small Business and Supplier Diversity should monitor whether personnel responsible for the post-certification process follow procedures adequately. Management should provide training to agency personnel who are involved in the post-certification process to ensure that agency personnel adequately understand and perform the appropriate post-certification activities in accordance with the CAPP Manual and agency internal controls.

Memorandum of Understanding (MOU)

Agencies can make use of service providers to support agency operations. The Bureau (through the Scope of Services document), Accounts, and Human Resources all have agreements in place with the agencies in order to define the responsibilities of the agency and the service provider in payroll operations. The understanding must be documented, complete, and up to date so that payroll is processed efficiently and that agencies and the service providers have a clear delineation of who is responsible for which internal controls in the processing of payroll.

We found that at one agency out of nine, the applicable MOU was not sufficient to support adequate internal controls over the payroll process, in regards to the service provider's area of control.

Inspector General Finding: Review and Update Fiscal Services Memorandum of Understanding

The Inspector General does not annually review or update their fiscal services MOU with Accounts. The agencies last reviewed the MOU in 2012 and the MOU still references use of the statewide accounting system no longer the system of record, as opposed to the current system of record implemented in 2015. In addition, the existing MOU does not outline all existing responsibilities and services provided by Accounts for the Inspector General, including required payroll reconciliations.

Accounts performs the fiscal and accounting functions for the Inspector General; therefore, the two agencies have an agreed upon MOU that transfers fiscal services from the Inspector General to Accounts. The MOU states that the agencies should update the agreement at least annually and more

frequently in the event a significant change occurs. In addition, the MOU should document in detail the various functions performed by Accounts for the Inspector General.

Although Inspector General has frequent interactions with its fiscal provider, without reviewing and updating the MOU periodically, Inspector General accepts a greater risk that Accounts is not performing or recording accounting functions timely or accurately.

The current MOU includes a statement explaining that the agreement is in effect for the period beginning July 1, 2012, and will remain in full force and effect until amended or rescinded by written agreement of both parties. The Inspector General's office manager believed that this statement allowed the MOU to continue indefinitely without review.

Inspector General should periodically review the MOU with Accounts to ensure that all necessary fiscal and accounting functions are included and determine whether significant changes have occurred.

CONCLUSION

Except for the specific instances outlined in the "Audit Findings" section above, the nine agencies audited are maintaining adequate internal controls and ensuring compliance with applicable statewide and agency-specific policies and procedures. We found that the nine audited agencies processed payroll effectively and accurately. The audit determined that there were no instances of incorrect compensation to employees during fiscal year 2016.



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Auditor of Public Accounts

Commonwealth of Virginia

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September 5, 2017

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable Robert D. Orrrock, Sr.
Chairman, Joint Legislative Audit
and Review Commission

We have audited the payroll operations of nine Commonwealth agencies for fiscal year 2016 and performed limited audit procedures on the remaining cycled agencies, and are pleased to submit our report entitled **Cycled Agency Payroll Review**. 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.

A non-statistical sampling approach was used. Our samples 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 of nine cycled agencies as detailed in the report.

Exit Conference and Report Distribution

We provided an initial copy report to management of the nine agencies cited in this report on September 13, 2017. We met with management of the following agencies: Juvenile Justice on September 9, 2017 and Health Professions on October 3, 2017. For those agencies that elected to prepare responses to the recommendations of our review, we included the responses in the section titled "Agency Response." We did not audit management's responses and, accordingly, we express no opinion on them.

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

AUDITOR OF PUBLIC ACCOUNTS

KJS/clj

POOL OF CYCLED AGENCIES - TESTS OF CONTROLS

Cycled Agencies	Segregation of Access	Agency Head Salary
Commonwealth's Attorneys' Services Council		✓
Compensation Board		✓
Department of Criminal Justice Services	✓	✓
Department of Environmental Quality	✓	✓
Department of Fire Programs		✓
Department of Forensic Science	✓	✓
Department of Forestry	✓	✓
Department of Health Professions		✓
Department of Historic Resources	✓	✓
Department of Housing and Community Development	✓	✓
Department of Human Resource Management	✓	✓
Department of Juvenile Justice	✓	✓
Department of Labor and Industry	✓	✓
Department of Military Affairs	✓	✓
Department of Mines, Minerals and Energy	✓	✓
Department of Planning and Budget		✓
Department of Professional and Occupational Regulation	✓	✓
Department of Rail and Public Transportation		✓
Department of Small Business and Supplier Diversity		✓
Frontier Culture Museum of Virginia	✓	✓
Gunston Hall		✓
Indigent Defense Commission	✓	
Jamestown-Yorktown Foundation	✓	✓
Marine Resources Commission	✓	✓
New College Institute	✓	✓
Office of the State Inspector General	✓	✓
Southern Virginia Higher Education Center		✓
Southwest Virginia Higher Education Center		✓
State Board of Elections		✓
State Council of Higher Education for Virginia		✓
The Library of Virginia	✓	✓
The Science Museum of Virginia	✓	✓
Virginia Commission for the Arts	✓	✓
Virginia Information Technologies Agency	✓	✓
Virginia Museum of Fine Arts	✓	✓
Virginia Museum of Natural History	✓	✓
Virginia Workers' Compensation Commission	✓	✓



October 2, 2017 (revised October 4, 2017)

Ms. Martha Mavredes
The Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia, 23218

Re: Payroll Audit Agency Response

Dear Ms. Mavredes:

We are providing this letter in connection with your audit of the payroll operations of the Virginia Museum of Fine Arts for the fiscal year ending June 30, 2016. We confirm that we are responsible for the proper reporting of the Virginia Museum of Fine Arts' payroll operation. This letter outlines our path forward with regards to the four (4) findings, one a repeat finding, as outlined below.

The Virginia Museum of Fine Arts (VMFA) Department of Human Resources has been in full transition mode since January 2016. New executive HR staff have been hired, in addition to higher level generalist positions to assist with upgrading the overall structure and levels of employee engagement and HR policies/practices within the agency. Currently, Human Resources has made great strides and continues to review and update HR policies and practices within the agency.

As noted from the Audit Summary report, which we are in concurrence with the findings, VMFA had four (4) findings and one (1) is a repeat finding:

1. Improve Internal Controls over Sensitive Information
2. Improve Internal Controls over Terminated Employees
3. Adequate Policies and Procedures (2016)/Update Policies and Procedures (Repeat Finding)
4. Follow 1500 Hour Rule for Wage Employees

Proposed / In-Progress Corrective Actions per finding:

1. Improve Internal Controls over Sensitive Information

- a. VMFA utilizes the Payroll Service Bureau (PSB) to process agency payroll. Finding concluded that VMFA sent sensitive payroll data via email transmittal that was not encrypted during the period reviewed by auditors. Staff indicated that they were not aware that this was not an appropriate standard. All payroll staff and HR management have been advised and given instruction to utilize encryption standards when handling or transmitting sensitive employee information.
- b. After March 2017, PSB implemented the PSB Secure Portal, and VMFA compiled and began using this secure method to transmit all payroll and related information for processing. All sensitive and non-sensitive items are submitted via the PSB portal for processing.

OFFICE OF THE DIRECTOR

VIRGINIA MUSEUM OF FINE ARTS

200 N. Boulevard | Richmond, Virginia 23220-4007 | T 804.340.1500 | F 804.340.1502 | www.vmfa.state.va.us

2. Improve Internal Controls over Terminated Employees

Currently we have taken the following corrective actions with terminated employees and employee files:

- a. Upon notification HR sends out notification of resignation or termination to; security, purchasing, library, and food service/Micros. This is to account for badges, keys, books, credit cards etc.
- b. Internally, HR instituted the Personnel Action Form (PAF), which initiates the process for termination and taking terminating employees out of the payroll system and deactivating their accesses.
- c. We continue to use the Access removal form, which goes to department to complete and certify for the employee file. HR has instituted tracking of the access removal form by HR Assistant. Updates were sent out to departmental managers.
- d. Three (3) Payroll Workshops were given to VMFA Managers to discuss recent changes and clarification of payroll deadlines/cycles. Another round of workshops at top of 2017.

3. Adequate Policies and Procedures (2016)/Update Policies and Procedures Repeat Finding

- a. Reviewing all HR policies revolving around salary changes. We instituted the Personnel Action Workshop (PAW) which captures the action, justification and approval to move forward with the action. PAW was rolled out Oct/Nov timeframe of 2016 and is now widely used by managers and agency leadership.
- b. Ensuring 1500 Hour rule policy has been properly updated and socialized with frontline managers.
- c. Updating termination policies and practices (retrieval of agency items and signoffs etc.) and socializing updates through frontline workshops and communications.

Proposed/In progress:

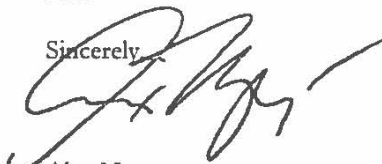
- d. Compensation Changes and Classification Workshop to discuss PAW and salary changes; Spring 2017.

4. Follow 1500 Hour Rule for Wage Employees

- a. Recently instituted new internal HR protocol to notify Deputy Director HR (DDHR) when wage employees hit the 1400 hour mark. DDHR will contact local manager and Division Head to ensure they are monitoring the hours. HR continues to monitor all wage employees through a monthly generated report from the Payroll Service Bureau (PSB). This ensures an accurate account and capturing of real-time wage employee hours.

To conclude, VMFA has been through two (2) years of internal revamping and restructuring of the human resource functions. As noted in the summary, there have been an improvement in many areas, but there is still work to be done. Over the course of 2017, there have been the addition of new forms, practices and HR policy review which will correct the actions noted within the payroll audit summary. We appreciate the assistance and explanation given by the audit team to ensure that the new team is up to date on state regulations and practices within the state/federal regulations. We continue to process payroll effectively and accurately for our VMFA staff.

Sincerely,



Alex Nyerges
Director



COMMONWEALTH of VIRGINIA

David E. Brown, D.C.
Director

Department of Health Professions
Perimeter Center
9960 Mayland Drive, Suite 300
Henrico, Virginia 23233-1463

www.dhp.virginia.gov
TEL (804) 367- 4400
FAX (804) 527- 4475

October 10, 2017

Martha S. Mavredes, CPA
Auditor of Public Accounts
P. O. Box 1295
Richmond, Virginia 23218

Dear Ms. Mavredes,

Please accept this letter as our response to your audit of payroll operations for fiscal year 2016.

DHP's position is that its IT Security Policy and Program adequately addresses the transmission of sensitive information, as it mirrors SEC501, including SC-8 Transmission Integrity and SC-9 Transmission Confidentiality. The "Awareness and Training" section of the Policy requires all DHP employees to take the DHP Security Awareness Training within 30 days of hire and annually thereafter. This training includes information on the transmission of personally identifiable information. DHP has established a practice of reviewing all policies annually and will continue to review the IT Security Policy for improvements. The agency procured VITA's email encryption service several years ago and we will continue to train and guide employees on its use.

If you have any questions, please contact Lisa R. Hahn, Chief Deputy.

Sincerely,

David E. Brown, D.C.
Director

DEB/lzr



COMMONWEALTH OF VIRGINIA
Office of the State Inspector General

Michael Westfall
Acting State Inspector General

P.O. Box 1151
Richmond, Virginia 23218

Telephone (804) 625-3255
Fax (804) 786-2341
www.osig.virginia.gov

September 26, 2017

Via Electronic Mail
Martha S. Mavredes, CPA
Auditor of Public Accounts
P. O. Box 1295
Richmond, VA 23218

Dear Ms. Mavredes:

The Office of the State Inspector General's (OSIG) response to the results of APA's Cycled Agency Payroll Report (received via email on September 13, 2017) follows.

Result - Review and Update Fiscal Services Memorandum of Understanding

The Inspector General has a Memorandum of Understanding (MOU) with Accounts outlining the fiscal and accounting functions that Accounts performs. Per the MOU, "This agreement should be updated at least annually and more frequently in the event significant change occurs." However, we determined this agreement has not been updated since August 2012, and there has been a significant change with the implementation of a new state accounting system. Inspector General should periodically review the MOU with Accounts to ensure that all necessary fiscal and accounting functions are included and determine whether significant changes have occurred.

Agency Response

OSIG Business Manager contacted the Finance Manager at Accounts on June 20, 2017 to receive an updated MOU. At that time, the MOU was still in draft form. We will continue working with DOA to receive and approve the updated MOU.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael C. Westfall".

Michael C. Westfall
Acting State Inspector General

Cc: Donna Hahn, Business Manager



COMMONWEALTH OF VIRGINIA

Andrew K. Block, Jr.
Director

Department of Juvenile Justice

September 26, 2017

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

Dear Ms. Mavredes:

The agency concurs with the audit finding related to internal controls over terminated employees and as such, implemented the following solution:

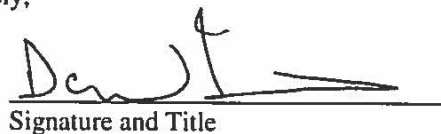
Current policy requires all supervisors to ensure human resources is notified immediately upon an employee's separation or expected separation. Upon receiving this notification, human resources reminds the supervisor, via email, of all policy requirements related to employee terminations, including relevant deadlines for out-processing procedures. Human resources also immediately communicates the employee separation with the individuals holding the following positions: Account Facilitator, Senior Operations Technician, Accounting Manager and Procurement Manager who will in turn, monitor the necessary and timely removal of systems access, etc.

Upon an employee separation, the supervisor completes a separation checklist which includes confirming the removal of access to all systems and collection of all state/agency property within the employee's possession. This completed separation checklist must be submitted to human resources within two business days of the employee's separation. Human resources tracks the return of all separation checklists and in the event one is not received within the two-day timeframe, emails the supervisor with a copy to the organizational unit head, requesting the separation checklist be submitted within 24 hours. If the document is not received within that timeframe, an email is sent to the Deputy Director responsible for the separating employee's work unit with a copy to the HR Director, requesting the separation checklist be submitted immediately. Copies of all communication throughout this process is retained in human resources.

In addition to adhering to the policy described above, human resources has also implemented a systematic approach to capturing employee separation data from other human resource functions. This information will be cross-checked with previously received separation notifications and completed checklists; providing additional internal control.

Sincerely,


Signature and Title


Signature and Title

DIRECTOR
Signature and Title

DEPUTY DIRECTOR
Signature and Title



COMMONWEALTH of VIRGINIA

MG TIMOTHY P. WILLIAMS
THE ADJUTANT GENERAL

DEPARTMENT OF MILITARY AFFAIRS

*Adjutant General's Office
Virginia National Guard
5901 Beulah Road*

SANDSTON, VIRGINIA 23150

October 3, 2017

Mrs. Martha Mavredes
The Auditor of Public Accounts
P.O. Box 1295
Richmond, VA 23218

Re: Payroll Audit Agency Response

Dear Ms Mavredes:

We are providing this letter in connection with your audit of the payroll operations of the Virginia Department of Military Affairs for the fiscal year ending June 30, 2016, and the two findings noted.

The Department of Military Affairs concurs with the draft report on the subject audit engagement. We will develop and publish a policy on the use, protection, and transmission of sensitive information, particularly Personally Identifiable Information (PII). In the particular instance noted, we are now uploading PII into the Payroll Service Bureau secure portal, or mailing/hand delivering this sensitive information.

We are almost finished addressing the second finding, Control over Terminations, by developing a comprehensive In/Out processing checklist that will become part of the employee's personnel file.

DMA appreciates your diligence during this audit engagement and your recommendations. If you have any further questions, please do not hesitate to contact my office at (804)236-7880.

Sincerely,

A handwritten signature in black ink, appearing to read "Timothy P. Williams".

TIMOTHY P. WILLIAMS
Major General, VaARNG
The Adjutant General



Terry McAuliffe
Governor

Todd Haymore
Secretary of Commerce & Trade

COMMONWEALTH of VIRGINIA

Department of Small Business and Supplier Diversity

Tracey G. Wiley
Director

September 28, 2017

Via Electronic Mail
Martha S. Mavredes, CPA
Auditor of Public Accounts
P.O. Box 1295
Richmond, VA 23218

Dear Ms. Mavredes:

The Department of Small Business and Supplier Diversity's (SBSD) response to the results of the APA's Cycled Agency Payroll Report (received via e-mail on September 13, 2017) follows.

Result - Secure Transmission of Payroll Data

Agencies did not always ensure that they transmitted sensitive data securely. Agencies use the Bureau to process payroll and until March 2017, Agencies regularly sent the Bureau unencrypted emails containing personally identifiable information. After March 2017, Agencies began to use the Bureau's secure portal. In addition, Agencies do not have adequate policies and procedures addressing the transmission of sensitive information. (Excerpt of Finding)

Agency Response

SBSD has taken corrective action in FY17 and begun using the secure portal created by the Payroll Services Bureau. The agency also created encrypted e-mail accounts for staff that are required to send and receive sensitive information.

Result - Agencies' Controls over Terminations

Military Affairs and Small Business and Supplier Diversity did not have written policies and procedures over the termination process, resulting in a lack of documentation evidencing the removal of access privileges and the return of Commonwealth property and information system-related property. (Excerpt of Finding)

Agency Response

SBSD has created an employee termination checklist to ensure proper controls are in place for removal of access. The agency has created policies in FY17 that detail the process and responsibility for termination between the agency, payroll services bureau and the shared service center. The agency has also created employee files to ensure documentation is maintained within the agency as well as the shared service center the agency uses for human resource processing.

Result - Controls over Payroll Certification

Small Business and Supplier Diversity did not follow the appropriate post-certification activities as outlined within the CAPP Manual. CAPP Manual Topic 50820 outlines and describes the reports that should be minimally included during the post-certification review. Small Business and Supplier Diversity does not have policies and procedures governing the post-certification process. Due to the lack of proper

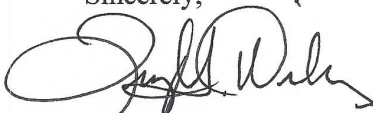
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policies and procedures, Small Business and Supplier Diversity personnel did not understand their responsibilities over the post-certification activities as outlined within CAPP Manual. Agency personnel could not provide evidence of performing the required payroll to accounting system reconciliations during the fiscal year audited.

Agency Response

SBSD in FY 17 has fully implemented appropriate pre and post payroll certification activities. A checklist has been created for both processes and is followed during each certification period. These activities are completed and certified after each payroll cycle. The agency has also created procedures as well as flow charts that depict the payroll process fully.

Sincerely,

A handwritten signature in black ink, appearing to read 'Tracey Wiley', with a large, stylized initial 'T'.

Tracey Wiley
Director

cc. Annette Sherrill, Director of Administration

CYCLED AGENCY PAYROLL REVIEW

as of June 30, 2016

Fine Arts

Alex Nyerges, Director, and Chief Executive Officer
Hossein Sadid, Chief Financial Officer
Kimberly Wilson, Deputy Director of Human Resources

Forestry

Bettina Ring, State Forester
Fernanda Crandol, Director of Finance

Health Professions

David Brown, Director
Lisa Hahn, Chief Deputy Director
Anita Watkins, Financial Services Director

Indigent Defense

David Johnson, Executive Director
Angela Thompson, Chief Financial Officer

Inspector General

Michael Westfall, Acting State Inspector General
Donna Hahn, Business Manager

Juvenile Justice

Andrew Block, Director
Daryl Francis, Deputy Director, Accounting and Finance
Theodore Darden, Accounting Manager

Military Affairs

Major General Timothy P. Williams, the Adjutant General of Virginia
Donald Sutherland, Fiscal Director
Stephen Arthur, Deputy Finance Director

Small Business and Supplier Diversity

Tracey Jeter, Director
Jennifer Mayton, Chief of Staff
Annette Sherrill, Director of Administration

Workers' Compensation

Wesley Marshall, Chairman, Commissioner
Evelyn McGill, Executive Director
Ed Rice, Chief Financial Officer
Amy Pearson, Assistant Financial Officer